COMPANY LAW

Name of the Student

Name of the University

Author Note

# Issue

The issue in the given scenario is whether the directors of the organization named Ethos have caused a violation in relation to their duties as directors, primarily regarding two points:-

1. The validity and cogency of the loan amounting to fifteen thousand pounds that was forwarded by Ethos in favor of Mike.
2. The validity and cogency of the loan amounting to five thousand pounds that was forwarded by Ethos in favor of Ceri.

# Rule

The case of *Re Lands Allotment Company* [1894] 1 Ch 616 may be considered to be a relevant case in this regard[[1]](#footnote-1). In this case, the position regarding directors in relation to the shareholders has been discussed. It has been stated that even though the directors in a particular organization are not regarded as trustees, however, in relation to the responsibilities of the directors, they have always been measured and deliberated as trustees in relation to the money that they receive and are able to control. After the advent of the joint stock organizations, the directors shall be held to be accountable regarding the money that might have been misapplied and misused by the directors.

The case of *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512 is another significant case in this regard[[2]](#footnote-2). In this case, it has been stated that responsibility and obligation shall be owed by directors in relation to the organization and also in relation to creditors of the organization. Such responsibility is levied upon the directors in order to make sure that the dealings and activities of the organization are appropriately administered. It must be ensured that the property of the organization is not exploited or misused for the profit and advantage of directors and in the process cause detriment to the creditors.

Section 171 as provided in the Companies Act of the year 2006 states that a director in an organization should act within the authority as specified in the constitution of the organization[[3]](#footnote-3). They should not act beyond their authority or discretion.

Section 172 as provided in the Companies Act of the year 2006 states that it shall be the responsibility of the directors in a particular organization, to promote the success of the organization[[4]](#footnote-4). In the case of *Mills v Mills* (1938) 60 CLR 150, it was stated that it shall be the responsibility of the directors to perform their actions in relation to the interest and the welfare of the organization only[[5]](#footnote-5). They should not act to gain advantage for themselves. In the case of *Re Smith v Fawcett* [1942] Ch 304, it has been mentioned that it shall be the responsibility of the directors to perform the actions, which according to them, shall be in the best interests and the welfare of the company[[6]](#footnote-6).

Section 173 as provided in the Companies Act of the year 2006 states that a particular director must utilize independent judgment[[7]](#footnote-7). In the case of *John Crowther Group Plc. v Carpets International Plc. and Others* [1990] BCLC 460, it had been stated that it must be decided by the directors that what shall be in favor of the welfare of the organization[[8]](#footnote-8). In this case, it was mentioned that those actions must be performed by the directors, which according to them, is beneficial for the organization.

Section 174 as provided in the Act mentioned above states that it shall be the responsibility of the directors to exercise rational and sensible diligence and care in favor of the organization[[9]](#footnote-9). The case of *Re City Equitable Fire Insurance CO* [1925] Ch 407 shall be regarded as a relevant case in this regard[[10]](#footnote-10). In this case, it was mentioned that in order to comprehend the responsibilities of a director and how much reasonable and rational diligence and care must be shown by the director towards the organization, shall depend on the nature of business in respect of the organization. The responsibility shall also depend upon the way in which the labor and work regarding the organization is circulated among the officials and the directors. In this particular case, it has been mentioned that while discharging the responsibilities a particular director should perform his activities in an honest manner and also perform the activities with proper diligence and care.

Section 175 as provided in the Companies Act of the year 2006 states that it shall be the responsibility of a director to evade conflict in relation to the interests of his own in connection to the organization[[11]](#footnote-11). In the case of *Bray v Ford* [1896] AC 44, it has been said that a director shall not be permitted to be involved in a situation where the interests of the director and the responsibilities of the director may be in conflict[[12]](#footnote-12).

Section 176 as provided in the aforementioned Act states that a director should not accept any kind of benefits from outside parties. Acceptance of benefits gives rise to a conflict of interest and hence, must be evaded in under any circumstances.

Section 177 as provided in the Companies Act of the year 2006 states that if any particular director has any interest, indirect or direct, in relation to a transaction of the organization, then that particular director must disclose and inform the other directors regarding the interest of that director in relation to the transaction.

# Application

Ethos Plc is an international organization relating to graphic design. When Mike, a director of the organization, was suffering in a financial crisis, the other directors forwarded a loan amounting to fifteen thousand to Mike. This transaction was agreed upon by all the director at the meeting. Mike did not cast his vote in the meeting, although he was present. AOA of the organization named Ethos states that the organization may be involved in any activity relating to business of graphic design. Afterwards, a laon was forwarded in favor of Ceri, who is considered to be a primary client in favor of Ethos. Ceri shall pay back the amount of loan in two years. However, the members of Ethos demand that Ceri must pay back the amount instantly.

The case of *Re Lands Allotment Company* [1894] 1 Ch 616 shall be applied in the given scenario[[13]](#footnote-13). In this case, the position regarding directors in relation to the shareholders has been discussed. It may be said that even though the directors in Ethos are not regarded as trustees, however, in relation to the responsibilities of the directors, they should be measured and deliberated as trustees in relation to the money that they receive and are able to control. The directors of Ethos shall be held to be accountable regarding the money that might have been misapplied and misused by the directors.

The case of *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512 shall be applied in the given scenario[[14]](#footnote-14). The responsibility and obligation shall be owed by directors in relation to Ethos and also in relation to creditors of Ethos. Such responsibility is levied upon the directors in order to make sure that the dealings and activities of the organization are appropriately administered. It must be ensured by the directors of Ethos that the property of the organization is not exploited or misused for the profit and advantage of directors and in the process cause detriment to the creditors.

Section 171 as provided in the Companies Act of the year 2006 should be applied in the given scenario[[15]](#footnote-15). As per this section, the directors in Ethos should act within the authority as specified in the constitution of Ethos. They should not act beyond their authority or discretion.

It may be said that as per section 172 as provided in the Companies Act of the year 2006 the responsibility of the directors of Ethos shall be to promote the success of Ethos. The case of *Mills v Mills* (1938) 60 CLR 150 shall be applied in the given scenario[[16]](#footnote-16). As per this case, it shall be the responsibility of the directors of Ethos to perform their actions in relation to the interest and the welfare of the organization only. They should not act to gain advantage for themselves. The case of *Re Smith v Fawcett* [1942] Ch 304 shall also be applied in the given scenario[[17]](#footnote-17). As per this case, it shall be the responsibility of the directors of Ethos to perform the actions, which according to them, shall be in the best interests and the welfare of the company.

Section 173 as provided in the Companies Act of the year 2006 should be applied in the given scenario. As per this section, a particular director of Ethos must utilize independent judgment. The case of *John Crowther Group Plc. v Carpets International Plc. and Others* [1990] BCLC 460 should be applied[[18]](#footnote-18). It must be decided by the directors of Ethos in relation to what shall be in favor of the welfare of the organization. In this case, it was mentioned that those actions must be performed by the directors, which according to them, is beneficial for the organization.

Section 174 as provided in the Companies Act should be applied in the given scenario. It shall be the responsibility of the directors of Ethos to exercise rational and sensible diligence and care in favor of the organization. The case of *Re City Equitable Fire Insurance CO* [1925] Ch 407 shall be applied in the given scenario[[19]](#footnote-19). As per this case, it must be mentioned that in order to comprehend the responsibilities of director of Ethos and how much reasonable and rational diligence and care must be shown by the director towards the organization, shall depend on the nature of business in respect of the organization. The responsibility of the director of Ethos shall also depend upon the way in which the labor and work regarding the organization is circulated among the officials and the directors. In this particular case, it has been mentioned that while discharging the responsibilities a particular director should perform his activities in an honest manner and also perform the activities with proper diligence and care. The directors of Ethos should similarly perform their activities in an honest manner and also perform the activities with proper diligence and care.

Section 175 as provided in the Companies Act of the year 2006 should be applied in the given scenario[[20]](#footnote-20). As per this section, it shall be the responsibility of a director in Ethos, to evade conflict in relation to the interests of his own in connection to the organization. The case of *Bray v Ford* [1896] AC 44 should be applied in the given scenario[[21]](#footnote-21). As per this case, that a director shall not be permitted to be involved in a situation where the interests of the director and the responsibilities of the director may be in conflict.

Section 176 as provided in the Companies Act should be applied in the given scenario[[22]](#footnote-22). A director should not accept any kind of benefits from outside parties. Acceptance of benefits gives rise to a conflict of interest and hence, must be evaded in under any circumstances.

Section 177 as provided in the Companies Act of the year 2006 states that if any particular director has any interest, indirect or direct, in relation to a transaction of the organization, then that particular director must disclose and inform the other directors regarding the interest of that director in relation to the transaction[[23]](#footnote-23).

After the application of the aforementioned rules, it may be said that after forwarding the loan (amounting to fifteen thousand) to Mike, if the organization faces any kind of detriment or harm then it may be said that the directors of Ethos may have caused a violation of their responsibilities as directors.

After the application of the rules mentioned above, the loan (amounting to five thousand) to Ceri shall be valid because Ceri is a primary client regarding the business and the AOA of the business specifically mentions that Ethos should be involved in any activity relating to business of graphic design.

# Conclusion

In conclusion it may be said that the violation of responsibilities of directors shall be in relation to two aspects:-

1. The loan forwarded to Mike may be valid if the forwarding of the loan does not cause any kind of detriment or damage to the organization.
2. The loan forwarded to Ceri shall be held to be valid.

# References

Companies Act, 2006.

*John Crowther Group Plc. v Carpets International Plc. and Others* [1990] BCLC 460.

*Mills v Mills* (1938) 60 CLR 150.

*Re City Equitable Fire Insurance CO* [1925] Ch 407.

*Re Lands Allotment Company* [1894] 1 Ch 616.

*Re Smith v Fawcett* [1942] Ch 304.

*Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512.

1. *Re Lands Allotment Company* [1894] 1 Ch 616. [↑](#footnote-ref-1)
2. *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512. [↑](#footnote-ref-2)
3. Companies Act, 2006. [↑](#footnote-ref-3)
4. *Ibid* [↑](#footnote-ref-4)
5. *Mills v Mills* (1938) 60 CLR 150. [↑](#footnote-ref-5)
6. *Re Smith v Fawcett* [1942] Ch 304. [↑](#footnote-ref-6)
7. Companies Act, 2006. [↑](#footnote-ref-7)
8. *John Crowther Group Plc. v Carpets International Plc. and Others* [1990] BCLC 460. [↑](#footnote-ref-8)
9. Companies Act, 2006. [↑](#footnote-ref-9)
10. *Re City Equitable Fire Insurance CO* [1925] Ch 407. [↑](#footnote-ref-10)
11. Companies Act, 2006. [↑](#footnote-ref-11)
12. *Bray v Ford* [1896] AC 44. [↑](#footnote-ref-12)
13. *Re Lands Allotment Company* [1894] 1 Ch 616. [↑](#footnote-ref-13)
14. *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512. [↑](#footnote-ref-14)
15. Companies Act, 2006. [↑](#footnote-ref-15)
16. *Mills v Mills* (1938) 60 CLR 150. [↑](#footnote-ref-16)
17. *Re Smith v Fawcett* [1942] Ch 304. [↑](#footnote-ref-17)
18. *John Crowther Group Plc. v Carpets International Plc. and Others* [1990] BCLC 460. [↑](#footnote-ref-18)
19. *Re City Equitable Fire Insurance CO* [1925] Ch 407. [↑](#footnote-ref-19)
20. Companies Act, 2006. [↑](#footnote-ref-20)
21. *Bray v Ford* [1896] AC 44. [↑](#footnote-ref-21)
22. Companies Act, 2006. [↑](#footnote-ref-22)
23. *Ibid* [↑](#footnote-ref-23)