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A Director's Duty of Loyalty and the Relevance
of the Company's Scope of Business: *Cheng Wai Tao v*
Poon Ka Man Jason

Pearlie Koh*

The Hong Kong Court of Final Appeal has utilised a 'scope of business' inquiry to delineate the boundaries of the no-conflict rule for the company director. Such an inquiry is directed at discerning the realistic ability of the company to exploit any particular business opportunity and a strict capacity approach is eschewed, at least where the no-conflict rule is concerned. The decision is premised on a bifurcation between the no-conflict and no-profit rules, suggesting

89 *ibid* at [179] *per* Lord Neuberger.

90 *ibid* at [180]-[182].

91 *ibid* at [134] *per* Lord Kerr.

92 *ibid* at [164] *per* Lord Neuberger.

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that the tests to determine breach of these fiduciary rules are not necessarily the same, thus permitting a more nuanced consideration of directorial breaches.

INTRODUCTION

It is ‘old hat’¹ that the relationship a director has vis-à-vis his company is fiduciary in nature. The company is accordingly entitled to the director’s ‘single-minded loyalty’.² To ‘encourage’ such loyalty, equity dictates that the director, in the absence of informed consent by the company, is strictly ‘not entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict’.³ The no-conflict rule embedded in this proscriptive statement applies not only to an actual conflict, but also to a possibility of conflict.⁴ The rule, as stated, is clearly capable of reaching far. This potential is, however, bridled by the courts’ preference for some perspective to be placed on the idea of theoretical conflict. It has therefore been repeatedly said that any possibility of conflict must be ‘real [and] sensible’⁵ from the viewpoint of the reasonable man, looking at the relevant facts and circumstances of the particular case.

But what factors are relevant in testing for conflict? This depends on which of two camps one is in. What divides the camps, it has been said,⁶ is the question of how to test for conflict. Should this be a *capacity* test or a *capability*⁷ test? The focus of each is different. The capacity test asks whether the impugned profit arose out of the director’s position as a director whilst the capability test assesses the company’s ability to make (and also desire or interest in) that particular profit. Allegations of breach of the no-conflict rule by directors often involve a director’s unauthorised pursuit of a business opportunity. Where the focus is how the director came by the opportunity (ie, the capacity test), it is clearly irrelevant whether the company was itself capable of exploiting the opportunity (ie, capability questions). As long as the link to the director’s office can be established, the illicit profit must be surrendered. This approach, lauded by its proponents for its deterrent effect and clarity of application, has been criticised as being harsh and unrealistic.⁸ On the other hand, the capability test is more flexible and fact-sensitive, demanding that account be taken of factors that might demonstrate the company’s realistic ability to exploit

1 P. Birks, ‘The Content of Fiduciary Obligation’ (2000) 34 *Isr Law Rev* 3, 23.

2 *Bristol & West Building Society v Mothew* [1998] Ch 1, 18. For a recent consideration of the no-conflict rule in the context of shadow directors, see S. Witney, ‘Duties Owed by Shadow Directors: Closing in on the Puppet Masters?’ [2016] *JBL* 311.

3 *Bray v Ford* [1896] AC 44, 51 *per* Lord Herschell.

4 *Aberdeen Railway v Blaikie Brothers* [1854] 1 Macq 461, 471.

5 *Boardman v Phipps* [1967] 2 AC 46, 124.

6 D. Ahern, ‘Guiding Principles for Directorial Conflicts of Interest: *Re Allied Business and Financial Consultants Ltd; O’Donnell v Shanahan*’ (2011) 74 *MLR* 596.

7 See D. Kershaw, *Company Law in Context – Text and Materials* (Oxford: OUP, 2nd ed, 2012) 524.

8 A. Berg, ‘Fiduciary Duties: A Director’s Duty to Disclose His Own Misconduct’ (2005) 121 *LQR* 213, 220.

the opportunity. If this fact is not present, it cannot be said that there is a ‘real sensible possibility’ of conflict if a director pursues that opportunity for himself.

The occasion for consideration of the issue arose before the Hong Kong Court of Final Appeal in the case of *Cheng Wai Tao v Poon Ka Man Jason*⁹ (*Cheng Wai Tao*). Spigelman NPJ, who delivered the majority judgment, settled the debate in Hong Kong law. His Honour applied the capability test, and held that the boundaries of the no-conflict rule were delineated by the company’s ‘scope of business’.

FACTS

Ricky was an entrepreneurial chef who decided to start a chain of sushi restaurants in Hong Kong under the trade name ‘Itamae Sushi’ and associated marks and logos that he designed and owned.¹⁰ He roped in his business partners (for present purposes, the relevant individuals were siblings Jason and Daisy) with whom he had been running a successful chain of Japanese noodle restaurants (the ‘Ajisen business’). Each restaurant in the Ajisen business was operated by a separate corporate entity in which Ricky and his partners held shares. As was accepted both at trial and by the Court of Appeal,¹¹ the business partners had, pursuant to what was referred to as the ‘2004 Agreement’, decided to apply this particular modus operandi to their proposed collaboration in the sushi restaurant business. The company, Smart Wave, was incorporated to manage and operate the first sushi restaurant under the banner Itamae Sushi, and Ricky was appointed its sole director. However, the shares of Smart Wave were held not only by Ricky, Jason and Daisy as some 28 per cent were issued to five individuals who were either suppliers or employees of Smart Wave. This particular fact was of immense significance to the outcome of the case, as we shall see.

The first restaurant was, in Jason’s words, a ‘huge success’,¹² and in the pithy words of the trial judge, ‘inevitably, success breeds dispute’.¹³ Indeed, Ricky, who maintained throughout that he was entitled to, proceeded to open more successful restaurants. Each of these restaurants was operated by a different company in which Ricky was the sole shareholder. Jason and Daisy commenced a derivative suit on behalf of Smart Wave against Ricky for breach of directors’ duties. At first instance, the High Court found that Smart Wave ‘was never intended by its shareholders to have the exclusive right to carry on the sushi restaurant business’ under the Itamae Sushi name,¹⁴ and held that Ricky could not therefore be said to have acted in breach of his duties. The Court of Appeal reversed the trial judge’s decision. In its view, the state of the evidence did

9 [2016] HKCFA 23.

10 This was initially disputed, but the High Court accepted that ‘Ricky’s evidence establishes a prima facie case of his insistence on the ownership of the marks’: *Fine Elite Group Ltd v Cheng Wai Tao* [2013] HKCFI 838 at [28].

11 n 9 above at [42].

12 *ibid* at [8].

13 n 10 above at [4].

14 *ibid* at [63].

not support the judge's conclusion that all the shareholders of Smart Wave had agreed to limit the scope of Smart Wave's business to a single sushi restaurant. It will be recalled that the shareholders of Smart Wave included those five other individuals who together held 28 per cent of the company. In the view of the Court of Appeal, there was no affirmative evidence that these five minority shareholders had consented or acquiesced to the reduction in the business scope of the company. The Appeal Committee of the Court of Final Appeal granted leave to appeal on the basis of a question of 'great, general and public importance',¹⁵ which was '[w]hether the "no-conflict rule" applies to a director of a chain business where the agreed *modus operandi* was to have one company for one agreed operation'.¹⁶ By a majority of three to two, the Hong Kong Court of Final Appeal dismissed Ricky's appeal. All five justices were agreed that the success or otherwise of Ricky's case depended on whether Smart Wave was, as Ricky had asserted, a single or limited purpose company. The divided conclusion was therefore not the result of a disagreement as to the law — their Honours parted ways where it came to proof of that restriction. Whilst the minority considered the primary facts found at first instance to support the trial judge's conclusion that Smart Wave was a limited purpose company, the majority disagreed. In the circumstances, Ricky was found to be in breach of the no-conflict rule.

APPLICATION OF THE CONFLICT AND PROFIT RULES

Counsel for Jason and Daisy had sought to persuade the court that the company's scope of business was irrelevant to corporate opportunity cases on the basis of the English Court of Appeal decision in *Re Allied Business and Financial Consultants Ltd; O'Donnell v Shanahan*¹⁷ (*O'Donnell*). Rimer LJ had considered it irrelevant whether the particular opportunity that was exploited by the directors fell within or without the scope of the company's business, because the directors had obtained that information 'in the course of acting as directors of the company and the opportunity also came to them in such course'.¹⁸ In arriving at this conclusion, his Lordship had distinguished the old authority of *Aas v Benham*¹⁹ on the ground that that case concerned 'the fiduciary duties owed by a partner whose duties were circumscribed by the contract of partnership'.²⁰ *Aas v Benham* was a decision that concerned a partner who had, in setting up a separate business for which he received profits, availed himself of information obtained whilst he was a partner of the firm. The English Court of Appeal had applied a scope of business test to exonerate the partner from any liability to account to the firm for his profits.²¹

15 n 9 above at [64].

16 *ibid.*

17 [2009] 2 BCLC 666.

18 *ibid* at [54].

19 [1891] 2 Ch 244.

20 n 17 above at [68].

21 n 19 above, 255 *per* Lindley LJ.

Counsel's argument did not resonate with Spigelman NPJ who opined that 'the reasoning in *O'Donnell v Shanahan* may go too far'.²² In his Honour's view, there was little if any reason for different tests to apply to partners and to directors, both of which are well established categories of fiduciaries. Spigelman NPJ thus concluded that a scope of business inquiry was relevant to directors.²³

Indeed, Rimer LJ's judgment has been at the same time criticised²⁴ and praised,²⁵ depending on which camp the commentator belongs to. This divergence may be traced to an unresolved and fundamental question on the taxonomy²⁶ of the no-conflict and no-profit rules, and that is whether these rules are separate rules or whether there is only the one no-conflict rule.

Whilst English courts have at times accepted that the rules are separate,²⁷ it is also not uncommon for the dividing line to be obliterated, and the rules spoken of in terms only of the no-conflict rule, with the no-profit rule treated merely as an aspect of the former.²⁸ Indeed, section 175 of the Companies Act 2006 reflects this latter perspective.²⁹ But Rimer LJ did not, in *O'Donnell*, conflate the rules. Instead, his Lordship patently dealt with them as separate rules activated by different considerations. This recognition that the rules have differing, albeit overlapping, spheres of operation is significant. Underpinning it is the implicit acceptance that the rules are galvanised for different reasons and in different situations. As Deane J explained in *Chan v Zacharia*,³⁰ the purpose of the no-conflict rule is to 'preclude the fiduciary from being swayed by considerations of personal interest' whilst the objective of the no-profit rule is to 'preclude the fiduciary from actually misusing his position for his personal advantage'. Maintaining a distinction between the rules may therefore permit a better appreciation of the scope of the respective spheres, and the considerations that are relevant for delineating each sphere.

These considerations are not necessarily co-extensive. When considering the no-conflict rule, it is important to note that the 'conflict' refers to a conflict between the director's *duty* to the company and his personal interests, and not to a conflict between the company's *interests* and the director's interests (although note that section 175 of the Companies Act 2006 obliges a director to avoid a situation involving unauthorised conflicts between his personal interests and

22 n 9 above at [85].

23 *ibid* at [87].

24 See, for example, E. Lim, 'Directors' Fiduciary Duties: A New Analytical Framework' (2013) 129 LQR 242.

25 See, for example, Ahern, n 6 above.

26 *ibid*, 598.

27 See, for example, *Don King Productions Inc v Warren* [2000] Ch 291, 341; *Quarter Master (UK) Ltd v Pyke* [2005] 1 BCLC 245 at [55]; *Wilkinson v West Coast Capital* [2005] EWHC 3009 at [246]; *Re Allied Business and Financial Consultants Ltd* [2009] 2 BCLC 666. See also *Chan v Zacharia* (1984) 154 CLR 178, 198 *per* Deane J of the High Court of Australia.

28 See, for example, *Boardman* n 5 above, 123; *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 1 WLR 1126, 1129 and, most recently, in *FHR European Ventures LLP v Mankarious* [2014] UKSC 45 at [5], where Lord Neuberger also expressed the view that the no-profit rule was part of 'wider [no-conflict] rule'.

29 See B. Hannigan, *Company Law* (Oxford: OUP, 4th ed, 2016) at [12-2]; Kershaw, n 7 above, 574.

30 (1984) 154 CLR 178, 198.

‘the interests of the company’). As Finn observed in his seminal work, *Fiduciary Obligations*,

[t]rite though the point is, it must be made. A fiduciary’s liability for a profit stems *not* from a conflict between his interests and his beneficiary’s *interests*, but from a conflict between his own interests and the *actual undertaking* he has made (his duty) to his beneficiary.³¹

It follows therefore, that before any question of breach of the no-conflict rule may be considered, the precise scope and ambit of the director’s undertaking to his company must first be ascertained. Lord Upjohn said as much in *Boardman v Phipps*

Once it is established that there is such a [fiduciary] relationship, that relationship must be examined to see what duties are thereby imposed upon the agent, to see what is the scope and ambit of the duties charged upon him . . . Having defined the scope of those duties one must see whether he has committed some breach thereof and by placing himself within the scope and ambit of those duties in a position where his duty and interest may possibly conflict. It is only at this stage that any question of accountability arises.³²

The duties owed by a director may be qualified, for example, in the company’s constitution or by an agreement that binds all the shareholders and the company,³³ or the factual circumstances may be such as to reduce the scope and extent of the duties owed.³⁴ To this inquiry, the question of the company’s scope of business is clearly relevant, for that would delineate the director’s ‘actual undertaking’ and hence permit proper demarcation of the duty he owes.

On the other hand, the no-profit rule reproves the *actual* misuse or abuse of position. In the inquiry into whether there is a breach of this rule, it is crucial to examine whether the impugned profit arose ‘in the course and execution’ of the fiduciary relationship.³⁵ Thus, in *Regal (Hastings) Ltd v Gulliver*,³⁶ despite having acted in good faith and despite the company being quite incapable of making the impugned profit itself, the directors were held liable to account as the profits had been made by reason and in the course of the fiduciary relationship. As

31 P. D. Finn, *Fiduciary Obligations* (Sydney: The Law Book Company, 1977) at [540] (emphasis added).

32 *Boardman* n 5 above, 127. Thus, in *Burland v Earle* [1902] AC 83, a company was not entitled to the profit made by a director who had sold property he had acquired to the company without disclosing that fact because there was no ‘evidence whatever of any commission or mandate to [the director] to purchase on behalf of the company, or that he was in any sense a trustee for the company of the purchased property’: *ibid*, 98.

33 See, for example, *Wilkinson v West Coast Capital* [2005] EWHC 3009, where the fact that the company’s capacity to acquire a new interest was restricted in a shareholders agreement to which the company was itself a party was held to constrain the company’s ‘interests’ such that a director who acquired that new interest was held not to have breached the no-conflict rule.

34 See *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201 and *Foster v Bryant Surveying Ltd v Bryant* [2007] 2 BCLC 717, where the directors in question had been excluded from effectively performing their role as directors.

35 *Parker v McKenna* (1874) LR 10 Ch App 96, 118.

36 [1942] 1 All ER 378.

Lord Russell of Killowen famously said, '[t]he liability arises from the mere fact of a profit having, in the stated circumstances, been made'.³⁷ This is a strictly capacity-focused inquiry, on which the question of the company's scope of business can have no bearing.

With this bifurcation in the rules and the concomitant differentiation in the focus of the applicable tests, it becomes clear that there should really be no question of choosing between a strict capacity-focused approach for liability or embracing flexibility by permitting reference to the peculiar circumstances obtaining.³⁸ Rather, one should ask which inquiry is the appropriate one to make in the present circumstances.

In *O'Donnell*, Rimer LJ clearly intended to apply the strict capacity-focused approach, but specifically to the no-profit rule. His Lordship stated

If an opportunity comes to [the director] in his capacity as a fiduciary, his principal is entitled to know about it . . . The authorities relating to directors' accountability not only do not support the 'scope of business' exception in relation to the 'no profit' rule, they are contrary to it.³⁹

It should be noted that, on the facts of *O'Donnell*, Rimer LJ also found the directors to have separately breached the no-conflict rule, but that that conflict was present independently of the company's scope of business.⁴⁰ It was therefore not Rimer LJ's view that a scope of business inquiry was irrelevant to the issue of breach of the no-conflict rule.⁴¹ Seen in context therefore, it would appear that Spiegelman NPJ's opprobrium of *O'Donnell* might have been, with respect, somewhat misplaced.

It should be pointed out that Rimer LJ was not dealing with the statutory restatement of the no-conflict and no-profit rules. Although section 170 of the Companies Act 2006 provides explicitly for the statutory duties to be interpreted and applied in the same way as the common law and equitable rules on which they are based, it might require some inspired maneuvering around the language employed in section 175 if this bifurcated approach is to survive within the statutory framework. The position may well be different in Hong Kong, where directors' duties remain within the purview of the common law. His disagreement with Rimer LJ notwithstanding, Spiegelman NPJ had clearly accepted, and it is submitted with respect rightly, that the no-conflict and no-profit rules are separate rules, even as he recognised the overlap between the two rules, and especially in business opportunity cases. *Cheng Wai Tao*, as his Honour noted, had proceeded solely on the basis of the no-conflict rule. In the circumstances, a conclusion that, under Hong Kong law, the scope of business test is of no relevance to a consideration of the no-profit rule cannot therefore be excluded.

³⁷ *ibid*, 385.

³⁸ cf, Ahern, n 6 above, 597; see also discussion in Kershaw, n 7 above, 518.

³⁹ n 17 above at [55]-[56].

⁴⁰ *ibid* at [74]-[75].

⁴¹ As Spiegelman NPJ appeared to have suggested: n 9 above at [85].

ESTABLISHING ‘SCOPE OF BUSINESS’

Spigelman NPJ noted

[A] ‘scope of business test’ may be applicable to a company. The facts and circumstances of a particular case may be such as to *modify the subject matter to which the fiduciary duties of a director apply*.⁴²

The modification in this case, as Ricky contended, was a limitation on the company’s scope of business to a single restaurant. If this could be established, it would confine Ricky’s undertaking to Smart Wave as its director to only that single sushi restaurant owned by Smart Wave. Accordingly, Ricky’s establishing and running of other sushi restaurants would not, on this premise, place him in any position of conflict given the limited scope of his undertaking, and hence duty, to the company. Establishing the restriction contended for was therefore pivotal to the success of Ricky’s case. In this regard, Spigelman NPJ emphasised that the modification ‘must be binding in the corporate context’,⁴³ and his Honour accepted that the means by which this modification may be effected may be formal, through, for example, a provision in the company’s constitution or a shareholders’ resolution, or informal, ‘as long as it is, in substance, equivalent to a formal modification’.⁴⁴ As the single-restaurant restriction was not stipulated in the company’s constitution, nor was it the subject matter of an appropriate shareholders resolution, Ricky had to rely on the unanimous consent rule attributed to *Re Duomatic Ltd*,⁴⁵ which would accord to the informal assent of all the shareholders the binding effect of a properly passed general meeting resolution.

As already alluded to, it was at this point that the judges parted ways. Whilst there was little dispute that Ricky, Jason and Daisy had agreed to the restricted scope of the company’s operations, there was no independent evidence that the remaining shareholders had. But the minority judges, like the trial judge, were prepared to *infer* this from the factual circumstances, including the fact that these other shareholders had been recruited by Ricky, and that it was Ricky who had paid for the shares for all except one of these shareholders.⁴⁶ In contrast, Spigelman NPJ felt unable to make the inference precisely because of these facts. His Honour stated

In my opinion, the fact that these shareholders had such a close relationship with Ricky, is a basis for drawing the opposite conclusion. First, [Ricky] did not call them in support of the alleged ‘agreement’ or ‘understanding’. That is a foundation for the usual inference that nothing they could say would support his case. Secondly, the more probable inference is that they were reluctant to jeopardise that relationship by complaining, let alone joining in hostile legal proceedings.⁴⁷

42 *ibid* at [87] (emphasis added).

43 *ibid*.

44 *ibid*.

45 [1962] 2 Ch 365.

46 n 9 above at [29].

47 *ibid* at [124].

Spigelman NPJ's approach, with respect, is likely to be the correct one. Whilst the cases show that the consent necessary for the *Duomatic* principle may be inferred from a variety of factors,⁴⁸ the fact remains that the principle requires such consent to be *objectively* established.⁴⁹ As Newey J said in *Re Tulsense Ltd; Rolfe v Rolfe*:

[A] shareholder's mere internal decision [cannot] of itself constitute assent for *Duomatic* purposes . . . [F]or a mere internal decision, unaccompanied by outward manifestation or acquiescence, to be enough would . . . give rise to unacceptable uncertainty and, potentially, provide opportunities for abuse. . . . [T]here must be material from which an observer could discern or (as in the case of acquiescence) infer assent.⁵⁰

Given the lack of any outward manifestation of assent on the part of those remaining shareholders or any other objective material from which to infer unqualified assent, it would seem, with respect, that the minority judges in *Cheng Wai Tao* might have been overly generous in their application of the unanimous consent rule.

At this juncture, it is of interest to juxtapose the Hong Kong court's treatment of the restriction on the scope of the company's operations with the approach taken by the English Court of Appeal in the difficult decision of *Bhullar v Bhullar*.⁵¹ The well-known facts may be briefly stated. The company was set up by two families to acquire properties for investment, with the company's shares split equally between the two sides. Unfortunately, the relations between the two families broke down, and were at a 'state of considerable acrimony'.⁵² At this stage, the claimant side of the family informed the defendant side that they did not wish for the company to acquire further properties. The defendant side, in the words of Jonathan Parker LJ, 'accepted this decision in principle'.⁵³ Subsequently, the defendants, who were directors on the company's board, chanced upon property adjacent to one of the company's existing properties, and acquired it for themselves.

Given the shareholders' agreement not to acquire further properties, it could be argued that the company's scope of operations had been restricted by the shareholders' unanimous consent. It should then follow that the duties owed by the defendant directors had been correspondingly qualified. The relevance of a scope of business inquiry in this sense however carried little if any weight with the court.⁵⁴ Instead, the court appeared to have utilised the scope of business inquiry to impose liability on the defendants. Accepting that it would have been 'worthwhile'⁵⁵ for the company itself to purchase the property, which meant that the opportunity to acquire it fell 'plainly in the company's line

48 *EIC Services Ltd v Phipps* [2004] 2 BCLC 589 at [122]

49 *Schofield v Schofield* [2011] 2 BCLC 319 at [32].

50 [2010] 2 BCLC 525 at [41].

51 [2003] 2 BCLC 241.

52 *ibid* at [10].

53 *ibid*.

54 Although there appeared to have some attempt to argue the point by counsel for the defendants, see n 51 above at [20].

55 *ibid* at [15].

of business’,⁵⁶ the court agreed with the trial judge that the facts disclosed ‘a real sensible possibility of conflict’.⁵⁷ With respect, such an approach fails to appreciate the true premise for the operation of the no-conflict rule. As pointed out above, what the rule proscribes is a conflict between the director’s duty to the company and his personal interests. Accordingly, whatever a company’s extant business interests may be, the director’s undertaking or duty in respect thereof may yet be circumscribed by the particular circumstances of the case, including an agreement to restrict the scope of the company’s actual operations.

THE MASHONALAND PRINCIPLE

Counsel for Ricky had attempted to rely on *London and Mashonaland Exploration Co Ltd v New Mashonaland*⁵⁸ (*Mashonaland*) for the proposition that there was ‘no completely rigid rule that a director may not be involved in the business of a company which is in competition with another company of which he was a director’.⁵⁹ Spigelman NPJ did not think that *Mashonaland* would do much to advance Ricky’s case. Indeed, criticism (both judicial and academic) of Chitty J’s ex tempore judgment has been sustained and well-rehearsed. His Honour referred to a fuller report of the case that had appeared in *The Times*,⁶⁰ which he thought put Chitty J’s judgment in a ‘different light’.⁶¹ From this report, it may be readily appreciated that the director in question, Lord Mayo, was a desired name to have on the boards of the rival companies only, as Spigelman NPJ put it, ‘to enhance the reputability of the investment [in the respective companies]’.⁶² Lord Mayo had held no active role in the plaintiff company. As a matter of fact, Chitty J had contrasted Lord Mayo’s position with that of a director ‘in a position similar to that of a managing partner’ who might therefore ‘stand in some such position to the company as would a confidential manager to a private firm’.⁶³ If one accepts that what the no-conflict rule proscribes is a conflict between duty and personal interests, it would be obvious that the occasion for Lord Mayo to be placed in a position of conflict would have been remote at best given that he had ‘never acted as a director, nor attended any board meeting’⁶⁴ and, as Spigelman NPJ noted, ‘never would’.⁶⁵

What then of Lord Blanesburgh’s approbation of Chitty J’s decision in *Bell v Lever Brothers Ltd*?⁶⁶ A closer look at the context of Lord Blanesburgh’s comment discloses that his Lordship was referring to what he had termed ‘contracts of the second class’.⁶⁷ By this, he meant contracts in which the

56 As counsel for the claimants argued, *ibid* at [24].

57 *ibid* at [42].

58 [1891] WN 165.

59 *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201 at [72] *per* Brooke LJ; see also at [79] *per* Sedley LJ.

60 10 August 1891, 3.

61 n 9 above at [96].

62 *ibid* at [97].

63 *The Times* 10 August 1891, 3.

64 *ibid*.

65 n 9 above at [97].

66 [1932] AC 161, 194–195.

67 *ibid*, 195.

company ‘has no interest at all’.⁶⁸ To such contracts, the no-conflict rule, again on the tighter view of ‘conflict’, does not apply. It appears therefore that Lord Blanesburgh had considered Chitty’s J’s judgment as being relevant only to a situation in which the no-conflict rule is inapplicable, and in such cases, the director can only be made liable to account for his profit if ‘in earning that profit he has made use either of the property of the company or of some confidential information which has come to him as a director of the company’.⁶⁹ And this, as Spigelman NPJ observed, is simply ‘an orthodox reflection of the scope of duty principle’.⁷⁰ In the circumstances, *Mashonaland* should, quite rightly, be ‘regarded as standing for no wider a proposition than the trite statement that the law will not interfere in the absence of evidence of a real possibility of breach of fiduciary duty’.⁷¹

THE PROSCRIPTIVE-PRESCRIPTIVE DIVIDE

There is a final point. Spigelman NPJ stated that ‘[t]he duty of a director to act in the best interests of the company is a statement of the *positive* duty of loyalty which is broader than, but encompasses, the conflict rule’.⁷² Whilst his Honour had no further need to discuss the duty of loyalty, the fact that he had assuredly described the duty as a positive obligation is of note. The question whether fiduciary duties impose positive or prescriptive duties has long been a vexed one. In *Item Software (UK) Ltd v Fassihi*,⁷³ Arden LJ saw as part of the fundamental duty of loyalty to which a director is subject, the prescriptive duty to disclose his own misconduct to his principal.⁷⁴ Arden LJ’s decision engendered much debate as it was seen as contrary to the perceived orthodoxy that fiduciary duties, imposed by equity, are proscriptive only.⁷⁵ As Lord Woolf famously said, ‘[equity] tells the fiduciary what he must not do. It does not tell him what he ought to do’.⁷⁶ But Lord Woolf attributed the source of this truism to the important decision of the High Court of Australia in *Breen v Williams*.⁷⁷ There, Gummow J had stated in no uncertain terms that

[i]t would be to stand established principle on its head to reason that because equity considers the defendant to be a fiduciary, therefore the defendant has a legal

68 *ibid*, 194.

69 *ibid*.

70 n 9 above at [92].

71 *ibid* at [104].

72 *ibid* at [72] (emphasis added).

73 [2005] 2 BCLC 91.

74 *ibid* at [41].

75 B. Hannigan, ‘Reconfiguring the No Conflict Rule – Judicial Strictures, a Statutory Restatement and the Opportunistic Director’ (2011) 23 SALJ 714 at [13]. See further, M. Conaglen, ‘The Nature and Function of Fiduciary Loyalty’ [2005] 121 LQR 452; cf R. Lee, ‘In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen’s Analysis’ (2007) 27 OJLS 327; R. Nolan, ‘Controlling Fiduciary Power’ [2009] CLJ 293. See also the Explanatory Notes to the Companies Act 2006 (c 46) (UK) at para 298.

76 [1998] Ch 439, 455.

77 (1996) 186 CLR 71. See also P. J. Millett, ‘Equity’s Place in the Law of Commerce’ (1998) 114 LQR 214, 222-223.

obligation to act in the interests of the plaintiff so that failure to fulfil that positive obligation represents a breach of fiduciary duty.⁷⁸

Breen,⁷⁹ however, was a case that concerned a patient who was seeking access to her medical records from her doctor, and not a corporate director. This potential point of distinction has, however, been dismissed judicially on the ground that the statements in *Breen* were ‘cast in very general terms, and not limited to the doctor–patient relationship’.⁸⁰ *Fassihi* has therefore been considered inconsistent with Australian law.⁸¹

It is however important to note that a doctor, quite unlike a director or a trustee, does not occupy a fiduciary office. As Finn notes, the class of fiduciary office holders, of which company directors and trustees are important members, are distinguished from other fact-based fiduciaries in that ‘while they are entrusted with discretions to be exercised for another’s benefit, they are not subject to the immediate control and supervision of that other in their exercise’.⁸² As a consequence, the fiduciary office holder is ‘positively required in his decision making to act honestly in what he alone considers to be in the interests of . . . his beneficiaries’.⁸³ Finn is not alone in drawing this distinction – Glover appears to do so too as he states that ‘[f]iduciary duties do not impose positive obligations on fiduciaries *who are not trustees*’.⁸⁴ The qualification is critical, and yet so frequently ignored.⁸⁵

The resulting confusion has led to attempts to reconcile these seemingly contradictory positions by asserting that the duty of loyalty is not really a fiduciary duty at all but rather imposes ‘a broad, general, aspirational statement’.⁸⁶ But surely this accords insufficient respect to the duty that has been described as ‘the distinguishing obligation of a fiduciary’⁸⁷ and which is a ‘time-honoured rule’⁸⁸ for directors. According to Professor Birks, it is the ‘the third degree of altruism’⁸⁹ which requires ‘not only positive action in the interest of another but also disinterestedness’ that is that ‘very rare obligation . . . commonly called the fiduciary obligation’.⁹⁰ It is of interest to note that Owen J of the Supreme Court of Western Australia took the view in *Bell Group Limited (in liq) v Westpac*

78 *ibid*, 138. See also, joint judgment of Gaudron and McHugh JJ, *ibid*, 113 and *Pilmer v Duke Group Ltd* (2001) 207 CLR 165, 197.

79 See R. Nolan, ‘A Fiduciary Duty to Disclose?’ (1997) 113 LQR 220.

80 *P & V Industries Pty Ltd v Porto* (2006) 14 VR 1, 5.

81 *ibid*, 9.

82 Finn, n 31 above at [111].

83 Finn reiterates the point in P. D. Finn, ‘The Fiduciary Principle’ in T. G. Youdan (ed), *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) 1, 27.

84 J. Glover, *Equity, Restitution and Fraud* (Sydney: LexisNexis Butterworths, 2004) at [4.2] (emphasis added).

85 Surprisingly, even by those who argue that prescriptive fiduciary obligations can exist: see R. Lee, ‘In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen’s Analysis’ (2007) 27 OJLS 327, 337 who cites (at n 47) Finn for his proposition that ‘no more than loyalty is exacted’. Finn however explicitly qualifies his statement by excluding the class of fiduciary office holders: see Finn, n 83 above, 28.

86 Hannigan, n 75 above at [16].

87 *Bristol and West Building Society* n 2 above, 18.

88 *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11, 21.

89 Birks, n 1 above, 20.

90 *ibid*, 37.

*Banking Corporation (No 9)*⁹¹ that the duty imposed upon directors to act bona fide in the interest of the company was indeed fiduciary despite its essentially prescriptive character.⁹² Perhaps to illustrate the unproductive nature of the debate, Owen J flipped the bona fide duty rule around and re-couched it with a proscriptive bent, in the same way that possibly every other positive rule can be expressed negatively.⁹³ It may be that the epithet ‘proscriptive’ simply and literally means that equity does not prescribe what directors must do because, as Lord Greene famously expressed, ‘they must exercise their discretion bona fide in what they consider – not what a court may consider – to be in the interests of the company’.⁹⁴

CONCLUSION

Cheng Wai Tao helpfully provided an opportunity for the highest court in Hong Kong to weigh in on the enduring debate about scope and classification in the area of directors’ duties. It has been repeatedly affirmed that what defines the fiduciary is the duty of loyalty to which he is subject. For the corporate director, this ‘first and greatest obligation’⁹⁵ requires him to act positively in the interests of the company. But, as Professor Birks observed, this duty to act in another’s interests only becomes elevated to the status of a fiduciary duty when it is bound with an obligation of ‘disinterestedness’,⁹⁶ an obligation which demands the denial of self-interest. However, the clearly proscriptive duty of disinterestedness, manifested in the no-conflict and no-profit rules, is necessarily ‘parasitic’⁹⁷ on the primary obligation and is unworkable without it.⁹⁸ The fiduciary obligation is therefore a complex obligation – the prescriptive cannot be fiduciary without the proscriptive, but the proscriptive is unintelligible without the prescriptive. Perhaps what this tells us is simply that the debate about classification is really quite unnecessary.

The application of the duty of disinterestedness, on the other hand, is a different matter. The statutory statement of directors’ duties in the Companies Act 2006 has placed the no-profit rule within the folds of the no-conflict rule. This strongly suggests that in order for the no-profit rule to apply so that liability to account is imposed on the director, there must first be a conflict (actual or possible) between the company’s and the director’s interests.⁹⁹ It has been observed that this is a ‘more balanced approach . . . and avoids the risk . . . of fiduciaries being held accountable through the unreasonable and inequitable application of equitable principles’.¹⁰⁰ With respect, the inequity

91 (2009) 70 ACSR 1.

92 *ibid* at [4574]-[4577].

93 *ibid* at [4580].

94 *Re Smith and Fawcett Ltd* [1942] Ch 304, 306.

95 Birks, n 1 above, 22.

96 *ibid*, 20.

97 *ibid*, 29.

98 *ibid*.

99 Kershaw, n 7 above, 574; Hannigan, n 75 above at [43].

100 Hannigan, *ibid*.

was the result of a view that saw 'conflict' as being defined by a generous view of the company's 'interests', when it should have been defined by reference to the director's undertaking. On the other hand, the no-profit rule had a much stricter requirement for application – the actual abuse of the director's position. Linking the rules as section 175 does, paradoxically requires an expansive view of 'conflict' in order to capture situations of actual abuse. It is submitted that this position is not conducive either to clarity or to coherence.