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### **Companies' directors in Iraqi law and their divided loyalty : lessons drawn from English law**

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**Companies' Directors in Iraqi Law and their Divided Loyalty: Lessons Drawn from  
English Law**

**By**

**Raad Hashim Ameen Al-Temimi**

**A Thesis Submitted to Bangor University, School of Law in Fulfilment of the  
Requirements of Awarding the Degree of Doctor of Philosophy**

**23 June 2015**

## **Abstract**

The focus of this thesis is on the problematic aspects of directors' loyalty to their companies under Iraqi law. This issue belongs to one of the most complex areas of company law, because it relates to the fallibility of human nature and a director's temptation to put his personal interests ahead of the company's interests. A comparison with English law is undertaken, with an emphasis on recent developments, particularly the English Companies Act of 2006. This comparison is aimed at identifying defects in Iraqi law and providing solutions to problems arising from the incoherence of Iraqi legislation and its lack of a fiduciary doctrine.

In order to achieve this goal, this thesis focuses on certain managerial duties: the duty to act in the company's interests; the duty to avoid conflicts of interest; and the director's duty to declare his interest in transactions, as well as the enforcement of these duties.

The author of this thesis argues that in Iraqi law there are several legislative loopholes and contradictions with regard to addressing the problems of a director's divided loyalty. The main shortcoming is ascribed to the absence of a unifying conceptual underpinning of managerial duty within Iraqi legislation. This contrasts with the situation in English law, in which the fiduciary doctrine underpinning managerial duty operates to protect the company (as a vulnerable person) from certain aspects of a director's self-interest and dishonesty by imposing strict duties relating to any eventuality in which the director might be swayed by personal interests rather than his duty. The plurality of legislation dealing with managerial duties is a further challenge facing Iraqi law, and such a situation often leads to a conflict between the rules governing this area. The above shortcomings in Iraqi law inevitably affect its unity and its coherence, and limit its capability to address certain fundamental aspects of director's misbehaviour.

This thesis demonstrates that addressing the problems of the divided loyalties of directors under Iraqi law should take the form of a comprehensive systematic overhaul of Iraqi Company Law. This reform should take into account the necessity of transplanting certain aspects of U.K. fiduciary duties into Iraqi law, particularly the concept of fiduciary duty, in order to provide a clear guide, not only to the courts when they apply and interpret the law, but also to the director himself and other practitioners.

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## Table of Abbreviations

C.A.	The U.K Companies Act 2006
C.B.I.	The Iraqi Central Bank 2005
C.P.A.	the Coalition Provisional Authority 2004
D.T.I	The Department of Trade and Industry
E.S.V	Enlightened Shareholder Value
I.B.R.A.	The Insurance Business Regulation Act 2005
I.C.A.	The Iraqi Companies Act 1997
M.A.P.C.	The Model Articles for the Public Companies 2008
M.A.P.C.L.G.	The Model Articles for Private Companies Limited by Guarantee 2008
M.O.F.E.P.B.A.	The Mistrrial Order of Facilitating the enforcement of the Private Banks Act 2010
P.B.A.	The Private Banks Act 2004
R.C.E.S.M.S.C.	The Rules of Conduct for Employees of State and Mixed Sector Companies 2006
R.I.B.A.S.	The Rules of Iraqi Board of Accounting Standards 2012

### Table of Abbreviations of Journals' Titles

A B A Sec Real Prop Prob & Tr Proc	American Bar Association Section of Real Property, Probate and Trust Law Proceedings
Al-Rafidain Dev J	Al-Rafidain Development Journal
Alta L Rev	Alberta Law Review
Am U L Rev	American University Law Review
Arab L Q	Arab Law Quarterly
Banking L J	Banking Law Journal
Buff L Rev	Buffalo Law Review
Cal L Rev	California Law Review
C L J	Cambridge Law Journal
Can –USLJ	Canada-United States Law Journal
Canta L R	Canterbury Law Review
Canta L R	Canterbury Law Review
Case W Res J Int'l L	Case Western Reserve Journal of International Law
Co L N	Company Law Newsletter
Comm L World Rev	Common Law World Review
Comp Law	Company Law
CONV P L	Conveyancer and Property Lawyer
Crim Just Ethics	Criminal Justice Ethics
Del J Corp L	Delaware Journal of Corporate Law
Edin L Rev	Edinburgh Law Review
Ford J C F L	Fordham Journal of Corporate and Financial Law
Geo Mason L Rev	George Mason Law Review
I B L J	International Business Law Journal
I C C L R	International Company and Commercial Law Review
I C C L Rev	International Criminal Court Law Review
Insolv Int	Insolvency Intelligence

Int'l Bus Law	International Business Lawyer
Int J L M	International Journal of Law and Management
Int'l L	The International Lawyer
Int'l Trade & Bus L Rev	International Trade and Business Law Review
JBL	Journal of Business Law
J Corp L	The Journal of Corporation Law
J Crop L Stud	Journal of Corporate Law Studies
J I B L	Journal of International Banking Law
J Marshall L Rev	John Marshall Law Review
J Transnat' l L & Poly	Journal of Transnational Law & Policy
La L Rev	Louisiana Law Review
L J	Law Journal
L Q R	Law Quarterly Review
L Rev	Law Review
L S	Legal Studies
Man L J	Manitoba Law Journal
Marq L Rev	Marquette Law Review.
Melb U L Rev	Melbourne University Law Review
Mich J Private Equity & Venture Cap L	Michigan Journal of Private Equity & Venture Capital Law
Minn L Rev	Minnesota Law Review
Mod L Rev	Modern Law Review
N Ir Legal Q	Northern Ireland Legal Quarterly
O J L S	Oxford Journal of Legal Studies
O L Rev	Original Law Review
Oxford J Legal Stud	Oxford Journal of Legal Studies
SACLJ	Singapore Academy of Law Journal
S African L J	The South African Law Journal.
S Afr Mercantile Law Journal	South African Mercantile Law Journal
Sask L Rev	Saskatchewan Law Review

Sing L Rev	Singapore Law Review
SMU L Rev	SMU Law Review
Syd L R	Sydney Law Review
Theoretical Inq L	Theoretical Inquiries in Law
Tikrit University J L & Pol S	Tikrit University Journal of Legal & Political Science
Trinity C L Rev	Trinity College Law Review
Tru L I	Trust Law International
U Det L J	University of Detroit Law Journal
U N S W L J	University of New South Wales Law Journal
U PA L Rev	University of Pennsylvania Law Review
U Queensland L J	University of Queensland Law Journal
Va J Int'l L	Virginia Journal of International Law

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## Chapter One

### Introduction

A company is a legal person<sup>1</sup> who lacking a genuine will, must therefore depend on the will of the natural persons responsible for the company's operation. In the exercise of his powers, a director acts not only as an agent for the expression of a company's will, but as its "mastermind." The future of the company depends not only on his expertise, but also on the honesty and faithfulness he<sup>2</sup> brings to his role.

However, the above situation creates an unbalanced relationship. A director in this relationship is equipped with sufficient powers and information to enable him to control the company's affairs, but he may exploit them for his own advantage.<sup>3</sup> The impulse to give precedence to his personal interests may motivate a director to place his interests, or the interest of any another party, ahead of the company's interests. Thus the company will occupies a vulnerable position in this relationship.<sup>4</sup> It is vital, therefore, to impose on the director certain obligations that serve to constrain the instinctive human tendency toward self-interest. Otherwise, the director's behaviour is liable to pose a serious threat to the company's interests.

A director's self-interest is not only detrimental to the interests of the company, its members and other stakeholders, it is also prejudicial to the public interest. For example, other firms that may collapse as a result of directors' abuse of his office. Furthermore, the abuse may have repercussions on an international scale, in the form of the collapse of cross-border companies and the harm done to the economies of other countries. This matter has particular significance in the light of the phenomenon of globalization and the spread of international companies.

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<sup>1</sup> See Iraqi Companies Act 1997, Arts.5, 22; the Civil Code 1951, Arts. 47, 48. See also: Mark Stallworthy, 'Directors' Duties in Selected Markets: England and Wales' (1993) ICCLR 77.

<sup>2</sup> The use throughout this thesis of the pronouns "he" and "she" is merely a convenient grammatical convention. Therefore the term "director," are intended to apply to both males and females.

<sup>3</sup> Jie Li, 'the Peso Silver Case: an Opportunity to Soften the Rigid Approach of the English Courts on the Problem of Corporate Opportunity' (2011) 32(3) Comp law 68, 72.

<sup>4</sup> This point will be elucidated in depth in the next Chapter at paras 2.1.1, 2.1.3.

The legal mind has devised ways of restraining a director's self-interest by the imposition of certain obligations with which he must comply as a means of ensuring his probity and establishing his liability. These obligations are embraced within the concept of "fiduciary duty" under English law. They have recently been codified in the U.K Companies Act (hereinafter the C.A.) 2006, after having previously been scattered piecemeal among the provisions of the common law.<sup>5</sup> Iraqi law has also adopted this approach in its Companies' Act (herein after the I.C.A.) 1997 and in other legislation.<sup>6</sup>

In recognition of its increasing legal significance, much research has been undertaken in this area. The aim has been to consider where the balance should lie: on the one side, to avoid stifling the director's entrepreneurial business, while at the same time ensuring that he does not abuse his office. This thesis represents another effort to re-assess this area of law within the context of one civil law jurisdiction, Iraq.

The focus of this thesis is on a director's duties under Iraqi Company law. The I.C.A. 1997 is the legislative product of a country with a transitional economy that has been endeavouring to adopt the principles of capitalism in the aftermath of the Anglo-American invasion of Iraq in 2003 (the war for liberty of Iraq). The war to remove the regime of Sadaam Hussein ended on 9 April 2003, and the socialist system of the Ba'ath party was replaced by the doctrine of liberty of trade.<sup>7</sup> The reform of the I.C.A. 1997 in 2004,<sup>8</sup> in conjunction with enactment of other economic legislation, was among the first fruits of this transition after the aforementioned invasion.<sup>9</sup>

Several factors have impelled the author to choose the present topic. It will be demonstrated shortly<sup>10</sup> that there has been a dearth of academic debate in this area,

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<sup>5</sup> See ss. 170-177 of this Act.

Interestingly, the solutions devised by English law have recently attracted the attention of the international legislature in its attempts to combat corruption and conflicts of interest. These endeavours resulted in the United Nation Convention against Corruption of 2004. See, for example, Article 12 of this Convention, which deals with corruption in Private Sector Entities. Iraq's accession to this Convention was made under the Act No.35, 2007.

<sup>6</sup> Such as the Private Banks Act 2004 (herein after the P.B.A.); the Insurance Business Regulation Act 2005 (herein after I.B.R.A.).

<sup>7</sup> Iraqi Constitution 2005, Arts.25, 26; the Act of the Ministry of Trade No. 37 2011, Art.2 (Second).

<sup>8</sup> This reform was made under the Order No.64 of 2004, taken by the Coalition Provisional Authority (hereinafter the C.P.A.).

<sup>9</sup> Such as the P.B.A. 2004; the I.B.R.A. 2005 (herein after I.B.R.A.).

<sup>10</sup> See para 1.2 of this Chapter.

thus providing an opportunity to develop Iraqi law through an exploration of its shortcomings. Further motivations have influenced the author. Iraq is a country rich in natural resources, and is virgin territory for investment by international companies. It is in the interests of these companies to access Iraqi legal literature in order to understand the structure of the country's company law and the degree of protection that it provides for investments. It is vital for international investors to be able to identify *ex ante* any *lacunae* in Iraqi law so that they are provided with a decisive legal means to safeguard these investments, for example by special agreements between the parties concerned. Alternatively, international investors may wish to exercise an influence on the legislature with the aim of making this area of law more congenial to investors who are contemplating an engagement with the Iraqi market. This study also provides an opportunity to judge which legal system is better in providing a realist solution to problems of conflict of interests: Is it the English law paradigm or the Civil law paradigm?

For many reasons, the C.A. 2006 has been chosen for this study as a model for comparison with Iraqi law. First, English law has a long tradition of creating rules to govern the duties of directors. The second reason, and perhaps the most important, is that since the last reform of the I.C.A. 1997 by the the C.P.A. in 2004,<sup>11</sup> the notions philosophy underpinning the Anglo-Saxon school of law has become recently an important source for Iraqi Company law, as it will be demonstrated in this thesis. The third reason is that fraudulent actions and breaches of duty on the part of a director do not differ from one country to another. Thus, utilising the more sophisticated U.K legal regime as a paradigm for the identification of legal deficiencies will be conducive to achieve the study's aims.

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<sup>11</sup> This authority consisted of officials from the U.K and from the U.S.A and replaced Saddam Hussein's regime on 9 April 2003. This Authority was entrusted with enacting the relevant legislation to achieve welfare for Iraqi people, pursuant to the Resolutions No.1483 and 1511 of 2003, taken by the U.N Security Council.

## 1.1 Scope and Limitations of the Scope of the Thesis

This thesis is a legal study. It focuses on the adequacy and efficiency of the managerial duties in Iraqi Company Law,<sup>12</sup> which are called “fiduciary duties” under English law, in addressing the problems connected with the divided loyalty of a director. Divided loyalty can be envisaged as a situation where a director is swayed by his own interests at the expense of the duty he owes to his company.

However, there are three limitations on the scope of this thesis: The first is that the study is restricted to commercial companies. For that reason, charity companies will be outside its scope. The I.C.A. 1997 and the other Iraqi companies Acts, unlike the C.A. 2006, do not regulate charity enterprises.<sup>13</sup>

The second limitation is that this study is confined to those duties cited in the I.C.A. 1997 and other legislation that is comparable to the general duties set out under the UK Companies Act 2006, part 10, chapter 2. This will ensure that the study is concentrated on a limited number of points, in keeping with the standards of academic research. The thesis will be confined to the study of three main duties: the duty to act in the interests of the company; the duty to avoid conflicts of interest; the duty to declare an interest in a deal or a transaction. The means of enforcing these duties will be examined, but other remaining duties<sup>14</sup> will be outside the scope of this study.

The ambit of this study will however include all Iraqi legislation related to companies, such as the Civil Code 1951; the Private Banks Act (herein after P.B.A.) 2004; the Insurance Business Regulation Act (herein after I.B.R.A.) 2004 and any other relevant Acts. There are two reasons for this inclusivity: Firstly, the Companies Act No.21 1997 does not encompass all the rules governing the above duties, which are scattered

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<sup>12</sup> Managerial duty is the phrase which will be widely utilised throughout this thesis, which is equivalent in its meaning to “fiduciary duty”. This usage is ascribed to the fact that the Iraqi lawmaker does not employ the term “fiduciary duty” in legislation. The author is of the view that managerial duty, under Iraqi law, is any statutory restriction on a director’s will that obliges him to act in the company’s interests according to his powers set out by the law.

<sup>13</sup> The Societies Act No.13 of 2000 regulates the affairs of Iraqi charitable entities (Societies). The Act defines the "Society" in Art.1 thereof as ‘a group which has a permanent capacity and consists of a number of natural and legal persons for purposes other than achieving a financial profit. This includes Social Clubs’.

<sup>14</sup> Such as for example: the duty to act within powers (s.171 of the C.A. 2006); or the duty to exercise independent judgment (s.173).

throughout these various Acts. The second reason is to achieve the utmost benefit from this study by highlighting the deficiencies in all of these pieces of legislation, and to explore the degree of harmony or divergence between them.

## 1.2 Literature Review

One of the greatest difficulties confronting the researcher is the paucity of domestic Iraqi legal literature which address this theme. This difficulty is attributable to the failure to deal with several facets of fiduciary duty by the Iraqi legislators and Iraqi academic commentators. The result is that it is difficult to draw courts and jurists towards an extensive legal debate on this theme. Conversely, there has been over the years a considerable amount of literature in English law dealing with this area of company law. This literature has contributed to the reconfiguration of fiduciary duties contained in the C.A. 2006.

One of the main problems with Iraqi law is the ambiguity of the conceptual framework underpinning the director's duty. There is a need therefore, to identify the general notion that represents the basis of *managerial duty* and vindicate the consideration of this theme. This theme has been discussed intensively in the English legal literature under the heading of "fiduciary doctrine".<sup>15</sup> It should be mentioned here that the English literature discusses the theoretical basis of the fiduciary doctrine within a general framework that embraces all persons who can be described as fiduciaries and is not restricted just to company directors. The compatibility of these theories with the nature of the director's duty is nevertheless open to discussion, and the question will be considered in this thesis.

The absence of a conceptual framework of managerial duty in Iraqi law includes also the concept of a director's loyalty to his company: the term that is often utilized at

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<sup>15</sup> Stephen Mayson, Dereck French & Christopher Ryan, *Mayson, French & Ryan on Company Law* (31 th edn, OUP 2014-15) 468-469, para 16.3; Daniel J. Carr 'English Influences on the Historical Development of Fiduciary Duties in Scottish Law' (2014) 18(1) Edin L R 29; Leonard I. Rotman, 'Fiduciary Doctrine: A Concept in Need to Understanding' (1996) 34(4) Alta L Rev 821; Kelli A. Alces, 'Debunking the Corporate Fiduciary Myth' (2009) 35(2) J Corp L 239, 257-269.

common law.<sup>16</sup> Unfortunately, little attention has been given to the content of this concept by legal commentators.<sup>17</sup> For example, there is a question as to whether the term “loyalty” is a specific “duty” or merely a legal concept. Is the concept of “loyalty” present in Iraqi law and, if so, what is its content? This matter acquires a particular significance as the latter duty has been described by some commentators of English law<sup>18</sup> as being at the core of fiduciary duties, and it is often equated with the concept of the duty to act in the extensively company’s interests.

One of the most fundamental fiduciary duties under the Anglo-Saxon regime has not been discussed extensively in the Iraqi literature: *the duty to act in the interests of the company*. Iraqi scholars have debated this duty *within the context of duty of care*,<sup>19</sup> and as a result there has been a statutory conflation of these two duties. English legal commentators, by contrast, have discussed the duty to act in the company’s interests in a comprehensive manner, by clarifying its content.<sup>20</sup> The touchstone in making a distinction between the duty to act in the interests of the company and the duty of care is the principle of good faith,<sup>21</sup> which has not been discussed by Iraqi commentators

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<sup>16</sup> See for example *Bristol and West Building Society v Mothew* [1996] 4 All ER 698, 711- 712 (CA); *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd’s Rep 643 (QB); *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [6] (Mummery L.J).

<sup>17</sup> Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 238, para 130; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245; Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 461.

<sup>18</sup> John Lowry, ‘The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure’ (2009) 68(3) C L J 607; Martin Day, ‘Fiduciary Duties’ (2009) 15(6) *Trusts & Trustees* 447, 448; Sarah Worthington, ‘Directors Duties, Creditors’ Rights and Shareholders Intervention’ (1991) 18 *Melb U L Rev* 121; Nicholas Bourne, *Bourne in Company Law* (4th edn, Routledge publishing 2008) 179, para 12.7.

<sup>19</sup> See for example: Murtaza Nasser Nasrallah, *the Commercial Companies* (Coaching publisher 1969) 242, parar 201; Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 461; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245-246; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 243, para 131; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247.

<sup>20</sup> See for example: Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 506-525, paras 16-24-36; Stephen Mayson, Dereck French & Christopher Ryan, *Mayson, French & Ryan on Company Law* (30<sup>th</sup> edn, OUP 2013) 476-487, paras 16.6.1-13; Mark Hsaio, ‘A Sprouting Duty of Honesty and Loyalty? Companies Act 2006’ (2009) 20(9) *I C C L R* 301.

<sup>21</sup> This finding may be ascribed to the fact that the breach of the duty to act in a company’s interests is *often* linked with perpetrating a deliberate wrongdoing, unlike the violation of the duty of care which might be perpetrated recklessly. For further elucidation to this issue, see Chapter 3, section two of this thesis.



of company law,<sup>22</sup> again in contrast to their English law counterparts.<sup>23</sup> This difference raises several questions, such as: what are the content of the principle of good faith, and how do we ascertain whether it has been observed by a director in fulfilling his duty? Also, what are the legal advantages to be gained by applying the principle in this area of law? <sup>24</sup>

The Iraqi literature also refers to a “company’s interests,”<sup>25</sup> but without identifying the meaning of the term.<sup>26</sup> It does not define the meaning and scope of a company’s interest that a director must pursue as his goal. Is this interest confined to promoting only the shareholders’ interests, or does it embrace other interests, such as those of stakeholders? However, the identification of a company’s goal and whether it includes the above participants is a matter that has increasingly attracted the attention of English

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<sup>22</sup> Murtaza Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 243, par 201; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245-246; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 243, para 131.

<sup>23</sup> Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 206-207, paras 9.3-9.12; Stephen D. Girvin & Sandra Frisby & Alastair Hudson, *Charlesworth’s Company Law* (18th edn, Thomson Reuters legal ltd 2010) 328; Daniel Attenborough, ‘How Directors Should Act When Owing Duties to the Companies’ Shareholders: Why We Need to Stop Applying Greenhalgh’ (2009) 20(10) I C C L R 339; John Kong Shan Ho, ‘Is Section 172 of the Companies Act 2006 the Guidance for CSR?’ (2010) 31(7)Comp Law 207; Andrew Keay, ‘Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom’s ‘Enlightened Shareholder Value Approach’ (2007) 29 Sydney Law Review 577; Davy Ka Chee Wu, ‘Managerial Behaviour, Company Law, and the Problem of Enlightened Shareholder Value’ (2010) 31(2)Comp Law 53; Deryn Fisher, ‘The Enlightened Shareholder-Leaving Stakeholders in the Dark: Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of their Decisions on Third Parties?’ (2009) 20(1) I C C L R 10; Sarah Kiarie, ‘At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?’ (2006) 17(11) I C C L R 329; Ji Lian Yap, ‘Considering the Enlightened Shareholder Value Principle’ (2010) 31(2) Comp Law 35; Mark Hsaio, ‘A Sprouting Duty of Honesty and Loyalty? Companies Act 2006’ (2009) 20(9) I C C L R 301.

<sup>24</sup> See Martha Bruce Fcis, *Rights and Duties of Directors* (3th edn, Tolley, London and Dublin 2000) 34.

<sup>25</sup> Murtaza Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 243, par 201; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 230; Mowafaq Hassan Raza, *The Companies Act, its Goals, Basis and its Contents* (the Legal Searches Centre 1985) 144; Bassem Mohammed Saleh & Adnan Ahmed Walee Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247; Farouk Ibrahim Jassim, *The Brief in the Commercial Companies* (first edn, the Legal Library 2007) 118-119; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 125-126.

<sup>26</sup> Bassem Mohammed Saleh & Adnan Ahmed Walee Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 73; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 13; Mowafaq Hassan Raza, *The Companies Act, its Goals, Basis and its Contents* (the Legal Searches Centre 1985) 113.

scholars in the light of the adoption by the C.A. 2006 (s.172) of the new principle of Enlightened Shareholder Value.

*The duty of avoiding conflicts of interests* is another significant aspect of the fiduciary obligation. The Iraqi literature<sup>27</sup> nevertheless never discusses the matter intensively, due to the legislative failure to enshrine this duty by means of a clear provision. By contrast, the efforts of English scholars to explain the contents of this duty<sup>28</sup> have led to its codification in s.175 of the C.A. 2006, which drawn a general framework for it. These efforts include the identification of actual and potential conflicts of interest; and also the abuse of directorial office by exploitation of the company's opportunity or its information<sup>29</sup> or property.<sup>30</sup> It is anticipated that the failure of Iraqi law in dealing with this duty will inevitably create a difficulty in identifying whether a director is in a position of conflict of interest when he exploits a corporate opportunity in pursuit of his own interests.<sup>31</sup> Several tests have been given by English courts with the aim of identifying the meaning of a "corporate opportunity", and has been a subject of debate among English legal commentators.<sup>32</sup>

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<sup>27</sup> Murtaza Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 244, par 201; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 74-75 ; Bassem Mohammed Saleh & Adnan Ahmed Walee Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 77-80.

<sup>28</sup> Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 557-570, paras 16.63-16.69 ; Alastair Hudson, *Understanding Company Law* (1th edn Routledge 2012) 132; Alistair Alcock, John Birds, Steve Gale, *Alcock, Birds and Gale on the Companies' Act 2006* (Jordan publishing Ltd 2009) 187, para 13.26-13.29; Stephen Mayson, Dereck French & Christopher Ryan, *Mayson, French & Ryan on Company Law* (30 th edn, OUP 2013) 502-505, para 16.9.4-16.9.4.5; Richard Slynn, 'Directors' Duties' in Thomson Reuters (edn), *A Practitioners Guide to Directors' Duties and Responsibilities* (2010) 110-112; Alan Dignam & John Lowry, *Company Law* (4<sup>th</sup> edn, OUP 2006) 307-310, para 14.26-14.39; John Birds and others, *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordan Publishing Ltd 2011) 644, para 16.8; Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 245-248, paras 11.1-11.7; Stephen D. Girvin & Sandra Frisby & Alastair Hudson, *Charlesworth's Company Law* (18th edn, Thomson Reuters Legal Ltd 2010) 354-359, para 17.047-17.50.

<sup>29</sup> See Mark Hsaio, 'A Sprouting Duty of Honesty and Loyalty? Companies Act 2006' (2009) 20(9) I C C L R 301, 305; Deirdre Ahern, 'Legislating For the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: The Devil in the Detail' (2010) 45 Irish Jurist 82; Michael Hadjinestoros, 'Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to their Companies' (2008) 19(2) I C C L R 70, 73; Pearlie Koh, 'Once a Director, Always a Fiduciary?' (2003) 62(2) CLJUK 403, 430.

<sup>30</sup> Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 560, para 16-65.

<sup>31</sup> Talib Hassan Musa, *the Commercial Companies* (1 edn, Time Publisher 1973) 209, para 152; Bassem Mohammed Saleh & Adnan Ahmed Walee Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 77-80; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245-250.

<sup>32</sup> See in discussing this theme Paul Davies, *Introduction to Company Law* (2th edn, OUP 2010) 179; Nicholas Bourne, *Bourne in Company Law* ( 4th edn., Routledge publishing 2008) 155; Tony

Iraqi commentators have only succeeded in giving a partial explanation of conflict of interest.<sup>33</sup> This takes the form of avoiding conflicts of duties and is set forth under Art.110 of the I.C.A. 1997. Under this duty a director is prohibited from serving a rival company. However, Iraqi literature has not discussed the scope of a director's freedom to compete with his company, and the extent of its consistency with a company's interests.<sup>34</sup> Likewise, the Iraqi commentators have not discussed situations whereby a director owes multiple duties outside the frame of the engagement in serving another company.<sup>35</sup> The issue has received attention in the English literature,<sup>36</sup> and the arguments are inclined to suggest that this matter constitutes a potential conflict of interests and must therefore be prohibited.<sup>37</sup> The Iraqi literature, however, fails to give a balanced analysis of which approach is better: that of allowing a director to be a multi-director, or that of prohibiting this activity or regulating it by law.<sup>38</sup>

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Singla, 'The Fiduciary Duties of Resigning Directors' (2007) 28(9) Comp Law 275; John Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) <<http://www.qscience.com/doi/pdf/10.5339/irl.2012.5>> accessed 21 September 2012, 11-12; Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (9<sup>th</sup> edn, OUP 2010) 349; Rod Edmunds & John Lowry, 'The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolution' (2000) J B L 122, 131; Jie Li, 'The Peso Silver Case: An Opportunity to Soften the Rigid Approach of the English Courts on the Problem of Corporate Opportunity' (2011) 32(3) Comp Law 68, 73(Case Comment); Hans C. Hirt, 'The Law on Corporate Opportunities in the Court of Appeal: Re Bhullar Bros Ltd' (2005) J B L 669, 672; Nicholas Collins, 'In-depth, The No-Conflict Rule: the Acceptance of Traditional Equitable Values?' (2008)14(4) Trusts & Trustees 218; John Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) <<http://www.qscience.com/doi/pdf/10.5339/irl.2012.5>> accessed 21 September 2012, 10.

<sup>33</sup> Khalid Al-Shawi, *Explain the Iraqi Commercial Companies' Act* (First edn, Al-Shaap publisher 1968) 478; Al-Okkaily A, *The Mediator in the Commercial Companies* (the Culture House 2007) 294; Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 432.

<sup>34</sup> See for example: Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 247; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247; Mowafaq Hassan Raza, *The Companies Act, its Goals, Basis and its Contents* (the Legal Searches Centre 1985) 143-145; Talib Hassan Musa, *the Commercial Companies* (1 edn, Time Publisher 1973) 209, para 152.

<sup>35</sup> Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 231.

<sup>36</sup> See Derek French, Stephen W. Mayson and Christopher L. Ryan, *Mayson, French & Ryan on Company Law* (2<sup>th</sup> edn, OUP 2013) 506-507.

<sup>37</sup> Brenda Hannigan, *Company Law* (2<sup>th</sup> edn, OUP 2009) 248-249, paras 11.9-11.11; Paul Obo Idornigle, 'Interlocking Directorates and Corporate Governance' (2004) 32 Int'l Bus Law 75, 80; Arthur B. Laby, 'Resolving Conflicts of Duty in Fiduciary Relationships' (2004) 54 American University L Rev 75, 76; Martin Day, 'Fiduciary Duties' (2009) 15(6)Trusts & Trustees 447, 450; Kenneth W. Nielsen, 'Directors' Duties under Anglo-American Corporation Law' (1966) 43 U Det L J 605, 646; Ben Pettet, John Lowry and Arad Reisberg, *Company Law* (1<sup>th</sup> edn, Pearson Education Ltd 2012) 160-167; Davis Kershaw, *Company Law in Context* (2<sup>th</sup> edn, OUP 2011) 578; Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (9<sup>th</sup> edn, OUP 2010) 382.

<sup>38</sup> Talib Hassan Musa, *the Commercial Companies* (1 edn, Time Publisher 1973) 203, para 151; Khalid Al-Shawi, *Explain the Iraqi Commercial Companies' Act* (First edn, Al-Shaap publisher 1968) 478.

The *concept of loyalty* leads us to discuss two of its facets: the nominee director, and the duty to avoid accepting a benefit from a third party. Again, these concepts are not discussed at all by Iraqi scholars.<sup>44</sup> The English literature has debated this legally adopted precept, by which it is binding on a nominee director to owe his loyalty to the company rather than to his nominator.<sup>45</sup> A breach of this rule results in the nominee, rather than the nominator, incurring the entire liability.<sup>46</sup> This is the case even if the nominator's instructions to the nominee have caused harm to the company. No answer to this problem is to be found in the Iraqi literature.<sup>47</sup>

Another serious threat to a company's interests under Iraqi law is clearly indicated by the *absence of any rule that prevents a director from accepting a benefit from a third party*. Neither Iraqi law nor Iraqi legal commentators have discussed this theme,<sup>48</sup> in contrast to English law and its commentators.<sup>49</sup> A question that will be discussed in

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Cf with Michele Havenga, 'Company Directors-Fiduciary Duties, Corporate Opportunities and Confidential Information' (1989) 1 S Afr Mercantile L J 122, 127; Nicholas Bourne, *Bourne on Company Law* (4<sup>th</sup> edn, Routledge-Cavendish 2008) 157, para 12.8.

<sup>44</sup> Murtaza Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 245, par 204; Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 461; Lateef Jabr Commanee, *the Commercial Companies* (First, edn, Al-Mustansiriya University 2008) 245-246; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 243, para 131; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247.

By contrast, see in English literature Paul Davies, Sarah Worthington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 574-576, paras 16.75; Brenda Hannigan, *Company Law* (2<sup>th</sup> edn, OUP 2009) 270-271, paras 11.73-11.82; Alistair Alock, John Birds, Steve Gale, Alock, Birds and Gale on the *Companies' Act 2006* (Jordan publishing Ltd 2009) 187-188, paras 13.30-13.31; Richard Slynn, 'Directors' Duties' in Thomson Reuters(edn), *A Practitioners Guide to Directors' Duties and Responsibilities* (2010) 115-117; Stephen D. Girvin & Sandra Frisby & Alastair Hudson, *Charlesworth's Company Law* (18<sup>th</sup> edn, Thomson Reuters legal ltd 2010) 361-365, paras 17.052-17.56.

<sup>45</sup> Stephen Mayson, Dereck French & Christopher Ryan, *Mayson, French & Ryan on Company Law* (2<sup>th</sup> edn, OUP 2013) 501-502, para 16.9.3.

<sup>46</sup> Deirdre Ahern, 'Irish Legislative Proposals for Clarification of Nominee Directors' Best Interests Duty' (2010) 31(9) Comp Law 291; Teh Tai Yong and Mohammad Rizal Salim, 'Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors' (2008) 50(4) Int J L M 168; Paul Redmond, 'Nominee Directors' (1987) 10(2) U N S W L J 194; Christopher Penman, 'Nominee Directors in Hong Kong' (1985) 15 Hong Kong L J 5; J J Du Plessis, 'Nominee Directors Versus Puppet, Dummy and Stooge Directors: Reflections on these Directors and their Nominators or Appointors' (1995) J S Afr L 310.

<sup>47</sup> Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 478; Mowafaq Hassan Raza, *The Companies Act, its Goals, Basis and its Contents* (the Legal Searches Centre 1985) 132-135; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 236-237.

<sup>48</sup> Khalid Al-Shawi, *Explain the Iraqi Commercial Companies' Act* (First edn, Al-Shaap publisher 1968) 470; Mowafaq Hassan Raza, *The Companies Act, its Goals, Basis and its Contents* (the Legal Searches Centre 1985) 143-145; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247-251.

<sup>49</sup> See for example: Richard Nolan, 'Bribes: A Reprise' (2011) 127 L Q Rev 19; Lusina Ho, 'Bribes and the Constructive Trust as a Chameleon' (2012) 128 L Q Rev 486; Paul Davies, *Introduction to*

this thesis is the following: does the non-regulation of this point under Iraqi law mean that accepting a benefit by the director from a third party is a legitimate form of conduct?

The *director's duty to declare his interest in a deal* is another obligation that Iraqi commentators,<sup>50</sup> unlike their English counterparts,<sup>51</sup> have failed to discuss this duty in-depth. This matter has nonetheless acquired significance, because Art.119 of the I.C.A. 1997 and Art.21 (2) of the Private Banks Act (herein after the P.B.A.) 2004 have recently identified this duty, which is comparable with ss.177, 182 of the C.A. 2006. One of the most important elements of this duty under Art.119 of the I.C.A. 1997 is that the declaration must be addressed to the general assembly, which raises a query about the appropriateness of this approach with the nature of commercial activity. Iraqi law has not defined the meaning of an interested director.<sup>52</sup> What, for example, is the definition of a deal that attracts the application of this rule?<sup>53</sup> Does it include other legal actions taken by the company when the latter is considered as a unilateral will? With respect to the rules governing the discharge of this duty, there are several matters that need to be resolved. For example, there is a fog of uncertainty around the time element in the disclosure of interests. The method of declaring the interest presents a further vagueness. How is the matter of a conflict of interests to be addressed when all the directors have an interest in the deal in question? This duty under Iraqi law also includes the companies with a sole owner (who is simultaneously its sole director). This is in contrast to the C.A. 2006 (s.186) which excludes the director from this duty, although commentators<sup>54</sup> on the latter law have not offered an

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*Company Law* (2th edn, OUP 2010) 182; Alistair Hudson, *Understanding Company Law* (first edn, Routledge 2012) 144-145; Alistair Alock, John Birds, Steve Gale, *Alock, Birds and Gale on the Companies' Act 2006* (Jordan publishing Ltd 2009) 187-188.

<sup>50</sup> Akram Yamulki A & Bassem Mohammed Saleh, *The Commercial Companies: Part.2* (Baghdad University Publisher 1983) 248; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 247-248.

<sup>51</sup> See for example John H. Armour, 'Directors' Self-Dealing: the Plot Thickens' (1997) 113 (Oct) L Q R 540.

<sup>52</sup> Lateef Jabr Commanee, *the Commercial Companies* (First, edn, Al-Mustansiriya University 2008) 246-247. cf with English literature such as: David Kershaw, *Company Law in Context* (2th edn, OUP 2012) 493; Andrew Griffiths, 'Interlocking Directorships and the Danger of Self Dealing: The Duties of Directors with a Conflict of Interest' (1999) 10(9) I C C L R 280; Stephen Girvin., Sandra Frisby & Alastair Hudson, *Charlesworth's Company Law* (18<sup>th</sup> edn, Thomson Reuters 2010) 368-369, para.17-061; Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L R 96, 98.

<sup>53</sup> See English literature such as Luca Enriques, 'The law on Company Directors' Self-Dealing: a Comparative Analysis' (2000) 2 Kluwer Law International <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=135674](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=135674)> accessed 20 March 2013 297, 299.

<sup>54</sup> Richard Nolan, 'Disclosure of Directors' Interest' (1995) Comp Law 216, 217.

alternative solution to this situation, which constitutes a threat to a company. Likewise, the C.A. 2006, unlike the I.C.A. 1997, does not require a formal meeting to be held in order to discuss the conflict of interests. Thus the rationality of each approach is brought into question. It should be asked finally whether Iraqi law contains harsh rules to enforce the above duty, as is the case with English law.

Finally, the problem inherent in all the Iraqi Companies' Acts is *the failure to formulate special rules for the enforcement of the director's duty*. These rules should be appropriate to the nature of managerial duty and in their absence resort must be made to the Civil Code 1951. No such gap-filling measure is necessary in the case of English law.<sup>55</sup> The question that has not been addressed by the Iraqi literature,<sup>56</sup> which will however be discussed in this thesis, is the following: are the general principles of the Civil Code 1951, employed for remedial purposes, adequate to provide an *ex ante* protection to the company against a director's abuse of his powers? There has been no discussion by Iraqi legal commentators as to whether it is permissible under Iraqi law to release a director from his liability, and whether it should be under any conditions.<sup>57</sup> On the other hand, can the English legal provision that allows a director to be stripped of the benefits he has gained, thus deterring him from abusing his duty, be applied by means of the Civil Code 1951? Under Iraqi law, the liability of a third party, who is involved in a breach of the duty, have not been debated hitherto by Iraqi legal works.<sup>58</sup>

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<sup>55</sup> Paul Davies, Sarah Worthington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 576-581, paras 16.76-16.81; Susan McLaughlin, *Unlocking Company Law* (first edn, Hodder education 2009) 356-357; *Boyle & Birds' Company Law* (8<sup>th</sup> edn, Jordan Publishing Ltd 2011) 650, para 16.8.2.

<sup>56</sup> Akram Yamulki A & Bassem Mohammed Saleh, *The Commercial Companies: Part.2* (Baghdad University Publisher 1983) 249-250; Ahmed Ibrahim Al-Bassam, *The Commercial Companies in Iraqi Law* (Second edn, Al-Zammaan publisher 1967) 186-188; Khalid Al-Shawi, *Explain the Iraqi Commercial Companies' Act* (First edn, Al-Shaap publisher 1968) 149-150.

<sup>57</sup> Fawzi Mohammad Sami, *the Commercial Companies, a Comparative Study* (the Culture House publisher 2006); Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247-250; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 243-247, para 131; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245-250.

<sup>58</sup> Khalid Al-Shawi, *Explain the Iraqi Commercial Companies' Act* (First edn., Al-Shaap publisher 1968) 487; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245-250; Akram Yamulki & Bassem Mohammed Saleh, *the Commercial Companies: Part.2* (Baghdad University Publisher 1983) 249-250; Fawzi Mohammad Sami, *the Commercial Companies, a Comparative Study* (the Culture House publisher 2006); Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247-250; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 243-247, para 131; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245-250.

While the English literature has scrutinized this matter extensively.<sup>59</sup> Attention must therefore be directed to an analysis of the provisions of the Civil Code 1951 and other related legislation. The thesis will undertake to ascertain whether the Civil Code 1951 is capable of providing an effective means of preventing a third party from assisting a director in a breach of his duty.

To summarize, it appears from a review of the relevant English and Iraqi literature that there is a dearth of Iraqi work dealing with the various aspects of directorial self-interest and opportunism. By contrast, English law and legal literature have covered this theme comprehensively. This contrast motivates the author's subsequent endeavour to discover and demonstrate the gaps in Iraqi law and literature. English law and its literature will be therefore be used in this thesis as a paradigm to discovering the deficiencies of Iraqi law. Accordingly, this thesis is intended as a contribution to knowledge through an examination of the position of Iraqi law in relation to these issues.

### **1.3 Thesis Statement and Main Questions**

It is posited firstly that, in regard to directorial duties, Iraqi law refers to some facets of *managerial duty*. Burdening a director with liability is vital in order to ensure that he complies with his duties in a manner consistent with modern company law. It must be remembered that protecting the interests of a company's members is a central objective of the I.C.A. 1997.<sup>60</sup> This personal liability is crucial also for achieving numerous aims. These include the following:-

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<sup>59</sup> Stephen D. Girvin & Sandra Frisby & Alastair Hudson, *Charlesworth's Company Law* (18th edn, Thomson Reuters legal ltd 2010) 371-380, para 17.067-17.076; Tom Hibbert, 'Dishonesty and knowledge of Accessories and Recipients' (2000) 15(6) *J I B L* 138; Tsun Hang Tey, 'Fiduciaries, Third Parties and Remedies-Singapore's Perspectives and Contribution' (2010) 24(4) *Tru L I* 234; Pauline Ridge, 'Justifying the Remedies for Dishonest Assistance' (2008) 124 *L Q Rev* 445; Simon Gardner, 'Knowing Assistance and knowing Receipt: Taking Stock' (1996) 112 *L Q Rev* 56; Patricia Shine, 'Knowledge, Notice, Bad Faith and Dishonesty: Conceptual Uncertainty in Receipt Based Claims in Equitable Fraud' (2013) 24(8) *I C C L Rev* 293.

<sup>60</sup> The I.C.A. 1997, Art.1(3).

First of all, the director's liability serves to sustain the company itself, since permitting a director to place himself in a position of disloyalty to the company will undoubtedly impinge upon that company's stability. Secondly, providing some level of protection is decisive, not only for sustaining the interests of the company's members, but also is in the interests of other stakeholders, and will motivate them to invest money and efforts in the company.

It is posited secondly that Iraqi law, in attempting to deal with directorial duties, has revealed its shortcomings in several aspects. This allegation is based on the perception that there has been a lack of legal sophistication in the formulation of laws relevant to this area. Furthermore, there has been a failure to codify certain aspects of the theme. These deficiencies can be ascribed to the differences between Iraq and the U.K. in their legal, political and economic structure, viz:

1. English law has an integrated theory that involves a conceptual framework underpinning the fiduciary obligation. A fiduciary under this system must act to serve the interests of the company exclusively, and must avoid placing himself in a position that might lead to harming the company's interests. From such a general doctrine other sub-duties flow, and these constitute collectively the breadth of fiduciary duty. This concept, which is a crucial foundation for building a detailed set of duties, is absent from Iraqi law.

Moreover, this doctrine has taken inspiration from the principles of Equity, which provide English courts with a wide discretion in finding a fair, appropriate and pragmatic rule for each case, without the restrictions imposed by statutory provisions. This privilege enables the court to develop rules to deal with any new method of directorial misbehaviour that might emerge. It will do so more effectively than the Iraqi courts, which are circumscribed by inflexible statutory provisions.

2. The differences between the two countries cited are not restricted to the political and economic aspects so far discussed. Other factors must be noted. For example, the U.K.'s commitment to free trade means that conflicts of interests assume that the existence of competition in economic life, necessitates the creation of special rules to



regulate company's affairs by way of complex and sophisticated legislation.<sup>61</sup> Such a problem may not be apparent under a socialist regime (like the one that prevailed in Iraq for a long time), or in a less-advanced economy. Consequently there has hitherto been no incentive to develop this area of law, since it is need that is "the mother of invention".

The shortcomings of Iraqi law in dealing with directorial self-interest through the imposition of managerial obligation will inevitably motivate the director to be *swayed by personal interests rather than duty*. Moreover it will provide a safe-harbour for him to *maintain his divided loyalties*.

It is suggested, thirdly, that English law involves the best solution to problems related to the divided loyalty. The espousal of these principles by Iraqi law will be examined, as English law affords the best solution to the problems of conflict of interests in this area of the law.

This thesis will focus on answering the following principal question, that is, the extent to which Iraqi law provides companies with adequate and effective safeguards for protecting them from a director's abuse of his powers. As mentioned earlier, to ascertain the correctness of the above hypothesis requires a different system of law to provide an alternative paradigm to be used in a critique against which to assess the imperfections of Iraqi law in question. That alternative system is English law.

The task in question requires other subsidiary questions to be posed and answered: does Iraqi law contain features of the fiduciary duty concept, as it is understood under English law? What are the similarities or differences between the law of the two countries with regard to providing protection to the company and its shareholders? Also, what are the defects and inadequacies in Iraqi law which would provide a suitable basis for suggesting a reform of Iraqi company law, in order for it to be consistent with the capitalist regime adopted recently in Iraq.

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<sup>61</sup> A simple example for the differences in the legal sophistication is that the C.A. 2006 contains 1174 Sections, while the I.C.A. 1997 contains only 221 Articles.

## 1.4 Methodology and Structure

This is a legal study focusing on Iraqi company law, and aims to address the problems of divided directorial loyalty and conflicts of interests by examining the rules that govern this area of law, and by making relevant comparisons between these and the English Companies Act of 2006. This study is the outcome of research into legal material and court decisions.

English materials, in the form of legal literature and case law, will be used widely, due to the scarcity of Iraqi sources related to this topic. To address the challenge posed by the latter situation, an analytical approach will be broadly adopted in addressing the problems of Iraqi law. The thesis will take the shape of a critical study of the legal realities of Iraqi law rather than that of a descriptive discourse. References will sometimes be made to the position of some Arabic jurisdictions in relation to certain aspects of this theme. These references are intended to demonstrate that the defects of Iraqi law may be ascribed to the influence of these jurisdictions, with which it shares certain flaws.

The problems explored in this thesis will be addressed in Seven Chapters, preceded by this introductory chapter. Recommendations for the further development of Iraqi law will be posed in the conclusion to each Chapter and in Chapter Eight.

In Chapter Two, entitled “*The Endeavour to Find the Features of the Fiduciary Doctrine of English Law in Iraqi Law*”, the focus will be on determining whether this concept has a root in Iraqi law. The investigation will be concentrated on the meaning of fiduciary duty and on the definition of a fiduciary. It will also explore the reason for the imposition of a fiduciary duty and the theories that have been mooted to identify the circumstances that may trigger the fiduciary duty. This investigation requires an analysis of the characteristics of Iraqi company law in order to demonstrate whether it embraces elements of fiduciary duty. There will also be an investigation of the Civil Code of 1951, which appears, *prima facie*, to have introduced into Iraqi law principles similar to those that underpin fiduciary duty in English law. Giving a final answer to the above question will require an analysis of the characteristics of company law. Such

an analysis will also be needed in order to assess the possibility of transplanting a fiduciary duty concept into Iraqi law.

In Chapter Three, “*The Duty to Act in the Company’s Interests*” under Iraqi law will be examined. In this Chapter, aspects of the concept of loyalty will be analysed: the meaning of undivided loyalty as it appears under English law; whether Iraqi law embraces this concept; and the attributes of this principle. The components of this duty under Iraqi law will be discussed in the light of *the conflation of the above duty and the duty of care* to be found in both Art.120 of the I.C.A. 1997 and Art.17(6) of the P.B.A. 2004. It will be argued in the Chapter that this conflation results in the director receiving inadequate guidance on how to act in pursuing a company’s interests. The Chapter will also explore the objective of companies, that is to say, whether they are founded in order to promote the interests of their members alone, or whether the interests of stakeholders are included. This exploration will include the rules governing the clashes between the interests of the above constituents of the company.

In Chapter Four, which is entitled “The Duty to Avoid Conflicts of Interest between a Director and his Company”, the focus will be on an examination of the adequacy and effectiveness of the rules of Iraqi law<sup>62</sup> in restraining a director from involvement in such a conflict. This investigation explores the meaning of corporate opportunity which a director is forbidden to exploit and the difficulties in identifying them. An examination of the no-conflict rule under Iraqi law involves an assessment of its efficacy in constraining a director from engaging directly, or indirectly, in competition with his company within the period of his service and afterwards.

In Chapter Five, which is entitled “Question of Divided Loyalty: the Nominee Director, and Directors who accept benefits from a Third Party”, the discussion will tackle the problems pertaining to certain applications of the no-conflict rule, namely the position of the nominee director and the *duty to avoid accepting a benefit from a third party*. In the case of the nominee director, the investigation will explore whether the provisions of Iraqi law regarding nomination constitute an exception to the no-conflict rule, or whether the principle is upheld by the law. The Chapter goes on to ask

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<sup>62</sup> Such as the I.C.A. 1997, Art. 1(3) and the I.B.R.A. 2005, Art.42 (Second).

whether the Iraqi director is given implicit licence to breach the principle of loyalty (as a consequence of the law's failure to prohibit explicitly the acceptance of benefits from a third party).

Chapter Six will highlight "*The Duty to Declare an Interest in a Deal*". It will be argued that the formulation of this duty in Iraqi law contains pitfalls and defects that these may limit its effectiveness in restraining directorial abuse. The discussion here involves an exploration of the conditions that raise the duty of disclosure, including those rules governing a company's decision to grant approval for a conflict of interests. Finally, the investigation will examine the extent of strictness of the duty in Iraqi law. It will ask whether the director's liability is premised on particular conditions, irrespective of a demonstration of the elements of civil liability. This investigation includes a review of certain transactions that are of necessity governed by special rules.

In Chapter Seven, the issue of enforcement of managerial duties will be approached in the light of the non-regulation of this matter by the I.C.A. 1997, and in other special legislation relevant to the company's affairs. This investigation raises the question of the adequacy and effectiveness of rules of the Civil Code 1951 that were aimed at restraining a director from abusing his office for his personal interest. To attain this purpose, the rules that govern the decision to sue or to release a director from liability will be discussed. There will be an in-depth discussion of the remedies which can be imposed on the delinquent director and their capability to deter him *ex-ante* from holding a divided loyalty to the company. In this chapter, the study will examine the basis of the liability of a third party involved in a breach of managerial duty, and the remedies that can be imposed on that party under Iraqi law.

Chapter Eight will contain a summary of the findings of the research. This Chapter will include suggestions on how Iraqi law might be improved in view of the conclusions reached by the thesis. There will also be an outline of possible future research in this area.

## Chapter Two

### The Endeavour to Find the Roots in Iraqi Law of the Fiduciary Doctrine of English Law

**Introduction:** The fiduciary doctrine is a comprehensive concept that was developed by the courts of equity over a long period of time by analogy to the trust. Its development was fostered by the enactment of the Joint Stock Companies' Act 1844 and the emergence of the concept of a legal person. At that time, companies were founded by a deed of settlement, under which its property was entrusted to a director as a trustee.<sup>1</sup>

Although this doctrine was associated at its emergence with the notion of trust,<sup>2</sup> its application afterwards included all relations<sup>3</sup> in which the interests of one person were subject to the discretion of other persons, including a company's

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<sup>1</sup> Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 495, para 16-17; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 22, para 2.34; Alan Dignam, John Lowry, *Company Law* (8<sup>th</sup> edn OUP 2014) 333, para 16.7; John P. Lory, 'Regal (Hastings) Fifty Years on: Breaking the Bonds of the Ancient Regime?' (1994) 45(1) N Ir Legal Q 1; Geoffrey Nicoll, 'Directors' Duties and Risk Management in China' (1998) 4 Canberra L Rev 217, 227; Peter Devonshire, 'Account of Profits for Breach of Fiduciary Duty' (2010) 32 Sydney 389, 390; Beth Nosworthy, 'Directors' Fiduciary Obligations: Is the Shareholder an Appropriate Beneficiary?' (2010) 24 Australian Journal of Corporate Law 282 <<http://ssrn.com/abstract=1722490>> Accessed 23 May 2012, 286.

<sup>2</sup> The first reference to the "fiduciary doctrine" was made in *Keech v Sanford* [1726] 25 E R 223(CH). In this case a trustee on a lease had entered into negotiation with the lessor to renew the lease before its expiry for the benefit of an infant. Due to the owner's refusal to renew the lease for the infant, the trustee had secured the property for his own interest. The court held that the trustee was responsible for accounting to the infant for the gained profit. In this case Lord Chancellor stated at p. 62:-

I must consider this as a trust for the infant; for I very well see, if a trustee, on the refusal to renew, might have a lease to himself, few trust estates would be renewed to cestui que use; though I do not say there is a fraud in this case, yet he should rather have let it run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to cestui que use.

<sup>3</sup> For example, minors, clients of the attorney, the promoters' customers and the principal in the agency contract.  
See Scott Fitzgibbon, 'Fiduciary Relationships are not Contracts' (1999) 82(2) 82 Marq L Rev 303, 306-307; Zipora Cohen, 'Fiduciary Duties of Controlling Shareholders: A Comparative View' (1991)12(3) U Pa J Int'l Bus L 379, 380.

directors. To protect persons whose interests were being looked after by the fiduciary, strict duties were imposed on a fiduciary when dealing with their interests in order to avoid abuse. This doctrine thus represents a pillar for protecting vulnerable interests from the fiduciary's self-interest.

Ascertaining the presence of the fiduciary duty (or any other similar legal notion) in any legal system is necessary in order to ensure that the pillars for safeguarding these interests are present. This is because a resort to this general framework is needed in order to allow the law to address a fiduciary's misconduct in cases where there are shortcomings in the statutory provisions for doing so.

There is no mention of this doctrine in Iraqi law, either in the Companies' Act (herein after the I.C.A.) 1997, or in the Civil Code 1951. This raises the need for an analysis of the Iraq legal system to show whether it espouses a comparable concept to that laid out under English law, and then to ascertain whether the company's interests are shielded from the director's abuse by this obligation.

To answer the above question, this Chapter will be divided into Three Sections. In the first section, the concept of fiduciary duty in English law will be explained; a clarification of the legal system of Iraqi company law in governing a director's duty, including its characteristics, will be presented in Section Two (for ascertaining whether the fiduciary duty has a presence in this system); and finally in Section Three, the position of Iraqi civil law towards this doctrine will be reviewed.

## Section I

### The Concept of Fiduciary Duty in English Law

**Introduction:** The word “fiduciary” is derived from the Latin word “*fiducia*,” which conveys the notions of trust and confidence. <sup>4</sup>

The fiduciary duty is one of the most complex concepts in the law, and identifying its content is difficult because it covers several relationships. For this reason, scholars have sought <sup>5</sup> to give numerous definitions of these relationships in order to derive a uniform concept<sup>6</sup> from the study of its common characteristics.

Clarification of this doctrine requires first of all a determination of who the fiduciary is. What are the justifications for subjecting a fiduciary to harsh penalties? Under what circumstances does a fiduciary duty arise? In other words, what is the theoretical underpinning of this duty? All these issues will be subject to further analysis in this Section.

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<sup>4</sup> Leonard I. Rotman, ‘The Vulnerable Position of Fiduciary Doctrine in the Supreme Court of Canada’ (1996) 24(1) Man L J 60; Dennis Klinck, ‘Things of Confidence: Loyalty, Secrecy and Fiduciary Obligation’ (1990) 54 Sask L Rev 73, 90; Derek French, Stephen W. Mayson and Christopher L. Ryan, *Mayson, French & Ryan on Company Law* (29 th edn, OUP 2013) 476, para 16.3.2; Mr Justice R. P. Meagher & Adrian Maroya, ‘Crypto- Fiduciary Duties’ (2003) 26(2) U N S W L J 348, 350-351.

<sup>5</sup> Leonard I. Rotman, ‘The Vulnerable Position of Fiduciary Doctrine in the Supreme Court of Canada’ (1996-1997) 24(1) Man L J 60, 61.

<sup>6</sup> The relations that lead to the emergence of a fiduciary duty have been classified into two groups. These are as follows:

1- Status-based relations: under this approach, the fiduciary duty can be identified by general attributes of the relation itself, such as the relation between a director and his company.

2- The fact-based relationship: according to this approach, there are common characteristics fixed in all fiduciary relationships, under which the fiduciary duty arises when a person is empowered to exercise his discretion in the interests of another person. These circumstances create a fiduciary duty.

For more details about these approaches see: Razeen Sappideen, ‘Fiduciary Obligations to Corporate Creditors’ (1991) J Bus L 365, 20; P. B. Mile, ‘A Theory of Fiduciary Liability’ (2011) 56(2) McGill L J 235, 141-142; Robert Flannigan, ‘The Fiduciary Obligation’ (1989) 9 Oxford J Legal Stud 285, 301.

### 2.1.1 Who is the Fiduciary?

The aforementioned difficulties in identifying the fiduciary doctrine<sup>7</sup> lend it an elusive character.<sup>8</sup> For this reason, the English Companies' Act 2006 (herein after the C.A.) avoided giving a definition of the concept. The sole judicial attempt at definition was made by Millett L.J. in *Bristol and West Building Society v Mothew*, who stated that:-

A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal.<sup>9</sup>

The key feature of the above statement is that it enumerates the various aspects of the duty incurred by a fiduciary, while omitting to define a specific concept of this term. The above dictum refers explicitly to the fact that it is the special circumstances of the relationship that may give rise to the fiduciary duty.<sup>10</sup>

It can, however, be stated that a fiduciary, when acting as a company director, is to be defined as a person who, by virtue of exercising his discretion over the interests of a company, must always be loyal to it. The loyalty implies that he must

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<sup>7</sup> Pearlia Koh, 'Once Director, Always a Fiduciary?' (2003) 62(2) Cambridge L J 403, 405; Stephen Griffin 'Conduct Amounting to a Breach of the Conflict of Interest Duty' (2010) 268 Co L N 1, 2; Bikramaditya Ghosh & Karmendra Singh, 'Directors' Duties in India: Strengthening the Laws on Trusteeship' (2009) 20(6) I C C L R 199; Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: The Devil in the Detail' (2010) 45 Irish Jurist 82, 291; Arthur B. Lary, 'Resolving Conflicts of Duty in Fiduciary Relationships' (2004) 54(75) Am U L Rev 75, 80-81; Martin Day, 'Fiduciary duties' (2009) 15(6) Trusts & Trustees, 447.

<sup>8</sup> Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 24, para 2.38; Beth Nosworthy, 'Directors' Fiduciary Obligations: Is the Shareholder an Appropriate Beneficiary?' (2010) 24 Australian Journal of Corporate Law 282 <<http://ssrn.com/abstract=1722490>> Accessed 23 May 2012, 286.

<sup>9</sup> [1996] 4 All E R 698, 711-712 (CA).

<sup>10</sup> P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 21, para 3.



avoid any potential conflict between the interests of the company and his personal interests (or the interests of a third party).

It can be understood from this definition that the notion of fiduciary duty is therefore based on the following foundations:

1. The existence of a legal relationship premised on the considerations of confidentiality and reliance,<sup>11</sup> whatever the nature of this relationship.
2. The circumstances of this relationship empower a fiduciary to deal with a company's affairs<sup>12</sup> and give him the ability to impinge on the beneficiary's interests. This broad discretion renders the company in a position of vulnerability.<sup>13</sup>
3. The beneficiary must depend on the fiduciary's discretion, his competence, integrity and his honesty in discharging his duty.<sup>14</sup>
4. This position imposes on a fiduciary the duty to act solely in the interests of the company and to avoid putting himself in a position in which his duty might be in conflict with his own interests. To ensure the attainment of this purpose, harsh penalties will be imposed on a fiduciary<sup>15</sup> to preventing him benefitting from the consequences of a breach of the duty.<sup>16</sup> These harsh consequences will be exhibited in the forthcoming Chapters.

The imposition of a fiduciary duty, or its cessation, revolves around the fiduciary's ability to exercise his discretion. So, regard should be given to the continuous period of time of a fiduciary's incumbency, rather than to the specific time of his election to the post.<sup>17</sup> Likewise, the fiduciary duty vanishes at the time when the

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<sup>11</sup> Lawrence E. Mitchell, 'The Death of Fiduciary Duty in Close Corporations' (1990) 138 U PA L Rev 1675, 1684.

<sup>12</sup> Professor David Milman, 'The Rise of the Objective Concept of "Unfairness" in UK Company Law' (2010) 3 Co L N 1, 2; Paul L. Davies, Sarah Worthington and Eva Micheler, *Gower and Davies' Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 496, Para 16.17.

<sup>13</sup> Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 24, para 2.39.

<sup>14</sup> P. B. Mile, 'A Theory of Fiduciary Liability' (2011) 56(2) McGill L J 235, 144.

<sup>15</sup> Curk Shue Sing, 'Avoidance of Loss, Regal Hastings and the No Conflict Rule' (2013) 34(3) Comp Law 73, 76.

<sup>16</sup> Stanley M. Beck, 'Constraints on Pursuing Corporate Opportunity' (1988) Can-USLJ 143.

<sup>17</sup> *Lindgren v L & P Estates Ltd* [1968] Ch 572, 591 (Ch).

fiduciary actually ceases to be in a position to exercise his powers. Thus, if a director was forced to terminate his service and was then approached by one of the company's customers who wished to employ that director in his company, equity would dictate that the fiduciary duty vanishes.<sup>18</sup> This principle would also be the case if the director had been expelled from the management and was barred from receiving his remuneration, so that he was thereafter forced to incorporate his own company and subsequently dealt with one of the plaintiff's customers.<sup>19</sup>

### 2.1.2 The Functions of a Fiduciary Duty

It seems appropriate here to examine the reasons for imposing a fiduciary obligation on a director. In other words, what advantages can be gained from imposing this obligation?

The fiduciary duty provides many advantages to directors and to their companies, such as the following: first, a fiduciary duty plays a role in reducing management costs.<sup>20</sup> To explain this point, it is assumed that a company's members should run their own affairs. As a result of adopting the principle of separation between management and ownership,<sup>21</sup> (one of the principles of modern company law), the companies' members may delegate their power of management to professional persons (directors). Shareholders, however, will still retain their controlling right over the directors' activities.<sup>22</sup> Hence, the fiduciary duty may be applied as an alternative means of exercising excessive oversight,<sup>23</sup> which is inappropriate when

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<sup>18</sup> *Foster Bryant Surveying Ltd v Bryant* [2007] EWCA Civ 200, [2007] 2 BCLC 239.

<sup>19</sup> *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201. Although the director in this case did not resign from his post, the court considered him as in the position of having resigned.

<sup>20</sup> Darinam M. Ibrahim, 'Individual or Collective Liability of Corporate Directors?' (2008) 93 Iowa L Rev 932, 947.

<sup>21</sup> Leith Ajlouni, 'Directors' Duties and the Protection of Creditors' Interests: An Examination of Directors' Duties to Creditors of Financially Troubled Companies with the View of Expanding the Scope of Directors' Fiduciary Duties to Include the Interests of Creditors of Companies Operating while Insolvent or Doubtfully Solvent' (Phd thesis, the University of Reading 2002) 186.

<sup>22</sup> Derek French, Stephen W. Mayson and Christopher L. Ryan, *Mayson, French & Ryan on Company Law* (31th edn, OUP 2014-15) 422, para 15.2.5; Sen Hwei Chan & Larelle Law, 'Interests of the Company as a Whole: An Economic Appraisal of Fiduciary Controls' (1998-1999) 20 U Queensland L J 186, 187.

<sup>23</sup> *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 [66] (Arden L J).

the business is premised on speed in taking commercial decisions. Holding a general meeting and deploying information related to the directors' conduct, for example, may be costly and may not achieve its objectives, owing to the apathy of shareholders, who may fail to attend these meetings.<sup>24</sup> By delegating management powers and imposing strict duties, the investor will not need to exercise excessive oversight and will be able to devote his efforts to other investments.<sup>25</sup>

Secondly, it is an effective means for maintaining the interests of the company, by imposing sanctions on the wrongdoers for the purpose of avoiding harmful activities and bad management. It also prevents cheating and a director's self-interest, which are called "agency problems".<sup>26</sup> Simultaneously, this obligation will assist in redressing any damage caused by a wrongdoer as a result of violating this duty. This policy will lead to combating aspects of corruption and will bring many benefits both to the general economy. It has a positive legal influence on the global economy, particularly with regard to cross-border companies, which often conduct their affairs in places far removed from shareholders' surveillance.

Thirdly, imposing fiduciary duties by law is a better means of bridging any legal gaps in the director's contract of service with the company.<sup>27</sup> It is assumed that the contracting parties did not and could not expect<sup>28</sup> all the contingencies that may occur in the near future, even in cases where the contract is drafted by a professional person. Therefore, the fiduciary duty is a means of "filling-in" innate imperfections in the design of a director's contract of service.<sup>29</sup>

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<sup>24</sup> Sen Hwei Chan & Larelle Law, 'Interests of the Company as a Whole: An Economic Appraisal of Fiduciary Controls' (1999) 20 U Queensland L J 186, 189.

<sup>25</sup> Kelli A. Alces, 'Debunking the Corporate Fiduciary Myth' (2009) 35(2) J Corp L 239, 262; Hans C. Hirt, 'The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interests' (2005) Mar JBL 159, 167.

<sup>26</sup> *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 [66] (Arden L J).

<sup>27</sup> Kelli A. Alces, 'Debunking the Corporate Fiduciary Myth' (2009) 35(2) J Corp L 239, 241.

<sup>28</sup> Andrew Keay and Hao Zhang, 'Incomplete Contracts, Contingent Fiduciary Duties and Director's Duty to Creditors' (2008) 32 Melb U L Rev 141.

<sup>29</sup> Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 25, para 2.41; Leith Ajlouni, 'Directors' Duties and the Protection of Creditors' Interests: An Examination of Directors' Duties to Creditors of Financially Troubled Companies with the View of Expanding the Scope of Directors' Fiduciary Duties to Include the Interests of Creditors of Companies Operating while Insolvent or Doubtfully Solvent' (Phd thesis, the University of Reading 2002) 21; Chan & Law, 'Interests of the Company as a Whole: An Economic Appraisal of Fiduciary Controls' (1998-1999) 20 U Queensland L J 186, 189.

### 2.1.3 The Theoretical Bases of Fiduciary Relationships

It has been shown that a fiduciary duty stems from the circumstances of the relationship, and is therefore potentially unlimited.<sup>30</sup> It is therefore logical to explore the grounds on which the fiduciary is acting. Accordingly, studying the general concept of this doctrine is significant from two aspects: firstly, it gives a legal justification for imposing strict obligations on the person whenever he is placed in such circumstance. Secondly, it is a useful means for ascertaining whether a certain relationship can be described as a fiduciary relationship. Settling this issue has legal significance in determining the scope of applying this obligation: striking, as it does, a distinction between fiduciary and non-fiduciary duties allowing a comparison to be made between this doctrine and the concept of “managerial duties” under other legal systems.

Many theories have been mooted for the purpose of exploring these circumstances, such as the property theory and theories based on reliance, inequity, the contractual aspect, unjust enrichment, utility, and the power and discretion theory.<sup>31</sup> These will now be discussed.

#### 2.1.3.1 The Property (Trust) Theory

This theory stems from the fact that the fiduciary duty arises when a person has legal or actual power over the property entrusted to him by another person.<sup>32</sup> This

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<sup>30</sup> In this context, Slade J in *English v Dedham Vale Properties Ltd* [1978] 1 W L R 93, 110 (CH) stated that:-

I do not think that the categories of fiduciary relationships which give rise to a constructive trusteeship should be regarded as falling into a limited number of strait-jackets or as being necessarily closed. They are, after all, no more than formulae for equitable relief.

<sup>31</sup> Leonard I. Rotman, ‘Fiduciary Doctrine: A Concept in Need of Understanding’ (1996) 34(4) *Alta L Rev* 821, 839.

<sup>32</sup> Dennis Klinck, ‘Things of Confidence: Loyalty, Secrecy and Fiduciary Obligation’ (1990) 54 *Sask L Rev* 73, 90; L. S. Sealy ‘Fiduciary Relationship’ (1962) 20(1) *C L J* 69, 74-75.

position imposes on him the obligation to act in the interests of the beneficiary<sup>33</sup> and warrants the imposition of a strict standard of duty.

The theory takes us back to the historical basis of the fiduciary doctrine, to the first case<sup>34</sup> that related to a trust and placed the fiduciary on the same footing as a trustee.<sup>35</sup> This historical background explains why the common law often considers a director as a “trustee” of the company.<sup>36</sup>

However, the theory has been subject to criticism: First, the director under English law is an agent of the company<sup>37</sup> rather than a trustee,<sup>38</sup> although he has ‘...trustee-like responsibilities...’.<sup>39</sup> Notably, a director holds a company’s property as a quasi-trustee and not as a *cestui que* trustee.<sup>40</sup> This position furnishes a trustee with powers analogous to the powers of the owner<sup>41</sup> in enabling him the deal with the property on behalf of his company. Secondly, a director is acting as an entrepreneur: he bears the risks involved in promoting the company’s success,<sup>42</sup> and needs to achieve a balance between conflicted interests, rather than being

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<sup>33</sup> Razeen Sappideen, ‘Fiduciary Obligations to Corporate Creditors’ (1991) J Bus L 365, 384.

<sup>34</sup> *Keech v Sanford* [1726] 25 E R 223 (ch).

<sup>35</sup> In applying this approach see *Alexander v Automatic Telephone Company* [1900] 2 Ch 56, 59 (CH).

<sup>36</sup> Geoffrey Morse, *Palmers Company Law* (2th edn, Sweet & Maxwell 2009) para 8.2306; John P. Lowry, ‘Regal (Hastings) Fifty Years on: Breaking the Bonds of the Ancient Regime?’ (1994) 45(1) N Ir Legal Q 1.

<sup>37</sup> For example see: *Aberdeen Rail Co v Blaikie* [1854] 1 Macq 249, 2 Eq Rep 1281; 23 LTOS 315, 1 Macq 461, 252 (HL) (Lord Cranworth LC); *Regal (Hastings) Ltd v Guliver* [1967] 2 AC 134 (HL). See also Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 496, paras 16-17; John Birds and others, *Boyle & Birds Company law* (8<sup>th</sup> edn, Jordan’s publishing Ltd 2011) 490, para 16.2.

<sup>38</sup> See *Re Lands Allotment Co* [1894] 1 Ch 616, 631 (CA); *Re Duckwari plc* (No 2), *Duckwari plc v Offerventure Ltd* (No 2) [1998] 2 BCLC 315, 321 (CA).

<sup>39</sup> *Bairstow v Queens Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531 [53] (Robert Walker LJ); *O'Donnell v Shanahan* [2009] EWCA Civ 751, [2009] BCC 822 [68]; *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* (in administrative receivership) [2011] EWCA Civ 347, [2012] Ch 453 [34] (Lord Neuberger MR); *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), [2012] 2 BCLC 369 [148] (Newey J).

<sup>40</sup> *Aberdeen Rail Co v Blaikie* [1854] 1 Macq 252, 2 Eq Rep 1281, 23 LTOS 315, 1 Macq 461, 251 (HL) (Lord Cranworth LC). See also Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn, Jordan Publishing Ltd 2011) 295, para 6.55; Stephen Mayson, Dereck French & Christopher Ryan, *Mayson, French & Ryan on Company Law* (31 th edn, OUP 2014-15) 468, para 16.3.2; Alan Dignam & John Lowry, *Company Law* (8<sup>th</sup> edn OUP 2014) 333, para 16.7.

<sup>41</sup> Emile Van Der Does De Willebois & Jean-Pierre Brun, ‘Using Civil Remedies in Corruption and Asset Recovery Cases’ (2013 ) 45 Case W Res J Int’l L 615, 620-621; Justice Joseph T. Walsh, ‘The Fiduciary Foundation of Corporate Law’ (2002) 27 J Corp L 333-343; George L. Gretton, ‘Constructive Trusts: Part 1’ (1997) 1(3) Edin L R 281, 282.

<sup>42</sup> Andrew Keay, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 23, para 2.36.

confined to protecting the company's properties,<sup>43</sup> and this is not the role of the trustee.<sup>44</sup> Thirdly, the property theory covers one aspect of a director's duties. While the fiduciary duty is based on a wider concept that includes not only material interests of a company, but also moral aspects, like its reputation, and its intangible assets (stakeholders).<sup>45</sup> In short, it can be said that not all fiduciaries are trustees, but all trustees are fiduciaries.

### 2.1.3.2 The Reliance Theory

The beneficiary, according to this theory, relies on the personal characteristics of the fiduciary, such as his integrity, honesty<sup>46</sup> and loyalty, and his capacity to achieve his duties in a sound manner. Thus, the imposition of strict consequences in cases when a fiduciary betrays the confidence invested in him seems logical. This theory seems close to the concept of confidence, and attributes a moral sense to the fiduciary duty.<sup>47</sup>

However, several criticisms can be made of the above theory. First, this concept leads to a widening of the concept of fiduciary duties. This is because the notion of reliance exists also in other non-fiduciary relationships, such as the relations between any contracting parties, which are also built on this consideration.<sup>48</sup> Second, the confidence is assumed to exist between natural persons and not in relation to legal persons, such as a company. Third, this theory focuses on the personal attributes of the fiduciary<sup>49</sup> and ignores the fiduciary's subsequent behaviour, which is vital for determining the nature of his liability. Fourth, the reliance theory does not give a convincing explanation of the situation of a *de*

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<sup>43</sup> The C.A 2006, s.172.

<sup>44</sup> John Birds and others, *Boyle & Birds Company Law* (8<sup>th</sup> edn, Jordans publishing limited 2011) 626.

<sup>45</sup> See s.172 of the C.A. 2006 which will be explained in Chapter 3 of this thesis.

<sup>46</sup> Kelli A. Alces, 'Debunking the Corporate Fiduciary Myth' (2009) 35(2) J Corp L 239, 241.

<sup>47</sup> Leonard I. Rotman, 'Fiduciary Doctrine: A Concept in Need to Understanding' (1996) 34(4) *Alta L Rev* 821; Geoffrey Nicoll, 'Directors' Duties and Risk Management in China' (1998) 4 *Canberra L Rev* 217, 841.

<sup>48</sup> See Iraqi Civil Code 1951, Art.150(1).

<sup>49</sup> Razeen Sappideen, 'Fiduciary Obligations to Corporate Creditors' (1991) J Bus L 365, 384; Leonard I. Rotman 'Fiduciary Doctrine: A Concept in Need of Understanding' (1996) 34(4) *Alta L Rev* 821, 841.

*facto* director who alleges without a legal basis that he is a director, but who has simply been appointed, without being selected by the company. This argument applies also to the case of nominee director who is appointed according to a decision taken by a third party, without any weight being given to a company's wishes in terms of the above requirements.<sup>50</sup> For all these reasons, the reliance theory seems to offer a far from adequate interpretation of this duty.

### 2.1.3.3 The Inequality Theory

This theory focuses on the unbalanced relationship between the fiduciary and the beneficiary (the company) which is under the discretion of the former.<sup>51</sup> The fiduciary's conduct may cause an abuse of the rights of the vulnerable party in this relationship (the company).<sup>52</sup> In order to protect the beneficiary in this unbalanced relation, a fiduciary must be subject to strict duties so as to ensure his integrity.<sup>53</sup>

However, an unbalanced relationship can be shown in all non-fiduciary relationships, particularly in contractual relationships.<sup>54</sup> This economic phenomenon has attracted the lawmaker's efforts to provide reasonable protection to the weaker party.<sup>55</sup> In addition, the unbalanced relationship encompasses tacitly the notion of one party's subordination to the will of another. This vision contradicts the principle of the collective exercise of power by a company's board of directors,<sup>56</sup> which operates to dilute the reliance on one person. Moreover, the supervision exercised by shareholders on the directors' activities, which includes

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<sup>50</sup> For more details about these themes see Chapter 5, Section one.

<sup>51</sup> Dennis Klinck, 'Things of Confidence: Loyalty, Secrecy and Fiduciary Obligation' (1990) 54 Sask L Rev 73, 90.

<sup>52</sup> Ibid, 90; P.J. Millett, 'Equity's Place in the Law of Commerce' (1998) 114 (Apr) L Q R 214, 219.

<sup>53</sup> Leonard I. Rotman, 'Fiduciary Doctrine: A Concept in Need of Understanding' (1996) 34(4) Alta L Rev 821, 842; Kelli A. Alces, 'Debunking the Corporate Fiduciary Myth' (2009) 35(2) J Corp L 239, 240.

<sup>54</sup> Dennis Klinck, 'Things of Confidence: Loyalty, Secrecy and Fiduciary Obligation' (1990) 54 Sask L Rev 73, 90.

<sup>55</sup> In this context see Art.167 of Civil Code 1951 concerning the contract of adhesion.

<sup>56</sup> See the comment of Lord Cranworth LC in *Aberdeen Railway Co v Blaikie* [1854] 1 Macq 252, 2 Eq Rep 1281, 23 LTOS 315, 1 Macq 461, 471 (HL).

the power to remove them at any time, contradicts the notion of absolute reliance on the fiduciary.

#### **2.1.3.4 The Contractual or Undertaking Theory**

The fiduciary duty, according to this theory, arises from a Contract between two parties, under which a fiduciary undertakes to act in the best interests of the beneficiary and is given the powers to perform his duty in full. However, this agreement has a particular nature, because it requires only the acceptance of this task by a fiduciary, without the express acceptance of the offer by the beneficiary. It is under this *quasi-contract* that the fiduciary duty arises.<sup>57</sup>

This theory offers a logical interpretation of a director's relationship to his company, but it contradicts essential principles of the law of contract. These principles necessitate the unison of two distinguishable wills (by the offer and its acceptance).<sup>58</sup> Moreover, the adoption of this analysis makes it impossible to impose additional obligations on a fiduciary in order to cover unexpected circumstances at the time of the agreement's conclusion. Finally, this theory is not commensurate with those legal regimes that do not delineate the relationship between a director and the company within a contractual framework, as is the case in Iraqi law.<sup>59</sup>

#### **2.1.3.5 Unjust Enrichment**

This theory focuses on the consequence of a fiduciary's exploitation of his powers for the purpose of obtaining personal benefit.<sup>60</sup> Here, the purpose of imposing the

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<sup>57</sup> Leonard I. Rotman, 'Fiduciary Doctrine: A Concept in Need of Understanding' (1996) 34(4) *Alta L Rev* 821, 240.

<sup>58</sup> *Ibid*, 384. See also Art.73 of the Civil Code 1951.

<sup>59</sup> For more details see this Chapter, para 2.3.1.1.

<sup>60</sup> Leonard I. Rotman, 'Fiduciary Doctrine: A Concept in Need of Understanding' (1996) 34(4) *Alta L Rev* 821, 848.



fiduciary duty is to prevent Unfair Enrichment of the director at the expense of his company.

This theory also fails in many respects to give a comprehensive analysis of the fiduciary relationship. Firstly, the focus should be on the duty itself and the circumstances surrounding its emergence, rather than on the consequences of violating it. It is not enough to define a duty by its effects, rather than by its content and its attributes.<sup>61</sup> Secondly, this theory does not offer an obvious ground for striking a distinction between fiduciary and non-fiduciary relations, because the breach of either type of obligation will give rise to the right of the beneficiary for damage. For example, a director would be liable to the company for violating his fiduciary duty, but also the duty of care, which is not a fiduciary duty.<sup>62</sup> Thirdly, it is envisaged that the director may breach his fiduciary duty without gaining a profit as a result of this conduct.<sup>63</sup> It is submitted also that a director's liability can be demonstrated by merely the breach of a duty, and it does not necessitate establishing that a benefit has been gained by reason of his misconduct.

#### **2.1.3.6 The Utility Theory**

Unlike the theory described above, the Utility Theory focuses on the purpose of imposing a fiduciary duty, which is to maintain integrity in the fiduciary relationship.<sup>64</sup> So, the fiduciary duty stems from any relationship that necessitates the maintenance of integrity in dealing with the interests of a counterparty to ensure obtaining the best results from his service.

Seemingly, the above theory tends to give expression to the notion of a fiduciary relationship coloured by ethical considerations and adds moral sense in discharging the duty. This theory seems a *prima facie* consistent with the C.A. 2006, under which a director is bound to act in good faith, and to have regard to

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<sup>61</sup> Ibid, 848.

<sup>62</sup> *Bristol and West Building Society v Mothew* [1996] 4 All ER 698 (CA).

<sup>63</sup> See the circumstances of *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244, [2005] 2 BCLC 91(CA).

<sup>64</sup> Leonard I. Rotman, 'Fiduciary Doctrine: A Concept in Need of Understanding' (1996) 34(4) *Alta L Rev* 821, 849.

‘the desirability of the company maintaining a reputation for high standards of business conduct’.<sup>65</sup> Undoubtedly, the expropriation of a corporate opportunity, or the receipt of a bribe by a director, are forms of conduct that offend against these considerations.<sup>66</sup> They warrant the imposition of severe sanctions on those who commit the wrongdoing.

However, the drawback inherent in this theory is that it involves a broad concept that make the adjustment of its boundaries extremely difficult when it is applied in practice.<sup>67</sup> This is because the protection of general integrity is the law’s objective in regulating any relationship, irrespective of whether that relationship has a fiduciary colouring. In addition, to determine the meaning of the ethical considerations prevailing in the commercial environment is not an easy task, given the ambiguity surrounding its meaning. Moreover, this theory may not be consistent with proscriptive fiduciary duties, which are not ‘founded upon principles of morality’ but rather are ‘based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty’.<sup>68</sup> Seemingly, this theory lacks precision in explaining fiduciary relationships comprehensively.

### **2.1.3.7 The Power and Discretion Theory**

This theory is based on an assumption that the powers and the discretion given to a fiduciary will allow him open-ended discretion and the ability to gain access to the company’s assets without the need to obtain the shareholders’ approval.<sup>69</sup> Any restriction of this discretion may result in the director’s failure to promote a company’s success.<sup>70</sup> Since this discretion could facilitate the abuse of the

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<sup>65</sup> The C.A. 2006, s.172(1-e).

<sup>66</sup> Leonard I. Rotman, ‘Fiduciary Doctrine: A Concept in Need of Understanding’ (1996) 34(4) *Alta L Rev* 821, 849.

<sup>67</sup> *Ibid*, 849.

<sup>68</sup> *Bray v Ford* (1896) AC 44, 51 (HL) (Lord Herschell).

<sup>69</sup> The same wide discretion has been given to the directors under Art.117 of the I.C.A. 1997 and Art.17(1) of the P.B.A. 2004.

<sup>70</sup> Whereas limited powers are granted to shareholders, and these are often associated with essential changes in the legal position of the company, such as a change to its name or its

beneficiary's rights, the law must provide strict rules for protecting the interests of a person who is subject to fiduciary discretion.

This theory is to be distinguished from other theories, such as those of reliance and inequity,<sup>71</sup> by its focus on the powers of the director rather than on the vulnerability of the company. However, the theory lacks a comprehensive explanation of the fiduciary relationship, because the exercise of discretion over the interests of another person is also conceivable in non-fiduciary relations, such as the duty of the judge<sup>72</sup> and of State bodies. Thus, although the abuse of office is one of the characteristics of the fiduciary duty, it is not a necessary condition for its existence.<sup>73</sup> The ex-director, for example, may continue in fulfilling his duty to avoid a conflict of interests even after leaving his office and the “vanishing” of his powers.<sup>74</sup>

#### **2.1.3.8 Findings of the Section**

To conclude, the hallmark of the aforementioned theories is that each of them focuses on one aspect or manifestation of the fiduciary relationships, but fails to draw a comprehensive notion that embraces all aspects of this relationship. Therefore, a combination of these theories seems the best solution to the question of identifying the basis of fiduciary duty. As far as the director's relationship with the company is concerned, it is true that the company's selection of a director depends on the latter's integrity and honesty, and his competence in the performance of his duty. To fulfil his duty properly, the director must be employing discretion when acting in the company's interests. This position creates an unbalanced relationship as a result of the reliance on a director. For this reason,

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articles, its merger with another company. See: Leith Ajlouni, 'Directors' Duties and the Protection of Creditors' Interests: An Examination of Directors' Duties to Creditors of Financially Troubled Companies with the View of Expanding the Scope of Directors' Fiduciary Duties to Include the Interests of Creditors of Companies Operating while Insolvent or Doubtfully Solvent' (Phd thesis, the University of Reading 2002) 21-22.

<sup>71</sup> Leonard I. Roman, 'Fiduciary Doctrine: A Concept in Need of Understanding' (1996) 34(4) *Alta L Rev* 821, 849.

<sup>72</sup> *Ibid*, 849-850.

<sup>73</sup> Mr Justice R. P. Meagher & Adrian Maroya, 'Crypto- Fiduciary Duties' (2003) 26(2) *U N S W L J* 348, 350.

<sup>74</sup> For more details for this theme, see Chapter 4, para 4.3.2 of this thesis.

the law should interfere in this relationship by providing protection to the company, which is the vulnerable party in this relation, so as to prevent the director from enriching himself through the abuse of his position. Thus, all of the above theories may assist in crystallizing the general framework of fiduciary doctrine.

## Section II

### The Position of Iraqi Company Law in Relation to the Concept of Fiduciary Duty

**Introduction:** Does the concept of the fiduciary doctrine exist in Iraqi Company law? In other words, does Iraqi law contain rules for the protection of a company that are comparable to the concept of English law previously described, or is there anything resembling an equivalent concept in this area of Iraqi law? It is extremely difficult to answer the above question without clarifying the general framework of Iraqi law governing the conduct of a director. Such a clarification is of significance in helping the reader to understand the current discussion in this Chapter and in the subsequent Chapters. The study of a legal system such as Iraqi company law should not be insulated from the study of its historical background and its legal structure. It is important to understand these legal realities before any attempt is made to answer the above question.

#### 2.2.1 Historical Background of Iraqi Company Law

Iraq has a phenomenally rich history and is known as the cradle of civilization. Many forms of legislation have been instigated within its borders. The Hammurabi Stele of 1790 B.C.<sup>75</sup> was the first legislation in the world to regulate some legal aspects of a company,<sup>76</sup> which is evidence of the high degree of sophistication and civilization of the ancient Iraqi legislators.

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<sup>75</sup> Iraqi Companies' Registration Administration 'A Brief Summary of the Companies' Registration Administration: Part 2' <[www.mot.gov.iq/arabi/index.php?name=Pages](http://www.mot.gov.iq/arabi/index.php?name=Pages)> accessed on 8 December 2013; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 11, para 3. The Stele was codified in 1790 B.C. in the ancient city of Babylon. It consisted of 282 Articles governing certain aspects of life in that time.

<sup>76</sup> The Code of Hammurabi referred to one type of company law under which one person gave money to another for use in trade, with the partners incurring the profit or loss that resulted from this trade. See Dr. Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 11.

It is not intended to go more deeply into that realm, and it is sufficient to mention the stages through which Iraqi law has passed since the beginning of the twentieth century.

The first stage begins after the occupation of Iraq by Great Britain in 1917, when the military authority issued a “Declaration of Companies” in 1919. This declaration encompassed the principles of the Indian Companies Act of 1913, which was in turn gleaned from English law.<sup>77</sup> This Act was continued in force until the enactment of the Civil Code 1951, which regulated the company's contract, alongside the Commerce Act 1943, which contained some rules concerning companies. Some of the above rules were replaced by the Commercial Companies Act No.31 1957, which borrowed the majority of its rules from French law and mirrored the liberty of trade.<sup>78</sup> This Act contained some aspects of managerial duties similar to that fixed under English law, for example, the director's duty to act in good faith in discharging his powers (Art. 14-b), and to avoid making a secret profit (Art.161-1).

The second stage begins after the 1958 Socialist Revolution, which had an impact on the political, economic and social aspects of life, including the legal system, which adopted socialist forms of legislation. Accordingly, the Commercial Companies' Act 1957 was replaced by the Companies Act No.36 1983 which aimed to adopt the principles of the socialist regime, including a planned economy.<sup>79</sup> This Act was then replaced by the Companies' Act (herein after the I.C.A.) 1997, which is still in force and does not differ from the former in its general framework.<sup>80</sup>

The regulation of the directors' duties in the above Acts was restricted to two Articles dealing with *the duty of care*<sup>81</sup> and *the duty to avoid multiple*

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<sup>77</sup> Professor Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 15; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 14.

<sup>78</sup> This Act regulated commercial companies solely, while the Civil Code 1951 has continued to govern civil companies.

<sup>79</sup> See Arts. 1, 2 of this Act. Moreover, this Act contains uniform rules for governing both civil and commercial companies.

<sup>80</sup> See Arts.1, 2 of this Act.

<sup>81</sup> See the Companies Act 1983, Art. 112; the I.C.A. 1997, Art. 120.

*directorships*.<sup>82</sup> The narrow and incomplete regulation of this important area of company law is attributable to political, economic and legal factors. The political and economic factors are due to the policies of the socialist regime, which held power in Iraq over a long period and led to the State's predominance over substantial sectors of the general economy. This situation rendered the scope for competition by private sector companies extremely narrow. For example, the number of registered companies before the elimination of the socialist regime on 9 April 2003 was 8,374. This number increased considerably after the removal of the regime, and by May 2012 there were 51,659 companies.<sup>83</sup> This reality explains the scarcity of judicial decisions in dealing with the breach of directorial duties at this time, and affects the author's ability to review the tendencies of Iraqi courts in tackling the problems associated with this thesis.

The legal factor could be due to the legislator's belief that the means of control exercised by the Company Registrars<sup>84</sup> was adequate to provide reasonable safeguards for companies. It should bear in mind that a director's culpability, which may be detected by way of the oversight practised by the State bodies, presupposes the presence of allegation of the breach of certain duty, which is utilized as a standard to ascertain of the existence of such violation. Moreover, this kind of control, in some circumstances, is inadequate and may have counterproductive. The supervision of State bodies is often dependent on information given by the company's members,<sup>85</sup> where ability to exercise an effective oversight, particularly in the large companies, is questionable. Moreover, such external control is not free from negative effects. A State body may demand that the company bring a criminal action against the delinquent director, which may later result in his removal on account of his being disqualified.<sup>86</sup> A company

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<sup>82</sup> See the I.C.A. 1983, Arts. 102; the I.C.A 1997, Art.110.

<sup>83</sup> See the report of the Companies' Registration Administration 'A Brief Summary of the Companies' Registration Administration: Part 1' <[http://www.mot.gov.iq/ara bi/index.php? name =Pages&op = page &pid = 57: Part1](http://www.mot.gov.iq/ara%20bi/index.php?name=Pages&op=page&pid=57:Part1)> accessed on 8 December 2013.

<sup>84</sup> With regard to the oversight on the companies, which is undertaken by the Companies Registrar, Art. 140 of the I.C.A. 1997 states that 'the company shall be subject to inspection by one or several professional inspectors, who will be chosen by the Registrar, in the case of a justifiable claim...that the company has violated the provisions of this law, its contract, or the decisions of its general assembly'. See also the Act of the Ministry of Trade No. 37 2011, Art.3 (Tenth).

<sup>85</sup> The I.C.A. 1997, Art.140 (Second).

<sup>86</sup> The I.C.A. 1997, Arts.106(2), 145.

might be in urgent need of the services of the disgraced director and, if the matter had been left to its own discretion, it might have retained him. In addition, such procedures are often widely publicized and are therefore susceptible to become known by the shareholders and the Stock Exchange market, thus prejudicing the company's reputation and the price of its market shares. The monetary procedures do not obviate the imposition of a fiduciary duty as a safe means to avoid the above results. The above methods of oversight have nevertheless been mentioned under recent legislation<sup>87</sup> for regulating company affairs. These new pieces of legislation empower a State body to remove a director.

The third stage began after the occupation of Iraq in April 2003 by the Coalition force,<sup>88</sup> which set up an interim governing authority, that is: the Coalition Provisional Authority (herein after the C.P.A.). This authority, *inter alia*, acted to reform the I.C.A 1997, under its Order No.64 2004, in order to transform the country from a socialist State to one embracing free trade.<sup>89</sup>

However, it will be seen elsewhere in this study that the reform contained partial and superficial amendments. At this stage the I.C.A. 1997 was amended in order to assimilate the above objectives. The C.P.A. introduced the other Acts to regulate certain sectors of the general economy, and these will be discussed shortly.<sup>90</sup>

### **2.2.2 The Structure of Iraqi Company Law**

It is desirable to help the reader gain an understanding of some of the main features structure of Iraqi company law, giving a general outlook on types of companies, categories of directors and the managerial duties mentioned in this law.

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<sup>87</sup> See the Insurance Business Regulation Act 2005, Arts.47 (Second-F); the Private Banks Act 2004, Art. 56(2-I, J).

<sup>88</sup> Which was consist of the military forces of the U.S and the U.K.

<sup>89</sup> The Preamble of the C.P.A Order No. 64 2004 stating that:-

[T]he need for development of Iraq and its transition from a non-transparent centrally planned economy to a free market economy characterized by sustainable economic growth through the establishment of a dynamic private sector, and the need to enact institutional and legal reforms to give it effect.

<sup>90</sup> See this Chapter, para 2.2.2.3, which is titled "the Duties of the Director".



### **2.2.2.1 Types of Companies under the I.C.A. 1997**

Companies under the I.C.A. 1997 can be classified into three main groups: First, companies with unlimited liability. These are the Solidarity Company, the Simple Company and the One Person Company.<sup>91</sup> The capital of these companies consists of the contribution of its members in money or work. The responsibility of the company's members for its debts is unlimited, and their liability for them is treated as if were for their own personal debts.<sup>92</sup> There is no board of directors in this type of company, and the company's management is entrusted to the managing director, who is permitted to be one of a company's members, or as any stranger.<sup>93</sup> This type of company is similar in nature to the Unlimited Company defined by the C.A. 2006.<sup>94</sup>

Second, there are the companies with limited liability, namely: the Joint Stock Company (equivalent to the public companies set forth in s.4 of the C.A. 2006), the Limited Company and the Limited Liability Company with One Owner. The capital of these companies consists of shares, and a shareholder's liability for the company's debts does not exceed the nominal value of his own shares that contribute to the company's capital. The management of the joint stock companies consists of the board of directors (which exists in this type of companies only) and the managing director. By contrast, the management of a Limited Company is entrusted to the managing director only.

These types of companies are classified in turn as Private and Mixed Sector Companies. In the Private Companies, the capital of the company consists of subscriptions by the private sector only. It should be observed that the State's subscription to the company's capital by a proportion of less than 25% does not

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<sup>91</sup> This type of companies is similar to the unlimited companies mentioned by the C.A. 2006, s.3 (4).

<sup>92</sup> For more elaboration about the meaning of shareholders' unlimited liability and its justifications see: Florence Gakungi, 'the Interpretation of the Doctrine of Piercing the Corporate Veil by the U.K Courts in More Successful than by the US Courts' (2012) 3 (2) King's Student L Rev 212.

<sup>93</sup> See Art. 123(Second) of this Act.

<sup>94</sup> See the C.A. 2006, s.3.

change its nature as a Private Company. For the founding of a Mixed Sector Company, the State's subscription in it must be equivalent to, or in excess of, 25% of its capital.<sup>95</sup>

### 2.2.2.2 Categories of Director under the I.C.A. 1997

The I.C.A. 1997 does not give a definition of a director.<sup>96</sup> However, a director can be defined as any person who exercises discretion over the interests of a company directly or indirectly according to powers determined by law, or as a person who alleges that he has the authority to do so. The I.C.A. 1997 refers to the *de jure* director as a position which belongs to one of the following three categories:

The first type are called the non-executive directors. Those, do not engage in day-to-day activity and exercise supervisory power over the executive director.<sup>97</sup> The matters concerning the number of directors and how to select them have been settled by the law.<sup>98</sup> Generally, a director must be a natural person,<sup>99</sup> but it is

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<sup>95</sup> See the I.C.A. 1997, Arts 6-9. It is worth noting that the State shareholding in the Mixed Sector Companies is confined only to the Joint Stock Companies and to Limited Companies.

<sup>96</sup> While s.251 of the C.A. 2006 defines a director in such a way that it 'includes any person occupying the position of director, by whatever name called'. Seemingly, the reason for this broad formulation is to accommodate all categories of directors.

<sup>97</sup> The I.C.A. 1997, Art.123 (First).

<sup>98</sup> Pursuant to the I.C.A. 1997, the board of directors consists of persons who must be selected in accordance with the following details.

1-If the joint Stock Company is a Private Company, the number of its directors must be between 5-9 members and elected by the general assembly (Art.104 (First)).

2-If the company is one of the Mixed Sector Companies, the number of its directors must be not less than 7 members, and must be chosen according to the following details, as cited by Art.103- First(1,2):

A- Two members who represent the State Sector are appointed under an order taken by the Minister (or his agent) if the subscription of the State Sector in the company's capital does not exceed 50%. If the subscription exceeds this ratio, the State Sector is entitled to appoint 3 members as directors on the company board.

B- Five members from outside the State Sector are to represent the shareholders, who are elected from the general assembly. All this pertains only if the shares of the State Sector do not exceed 50%. If it exceeds this ratio, the general assembly must elect 4 members from outside the State Sector to represent the shareholders in the company.

The I.C.A. 1997 requires the nomination of alternative directors in the Joint Stock Companies to replace the original directors if necessary. The alternative directors must be of the same number and must be selected in the same manner as that used in selecting the original directors (Art. 103-Second).

<sup>99</sup> The director, pursuant to Art.106 of the I.C.A. 1997, must possess the following qualifications: (1) Legal capacity, which means a minimum age of 18 years. This requirement also establishes that the director must be a natural person.

permissible for a legal person to be a member at the board, provided that the legal person is represented by a natural person.<sup>100</sup>

The second type of director is the managing director, who exercises a day-to-day activity under the supervision of the board of directors in the Joint-Stock Company, or under the supervision of the general assembly in the other types of companies.<sup>101</sup> The subordination of the managing director to the board's supervision leads to the former incurring obligations set out under labour law,<sup>102</sup> as well as those mentioned in the I.C.A. 1997. But this point is not the subject of a consensus in Iraqi law.<sup>103</sup>

The third type is the nominee director, who is appointed by the State Sector in the Mixed Sector Company, or by other groups of shareholders to represent its interests.<sup>104</sup>

However, the I.C.A. 1997 and the other special Companies Acts do not govern the situation of the *de facto* director, who alleges without legal appointment that he is empowered to conduct the company's affairs,<sup>105</sup> or has continued in discharging

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(2) He must not be prohibited from companies' management by legislation or by a resolution issued from a competent legal body.

(3) He must own a minimum of two thousand shares.

<sup>100</sup> For more details of this matter see chapter 5, section one of this thesis.

<sup>101</sup> The I.C.A. 1997, Arts.121 (First), 123(First). The same approach can be seen in *Equitable Life Assurance Society v Bowley* [2003] EWHC 2263 (Com Ct), [2004] 1 BCLC 180, when Langley J stated at [41] that '...I think, that a company may reasonably at least look to non-executive directors for independence of judgment and supervision of the executive management'.

<sup>102</sup> See the definition of an employee under the Labour Act No.71 1987, Art.8 (Second).

<sup>103</sup> The grounds for objection to this description arise from the broad discretion granted to the managing director in a way that seems inconsistent with considering him as an employee. The State Consultative Council (the higher State consultative body in Iraq) has supported this approach by its decision No.18/982 on 26/4/1982, in a situation in which one of company's members took over the post of the managing director. The Council opined that the subordination of a shareholder (as a director) to the supervision of the other shareholders, as an employee, may lead to prejudice the principle of equality between the company's members. It is suggested that this decision was built on a confusion between two distinct capacities: the *shareholder* and the *manager*. The shareholder's role as a director does not negate his subordination to the supervision of other shareholders as a director and not as a shareholder, nor does it detract from his shareholding rights. See also: Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 260-261.

<sup>104</sup> This matter will be discussed broadly in Chapter 5 of this thesis, Section one.

<sup>105</sup> For more details of this type of directors see Stephen Girvin, Sandra Frisby and Alastair Hudson, *Charlesworth's Company Law* (18<sup>th</sup> Sweet & Maxwell 2010) 315-317, paras 17.005-17.006; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 12-14, para 1.13.

his duties despite that his service had been terminated.<sup>106</sup> However the Civil Code 1951 covers this legal position.<sup>107</sup>

Also the I.C.A. 1997 does not refer to the *shadow director*, who is defined under the C.A. 2006 ‘a person in accordance with whose directions or instructions the directors of the company are accustomed to act’.<sup>108</sup> Notably, the C.A. 2006, which left the rules governing shadow director to the common law and the principles of equity, so that is amenable for further development in the future.<sup>109</sup> However, despite the fact that this matter could occur in the practical arena, the I.C.A. 1997 does not refer to a shadow director, nor does it set out special rules to cover this legal position. This legislative loophole creates inevitably a state of uncertainty about how to deal with persons, who direct their instructions to the *de jure* director, by the law.

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<sup>106</sup> *Revenue and Customs Commissioners v Holland* [2010] UKSC 51 [2010] 1WLR 2793 [82] (Lord Collins).

<sup>107</sup> Under the Civil Code 1951, Art.944 ‘If the agent...has acted without authority, the contract ceases of engender its effects...’ and the fate of the suspended contract depends on the principal’s ratification. This includes by analogy any activities issued from a director, which gives a company protection under the law from any harmful actions issuing from the *de facto* director, who will bear the sole responsibility for that behaviour. But the ratification of the agent’s action will lead to exclude him from liability. Thus, the company’s ratification makes the action of the *de facto* director equivalent to an action taken by a *de jure* director, pursuant to Art.136(1) of this Code.

It is instructive to mention that, in order to incur liability to the *de facto* director (as a fiduciary), the plaintiff must show that such person ‘...must be part of the corporate governing structure, and ... had to prove that he assumed a role in the company...’ (*Revenue and Customs Commissioners v Holland* [2010] UKSC 51, [2010] 1WLR 2793 [82] (Lord Collins) [93-94]). For more details about the position of the *de facto* director see the last case, parars [58-94]).

<sup>108</sup> S.251(1) of the C.A. 2006. For more details of this matter see Stephen Girvin, Sandra Frisby and Alastair Hudson, *Charlesworth’s Company Law* (18<sup>th</sup> Sweet & Maxwell 2010) 317-319, 17-007; Stephen Griffin, ‘Confusion Surrounding the Characteristics, Identification and Liability of a Shadow Director’ (2011) 24(3) *Insolv Int* 44.

For attaching liability to the shadow director as a fiduciary, the claimant must demonstrate that the majority of the directors in the company have influenced by his directions. *Re Hydrodan (Corby) Ltd* [1994] B C C 161 (Ch), 163 (Millett J); *Re Unisoft Group Ltd (No. 2)* [1994] B.C.C. 766 (Ch), 775 (Harman J); *Lord (Liquidator of Rosshill Properties Ltd (in liq) v Sinai Securities Ltd* [2004] EWHC 1764 (Ch), [2004] B C C 986 [27] (Hart J). See also the New Zealand Case *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 3 All ER 404, 424-425. See also Andrew Keay, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 17, para 2.24.

<sup>109</sup> The C.A. 2006, s.170(5).

In any event, the focus of this study will be on the content of the director's duty rather than on a discussion of the rules governing the *de facto* and shadow director, unless it is necessary to refer to each of them.

### 2.2.2.3 The “Duties” of the Director

The I.C.A. 1997 is general Act that governs all types of companies in all economic sectors,<sup>110</sup> except those that are subject to special legislation, and ‘to the extent it does not conflict with legislation applicable to these Acts.’<sup>111</sup> Other legislation, enacted after 9 April 2003, set out rules governing certain types of companies, such as the Private Banks Act 2004 (herein after the P.B.A.) which governs banks, and the Insurance Business Regulation Act 2005 (herein after the I.B.R.A.), which governs the affairs of insurance companies.

The above legislation did not lay down general principles for governing a director's relationship with the firm, including the determination of his liability; they merely mention some aspects of the director's duties. However, four general observations can be made about these Acts:-

First, it is noteworthy that neither the I.C.A. 1997 nor the aforementioned legislation use the term “duty”. Instead, other terms are utilised, such as “the jurisdictions and powers”,<sup>112</sup> or “Qualification of Insured Employees”.<sup>113</sup> The use of the term “duty” is of significance in drawing a director's attention to the requirement of the compliance with that duty and the consequences of violating

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<sup>110</sup> In this context, Art. Of this Act states that:

This law applies to mixed and private companies and to all investors. Its provisions shall apply to banks to the extent they do not conflict with Coalition Provisional Authority (C.P.A) Orders including CPA Order No. 40 promulgating the Banking Law, CPA Order No. 18 prescribing Measures to Ensure the Independence of the Central Bank of Iraq, the Central Bank of Iraq Law No. 64 of 1976, as amended, and regulations issued under the foregoing orders. This law shall apply to securities transactions, financial investment companies and insurance and re-insurance companies to the extent it does not conflict with legislation applicable to these transactions and entities or the jurisdiction of the competent state authorities for those sectors...

<sup>111</sup> The I.C.A. 1997, Art.3. These legislation are the P.B.A. 2004; the I.B.R.A. 2005.

<sup>112</sup> This is the title of Subsection 3 of Section 3 of the I.C.A. 1997.

<sup>113</sup> This is the heading of Chapter 5 of the I.B.R.A. 2005, (Arts. 42-45).

it. While “the jurisdictions and powers” refer to a director’s capacity to exercise certain activities. It is worth noting that commentators on Iraqi civil law make a *distinction between duty and obligation*, on the grounds that obligation, unlike duty, has a financial value at the time of its arising.<sup>114</sup> It is worth mentioning that the nature of the duty is determined at the instant of its existence. Therefore, the breach of a duty raises the company’s demand for damage, but this does not transform the nature of this duty into an obligation.

Second, the I.C.A. 1997 refers to the directors’ “duties” in various places within the text. For example, the no-conflict rule is mentioned within the Act’s objectives.<sup>115</sup> Whereas the rule concerning avoiding multi-directorships (avoiding conflict of duties) has been mentioned in the Section one, which deals with the “formation of the Board of Directors”.<sup>116</sup> The duty of declaring an interest in a deal to be concluded with the company<sup>117</sup> is mentioned in Sub-Section Three of the I.C.A. 1997.<sup>118</sup> This is in contrast to the sophisticated regulation of this subject in the C.A. 2006, which, in Chapter 2, part 10 (ss. 154-269), lays down in a consistent manner the rules governing the conduct of company directors.

Third, the other special Acts refer to the same duties as the I.C.A. 1997. For example, the duty to act in the interests of the company and concerning the duty to declare an interest in a deal are accommodated by Arts.17 (5), 21 of the P.B.A. 2004. The duty to avoid conflicts of interest is mentioned in Art.42 (Secondly-B) of the I.B.R.A. 2005. These two pieces of legislation also refer to the duty to avoid a conflict of duties.<sup>119</sup> This multi-regulation of the same duties may contradict with regulations laid down by the I.C.A. 1997, and may prejudice the unity and harmonious between the different pieces of legislation in tackling certain points of law, as it will be seen in the coming chapters.<sup>120</sup>

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<sup>114</sup> Hassan Ali Al-Znon, *the General Theory of the Obligations* (Al-Sanhoori Publisher 1976) 15; Abdul Majid Al-Hakim and Abdul Baqi Al-Bakri Mohammed Taha Al-Bashir, *The Brief in the Obligation Theory* (the Ministry of the Higher Education and Scientific Research 1980) 7.

<sup>115</sup> See the I.C.A. 1997, Article 1(3).

<sup>116</sup> See Section 2, sub-Section one of the I.C.A. 1997, Art. 110.

<sup>117</sup> See the I.C.A. 1997, Art.119; the P.B.A. 2004, Art.21.

<sup>118</sup> Which is titled “the Jurisdictions and Powers of the Board of Directors”.

<sup>119</sup> See Arts.17(5-A) of the P.B.A.2004; 42(Third) of the I.B.R.A. 2005.

<sup>120</sup> For more details about these contradictions, see Chapters 4, para 4.3.1.1 below.

Fourth, there is no reference to some aspects of fiduciary duties found in English law, such as the duty to avoid conflicts of interests within a general formulation that accommodate certain aspects of misbehaviour, nor is there any mention of a duty to avoid accepting a benefit from a third part.<sup>121</sup>

### **2.2.3 Does Iraqi Company Law Adopt the Doctrine of Fiduciary Duty?**

It is worth noting that neither the I.C.A. 1997 (including the other legislation mentioned previously<sup>122</sup>), nor Iraqi courts and law commentators use terms like “a fiduciary” in describing a director, or “fiduciary duty” when referring to managerial obligations. However, to give an over-hasty view in order to refute the existence of this doctrine in Iraqi law would be contrary to the analytical approach required by scientific research. A scrutiny of the characteristics of Iraqi company law may be helpful in answering the main question posed by this Chapter.

It is desirable, therefore, to explain and compare the general features of the I.C.A. 1997 and the relevant aspects of English law. In this context, the director’s duty in Iraqi law is distinguished by the fact that it is a statutory duty, limited by law. It does not mirror English law in its classification of fiduciary and non-fiduciary duties. Finally, these duties are owed to the company, as it will be shown below.

#### **2.2.3.1 The Provisions of the Companies’ Acts are the Principal Source of a Director’s Duties**

Iraq is a Civil Law jurisdiction. Unlike English Law, the statutory provisions (the Acts of Parliament) are the main source that must be applied by Iraqi courts.<sup>123</sup> By contrast, s.170(4) of the C.A. 2006 adopted dual sources of managerial duties that constitute collectively a director’s duty, stating that:-

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<sup>121</sup> By contrast, see ss.175, 176 of the C.A. 2006 which codified the above duties.

<sup>122</sup> Such as the P.B.A. 2004; the I.B.R.A. 2005.

<sup>123</sup> See the Civil Code 1951, Art.1 which will be the subject of further explanation in this Chapter, Section 3.

The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

Accordingly, the rules of Common law and Equity are the main sources of a director's duty in all situations not covered by the provisions of this Act. But there is confusion surrounding the formulation of the above section concerning which of the two sources may carry more weight, the statutory provisions or the common law. It is suggested that the following hierarchical sequence is the logical one to apply: Firstly, the statutory provisions have priority over other sources of law.<sup>124</sup> Secondly, the scope of applying equitable rules is in the area of interpreting the statutory rules and in filling any gap in the Act in order to address any problems resulting from its generality.<sup>125</sup>

### **2.2.3.2 The Statutory Provisions of the I.C.A. 1997 and the Other Special Acts are Mandatory and not Default Rules**

The above heading means that a director under these provisions is unable to conclude an agreement with the company contrary to the statutory provisions, either under the company's contract or pursuant to any other agreement. In other words, the directors' duties in Iraqi law are statutory restrictions on his behaviour, which can not be improved upon by either agreement, or by any other "equitable jurisdiction".

The mandatory nature of the provisions of the I.C.A. 1997 is attributable to two reasons: the first reason is the predominance of the socialist regime in the legal sphere over a long time. This regime favoured the notion of giving statutory provisions preponderance over contractual relations. Seemingly, this former legal regime has continued to pervade the legal reality of the Iraqi Companies' Acts

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<sup>124</sup> The C.A. 2006, s.180 (5).

<sup>125</sup> John Lowry, 'the Duty of Loyalty of Company Directors: Bridging the Accountability Gap through Efficient Disclosure' (2009) 68(3) C L J 607, 613; Mark Hsaio, 'A Sprouting Duty of Honesty and Loyalty? Companies Act 2006' (2009) 20(9) I C C L R 301.



until the present time: this has led to a shrinking of the role of libertarianism in legal life.<sup>126</sup>

The second reason could be the legislator's belief that by regulating this area of law under a mandatory provision the interests of the shareholders and the general economy (in which a company represents part of it) would be sufficiently protected. This interpretation can be gleaned from the fact that the founders of a joint stock company, who prepare its contract of incorporation, often subsequently constitute the majority of shareholders. However, it is not difficult for these persons to formulate the company's articles in a way that mirror, or indeed, allow them to advance their own personal interests.<sup>127</sup> It is noteworthy that legislation enacted after 9 April 2003 has maintained the characteristic described above.<sup>128</sup>

A different approach is adopted in the C.A. 2006. Although the statutory provisions of this Act are mandatory and not default,<sup>129</sup> they include numerous provisions that empower a company to insert fiduciary duties into its constitution or in the director's contract of service.<sup>130</sup> In this context, Art.232(4) of the C.A. 2006 states that 'nothing in this section<sup>131</sup> prevents a company's articles from making such provision as has previously been lawful for dealing with conflicts of interest'.<sup>132</sup> But the statutory provisions have been given a priority over the contractual regulations in areas that constitute a threat to a company's interests and those of minority shareholders. For example, s.232 of the C.A. 2006 prevents any provision in the company's articles or in a contract permitting the release of a director from liability for breaching a duty or allowing him to be given an indemnity for incurring the liability.

Accordingly, the duties mentioned under ss.171-177 of the C.A. 2006 are non-exhaustive, and it is permissible to create more duties either in the common

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<sup>126</sup> Mowafaq Hassan Raza, the *Company Law: its Goals, Basis and its Content* (the Legal Researches Centre 1985) 144; Abdul Baqi Al-Bakri and Zuhair Al-Bashir, *the Entrance for Studying the Law* (The House of the Wisdom 1989) 181-186.

<sup>127</sup> See the I.C.A. 1997, Art.13. Under Art.39 of this Act the company's founders must underwrite not less than 30% and not more than 55% of the company's capital.

<sup>128</sup> Such as the P.B.A. 2004, the I.B.R.A. 2005.

<sup>129</sup> *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 [35]. See also Tey Tsun Hang, 'Fiduciary duty: A More Cautious Approach' (1998) 19 Sing LR 367.

<sup>130</sup> The C.A. 2006, s.177 (6-c).

<sup>131</sup> Which relates to preventing the exclusion of a director from liability.

<sup>132</sup> In the same meaning see the C.A. 2006, s.180 (4-b).

law<sup>133</sup> or on a contractual basis, according to the nature of the circumstances which produce this sort of obligation.

The outcome of the above status quo of the I.C.A. 1997 is the loss of flexibility in tackling some issues for making the duty more appropriate to the nature of the relevant activities of a company, or in bridging a gap in the law. It is impossible to establish new duties appropriate to the company's needs and to the exigencies of providing additional safeguards. For example, Iraqi law does not contain a general rule for avoiding conflicts of interest,<sup>134</sup> or for the prohibition of accepting a bribe or a secret benefit from a third party<sup>135</sup>: the current position does not enable the company to regulate these matters in its Articles. It is well known that the provisions of the legislation are limited, that self-interest and opportunistic behaviour are unlimited, and that limited provisions are incapable of controlling limitless misbehaviour, whatever generality is used in drafting legal provisions. The above characteristic mirrors the size of the problem in Iraqi law.

### **2.2.3.3 The Absence of Distinction between Fiduciary and Non-Fiduciary Duties in Iraqi Law**

Generally, a duty in Iraqi law is a restriction on a director's will. The concept therefore includes the duty to avoid conflicts of interests, alongside the duty of care, since each of them leads to this result.

By contrast, English law classifies the director's duties as either fiduciary or non-fiduciary in nature.<sup>136</sup> The fiduciary duty being a proscriptive duty, rather than prescriptive, prevents a director from placing himself in a position that may give

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<sup>133</sup> *Breitenfeld UK Ltd v Harold John Harrison, John George Harrison, Gemma Lucy Harrison, Harrison Special Steels Ltd* [2015] EWHC 399 (Ch), 2015 WL 685420, [60] (Norris j.) [76]; Birds and others, *Boyle & Birds Company Law* (8<sup>th</sup> edn, Jordans Publishing Ltd 2011) 603.

<sup>134</sup> See Chapter 4, para 4.1.1.1 of this thesis.

<sup>135</sup> For more details about this issue see Chapter 5, Section 2 of this thesis.

<sup>136</sup> For more details about this matter see: Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96, 100; Rebecca Lee, 'Rethinking the Content of the Fiduciary Obligation' 3 (2009) CONV P L 236; Sarah Worthington, 'Corporate Governance: Remediating and Ratifying Directors' Breaches' (2000) 116 L Q R 638, 663; Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 SAclJ 714, 722.

rise to a conflict of interest with the company.<sup>137</sup> In other words, the fiduciary duty ‘...tells the fiduciary what he must not do. It does not tell him what he ought to do’.<sup>138</sup> This type of “negative” duty<sup>139</sup> includes the duty to avoid conflict of interests<sup>140</sup>; avoid the acquisition of secret profits<sup>141</sup>; and avoid the acceptance of a benefit from a third party. This interpretation, however, implies a duty to act in the best interests of the company<sup>142</sup> as a prescriptive duty, because it explains how a director *should act in fulfilling his duty*, although it does not impose specific restrictions.<sup>143</sup> However this perception has become questionable in the light of *Item Software (UK) Ltd v Fassihi*,<sup>144</sup> which encompasses the imposition on a director of the duty of confession to be attached to the above duty, and redefines a fiduciary duty as ‘prescriptive rather than merely proscriptive’ in nature.<sup>145</sup>

Under the above classification, the duty of care is not a fiduciary duty, because it concerns a standard for judging the director’s conduct in performing a certain action for the purpose of determining whether he has exceeded the legal requirements that must be followed by the reasonable (normal) person.<sup>146</sup> In other words, this duty concerns the concept of competence in performing a duty<sup>147</sup>

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<sup>137</sup> Richard C. Nolan, ‘The Legal Control of Director’s Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report’ (2005) 6 *Theoretical Inq L* 413, 420; Pey-Woan Lee, ‘Reassessing the Crime of Non-Disclosure under section 317 of the Companies Act 1985’ (2005) 5 *J Corp L Stud* 139, 144.

<sup>138</sup> Brenda Hannigan, ‘Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director’ (2011) 23 *SALJ* 714, 723 fn (55); P. J. Millett, ‘Equity’s Place in the Law of Commerce’ (1998) 114 (Apr) *L Q R* 214, 222-223; Sarah Worthington, ‘Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae’ (2013) 72(3) *C LJ* 720.

<sup>139</sup> Peter Watts, ‘the Transition from Director to Competitor’ (2007) 123(Jan) *L Q R* 21, 23.

<sup>140</sup> The C.A. 2006, s.175.

<sup>141</sup> The C.A. 2006, ss.176-177. *Item Software v Fassihi* [2004] EWCA Civ 1244 (CA), [2005] 2 *BCLC* 91 [41]. See also Rebecca Lee, ‘Rethinking the Content of the Fiduciary Obligation’ 3 (2009) *CONV P L* 236, 236. See also Michele Havenga, ‘Analyses/Analyses Breach of Directors’ Fiduciary Duties: Liability on What Basis?’ (1996) 8 *S Afr Mercantile L J* 366, 373-374; Robin MacDonald, ‘The Companies Act 2006 and the Directors’ Duty to Disclose’ (2011) 22(3) *I C C L Rev* 96, 100; Rebecca Lee, ‘Rethinking the Content of the Fiduciary Obligation’ 3 (2009) *CONV P L* 236; Sarah Worthington, ‘Corporate Governance: Remedying and Ratifying Directors’ Breaches’ (2000) 116 *L Q R* 638, 663.

<sup>142</sup> See the C.A. 2006, s.172.

<sup>143</sup> Brenda Hannigan, ‘Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director’ (2011) 23 *SALJ* 714, 723 fn(55).

<sup>144</sup> [2004] EWCA Civ 1244 (CA), [2005] 2 *BCLC* 91.

<sup>145</sup> *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), [2012] 2 *BCLC* 369 [193] (Newey J).

<sup>146</sup> See the C.A. 2006, s.174.

<sup>147</sup> See *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 *BCLC* 598 (CH) [89]. See also Andrew Key, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 2, para 1.5.

rather than with the concepts of a director's loyalty or honesty. S.178(2) of the C.A. 2006 implicitly excludes this duty from the fiduciary function<sup>148</sup> by stating:-

The duties in those sections<sup>149</sup> (with the exception of section 174 (duty to exercise reasonable care, skill and diligence) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.

The aforementioned classification of the fiduciary and non-fiduciary duties is non-existent in Iraqi law. For instance, Art.120 of the I.C.A. 1997, in one of its provisions, *subordinates* the duty to act in the company's interests to the duty of care.<sup>150</sup> Likewise, Art.17(6) of the P.B.A. 2004 *conflates* these duties by requiring a director, in pursuing the company's interests, to act in "the best interests" of the bank, which is a requirement connected with the duty of care.<sup>151</sup> While the above conflation and its legal effects will be discussed extensively in Chapter 3,<sup>152</sup> it can be said that, in this stance, the provisions of Iraqi law, by virtue of the above conflation, reflect the absence of the concept of fiduciary duty in the legislator's mind.

#### **2.2.3.4 A Director Owes his Duty to the Company**

This characteristic can be gleaned from reviewing the provisions of Iraqi law: for example, (A) Art.117 of the I.C.A. 1997 provides that 'the board of directors shall handle the necessary administrative, financial, planning, organizational and technical duties for running the company's businesses. (B) Art.117(Sixth) of this Act empowers a director to 'prepare statistical studies with the view to developing the company's business'. (C) Art.120 of this Act states that 'the chairman and members of the board of directors shall do their best to serve the interests of the

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<sup>148</sup> Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 SALJ 714, 723.

<sup>149</sup> Namely the duties that are enumerated in ss.171-177.

<sup>150</sup> This Article states that:-

The chairman and members of the board of directors shall do their best to serve the interests of the company as they would serve their own personal interests, and run the company in a sound and legal manner...

<sup>151</sup> For more details of these points see Chapter 3 of this thesis, Section 3, para 3.3.1.

<sup>152</sup> See this Chapter Para 3.2.2.

company as they would serve their own personal interests'. (D) Art.17(6) of the P.B.A. 2004 also provides that 'the members of the board of directors shall act ... in the best interests of the bank'. (E) More generally, Art.48(1) of the Civil Code 1951 provides that 'every legal person shall have representative to express of its will'.

The above provisions indicate implicitly that a duty is owed to the company. The company alone is entitled to enforce the duty against the director. It will do so in its own name and on its account, rather than on behalf of the shareholders or stakeholders.

This inference is consistent with the legal and pragmatic considerations of the independence of the legal person from its founders (its members) and the rules of agency.<sup>153</sup> Moreover, this result is crucial for maintaining the concept of the legal person,<sup>154</sup> and protects a director from an increase in the amount of litigation instigated by dissatisfied shareholders regarding decisions taken.<sup>155</sup>

This approach is consistent with the neoclassical approach of English common law, which crystallized after the leading case of *Percival v Wright*,<sup>156</sup> and was enhanced by subsequent authorities<sup>157</sup> and legal commentators.<sup>158</sup> It then became

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<sup>153</sup> Mark Hsaio, 'A Sprouting Duty of Honesty and Loyalty? Companies Act 2006' (2009) 20(9) I C C L R 301, 303.

<sup>154</sup> Kelli A. Alces, 'Debunking the Corporate Fiduciary Myth' (2009) 35(2) J Corp L 239, 245; Davy Ka Chee Wu, 'Managerial Behaviour, Company Law, and the Problem of Enlightened Shareholder Value' (2010) 31(2) Comp Law 53.

<sup>155</sup> Paul L. Davies, Sarah Worthington and Eva Micheler, *Gower and Davies' Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 480, para.16-5.

<sup>156</sup> [1902] 2 Ch 421, 426 (CH) (Swinfen Eady J).

<sup>157</sup> *Multinational Gas and Petrochemical Co. v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258, 280 (CA) (May L.J); the New Zealand case *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 3 All ER 404, 240; *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), [2012] 2 BCLC 369 [199]. In *Dawson International plc v Coats Patons plc* [1989] BCLC 233, 243 (OC), Lord Cullen has emphasised on the fact that:-

It is well recognised that directors owe fiduciary duties to the company. Thus, the directors have the duty of fiduciaries with respect to the property and funds of the company ...when discharging their functions the directors are under a fiduciary duty to the company to have regard to inter alia the interests of members and employees. These fiduciary duties spring from the relationship of the directors to the company, of which they are its agents...The directors are not normally the agents of the current shareholders ... Directors have but one master, the company.

<sup>158</sup> John Birds and others, *Boyle & Birds Company Law* (8<sup>th</sup> edn, Jordans publishing Ltd 2011) 491, para 16.3; Paul L. Davies, Sarah Worthington and Eva Micheler, *Gower and Davies' Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 479, para 16-4; Paul Davies, *Introduction to Company Law* (2th edition, OUP 2010) 147; Nicholas Bourne, *Bourne in Company Law* (5<sup>th</sup> edn, Cavendish Publishing Ltd 2011) 168-189, Para.12.2; Richard Slynn,

one of the foundations of English company law. S.170(1) of the C.A. 2006 reiterated the common law by stating that ‘the general duties specified in sections 171 to 177 are owed by a director of a company to the company’.

On the other hand, the I.C.A. 1997 involves certain provisions, later adopted by the C.P.A. in its legal reforms that suggest that a director owes his duty to shareholders rather than to a company. For example, one of the Act’s objectives is to ‘protect shareholders from conflicts of interest’,<sup>159</sup> and to ‘promote the provision of full information to owners in connection with decisions affecting their investment and their company’.<sup>160</sup> Moreover, the Act forbids the owners of capital in a company from exercising their voting rights in certain circumstances.<sup>161</sup> Surprisingly, this attitude was bolstered by Art.64 (first) of the Ministerial Order of Enforcement of the P.B.A. No.4, 2010, which deemed the directors to be ‘...the representatives of all shareholders...’.

These provisions represent a departure from the modern foundations of company law, because the company, and not the shareholders, is the owner of its assets<sup>162</sup> as a distinct legal person, separate from its members. The shareholders own specific personal rights,<sup>163</sup> stemming from their subscription to its capital. But these rights do not amount to those exercised by the owner. However these

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‘Directors’ Duties’ in Thomson Reuters Ltd, *A Practitioner’s Guide to Directors’ Duties and Responsibilities* (4<sup>th</sup>edn, 2010) 90, para 3.3; Stephen Griffin, *Company Law Fundamental Principles* (4<sup>th</sup>edition, Pearson Education publishing 2006) 313; Alistair Alcock, John Birds and Steve Gale, Alcock, *Birds and Gale on the Companies Act 2006* (Jordan Publisher 2009) 178, para 13.5; Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn, Jordan Publishing Ltd 2011) 280, para 6.12; Geoffrey Morse and others, *Charlesworth’s Company Law* (17<sup>th</sup> edn, Sweet & Maxwell, 2005) 297; Martha Bruce, *Rights and Duties of Directors* (3<sup>th</sup> edition, Tolley Publisher 2000) 33, para 4.10; A. Hudson, *A Hudson, Understanding Company Law* (first edn, Routledge 2012) 117; R.C. Nolan, ‘Enacting Civil Remedies in Company Law’ (2001)1(2) JCLS 245, 269; Sarah Worthington, ‘Directors’ Duties, Creditors’ Rights and Shareholders Intervention’ (1991) 18 Melb U L Rev 121; Michele Havenga, ‘Analyses/Analyses Breach of Directors’ Fiduciary Duties: Liability on What Basis?’ (1996) 8 S Afr Mercantile L J 366; Mark Hsaio, ‘A Sprouting Duty of Honesty and Loyalty? Companies Act 2006’ (2009) 20(9) I C C L R 301.

<sup>159</sup> Art.1(3) of this Act.

<sup>160</sup> Art.1(4) of this Act.

<sup>161</sup> See Art.4(third) of this Act.

<sup>162</sup> Dereck French, Stephen W. Mayson & Christopher L. Ryan, Mayson, *French & Ryan on Company Law* (31<sup>th</sup> edn, OUP 2014-15) 423-424, para 15.2.6.

<sup>163</sup> Robert Flannigan, ‘Fiduciary Duties of Shareholders and Directors’ (2004) JBL 277, 280; Bikramaditya Ghosh & Karmendra Singh, ‘Directors’ Duties in India: Strengthening the Laws on Trusteeship’ (2009) 20(6) I C C L R 199, 201-202.

provisions and the above traditional approach can be reconciled by saying that the emphasis of the above provisions on the shareholders is traceable to the fact that their interests represent the ultimate object of the company's endeavours. In other words, the shareholders would be directly harmed by any misbehaviour on the part of a director.

However, a director may owe his duty directly to the shareholders in some circumstances. Takeover bids, for example, require him to regard the shareholders' interests as predominant.<sup>164</sup> In transactions such as these, facts must not be concealed and the issuing of misleading or incorrect information must be avoided.<sup>165</sup> English law contains numerous rules stipulating the ways in which a director should deal with these interests, and makes it clear that, in special circumstances, a fiduciary duty may be owed to the shareholders. This requires a director 'to be honest' and imposes 'a duty not to mislead'.<sup>166</sup> In *Peskin v Anderson*, Mummery LJ emphasized that:

Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities, which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders.<sup>167</sup>

The I.C.A. 1997 encompasses provisions that presuppose the direct relationship of a director with a company's members: for example, when one shareholder offers his shares to the other shareholders for sale in a limited company,<sup>168</sup> or in the case of a sale of credit bonds.<sup>169</sup> Moreover, Iraqi legal commentators argue that a shareholder, in certain circumstances, is entitled to sue the delinquent director for

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<sup>164</sup> Justice Joseph T. Walsh, 'The Fiduciary Foundation of Corporate Law' (2002) 27 J Corp L 333, 336.

<sup>165</sup> Robert Flannigan, 'Fiduciary Duties of Shareholders and Directors' (2004) JBL 277, 294-294.

<sup>166</sup> See the dictum of Brightman J in *Gething v Kilner* [1972] 1 WLR 337, 341 (CH); *Dawson International plc v Coats Patons plc* [1989] BCLC 233, 243 -244 (OC) (Lord Cullen).

<sup>167</sup> [2001] 1 BCLC 372 (CA) [33].

<sup>168</sup> The I.C.A. 1997, Art.65.

<sup>169</sup> The I.C.A. 1997, Arts.77-84.

any prejudice to his rights according to the general principles of law.<sup>170</sup> This view, however, lacks a legal basis in the I.C.A. 1997 through the imposition of a clear duty. It is in the company's interests that the participants' interests in the firm should be given an equal, if not a greater, degree of significance than that given to the entity itself.<sup>171</sup>

#### 2.2.4 Findings of the Section

In a nutshell, scrutiny of the characteristics of Iraqi law makes it difficult to say that the statutory duties are based on a *fiduciary doctrine basis*, or even to a minimal degree on a similar notion. Studying the realities of Iraqi law does not suggest any similarity between the English and Iraqi legal systems with regard to fiduciary duty. This conclusion, as has been shown, is premised on several indicators within the Iraqi system: first, the non-mention to the term “fiduciary duty”; and the failure to use the term “duty”, gives an indicator of correctness of this inference. Second, the failure to regulate certain duties that represent the foundations of fiduciary duty under a comprehensive and comprehensible formulation. Third, there are “conflicts” between “fiduciary” and “non-fiduciary” duties. Under this status, duties that are “fiduciary” in nature are either subordinated to, or conflicted with, duties that are “non-fiduciary” in nature. Finally, it will be shown in the subsequent Chapters that the law failed to develop harsh rules that would operate to nullify any incentive for a fiduciary to violate his duty *ex ante*, which constitutes another foundation of fiduciary doctrine.

Set against this background, it is hard to impute the duties mentioned in Iraqi law to any other specific notion. Such a derivation would require the presence of an integrated legal system, covering all its aspects. This would enable the researcher to draw commonalities lines between its different aspects, converging at a certain point, namely, the conceptual framework. The current legal regulation of

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<sup>170</sup> Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 476; Mohamed Farid Arini, *the Commercial Companies* (the New House of University 2003) 266; Murtaza Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 251; Kamel Abdel Hussein Albulada & Aley Younis Al-Dabbagh, ‘The Civil Liability of the Board of Directors’ (2006)27(8) *Al-Rafidain of Rights* J 13, 49.

<sup>171</sup> For more details of this point see Chapter 3, Section 3, para 3.3.2 of this thesis. It is instructive to mention that Art.27 of the Bill of Securities Act contains a reference to this matter.



managerial duties reflects only a legislative ambition to provide the company with a certain level of protection against a director's abuse of his powers - no more, no less, and without acting to enshrining these controls with an underlying theoretical concept.

### Section III

#### Does Fiduciary Duty Have a Root in the Iraqi

#### Civil Code?

**Introduction:** As stated previously, the commercial legal system of Iraq is governed by the Commerce Act 1984 and the I.C.A. 1997. The I.C.A. 1997 does not supply any alternative rules to be invoked in cases where statutory provisions are absent. Art. 4 (Second) of the Commerce Act 1984, however, makes it clear that 'The Civil Code shall apply to all matters that are not governed by a special provision of this Act or in any other special Act.' The phrase "any other special Act" appears to refer to all Company Acts. Accordingly, the Civil Code 1951 seems to be applicable to all matters not dealt with by the I.C.A. 1997.

The Civil Code 1951 is the general law that applies to all legal relations, such as contractual relations, tort liability and rights *in rem*,<sup>172</sup> except for the civil statutes. Art.1 of the Civil Code 1951 has indicated a hierarchy of sources for the Code by stating:

1. The statutory provisions shall apply to all matters which, by their content and mode of expression, appear to be appropriate to those provisions.
2. In the absence of any applicable legislative provisions in the law the court shall adjudicate according to custom and usage; and in the absence of custom or usage in accordance with those principles of Islamic Sharia which are most consistent with the provisions of this

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<sup>172</sup> For more details about the content and the structure of this law in English literature: see Dan E. Stigall, 'From Baton Rouge to Baghdad: A Comparative Overview of the Iraqi Civil Code' (2005) 65 La L Rev 131; Dan E. Stigall, 'Iraqi Civil Law: Its Sources, Substance, and Sundering' (2006) 16(1) J Transnat' l L & Poly 1; Dan E. Stigall, 'A Closer Look at Iraqi Property and Tort Law' (2008) 68 La L Rev 765.

law, without being bound, however, by any specific school of thought; and otherwise in accordance with the rules of equity.  
3. The courts shall be guided in all the foregoing by adjudications determined by the judiciary and the jurisprudence of Iraq and by those of other countries in which the laws are consonant with Iraqi laws.

The above provision gives precedence to statutory provisions. Other sources are regarded as secondary, and are to be applied only when no statutory provision exists for the resolution of a particular case. Accordingly, the focus of this section will be on the primary source of Iraqi law, namely the statutory provisions of the Civil Code 1951 in relation to this issue.

It is worth mentioning that the Civil Code 1951, like the Company Acts, does not delineate a general rule for providing a vulnerable person with legal safeguards against any potential abuse. The commentators of this law do not use the term “fiduciary duty”. Instead, the Code regulates numerous relations that have a *prima face* similarity to the fiduciary concepts of English law. These are: illegitimate enrichment, fraud, agency, trust, and the exploitation and abuse of rights.

The motive for the investigation of these doctrines is to explore the extent to which each of them has similarities to the concept of fiduciary duty, and so to discover a basis for fiduciary duty in Iraqi law. Needless to say that the identification of the doctrine underpinning the concept of managerial duty has a considerable legal significance in bridging the gap in the statutory provisions by resorting to this general concept.

### **2.3.1 Agency Rules**

Some commentators on Iraqi law argue that a director’s relationship with his company is inherent in the agency contract set out in the Civil Code 1951.<sup>173</sup> They

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<sup>173</sup> See Arts.927-949 of this Act. See also Ahmed Ibrahim Al-Bassam, *The Commercial Companies in Iraqi Law* (Second edn, Al-Zammaan publisher 1967) 187; Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 476; Murtaza Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 251; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 71, para 41.

claim that the fiduciary duties set out in this Act form the basis for the fiduciary concept in Iraqi law. It has been shown in section one of this Chapter<sup>174</sup> that a director's powers represents a fertile land for applying the fiduciary duty, because this relationship furnishes him with a leeway to exercise wide discretion over the interests of the principal. This status may support the argument that agency relationship, as a basis of a director's relationship with his company, could be a basis for managerial duties under Iraqi law.

However, it should first of all be said of this theory: it has not gained a consensus among Iraqi legal commentators from the hand, and it has also been criticized on the grounds of its futility from the other hand.

Doubts of various kinds have been expressed about the correctness of the assumed relationship mentioned above. Firstly, it has been said that the directors' duty stems directly from the provisions of the law and so is governed by tort liability rather than by clauses of the contract.<sup>175</sup> A further objection is based on the nature of Iraqi Company Law, which imposes mandatory provisions and leaves no room for the regulation of agency contracts.<sup>176</sup> Moreover, the company, as a legal person, lacks a real will to conclude this contract, since a director will represent the wills of two parties in the contract. In addition, the I.C.A. 1997 did not support this proposition explicitly, in contrast to the Commercial Companies Act 1957, which had referred to this matter explicitly.<sup>177</sup>

Furthermore, the contract-based approach has become more tenuous in the light of recently enacted legislation that endows State bodies with a broad authority to control companies that fall under its jurisdiction. This amounts to a capacity to remove directors without the need to obtain the company's approval.<sup>178</sup> This strict

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<sup>174</sup> See paras 2.1.1, 2.1.3 of this Section.

<sup>175</sup> Ali Gamal Al-Deen Awadh, *The Commercial Companies* (the House of Arabic Renaissance 1961) 202-203, para 230; Aziz Al-Khafaji, *the Commercial Companies* (The Culture House 2007) 300; Kamel Abdel Hussein Albulada & Aley Younis Al-Dabbagh, 'The Civil Liability of the Board of Directors' (2006)27(8) *Al-Rafidain of Rights* J 13, 29.

<sup>176</sup> See Dr. Mowafaq Hassan Raza, *the Company Law: Its Goals, Basis and its Content* (the Legal Research Centre 1985) 144.

<sup>177</sup> Art.150 of the Commercial Companies Act No.31 1957 (repealed) was stated that a director's liability is subject to the rules governing the agent and the trustee under the Civil Code 1951.

<sup>178</sup> The I.B.R.A. 2005, Art.47 (Second-F); the P.B.A. 2004, Art.56 (1-J).

oversight is contrary to the time-honoured rule laid out in the Civil Code 1951 which gives a principal the exclusive right to cancel the agency contract.<sup>179</sup>

Given the foregoing, the author supports view, that the I.C.A. 1997 does not uphold the contractual basis for a director's relationship with his company. It is therefore suggested that a director/ company relationship is based on the concept of legal representation of a company by the director by operation of law<sup>180</sup> rather than by contract, which inevitably attracts the application of tort liability for the redress of directorial abuse. However, agency rules under the Civil Code 1951 did not spell out the fiduciary duty applicable to a director by analogy.<sup>181</sup> This is due to the principle expressed by the Civil Code 1951 that the agent in exercising his powers is often acting as a volunteer (unless of course he receives remuneration),<sup>182</sup> and it is illogical to subject the volunteer to strict rules. This is in contrast to the fiduciary duty which is applied to a director in a harsh manner, as it will be shown in the subsequent Chapters. This theory therefore does not provide an appropriate basis for a fiduciary doctrine under Iraqi law.

### 2.3.2 The Illegitimate Enrichment Doctrine

According to this source of obligation, any person who obtains a benefit from another person without having any other legal relationship with him (a legitimate reason)<sup>183</sup> becomes bound to compensate the latter for loss occurred as a result of this illegitimate enrichment.<sup>184</sup> It may be said that fiduciary duty is inherent in this theory on the basis that the result of any breach of duty is the acquisition of a benefit, which in itself constitutes an illegal enrichment.

This theory appears *prima facie* to resemble unjust enrichment as a theory mooted in order to justify the imposition of a fiduciary doctrine. It is therefore subject to

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<sup>179</sup> Art.947 of this Code.

<sup>180</sup> In this context, Art.48(1) of the Civil Code 1951 necessitates that every legal person must appoint its representative for expressing of its will.

<sup>181</sup> See Art.3 of this Code.

<sup>182</sup> The Civil Code 1951, Art. 940(1).

<sup>183</sup> The legitimate reason means: any obligation that arises from a contract, tort or provisions of law to be the basis of a person's liability.

<sup>184</sup> The Civil Code 1951, Art. 243.

the same criticisms as those made previously.<sup>185</sup> In particular, the Iraqi doctrine aims to achieve a *restitutionary* purpose. Under a fiduciary duty, however, the damage is “irrelevant”, since the focus is on addressing the threat to company’s interests *ex ante*, rather than providing compensation to the aggrieved.<sup>186</sup> Moreover, the absence of a legal relationship between the concerned parties is a condition for applying the enrichment theory under Iraqi law. It has been demonstrated above, however, that in Iraqi law there must be at least a legal relationship between the director and his company. Therefore, this principle seems irrelevant to the question whether fiduciary concept is a feature of Iraqi law.

### 2.3.3 Fraud Rules

Under the Civil Code 1951, fraud is one of the defects of the will arising at the concluding stage of the contract. It involves the use of deceptive methods employed to mislead the counterpart and motivates the latter to accept the conclusion of a contract from which the fraudster will obtain an illegitimate benefit.<sup>187</sup> To apply the rules of fraud, the plaintiff must establish not only the fraudulent actions practiced by the counterpart; he must also establish that he incurred grievous loss in the impugned transaction by receiving a value less than he deserved, or by paying a value higher than that which he should have paid.

This doctrine is however disqualified from being the basis of managerial obligation, because the notions of fraud and grievous damage are ingredients irrelevant to fiduciary duty, which are applicable even to a *bona fide* director.<sup>188</sup>

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<sup>185</sup> See this Chapter, para 2.1.3.5.

<sup>186</sup> For more details of this issue see Chapter 4, para 4.1.2.

<sup>187</sup> For more details about this theory in Iraqi law see Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 58; Professor Hassan Ali Al-Znon, *The General Theory of the Obligations* (Al-Sanhoori Publisher 1976) 99; Professor Aziz Karim Jaber Al-Khafaji, ‘Is the Unfairness a Defect in the Consent itself or in the Contract Itself’ (2009) 1 Al-Kufa Magazine for legal Political Science 15, 37-43; Yacoub Sarkhoh, ‘The Manger of Limited Liability Company under Kuwait Commercial Companies Law: A Comparative Study’ (1990) 5 Arab L Q 163, 197.

<sup>188</sup> In this context see *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144 (HL) (Lord Russell).

The narrow scope of this doctrine, however, does not preclude its applicability to a director who has failed to declare his interests in a deal concluded with the company, as the mere concealment of fact may be tantamount to fraud.<sup>189</sup>

### 2.3.4 The Trust (or Deposit) Contract

Trust is a legal position under which a person (the bailee) is obliged to receive a property from another person (the depositor) for the purpose of maintaining its physical safety for a period of time and then restoring to its former status.<sup>190</sup> This definition includes company property received into the director's hands.<sup>191</sup> So, it is could be arguable that trust is the basis of fiduciary duty.

However, the concept of trust under Iraqi law differs from the concept of trust under English law, as the latter gives the trustee broad powers akin to those vested in the owner. While the obligation of the trustee (bailee) under Iraqi law is confined to physical safeguarding of the property in question, rather than conferring upon him any further powers. The Civil Code 1951 merely gives the trustee a personal obligation to physically protect the company's property. Also the Civil Code 1951 does not subject the trustee to strict rules, as is the case under English law. Given that the Civil Code 1951 generally perceives the trustee as a volunteer, it would be irrational to subject him to harsh liability, unless the deposit contract is one of *quid pro quo*, as in the case of a director who often receives remuneration.<sup>192</sup> Moreover, the trust theory covers only that part of a director's duties which involves his physical dealing with company property, whereas a director's role requires him to safeguard all the interests of the firm, both physical and intangible.

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<sup>189</sup> For more elaboration for this theme see Chapter 7 of this thesis, para 7.2.2.

<sup>190</sup> Art.950 of the Civil Code 1951 defined the trust as: any 'property which comes into the hands of someone with the permission of its owner, actually or impliedly, and for a purpose other than owning it. This may happen under a contract like a trust or within a contract, such as rent'. It is worth noting that the depository may arise incidentally without a prior agreement between the trustee and the beneficiary. See the Civil Code 1951, Art.950(1).

<sup>191</sup> See the Civil Code 1951, Art.950.

<sup>192</sup> See the I.C.A. 1997, Art.102 (Ninth).

### 2.3.5 The Exploitation Doctrine

This is one of the will defects that expresses the exploitation by the counter party of vulnerability on the part of a contractor. Art.125 of the Civil Code 1951 addressed this defect by imposing civil consequences on the contracting party in situations where:

...advantage was taken by the contracting party of need, rashness, desires (cravings) weakness of perception or inexperience. In cases where the contract has resulted in grievous injury to him, he [the injured party] is entitled within one year from the date of contract to demand the reduction of the injury to a reasonable degree...<sup>193</sup>

This theory views fiduciary duty in the context of an unbalanced power relationship, whereby the vulnerability of one person is exploited by another, more powerful person.<sup>194</sup> It can be said that a dishonest director is in the position of someone who exploits a vulnerable person (in this case the company), by taking advantage of the inexperience of company members in matters of trade and management in order to achieve a benefit for himself.

It is not difficult to refute the above theory by means of the following arguments. First, assuming that the relationship between a director and his company is a contract-based relationship, the application of the principle of this theory is confined to clauses of the contract under which the exploitation can be shown. While the exploitation by a fiduciary may take place outside a contractual framework. Second, the remedial nature of this principle remains a stumbling block to its adoption as the basis of a fiduciary duty, since Art.125 of the Civil Code 1951 cannot be applied without proof of grievous damage.

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<sup>193</sup> [Emphasis added].

<sup>194</sup> Hassan Ali Al-Znon, *The General Theory of the Obligations* (Al-Sanhoori Publisher 1976) 105.

### **2.3.6 The Doctrine of Abuse of Rights**

Under the Civil Code 1951, a person exercising his own rights must not abuse the rights of others. Art.7 of the Civil Code 1951 has articulated this doctrine by stating:

1. He who exercises his right in an impermissible manner shall be liable.
2. The exercise of a right becomes impermissible in the following cases:-
  - (a) Where such exercise is intended to cause injury to a third party.
  - (b) Where the benefits sought from such exercise are insignificant such as it will be not at all be proportionate to the injury caused thereby to a third party.
  - c) Where the benefits to be obtained are unlawful.

It is not difficult to refute the exploitation doctrine on the grounds that it links with the abuse of rights rather than with the abuse of powers, as is the case with a fiduciary doctrine. It is a self-evident that the exercise of powers must be made according to a principal interest, rather than according to an absolutist right. However, this theory is applicable when a right is exercised with a view of facilitating the abuse of directorial office. For example, where a director uses the right of resignation to shield himself from the liability for exploiting a corporate opportunity.<sup>195</sup>

### **2.3.7 Findings of the Section**

A review of the above doctrines of civil law reveals that it is hard to find any principle in Iraqi law that can be reckoned either as the basis of managerial duty or as involving even the minimal attributes of fiduciary duty. This difficulty stems from the fact that the principles of Iraqi Civil law are premised on compensation (restitution). It requires compensation to be communicated to the aggrieved, but

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<sup>195</sup> See Chapter 4, para 4.3.2 of this thesis.



does not lay down rules to address the potential threat to the interests of a company, as the vulnerable person in an unbalanced relation. A fiduciary duty is premised on a subjective tendency. It focuses on confronting the potential threat to the principal's interests, with redressing its consequences being a consequence of the breach but not the sole focus. This point renders the doctrine distinct from those fixed under the Iraqi civil law.

In the above discussion<sup>196</sup> of Iraqi Company Law and special statutes relating to companies' affairs, references were made to some facets of fiduciary duty, although there is no established conceptual framework for a fiduciary doctrine or its equivalent in Iraqi law. Furthermore the Civil Code 1951 fails to include this doctrine among its general principles.

Since Iraqi law has not embraced a general doctrine that operates to restrain the director's abuse of his powers, the only way to shield a company from directorial abuse is by resorting to the statutory provisions of Iraqi law intended for that purpose. However, it will be shown in subsequent Chapters that the provisions of the Company Acts are incapable of exercising a deterrent role in restraining a director from the abuse of his powers. The author is of the view that the statutory obligations imposed by legislation in this context lack the capacity to deal with all future contingencies, no matter what degree of sophistication has been employed in drafting these provisions. Therefore the incorporation of a comprehensive conceptual framework for the regulation of managerial duties is indispensable if the intrinsic deficiencies of the statutory provisions are to be addressed.

But would it be possible to transplant the fiduciary duty concept into a civil law jurisdiction such as that of Iraq? It has been argued, for example, that equity principles, as the source of fiduciary duty, give a court sufficient flexibility to scrutinize the facts of a case and reach a fair judgment without being restricted by the onerous conditions imposed by the common law.<sup>197</sup> Equity offers a number of techniques for achieving this goal. For example, the onus of proving the breach can be shifted from the plaintiff to the defendant, giving the plaintiff a remedy for

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<sup>196</sup> See Section two of this Chapter.

<sup>197</sup> Namely, fault, damage and causation link, which will be tackled in-depth in Chapter 4, para 4.1.2.

the breach of a duty that cannot be granted to him under the common law.<sup>198</sup> The present researcher has reached the conclusion that any jurisdiction lacking Equity sensitivity, such as is the case in civil law countries, will confront insuperable difficulties in applying the principles of fiduciary duty<sup>199</sup> since equity rules are unworkable in those jurisdictions.

Other scholars<sup>200</sup> go beyond the above view and deny the possibility of transplanting this duty into civil law jurisdictions, whatever generality is used in order to formulate the duty. According to this view, such a formulation could lead to a diminution of the activities that a director is permitted to exercise. Such an outcome would be harmful to the general economy and thus to the welfare of society. If such an approach were adopted the court would be *unlikely* to play the role of lawmaker, because its function is to settle any dispute brought before it rather than to formulate new legal principles.<sup>201</sup> In this context, Art.2 of the Civil Code 1951 states that ‘no discretion is permissible in cases where there exists an explicit provision.’ Therefore, the deficiency of Iraqi law is, as has been shown above, is that the statutory provisions might not be capable of prohibiting certain harmful activities to the company. The reason for this is that certain forms of behaviour, unforeseeable at the time when the legislation was enacted, would be exempted, despite such behaviour being potentially harmful to the interests of a company.<sup>202</sup>

With respect, the above views involve an exaggeration. The transplantation of fiduciary doctrine into Iraqi law is not impossible. It has previously been mentioned<sup>203</sup> that Iraqi courts are not foreclosed from resorting to equity principles, nor are they forbidden from invoking the adjudications of the courts in certain other jurisdictions. In this context, Art.1 (3) of the Civil Code 1951 empowers the court to resort to the adjudications of other countries, but only when ‘its laws converge with Iraqi laws’.

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<sup>198</sup> Rebecca Lee, ‘Fiduciary Duty without Equity: “Fiduciary Duties” of Directors Under the Revised Company Law of the PRC’ (2007) 47(4) Va J Int'l L 897, 910-913.

<sup>199</sup> Ibid, 924-925.

<sup>200</sup> Katharina Pistor & Chenggang Xu, ‘Fiduciary Duty in Transitional Civil Law Jurisdictions’ (2002) <[www.wcgl.org/wp](http://www.wcgl.org/wp)> accessed 8 September 2013, 5.

<sup>201</sup> Ibid, pp.5, and 33-35.

<sup>202</sup> For more detail of this view see *ibid*, pp 5, 33-35.

<sup>203</sup> See the Civil Code, Art.1(2) which has been cited in the introduction of this Section.

On the other hand, the Iraqi Evidence Act 1979, emphasised on ‘broadening the judge’s power in directing the litigation and all its related evidences to ensure a sound application of law rules for reaching to a fair judgment in the concerned case’.<sup>204</sup> It could be argued that this provision confers on the courts a leeway to exercise their discretion for addressing the director’s opportunism. This provision implies also that the discretionary power of the court is inherent even in the civil law jurisdictions. This discretion is attributable to the fact that a judge in any legal system is bound to exercise his discretion in contentious cases in order to reach a fair judgment.

The prospective role of the court in a civil law jurisdiction such as Iraqi law, would depend on a successful implanting of the general framework of fiduciary doctrine into this law. This general principle gives the court the discretion to act within its framework. In this way the court would be guided by the explanations provided by legal provisions<sup>205</sup> and also equity principles and knowledge gleaned from the laws of civilized nations and their experience in this area of law. This general framework, however, is currently absent from Iraqi law. Given that the C.P.A. in its reform to the I.C.A. 1997, did not realize the substance of the problem, namely: incorporating the conceptual framework of managerial duty into the law, the overhaul took the shape of superficial amendments.

It could be argued that an attempt to transplant this concept into civil law is irrational, because it covers activities that are benevolent (*gratis*) in a way that is incommensurate with the harshness of fiduciary duty. Therefore, it is argued, it would be more appropriate to transplant this duty into commercial company law, in order to maintain the honesty of dealers in the commercial environment.

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<sup>204</sup> The Evidence Act No.107 1979, Art.1.

<sup>205</sup> This approach has been espoused by the C.A. 2006, ss.175, 177.

## **Conclusion**

The English concept of fiduciary duty is a powerful means of preventing the divided loyalty of a director. A director is placed under an obligation to pursue a company's interests exclusively, and to avoid placing himself in a position of conflict between his interests and his duty. This equitable concept is intended to protect the vulnerable person in this relationship (i.e., the company) from the abuse of a fiduciary.

Ensuring the existence of this concept in any legal regime suffices to shield a company from abuse by a fiduciary of his position, because the generality of the concept allows it to redress any pertinent inadequacies or "gaps" in the relevant statutory provisions.

The fiduciary concept, however, is an elusive one. Various attempts at definition have been proposed by means of identifying the circumstances that engender this duty. These include trust, reliance, power and discretion, unfair enrichment, and so on. All these attempts have failed to find an integrated definition of this doctrine, because each of them has focused on one aspect of the fiduciary relationship. It is suggested in this regard to combine all of these theories, since each of them illustrates an aspect of the environment that serves to trigger this duty.

An investigative attempt has also been made to find the roots of fiduciary duty in the I.C.A.1997, and this project also considered other Iraqi legislation relevant to company affairs. It was shown that these pieces of legislation contained a partial codification of certain aspects of fiduciary duty, but did not necessarily reflect a clear understanding of the concept.

Exploring the characteristics of company law reinforced the above argument concerning the non-existence of this concept, as a widespread concept, in Iraqi law. One of these characteristics is that the statutory provisions of Iraqi law are

insufficiently flexible to allow a transplanting the fiduciary duty by means of agreements outside the framework of these mandatory statutes.

Moreover, there is no mention of certain important aspects of fiduciary duty in Iraqi law, such as the duty to avoid a conflict of interests and the duty to avoid accepting a benefit or secret profits from a third party. Finally, the statutory provisions of Iraqi company law failed to make the distinction found in English law between fiduciary and non-fiduciary duties (such as the duty of care).

All these indicators mark the absence of fiduciary duty as a general notion in the collective mind of the Iraqi legislature when it prescribed managerial duties. Similarly, the C.P.A., during its reform of the I.C.A. 1997, paid no regard to the transplantation of the fiduciary doctrine into Iraqi law. Therefore, instead of becoming a new legal conception, the reform adopted a policy of superficial and partial treatments without impinging upon the substance of the problems surrounding Iraqi law.

Likewise, all attempts to find an approximate equivalent to fiduciary duty in the Civil Code 1951, revealed of the degree of asymmetry between Iraqi and English legal notions in this regard. This divergence is attributable to the fact that the rules of civil law have been designed for compensatory (restitutionary) purposes, rather than to confront the threat to the interests of the vulnerable person in an unbalanced relationship, such as that of a company's relationship to its director (the approach of English law). This reality reinforces the argument that the fiduciary doctrine is a *sui generis* doctrine, which is not a readily acceptable feature of civil law jurisdictions.

The above investigation leads to the final conclusion that the notion of fiduciary duty does not exist currently in Iraqi law. For this reason, attention must turn to the statutory provisions in order to address the problem of divided directorial loyalty.

But the situation does not preclude the possibility of successfully transplanting this concept into Iraqi law. Any plan of reform would benefit from the adoption of the following suggestions. First of all a general framework of this conception should be drafted for inclusion among the relevant legal provisions. The principles of

equity should be the main source for the regulation of managerial duties, so as to bridge any gap that may be discovered in the statutory provisions. Moreover, it is crucial to take advantage of the judicial experience of other civilized countries. English law would serve as a steady and well-developed guide for Iraqi courts in this regard.

Ensuring the existence of this concept in Iraqi law, it is suggested that the following Article should be incorporated into the I.C.A. 1997. The proposed Article includes all persons who have power and discretion over a company's interests, as follows:-

**Art.1: The Fiduciaries:**

1. A Director is a fiduciary on a company's interests in accordance to his duties as set forth in statutes or in the company's Articles, including those set out in the following Articles.<sup>206</sup>
  
2. The foregoing sub-paragraph applies also to a company's auditors, liquidators, receivers and every other employee who has power and discretion over the company's affairs, subject to the necessary adaptations to these duties to be appropriate with the particular nature of their position.
  
3. The following fiduciary duties are owed by the fiduciary to the company, unless the law states otherwise, or unless it is discerned from the circumstances that a certain duty is owed by the fiduciary to a company's members or to other persons.<sup>207</sup>

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<sup>206</sup> The managerial duties will be mentioned subsequently in the end of the following Chapters, which are: the duty to avoid conflict of interests, its applications; the duty to declare an interest in a transaction to be concluded with a company.

<sup>207</sup> There is no provision in Iraqi law that explicitly refers to that a director must owe his duty to the company, or that a certain duty may be owed in certain circumstances to other persons, such as the company's creditors.

4. In the case of the absence of a statutory provision applicable on the dispute the court shall resort to the equitable principles and the adjudications of the courts of common law.<sup>208</sup>

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<sup>208</sup> This proposed paragraph in contrast to Art.1 of the Civil Code 1951, which gives primacy to the custom, and Islamic jurisprudence in the case of the lack of statutory provision for settling a certain dispute. The proposal gives to the common law the priority over the other sources of law, because this source of the law will be, in the case of the codification of fiduciary duties in Iraqi law, the historical source of Iraqi law.

## Chapter Three

### The Director's Duty to Act in the Interests of the Company

Introduction: It is a time-honoured rule under English law that a director must act solely in his company's interests. This duty, in the pre-enactment of the C.A. 2006, has been described as the "fundamental duty",<sup>1</sup> (or the "central obligation"<sup>2</sup>), because it binds a director to furthering the interests of his company as the sole interest. This leads inevitably to avoidance of being swayed towards another interest. Moreover, the broad concept of this duty<sup>3</sup> means that it embraces all misconduct<sup>4</sup> that may not fall within the scope of other duties (e.g., the duty to avoid conflict of interests,<sup>5</sup> or the duty to declare an interest in a transaction<sup>6</sup>). For the above reasons, this rule is often considered as a synonym for the concept of loyalty.<sup>7</sup>

However, s.172 of the C.A. 2006 has replaced the rule stated above, by imposing the following duty: 'a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole...'. This Section points to shareholders and other stakeholders as interests that must be taken into account by a director. In effect, the above section offers a route map to be followed by a director wishing to avoid incurring liability, because it clarifies what is expected from him in performing his duty.<sup>8</sup>

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<sup>1</sup> *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 (Arden LJ); *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch), [2007] FSR 15 [132]. See also: John Birds and others, *Boyle & Birds Company law* (8th edn, Jordans Publishing Limited 2011) 634.

<sup>2</sup> Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan in Company Law* (29th edn, OUP, 2012-2013) 484, para 16.6.1.

<sup>3</sup> See the coming discussion of this concept in Section one, para 3.1.2 of this Chapter.

<sup>4</sup> Brenda Hannigan 'Reconfiguring the no Conflict Rule: Judicial Strictures, a Statutory Restatement and the Opportunistic Director' (2011) 23 SAclJ 714, 725.

<sup>5</sup> The C.A. 2006, S.175.

<sup>6</sup> The C.A. 2006, S.177.

<sup>7</sup> For more details about this conflation, see Section 1 of this Chapter.

<sup>8</sup> Clark W. Furlow, 'Good faith, Fiduciary Duties, and the Business Judgment Rule in Delaware' (2009) Utah L Rev 1061, 1069.



By contrast, Art.120 of the I.C.A. 1997 refers to a director's duty to act in the company's interest *within the context of the duty of care*. It will be demonstrated throughout this Chapter that Art.120 of the I.C.A. 1997 did not impose on a director a clear and independent duty *to foster the company's interests* which he was appointed to pursue. It also did not clarify for him *how to deal with the conflicting interests* in the company, namely: the interests of shareholders and stakeholders. This finding is built on the following factors: First, conflating the duty to act in the company's interests with the duty of care renders the law less comprehensible by the director and leads to irrational results. For instance whether the principle of good faith or bad faith must be considered as an element in discharging these distinctive duties. Secondly, the interests of the stakeholders have not been embraced by this Article, in spite of its significance in promoting the company's interests, and in solving conflicts of interests between participants in its activities. Consequently, the above status quo reflects an absence of an obvious obligation that would bind a director to pursue only a company interests.

The above elements, namely: the principle of good faith and a company's interests, are ingredients that shape the duty, and that will be the subject of the coming sections of this Chapter. But above all, it is desirable, at the outset, to explore the concept of loyalty, and its presence in Iraqi law. Tackling a director's loyalty, which seems *prima facie* similar in its concept to the above duty, is crucial not only to distinguish it from the duty to act in the company's interest, but also to highlight its legal significance.

## Section 1

### The Concept of Loyalty and its Attributes

**Introduction:** A director's loyalty to his company is a principle that is widely utilised by English law to a degree that it is sometimes be considered as a synonym for the duty to act in a company's interests.<sup>9</sup> Arden L J, for example, in *Item Software (UK) Ltd v Fassihi*, conflated the concept of loyalty with the duty to act in the interests of the company, and rendered the latter duty as if it were a synonym to the former principle by stating that:-

...I prefer to base my conclusion in this case on the fundamental duty to which a director is subject, that is the duty to act in what he in good faith considers to be the best interests of his company. This duty of loyalty is the 'time-honoured' rule...<sup>10</sup>

By contrast, the Iraqi Companies' Acts, and the C.A. 2006 have not utilized the terms "loyalty", "fidelity" or "undivided loyalty", in spite of their legal significance in determining the extent of a director's adherence with a company's interests. This matter raises the question of whether these concepts are to be found in Iraqi law, and if so, what are their attributes? Can loyalty concept be considered as a synonym for the duty to act in a company's interests under Iraqi law? Or does it imply a different notion?

#### 3.1.1 The Concept of Loyalty in Iraqi Law: An Absent-Present Connotation?

As mentioned, Iraqi law does not use the term "loyalty" in the Companies' Acts, and for this reason legal commentators and the courts do not pay attention to it.<sup>11</sup> This

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<sup>9</sup> John Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure' (2009) 68(3) C L J 607; Martin Day, 'Fiduciary Duties' (2009) 15(6) *Trusts & Trustees* 447, 448; Sarah Worthington, 'Directors Duties, Creditors' Rights and Shareholders Intervention' (1991) 18 *Melb U L Rev* 121; Nicholas Bourne, *Bourne in Company Law* (4th edn, Routledge publishing 2008) 179, para12.7.

<sup>10</sup> [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 [41]. In English literature see Stephen F. Copp, 'S.172 of the Companies Act 2006 fails People and Planet' (2010) 31(12) *Comp Law* 406.

<sup>11</sup> See for example: Mowafaq Hassan Raza, the *Company Law: it's Goals, Basis and its Contents* (the Legal Research Centre 1985) 144; Bassem Mohammed Saleh & Adnan Ahmed Walee AL-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 247; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Mustansiriya University 2008) 125-126.

absence could be attributed to the fact that the concept is the brainchild of Anglo-Saxon law, which bears little direct comparison to many Arabic Civil law jurisdictions.<sup>12</sup>

But despite the absence of references to this concept in Iraqi law, it may be found to exist within the concept of legal representation. The notion of representation is premised on the notion under which ‘... a person constitutes another person in his position to carry out a definite legal disposition’,<sup>13</sup> with the understanding that it cannot be conceived that the person could betray himself, nor act in a manner contrary to his own interests. The legal representative should be understood to bear the same attributes, because the law placed him in the same legal status as the principal. Thus the provisions of the Iraqi Companies’ Acts, by virtue of their mention of the duty to act in the company’s interests and to prevent multiple directorships, or competition with the firm, may serve to endorse this argument.<sup>14</sup>

However, by contrast, the absence of any reference to loyalty may lead to a contradiction between different legal principles. The I.C.A. 1997 gives Iraqi nationality to a company which is incorporated in Iraq.<sup>15</sup> Such recognition implies that a company should be loyal to the country.<sup>16</sup> The loyalty of a company to its country of origin has a robust link with the director’s loyalty to his company. This point requires further explanation. It is well known that a company obtains a licence to exercise its

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However, the Islamic Sharia barred the director from betraying the company. In the words of the Prophet Mohammed ‘I am the third of the two partners, unless a partner has betrayed the other.’ This means that God’s blessing on the partnership will be gone if one of the contractors has betrayed the other.

<sup>12</sup> See for example the Egyptian Companies’ Act No.159 1981; the Companies’ Act of Kuwait No.15 1960; the Companies’ Act of the United Arab Emirates No.8 1984; the Regulation of Companies of Saudi Arabia No.6 1965.

<sup>13</sup> The Civil Code 1951, Art.927.

<sup>14</sup> However, such an interpretation may not be available to a director if he is unfamiliar with the analysis of the statutory provisions. Therefore, this notion should float visibly on the legal surface by providing for an explicit use of the term in Iraqi legislation. This term has great legal significance, because it calls attention to the seriousness of the director’s task and is a reminder that his primary interests will be those of his master (the firm), and that he will be held to account for any deviation from his loyalty. “Loyalty” should be a watchword written in large letters, like the word “poison,” on a medicine bottle.

<sup>15</sup> The I.C.A. 1997, Art. 23.

<sup>16</sup> Awni Mohammed Al-Fakhri, *the Legal Regulation of Multiple-Nationality Companies* (Wisdom House 2002) 29, 39; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 48, para 40.

activities from the Companies Registrar<sup>17</sup> under an implicit condition that it is to respect the law and its contracts, which should aid the development of certain aspects of the general economy. Nationality creates a nexus between a person (natural or legal) and his society, and also involves feelings of loyalty.<sup>18</sup> If the director betrays the interests of his company, it is unlikely that the latter will be able to achieve its objectives. Hence, the company, as a legal person, might be placed in a position of disloyalty to society, since it has caused wastage to the latter's wealth and has harmed the public interest. For this reason some Arabic Companies' Acts require that the majority of board directors are of the same nationality as the company,<sup>19</sup> thus pursuing the idea that loyalty to the company has a robust link with loyalty to the community. In other words, a director's allegiance to his company may reinforce the latter's loyalty to the community, and confers on nationality its real meaning. Failure to install the principle of directorial loyalty could weaken the principle of the company's loyalty to the community, although an interactive relation between the two loyalties is indispensable.

The failure of the Iraqi Companies' Act to embrace this concept leads to a view of nationality as merely a formalistic matter devoid of practical content. Accordingly, it is suggested to incorporate this concept in the I.C.A. 1997, which would help to eliminate the above complexities, and clarifies the extent of a director's compliance with his duty and his adherence to a company's interests.

### **3.1.2 The Definition of Loyalty**

Legal commentators generally avoid giving a definition of this term in order not to restrict its meaning to a particular concept, which may not be able to embrace future developments. The dictionary definition of loyalty is a 'faithful adherence to one's

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<sup>17</sup> The I.C.A. 1997, See Arts. 17-25.

<sup>18</sup> Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 48, para 40.

<sup>19</sup> See the Companies Act of the United Arab Emirates No.8 1984, Art.100; the Bahraini Companies Act No.28 1975, Art.163(1); the Syrian Companies' Act No.29 2011, Art.141(1).

promise, oath, word of honour, etc.’<sup>20</sup> It can also mean ‘faithfulness and allegiance to one’s sovereign or government’.<sup>21</sup>

Judicial attempt to identify this concept has been made in *Bristol and West Building Society v Mothew*<sup>22</sup> and it is useful to repeat the dictum of Millett L.J. in this context, in which he emphasized that:-

A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal.<sup>23</sup>

Some legal commentators have contributed to the definition of fiduciary obligation. One commentator describes loyalty as the performance of a duty in entire good faith and in an unselfish manner.<sup>24</sup> Another commentator considered it as an embodiment of such ‘...notions as faith, trust, and devotion...’ that should be owed by a fiduciary to the principal.<sup>25</sup> Another commentator takes this principle to mean that the director must act in good faith and shall not place his personal interests ahead of the company’s interests.<sup>26</sup> Thus, loyalty entails the notion of self-denial.<sup>27</sup> At any event, it can be inferred from an analysis of the above definitions that loyalty consists of two elements, viz:-

1-The psychological element: notions such as fidelity, allegiance, dedication, adherence to the company’s interests, together constitute the concept of loyalty which

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<sup>20</sup> See Oxford English Dictionary <<http://0-www.oed.com.unicat.bangor.ac.uk/view/Entry/110759?redirectedFrom=loyalty#eid>> accessed on 1 May 2014.

<sup>21</sup> Longman Dictionary of Law (7th edn, Pearson Education 2007) 229.

<sup>22</sup> [1996] 4 All ER 698, 711- 712 (CA). This case relates to a breach of a duty by a solicitor. Cited with approval in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd (in administrative receivership)* [2011] EWCA Civ 347, [2012] Ch 453 [35] (Lord Neuberger of Abbotsbury MR).

<sup>23</sup> [1996] 4 All ER 698, 711- 712 (CA).

<sup>24</sup> Russell D. Noles, ‘The Divided-Loyalty Rule Caveat to Draftsmen to Avoid Absolute Liability of Trustee’ [1952] A B A Sec Real Prop Prob & Tr Proc 10.

<sup>25</sup> Neil Richards, ‘A Question of Loyalty’ (1993) 12(1) Crim Just Ethics 48, 49.

<sup>26</sup> John M. Sjoval, ‘What Duty Do Company Directors Owe to Banks and Other Creditors?’ (2004) 121 Banking L J 4, 9.

<sup>27</sup> Sarah Worthington, ‘Corporate Governance: Remediating and Ratifying Directors’ Breaches’ (2000) L Q R 638, 641.

inheres in the director's conduct and motivates him to further the company's interests. But it should be noted that these concepts are appropriate for describing the relationship between natural persons, rather than legal and abstract persons. It is difficult to say that a person should be loyal to an inanimate entity. However, this concept can be used to describe a legal nexus, rather than the moral relation between two persons. The real meaning of loyalty here is the affiliation of a fiduciary to an entity instead of the moral relations between two persons.

2- The material element: loyalty must result in conduct and decisions taken in the firm's interests. The reasons for disloyalty fall into two categories: first, where the director has been swayed by his personal interests. This behaviour can be described as opportunism, personal self-interest or the betrayal of the firm, as has been shown in the previous chapters. One example of this would be when a director acts to prejudice the company's interests by concealing his interests in a transaction, or by obtaining a benefit from a third party. The second sort of disloyalty would be where a director is placed in a position under which he is swayed to one interest on account of other interests. This position is conceivable when a director represents two distinct interests connected with the firm's activities in circumstances which render it difficult for him to reconcile the two, without the sacrifice of certain interests in favour of others. The multi-director and the nominee director are the most obviously susceptible in this respect. For example, a multi-director who engages in serving a similar or rival company, places himself not only in a position of conflict of duties, but also in a position of divided loyalty.<sup>28</sup> Service in two competitive companies requires a director to act equally between them. For instance, he should communicate any opportunity or information he has acquired to both of these firms,<sup>29</sup> and that would make it extremely difficult for him to carry out his duty to these companies properly.<sup>30</sup> A director's

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<sup>28</sup> Martin Day, 'Fiduciary Duties' (2009) 15(6) *Trusts & Trustees*, 447- 450; Kenneth W. Nielsen, 'Directors' Duties under Anglo-American Corporation Law' (1966)43 *U Det L J* 605, 646.

<sup>29</sup> Paul Davies, Sarah Worthington Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 572, f.n (315); D. E. McLay, 'Multiple Directorates and Loss of Corporate Opportunity: Bases and Remedies' (1980) 10 *Victoria U Wellington L Rev* 429, 143.

<sup>30</sup> Nicholas Bourne, *Bourne in Company Law* (4<sup>th</sup> edn, Routledge publishing 2008) 157; Elizabeth Boros, 'The Duties of Nominee and Multiple Directors: Part 2' (1990) *Co Law* 6; Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 573, para 17-73; Brenda Hannigan, *Company Law* (2<sup>th</sup> edn, OUP 2009) 249, para 11-9; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 291, para 9.65.

position in these circumstances is just like someone walking on a tightrope.<sup>31</sup> The hallmark of these situations is that the disloyalty may not be traceable to a director's bad faith or to his opportunism. Such a position has special attributes which will be discussed in the section that follows.

### 3.1.3 The Attributes of Loyalty

It seems from the above discussion that loyalty is distinguished by the following attributes:-

1- Loyalty as a duty implies addressing various wrongdoings that might not be within the scope of other duties. For example, Loyalty might involve declining to exploit a corporate opportunity<sup>32</sup>; or declaring an interest in a transaction, avoiding the acceptance of a benefit from a third party, etc. In other words, these duties are not synonymous with loyalty, but constitute applications of the broad concept, covering certain aspects of it, which collectively constitute the concept. This includes the duty to act in the company's interests under s. 172 of the C.A. 2006, which was formulated for a didactic purpose, to make a director aware of how to manage certain relations linked with the company, such as the shareholders and stakeholders.<sup>33</sup> It is hard to say that a director should be loyal to all these interests, which may be sometimes in conflict.

For this reason, the C.A. 2006 does not use the term "loyalty" to describe an independent duty; instead, it indicates aspects of that principle. This is because the broad meaning of the word makes it less comprehensible to a director, and it is better to use more easily comprehensible terms when dealing with those who may be unfamiliar with legal terminology. But this does not mean that "loyalty" is the only constituent of the fiduciary doctrine. The latter concept embraces a wider meaning,

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<sup>31</sup> Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 573, para 16-72.

<sup>32</sup> Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96, 100.

<sup>33</sup> Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 SALJ 714, 724.

and includes further duties, such as: agreements, the company's constitution,<sup>34</sup> and the duty of protecting the other participants in the company (like shareholders and creditors). Millett L.J. in *Bristol and West Building Society v Mothew*<sup>35</sup> made it clear that the duty to act in the company's interests is an application to the concept of loyalty rather than to be its synonym.

Accordingly, the relationship between the loyalty doctrine (as an abstract notion) and the other aspects of the fiduciary doctrine lies in that the first is unable to be enforced without reference to the relevant duties.<sup>36</sup>

2- The loyalty must be an absolute (entire). This principle is often termed as "undivided loyalty,"<sup>37</sup> which means that a director (in a case where he is acting for more than one company or being as a nominee director) must exert a single-minded allegiance to both of them,<sup>38</sup> as if he were acting in the interests of a single entity.<sup>39</sup> Accordingly, a director, when dealing with the company's interests, must ignore his personal interests or the interests of any other person.

3- Loyalty is a continuous relationship. That means that a director must engage in day-to-day loyalty. This feature means that the director must be loyal even outside of working hours. Iraqi law implicitly applies this attribute by preventing multi-directorships<sup>40</sup> and providing that a director must not be acting in competition with the company.<sup>41</sup>

4- Loyalty *per se*, as an abstract notion, cannot be subject to attenuation by an agreement or by the company's articles.<sup>42</sup> Such is the strictness of this principle that it cannot comprehend logically that a director may not be loyal, and then give him license

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<sup>34</sup> See the C.A. 2006, s. 178(2).

<sup>35</sup> [1996] 4 All ER 698, 711- 712 (CA).

<sup>36</sup> Matthew Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121(Jul) L Q Rev 452, 480.

<sup>37</sup> *University of Nottingham v Fishel* [2000] ICR 1462, 1489 (QB) (Elias J); *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643 (QB); *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [6] (Mummery L.J).

<sup>38</sup> Rebecca Lee, 'Rethinking the Content of the Fiduciary Obligation' (2009) 3 CONV P L 236, fn (37).

<sup>39</sup> Millett L.J. in *Bristol and West Building Society v Mothew* [1996] 4 All ER 698 (C.A).

<sup>40</sup> For more details on this area see Chapter 4, para 4.3.1.1 of this thesis.

<sup>41</sup> See the I.B.R.A. 2005, Art. 42(Second-b).

<sup>42</sup> This inference can be understood from reviewing the English common law, where the only exception is a timid attempt mentioned in *Cobden Investments Ltd v RWM Langport Ltd, Southern Counties Fresh Foods Ltd, Romford Wholesale Meats Ltd* [2008] EWHC 2810 (Ch), [2008] WL 4923175. More details of this authority will be discussed later in Chapter 5, para 5.1.2.1.2.



to betray his company, as this may constitute a threat to its fundamental interests. The fact that a company, under English law, is allowed to authorize<sup>43</sup> or re-regulate the conflict of interests<sup>44</sup> in its articles<sup>45</sup> does not detract from this principle. This flexibility in dealing with the above issues is attributable either to the absence of the company's interest in exploiting an opportunity, or because the situation could not constitute a threat to it: and this is not the case when dealing with the substance of the principle of loyalty.

It has been mentioned that the provisions of the Iraqi Companies' Acts are mandatory rules, and are unable to be subjected to amendment by agreement.<sup>46</sup> Hence, loyalty under this law likewise cannot be attenuated in any way.

5- Finally, the concept of loyalty is an interim relationship, because it depends on the continuation of the relationship itself. It is submitted that loyalty, like any other temporary obligation, vanishes as soon as the parties concerned agree to put an end to its existence. This assertion seems, *prima facie*, to contradict s.170(2) of the C.A. 2006, which extends the scope of the duties enunciated under ss.175 and 176 of the same Act to include the situation of a director who resigns but is deemed to be under a continuing obligation of loyal behaviour even after he leaves his office.

It will be seen<sup>47</sup> that s.170(2) of the C.A. 2006 has referred to limited situations related to benefits that have been gained by a director by virtue of exploiting of his prior position (or the use of his powers) during his period of service. This Section means tacitly that a director's loyalty does not extend to infinity, and then this inference is reinforced by statutory provisions.

In conclusion, it has been demonstrated in this section that the doctrine of loyalty to the company represents the principal duty that a director must comply with, from which other sub-duties stem. It cannot, therefore, be equated this doctrine with the duty to act in the company's interests, as the latter represents a branch of the loyalty tree.

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<sup>43</sup> See the C.A. 2006, ss.175(4), 176(3, 4), 177(6).

<sup>44</sup> See s.180(4-b) of the C.A. 2006.

<sup>45</sup> See Chapter 2, para 2.2.3.2 of this thesis.

<sup>46</sup> See Chapter 2, para 2.2.3.2 of this thesis.

<sup>47</sup> For more discussion about this issue, see Chapter 4, para 4.3.2, and Chapter 5, para 5.2.1.2.4 of this thesis.

## Section II

### A Director Must Fulfil his Duty in Good Faith

Introduction: It has been mentioned earlier to the confusion shrouding the formulation of Art.120 of Iraqi Companies' Act 1997 by reason of conflating the duty to act in the company's interests with the duty of care. This Article states:-

The chairman and members of the board of directors shall do their best to serve the interests of the company as they would serve their own personal interests, and run the company in a sound and legal manner. They are responsible before the general assembly for any action they undertake in this capacity.

A comparison between s.172 of the C.A. 2006<sup>48</sup> and Art.120 of the I.C.A. 1997 reveals differences between the two Acts. First, whereas s.172 of the C.A. 2006 renders the duty to act in the interests of the company a duty independent of the duty of care set out under s.174 (which is not a fiduciary duty<sup>49</sup>) Art.120 of the I.C.A. 1997 has conflated these duties and subjected the duty to act in the interests of the company with the duty of care.

In contrast to the approach adopted by the I.C.A. 1997, Art.17(6) of the Private Banks Act (hereinafter P.B.A.) 2004 contain wording similar to that of s.172 of the C.A. 2006.<sup>50</sup> Apparently, Art.17(6) of the P.B.A. 2004 contradicts Art.120 of the I.C.A. 1997, because the focus of Art.17(6) is on the duty to act in the bank's interests;

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<sup>48</sup> This provision has been mentioned in the introduction of this Chapter.

<sup>49</sup> In this context See also *Bristol and West Building Society v Mothew* [1996] 4 All ER 698, 711 (Millett LJ).

<sup>50</sup> This Article states:-

The members of the board of directors shall act honestly and in good faith with a view to the best interests of the bank. In carrying out their functions, they shall exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

It is worth noting that the above provision has no equivalent in Arabic civil law jurisdictions like the Companies' Act of United Arab Emirates No.8 1984; Syrian Companies Act no.29 2011; the Kuwait Commercial Companies' Act No. 15 1960; the Egyptian Companies' Act No.159 1981; Jordanian Companies' Act, No. 22 1997; the Saudi Companies' Regulation No.6 1965.

whereas the duty of care is a standard that is used for ascertaining whether a director has fulfilled this duty properly.

Apparently, Art.120 of the I.C.A. 1997 did not refer to the principle of good faith, which is an assumed ingredient in discharging any obligation, and a distinctive element for discriminating between the duty to act in a company's interests and the duty of care. This assumed principle raises numerous questions as to: the meaning of this principle in Iraqi law, and whether this principle is inherent in Art.120 of the I.C.A. 1997? If yes, how to verify whether the director undertaking certain conduct, has complied with this principle? What is the legal value of imposing this element? These questions will be subjected to more debate in the following sections.

### **3.2.1 The Existence and Meaning of the Principle of Good Faith in Iraqi Law**

Good faith is an elusive concept. So, Iraqi law, like English law, refrains from restricting and limiting its meaning by defining it,<sup>51</sup> leaving this hard task to the law commentators.

However, legal dictionaries often link this principle to the concept of "honesty".<sup>52</sup> Other dictionaries have defined this concept negatively (to avoid restricting its concept) by reference to situations of bad faith, such as the 'freedom from intent to deceive'.<sup>53</sup> The same approach has been espoused by one Iraqi commentator, who

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<sup>51</sup> Clark W. Furlow, 'Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware' (2009) *Utah L Rev* 1061, 1062; Andrew Keay, 'Good Faith and Directors' Duty to Promote the Success of their Company' (2011) *32(5) Comp Law* 138; Janet E. Kerr, 'Developments in Corporate Governance: the Duty of Good Faith and its Impact on the Director Conduct' (2006) *13(5) Geo Mason L Rev* 1037; Christopher M. Bruner 'Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law' (2006) *41 Wake Forest L Rev* 1131, 1152.

<sup>52</sup> *Longman Dictionary of Law* (7th edn, Pearson edu 2007) 266; J. E. Penner, *The Student's Law Dictionary* (OUP 2008) 131; See also: Company Law Reform Steering Group (herein after C.L.R.S.G), *Modern Company Law for a Competitive: The Strategic Framework* (1999) < [www.bis.gov.uk/files/ file 23279.pdf](http://www.bis.gov.uk/files/file_23279.pdf)> accessed 15 July 2012, para 5.1.5; Mark W. H. Hsaio, 'A Sprouting Duty of Honesty and Loyalty? Companies Act 2006' (2009) *20(9) I C C LR* 301, 303. However, this definition offers nothing to determine the meaning of good faith, since honesty involves a wide meaning that in itself needs to be defined.

<sup>53</sup> Oxford Legal Dictionary accessed <http://0-www.oed.com.unicat.bangor.ac.uk/view/Entry/79925?redirectedFrom=good+faith#eid2862073> accessed on 18 June 2014. This is the approach of American common law. For more details see: Sarah Helene Duggin and Stephen M. Goldman, 'Restoring Trust in Corporate Directors: The Disney Standard and the "New"

described the principle as one of avoiding intentional wrongdoing, fraud, abuse of the right and the gross negligence.<sup>54</sup> Another scholar thinks that this principle consists of two elements: the psychological (the person's belief) and ethical considerations, as described above.<sup>55</sup>

Iraqi legislation that connects with the Companies' Acts uses various terms in describing this concept, such as: honesty,<sup>56</sup> "soundness",<sup>57</sup> "fidelity and keenness".<sup>58</sup> Art.17 (6) of the P.B.A. 2004 states explicitly that a director must '...act honestly and in good faith...'. However, this provision lacks precision, because "honesty" is a notion used for clarifying the concept of good faith rather than an independent element. An investigation of the Sharia position, as an indirect source of the Iraqi Companies' Acts, reveals that honesty, integrity and the avoidance of cheating are the elements that should dominate the exercise of commercial activities, whatever their nature and whatever the capacity of the dealers.<sup>59</sup>

Accordingly, the principle of good faith can be described as a set of ethical considerations (such as honesty, fidelity, probity and decency) which are socially acceptable, and operate collectively to control the director's state of mind and thus motivate him to behave and take decisions in the light of the company's interests only. By contrast, malicious or dishonest motivations to act in pursuit of interests, other than those of the company, constitute bad faith, which taints the decision taken.<sup>60</sup>

The above concept seems close to the concept of loyalty that has been discussed earlier.<sup>61</sup> The similarity between these concepts has caused some American courts, as

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Good Faith' (2007) 56 Am U L Rev 211, 244; Elizabeth A. Nowicki, 'A Director's Good Faith' (2007) 55 Buff L Rev 457, 503.

<sup>54</sup> Abdul Jabbar Naji Saleh, the *Principle of Good Faith in Carrying out the Contracts* (first edn, Baghdad University 1975) 42-50.

<sup>55</sup> Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Rout Polisher 2013) 96.

<sup>56</sup> The Rules of Conduct of Employees of the State and Mixed Sector Companies, issued by the Integrity Commission (herein after the R.C.E.S.M.S.C 2006), Rule 2; The Commerce Act No.30 1984, Art.3 (concerning the basis of trade); the State Employees Disciplining Act No.14, 1991, Art.4(First) (which may govern the behaviour of the nominee of the State Sector in the Mixed Sector Companies).

<sup>57</sup> See the I.C.A. 2006, Art.120.

<sup>58</sup> The R.C.E.S.M.S.C., 2006, Rule 2.

<sup>59</sup> Many verses of the Koran refer to this concept, such as: Al- Nisa (verses 29; 58); Al-Isra (verse 34). In the words of the Prophet Muhammad, 'Actions are according to intentions, and each man is what he intends', viz: each person will be responsible according to his intention.

<sup>60</sup> Elizabeth A. Nowicki, 'Not in Good Faith' (2007) 60 SMU L Rev 441, 455-456.

<sup>61</sup> See Section 1 of this Chapter, para 3.1.2.

well as some commentators,<sup>62</sup> to equate them.<sup>63</sup> However, the justification for discriminating between the two principles is that loyalty connects to the outcome of the decision, that is, whether the decision reflects the notion of loyalty. Therefore, loyalty is gauged *objectively*, which is in contrast to good faith that is linked principally to the director's state of mind, which is to be assessed under *subjective* criteria. The case *Regal (Hastings) Ltd v Gulliver*<sup>64</sup> presents a good example of this distinction. While the directors in this case had acted in good faith, the court held that they were liable to account to their company. Thus, it cannot be said that the directors in this case were loyal to their company. Likewise, the enforcement of other prescriptive duties does not depend on the existence of this ingredient.

The failure to mention this principle in Art.120 of the I.C.A. 1997 does not mean that the legislature intended to discard it in drafting this Article. Scrutiny of the formulation of this Article and the general principles of the Iraqi law reveals that good faith is inherent in this duty, according to the following arguments:-

1. Art.120 of the I.C.A. 1997 imposes on the directors a duty to serve the company '...as they would serve their own personal interests...'. A director therefore must stand in dealing with the company's interests with the same degree of honesty that he does in dealing with his own personal interests. Since it is hard to envisage that a person could practise cheating or dishonest activities in conducting his personal affairs in a manner contrary to his own interests, he must also comply with this requirement in dealing with his company. In other words, the subjective standard in itself involves the principle of good faith.

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<sup>62</sup> Elizabeth A. Nowicki, 'A Director's Good Faith' (2007) 55 Buff L Rev 457, at 525 defined the good faith as '...a director must act in the corporation's best interest'.

<sup>63</sup> Christopher M. Bruner, 'Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law' (2006) 41 Wake Forest L Rev 1131, 1152; Elizabeth A. Nowicki, 'A Director's Good Faith' (2007) 55 Buff L Rev 457, 500.

<sup>64</sup> [1967] 2 AC 134, 152 (HL) (Lord Macmillan). In this case the directors of Regal were interested in acquiring a lease of two cinemas. For this purpose, a subsidiary company (Hasting) had been incorporated with a capital of £5,000. The owner of the cinemas refused to sell the lease unless he obtained the directors' personal guarantee, which the latter had refused to give. A new plan was made, by which the directors agreed to allow Regal to purchase shares equivalent to £2000 shares in Hastings. The rest of the amount would consist of a contribution by the directors of the company's capital. The scheme succeeded and engendered high profits for the directors. The new management of the company brought a claim against the former directors. The court held that the four directors were liable to account their company for the profits gained, as they had placed themselves in a conflict of interests, despite their genuine good faith and their belief that what had been done was in the company's interest.

2. This principle is the prevailing rule in fulfilling any obligation, whatever its nature.<sup>65</sup> In this connection, Art.3 of the Commerce Act 1984 states that ‘trade is an economic activity and based on confidence, honesty...’. Given that the director is a representative of the company (trader), he must respect this principle in undertaking his duties.

It is necessary to ask in this regard whether the formulation of Art.120 of the I.C.A. 1997 represents a rational approach. In other words, can the principle of good faith, as a cardinal element of the duty to act in the company’s interests, co-exist with the duty of care in a single formulation? The answer to the above questions depends on the means of ascertaining whether a director has acted in good faith, which will be the subject for further discussion in the following section.

### **3.2.2 Ascertaining whether a Director has Acted in Good Faith**

How to verify whether the director has complied with this principle in his conduct? Are his own assertions that he acted honestly to be depended upon, or must another criterion be used for ascertaining the correctness of his assertion? In answering the above question, the Iraqi Companies’ Acts have adopted two different (and contradictory) standards, one subjective and the other objective.

#### **3.2.2.1 The Subjective Standard**

The subjective approach is shown in Art.120 of the I.C.A. 1997, which was mentioned earlier. Art.189 of this Act (concerning the Simple Company<sup>66</sup>) similarly states that “the managing partner will do his best to take care of the company's interests the way he takes care of his own interests”. Thus, the director's good or bad faith depends on

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<sup>65</sup> Abdul Majid Al-Hakim, Abdel Baqi Al-Bakri and Mohammed Taha Al-Bashir, *The Civil Law: the Rules of the Obligations* (Second edn, The Ministry of Higher Education and Scientific Research 1980) 12-13, para 10; Hassan Ali Al-Znon, *the General Theory of the Obligations* (Al-Sanhoori Publisher 1976) 339, para 351.

<sup>66</sup> This Act singled out special provisions for this type of company, for unknown reasons.

*his state of mind* at the time of exercising the behaviour in question, because this is the touchstone of his liability.

The above subjective standard meets with the nature of good faith as a state of mind. This approach also allows a director a broad discretion that enables him to carry out his duties properly and confidently. The subjective standard also is vital to alleviate of a director's anxiety about the possibility of being exposed to a harsh standard of judgment should his conduct be reviewed by a court in the future,<sup>67</sup> and to develop the ethos of innovation and adventure which represents the hallmark of trade.

In this context, Art.117 of the I.C.A. 1997 states that:-

The board of directors shall handle the necessary administrative, financial, planning, organizational, and technical duties for running the company's business, other than those that fall within the jurisdiction of the general assembly.

Likewise, Art.17(1) of the P.B.A. 2004 states that:-

The board of directors of a bank shall be responsible for conducting the business and establishing the policies of the bank. In particular, establish the risk-management standards, investment policies, minimum prudential ratios, accounting standards and internal control systems of the bank.

It is worth noting that Art.120 of the I.C.A. 1997 was amended by the Coalition Provisional Authority (hereinafter the C.P.A.). The previous version of the I.C.A. 1997 had required that a director's standards of care should not fall below those of an "ordinary person" at any event. Thus, the amendment mirrors the legislature's wish to confer a broad discretion on a director. This approach accords with the approach

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<sup>67</sup> Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 207, para 9.8; L J David Kershaw, *Company Law in Context* (2th edn, OUP 2012) 337.

adopted by the English common law,<sup>68</sup> exemplified by s.172(1) of the C.A. 2006, that states ‘a director of a company must act *in the way he considers* in good faith ...’.<sup>69</sup>

However, the subjective standard, (which represents the old approach of English law concerning the standard of care<sup>70</sup>), is a low standard,<sup>71</sup> and thus involves a threat to the company, because the director can always allege that he has acted in good faith and in a constant belief that his behaviour was consistent with the company’s interests and his way of managing his personal affairs. Thus, the company will experience a difficulty in challenging the director’s behaviour, because it must demonstrate his bad faith. Moreover, ‘...*Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bona fide* yet perfectly irrational...’.<sup>72</sup>

Seemingly, this approach gives consideration to managerial effectiveness at the expense of safeguarding the company’s interests. But espousing the subjective standard in Art.120 of the I.C.A. 1997 in reviewing the director’s compliance with duty of care leads to an irrational attenuation of this duty, which should be based on comparing the errant conduct with the behaviour of the “ordinary” (reasonable) person

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<sup>68</sup> This test has long roots in common law since the well-known judgment *Re Smith and Fawcett* [1942] Ch 304 (AC). This test should apply albeit the director’s decision was conducive to a substantial damage to the company, or his belief was unreasonable as long as he was acting in a good faith. (See *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (CH) [97]; *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch), [2003] B C C 885; *Regina v Queenswood (Holdings) Ltd, Regina v Frederick William Smithson* [1968] 1 WLR 1246 (CA); *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 (CH) [120] (Jonathan Parker J); *Roberts v Frohlich* [2011] 2 BCLC 625 [84] (Norris J). In other words, ‘...the court... would not second guess a decision made by the company in accordance with its own constitution ...’.(*Cobden Investments Limited v RWM Langport Ltd, Southern Counties Fresh Foods Ltd, Romford Wholesale Meats Ltd* [2008] EWHC 2810 (Ch), [2008] WL 4923175 [53] (Warren J).

In American jurisprudence J See Janet E. Kerr, ‘Developments in Corporate Governance: the Duty of Good Faith and its Impact on the Director Conduct’ (2006) 13(5) *Geo Mason L Rev* 1037; Melvin A. Eisenberg, ‘The Duty of Good Faith in Corporate Law’ (2006) 31 *Del J Corp L* 1, 22.

<sup>69</sup> [Emphasis added].

<sup>70</sup> See for example: *Re Cardiff Saving Bank Marquis of Bute* [1892] 2 Ch 100 (CH); *Re City Equitable Fire Insurance Company Ltd* [1925] Ch 407, 428-429 (Romer J). However, common law has shifted recently from this standard in favour of adopting the objective standard set forth in s.174 of the C.A. 2006. For more debate about this theme see: Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008) 488-495, paras 16-12-16; Stephen Mayson, Dereck French & Christopher Ryan, *Mayson, French & Ryan on Company Law* (31<sup>th</sup> edn, OUP 2014-15) 488, para 16.8.1.

<sup>71</sup> Kiarie Mwaura, ‘Company Directors’ Duty of Skill and Care: a Need for Reform’ (2003) 24(9) *Comp Law* 283, 284.

<sup>72</sup> *Hutton v West Cork Railway Company* (1883) 23 Ch D 654, 671 (CA) (Bowen L.J).



in order to determine whether the director has transgressed the borders of the conduct of the ordinary person.<sup>73</sup>

For the above reason, English common law has developed another objective test, that of “reasonableness.” Under this test, a director becomes liable when it can be inferred from the circumstances that he did not act in a reasonable manner.<sup>74</sup> Such a test is applied particularly in circumstances under which the director’s conduct has caused substantial damage to the company,<sup>75</sup> or has been conducive to its insolvency, or encompasses the sacrifice of the interests of a subsidiary company in favour of the parent company without a justifiable reason.<sup>76</sup> For example, in one case the court held that a director was liable for damage that he caused to his company by signing a settlement with another company that contained undervalued conditions, in accordance with which his company undertook to give up 1,250,000 Euros in return for £166,163.33.<sup>77</sup>

It seems at first glance that English courts, by virtue of adopting the objective test, have abandoned the principle of good faith, since that behaviour may be measured by a subjective test. However, the subjective concept of good faith still operates in all situations: although a director ‘...will have a harder task persuading the court that he honestly believed it to be in the company’s interest; but that does not detract from the subjective nature of the test...’<sup>78</sup>

This analysis is compatible with the provisions of the Iraqi Civil Code of 1951, which always refers to gross negligence alongside fraud in other areas of law.<sup>79</sup> In other

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<sup>73</sup> The standard of the ordinary person represents the main standard for gauging the behaviour of the delinquent, according to Art.251(1) of the Civil Code 1951.

<sup>74</sup> Andrew Keay, ‘Good Faith and Directors’ Duty to Promote the Success of their Company’ (2011) 32(5) Comp Law 138, 142.

<sup>75</sup> Vinelott J. in *Re a Company, Ex Parte Burr* [1992] BCLC 724, 732 (CH). See also: Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 207, para 9.10; Geoffrey Morse, *Palmer’s Company Law: Annotated Guide to the Companies Act 2006* (2th edn, Sweet & Maxwell 2009) para 8.2609.

<sup>76</sup> In this line See *Hutton v West Cork Railway Company* (1883) L R 23 Ch D 654, 666 (CA) (Cotton L.J); *Re a Company, ex Parte Burr* [1992] BCLC 724, 731 (CH) (Vinelott J.); *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd Eaton Bray Ltd v Palmer* [2002] EWHC 2748 (Ch), [2003] B C C 885 [85] (Leslie Kosmin J).

<sup>77</sup> *Re Genosysis Technology Management Ltd, Wallach v Secretary of State for Trade and Industry* [2006] EWHC 989.

<sup>78</sup> *Regentcrest plc (In liquidation) v Cohen* [2001] 2 BCLC 80 (CH) (Jonathan Parker J). See also Jonathan Crow J’s comment in *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (CH) [90].

<sup>79</sup> See for example Arts: 170, 259, 566, 850 and 953 of the Civil Code 1951.

words, substantial damage incurred by the company is an indicator of a director's bad faith.

However, it is unlikely that Iraqi courts will espouse the flexible approach of English law in determining an appropriate test for each case, because the role of Iraqi courts is limited to applying legal provisions only when the connotations of those provisions are clear-cut.<sup>80</sup> Thus, the result of the C.P.A.'s amendment to Art.120 of the I.C.A. 1997 is the loss of an effective means of reviewing director's conduct, particularly in cases where there is an allegation that the director's conduct has fallen below the standard expected from an ordinary person.

### **3.2.2.2 The Objective Standard**

This is the approach adopted by Art.17(6) of the P.B.A. 2004 for measuring the director's conduct. A director must not in any event deviate from the standard of care of an ordinary person, and the impugned behaviour, under this subjective-objective standard, will eventually be subject to objective assessment by the court. Three comments can be made regarding this approach:-

First, the scope of Art.17(6) of the P.B.A. 2004 is limited to banks, and the directors of other companies are still subject to the aforementioned subjective standard. Second, this approach is contrary to Art.120 of the I.C.A. 1997, which indicates a subjective standard. This reflects the lack of coherence of the Iraqi Acts in addressing different economic areas. Such a *lacuna* may motivate a director not to serve in companies governed by Acts requiring high standards of behaviour. Third, as previously mentioned in this Chapter, the objective standard is a rigorous one, and may be incompatible with some uses of the broad powers conferred on a director when, in certain circumstances, he acts in good faith to promote the company's interests, but yet causes detriment to those interests. The director may then fear that, in terms of the objective standard, his behaviour is at fault because it is inconsistent with the behaviour of the ordinary person, (equivalent to the reasonableness test in English

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<sup>80</sup> The Civil Code 1951, Art.2.

law).<sup>81</sup> In other words, this inflexible standard may be conducive to limiting the director's discretion, increasing his responsibility and distorting the special nature of the good faith principle as representative of a director's state of mind. By contrast, it has been shown that English law has adopted the objective test *as an exception*, whenever the results of the director's behaviour suggest that he did not act in good faith.

To sum up, this legislative lack of uniformity is one of the consequences of the conflation of the duty of care and the duty of good faith, which must be independent, and reflects the misunderstanding of the content and the role of each of them. The duty to act in the company's interests connects with a director's state of mind when he acts either in pursuing the company's interests or for other interests. Whereas the duty of care relates to wrongdoing inherent in the behaviour itself, irrespective of the matter of fraud, or the *mala fide* of its perpetrator.<sup>82</sup> Thus, the fact that the director has acted in good faith is irrelevant for the application of s.174 of the C.A 2006, concerning the duty of care.<sup>83</sup> In this respect, Leslie Kosmin J in *Colin Gwyer & Associates Ltd v London Wharf* emphasised that:

...If directors act in good faith in the interests of the company and for proper purposes they will not be liable for breach of fiduciary duty if they make a mistake and act unreasonably, but may be liable for breach of their duty of care.<sup>84</sup>

Despite the fact that intentional violation of duty has a presence in the I.C.A. 1997,<sup>85</sup> where it is called "abuse",<sup>86</sup> the Act did not define the legal consequences of distinguishing between the intentional and unintentional fault and therefore equated them. English law, in contrast, has established the legal consequences of the distinction

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<sup>81</sup> L. J. Davis Kershaw, *Company Law in Context* (2th edn, OUP 2012) 347.

<sup>82</sup> Christopher M. Bruner, 'Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law' (2006) 41 Wake Forest L Rev 1131, 1149; Robert Flannigan, 'Fiduciary Duties of Shareholders and Directors' (2004) May JBL 277, 288.

<sup>83</sup> This section states:

- (1) A director of a company must exercise reasonable care, skill and diligence.
- (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person...

<sup>84</sup> [2002] EWHC 2748 (Ch), [2003] B C C 885 [83]. See also Jonathan Crow J remark in *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (CH) [89]. Andrew Keay, 'Good Faith and Directors' Duty to Promote the Success of their Company' (2011) 32(5) Comp Law 138, 143.

<sup>85</sup> See Arts. 1(3), 4(Third) of the I.C.A. 1997.

<sup>86</sup> Rule (15) of the R.C.E.S.M.S.C. 2006 defined abuse as '...harnessing for gain personal or financial gains, or abusing the rights of others rights and prejudicing them or attempting to cause that within the period of executing the work ...'. It is worthwhile to mention that the Integrity Commission is a State body for combating corruption.

between breach of the duty of care, which is governed by the common law, and breach of fiduciary duties, which are subject to equitable rules,<sup>87</sup> as follows: violation of the duty of care set out in s.174 of the C.A. 2006 leads to a director's liability for damage according to the common law, which requires a demonstration of its elements: fault, damage and a causative link<sup>88</sup>; whereas the breach of the duty to act in company's interests (or breaches of other fiduciary duties which are often committed intentionally) does not require the above elements of liability to be established. Moreover, the breach of this duty gives rise to a director's liability to account to his company for profits tainted by a breach of a duty.<sup>89</sup> The confiscation of profit under this duty is a crucial factor in inhibiting a director from abusing his powers, since it nullifies his incentive to engage in illegal activities.<sup>90</sup>

This distinction seems logical, because intentional wrongdoing constitutes a higher degree of threat to the company's interest than unintentional fault, and so requires the imposition of harsh sanctions. However, the current drafting of Art.120 of the I.C.A. 1997, and even Art.17 (6) of the P.B.A. 2004, by virtue of the conflation of the aforementioned obligations in one formulation, missed the opportunity to formulate this distinction and establish the above results. It has been demonstrated that good faith represents the cornerstone in the discrimination between these duties. In brief words, it is impossible to envisage co-existence between these distinctive duties in one Article.

### **3.2.3 Evaluating the Position of Iraqi Law towards the Principle of Good Faith**

To recapitulate, it has been shown throughout this section that the principle of good faith is inherent in the duty of care set out in Art.120 of I.C.A. 1997, by virtue of its

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<sup>87</sup> See the Explanatory Notes of the Companies Act 2006, para 300.

<sup>88</sup> *Bristol and West Building Society v Mothew* [1996] 4 All ER 698, 711 (CA) (Millett LJ).

<sup>89</sup> *Swindle v Harrison* [1997] 4 All ER 705, 733 (CA) (Mummery LJ).

<sup>90</sup> *Swindle v Harrison* [1997] 4 All ER 705, 733 (CA) (Mummery LJ). For more details about this issue see Chapter 7, para 7.2.3.2 of this thesis.

There is another result for discrimination between the above duties seems in that whenever liability of the delinquent has been established, under the common law (and under Iraqi law), compensation must be paid. There is no way to avoid or alleviate this liability by the court. Whereas the equitable remedy is a discretionary matter for the court, and the court's discretion includes the capacity to relieve a director from liability, completely or partially.

See also Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: The Devil in the Detail' (2010) 45 Irish Jurist 82, 103.

adoption of the subjective standard. The existence of this principle, in the light of the conflation between the aforementioned duties in one formulation, may result in a poor outcome, which seems to attenuate the duty of care (the subjective-objective standard in the law before its reform), in favour of espousing the subjective standard set forth in Art.120 of the I.C.A. 1997 (after the law's reform). While the formulation of Art.17(6) of the P.B.A. 2004 may be conducive to distorting the real meaning of this doctrine, as to a person's state of mind. This position leads to the following results: first, *the loss of the opportunity to create the duty to act in the company's interests as an independent duty*. Second, creating uncertainty about the existence of this principle. Conversely, the explicit mention of this principle will bring several legal advantages, such as:-

1. Good faith is a guide for a director, showing him how to act in pursuing the company's interests, though the ambiguity that encapsulates this concept, as shown above, renders it an obscure guide in this regard.

2. Good faith is a means of shielding a company from the director's abuse in a relationship that should be premised on confidence and reliability,<sup>91</sup> corresponding to the wide discretion with which he is empowered under Iraqi law.<sup>92</sup> Therefore, the purpose of imposing this principle is to avoid dishonesty and ill-intentioned behaviour, and to protect the firm's interests<sup>93</sup> by enabling a director's bad faith to be ascertained.

3. Good faith is a means of establishing the director's integrity and so lessens the probability of his incurring liability and makes it harder to accept an allegation that he acted improperly.<sup>94</sup> It has been seen earlier above that this concept is originally inherent, even under the objective standard spelt out in Art.17(6) of the P.B.A. 2004, because the ordinary (reasonable) person should not commit fraudulent actions or gross negligence. Thus, proving good faith provides an initial impression that the action has been achieved according to the behaviour of the reasonable person.

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<sup>91</sup> Elizabeth A. Nowicki, 'Not in Good Faith' (2007) 60 SMU L Rev 457, 510.

<sup>92</sup> See the I.C.A. 1997, 117; the P.B.A. 2004, 17(1).

<sup>93</sup> Elizabeth A. Nowicki, 'Not in Good Faith' (2007) 60 SMU L Rev 441, 454.

<sup>94</sup> Brian R. Cheffins and Bernard S. Black, 'Outside Director Liability Across Countries' (2006) 84(6) Tex L Rev 1385, 1402.

4. Good faith is a means of filling the gaps in the statutory provisions, because it is inconceivable that legal provisions should be able to control all contingencies that might take place in the future. This matter acquires a great deal of significance in civil law jurisdictions, such as Iraq, in which the discretionary power of the court is limited. Thus, filling the statutory gap with the ethical considerations that constitute this principle is the best way to uphold a director's probity in the commercial environment, and to promote a climate of confidence in this regard.

The above legal licence given to the court allows for the creation of other duties.<sup>95</sup> For example, the I.C.A. 1997 did not impose an obvious duty on a director to consider stakeholders' interests. In these circumstances, a director may not be liable for the results of his decision, which contained promoting, e.g., creditors' interests, on the ground that good faith requires him to consider these interests,<sup>96</sup> as it represents part of the sound management of the company. Likewise, ignoring the interests of shareholders is contrary to the duty of a *bona fide* management of the company's affairs, since it may motivate shareholders to leave the company, or at least to refrain from employing additional investments in it.

The creative role of the principle of good faith can be evidently shown in *Item Software (UK) Ltd v Fassihi*.<sup>97</sup> In this controversial case, the wrongdoer, a director, acted to sabotage negotiations between his company and its customer in order to secure a corporate opportunity for himself. The court concluded that the wrongdoer had had a duty to inform the company about his misconduct, in the same way that he had had a duty to inform it about the misbehaviour of his co-director.<sup>98</sup> In this case, Arden L. J made it clear that this sub-duty was premised on the duty to act in good faith in the company's interests.<sup>99</sup>

5. The principle of good faith may also provide a sound basis for certain statutory provisions, such as the duty to inform the competent authorities about any violation of

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<sup>95</sup> Melvin A. Eisenberg, 'The Duty of Good Faith in Corporate Law' (2006) 31 Del J Corp L 1, 6.

<sup>96</sup> Professor David Milman, 'Directors' Duties: Present Interpretations and Future Specifications' (2003) 3 Co L N 1, 2.

<sup>97</sup> [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91. Cited in *QBE Management Ltd v Dymoke* [2012] EWHC 80 (QB), [2012] I R L R 458, [189].

<sup>98</sup> *British Midland Tools Ltd v Midland International Tooling Ltd, Bradford Tool & Gauge Ltd, Donald Allen, Alan Morley, Wayne Allen, Alan Smith, William McGrath* [2003] EWHC 466 (Ch), 2003 WL 21236540 [81]-[90]; *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch), [2007] F S R 15 [128].

<sup>99</sup> *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 [41].

the law. For example, Art.140 (Third) of the I.C.A. 1997 obliges a director to notify the Companies Registrar of any justified allegation of a violation of legal provisions, violation of the company's contract or any decisions taken by its bodies. Likewise, Art.35(1) of the P.B.A. 2004 imposes on a director the duty to notify the State authorities of any case of money-laundering. Similarly, rule (6-18) of the Iraqi Accounting Standards Board (I.A.S.B.) 2012 imposes on a director the same duty concerning any misapplication of the company's funds.

Finding a basis for these statutory duties is of great significance, not only in determining their legal background, but also in determining whether a director has breached the duty of disclosure. If the notification to the competent body falls under Art.120 of the I.C.A. 1997, it will be subject to the director's discretion, according to his belief as to whether the notification is in the company's interests. The extent of fulfilment of duty may be assessed objectively to be so, according to the judgment of the ordinary person, pursuant to Art.17(6) of the P.B.A. 2004. Remarkably, the latter standard is consistent with Arden's L. J's conclusion in *Item Software (UK) Ltd v Fassihi*.<sup>100</sup>

6. Inserting this principle into Art.120 of the I.C.A. 1997 would be of help in interpreting some statutory terms enunciated in the law, such as to '... run the company in a sound and legal manner...'. The obedience to the law, as enunciated in Art.120 of the I.C.A. 1997, has a link with good faith as one of its manifestations, because the law, generally, is a formulation of the prevailing ethical standards of the community. So, the violation of the law is also a breach of good faith, even if a director's motivation is the desire to promote the company's interests (e.g. the avoidance of the payment of tax,<sup>101</sup> or committing criminal activities, such as 'financial crime, including fraud, money-laundering and financing terrorism'.<sup>102</sup> The shareholders, in this case, would expect the director to act lawfully, that is, according to the ethics of the community.<sup>103</sup>

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<sup>100</sup> [2004] EWCA Civ 1244 (CA), [2005] 2 BCLC 91 [44].

<sup>101</sup> Melvin A. Eisenberg, 'The Duty of Good Faith in Corporate Law' (2006) 31 Del J Corp L 1, 29.

<sup>102</sup> The P.B.A. 2004, Art.2(1); the I.B.R.A. 2005, Art.35.

<sup>103</sup> Melvin A. Eisenberg, 'The Duty of Good Faith in Corporate Law' (2006) 31 Del J Corp L 1, 38.

## Section III

### Furthering the Company's Interests

Introduction: It scarcely needs to be said that a company is neither more nor less than a legal person that derives its existence and its continuity from the participation of its members.

The relationship between the company's members is not always harmonious, however, and a conflict of interest may occur among them. When such conflicts occur, it is important that there should be special rules for addressing the problems involved, in order to prevent directorial abuse and, in some cases, to avoid the dissolution of the company itself.

On the other hand, a company is incapable of exercising its activities in isolation from other persons, for example, employees and creditors, who are called the "stakeholders". Thus, fostering the interests of the latter is also in the interests of the company and will result ultimately in promoting the interests of shareholders.

The aim of this section is to explore the extent to which the Iraqi Companies Acts provide safeguards for this kind of participant similar in nature to those found in English law. But, before explaining these elements, however, it would be worthwhile to define the meaning of the company's interests under Iraqi law.

#### 3.3.1 The Meaning of the "Company's Interests"

As was mentioned earlier, Art.120 of the I.C.A. 1997, Art.17 (5-b) of the P.B.A. 2004 and the Ministerial Order for Facilitating the Enforcement of the latter Act,<sup>104</sup> (herein after the M.O.F.E.P.B.A.) No. 4, 2010, refer to the "company's interests" as the goal that the director must promote as the basis for sound management.<sup>105</sup> The meaning of

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<sup>104</sup> See Art.64 (First) of this Ministerial Order.

<sup>105</sup> The firm's interests (its objective), must be set out as an obligatory clause in its contract (The I.C.A. 1997, Art.13 (Third)); it must be achievable (not impossible) (The Civil Code 1951, Art.126), and legitimate (The Civil Code 1951, Art.130). Accordingly, the company's contract is void if it fails to meet the above requirements (the I.C.A. 1997, Art.12 (Third)).



this term, however, is not defined, and it is left to the courts to explore and identify the meaning in the context of a case's facts.<sup>106</sup>

Basically, "interests" in the Arabic language means "reform," (overhaul) as opposed to "corruption". This concept encompasses obtaining a benefit and avoiding damage.<sup>107</sup> Thus, maximising the company's interests includes avoiding any prejudice to it,<sup>108</sup> and being compatible with common law.<sup>109</sup> It is equivalent to the term "success" used in Art.172(1) of the C.A. 2006, since the promotion of a company's interest will invariably result in success.

Under Iraqi law, gaining profits is generally an indicator of success, but an increase in the legal reserve represents another indicator.<sup>110</sup> The special Companies Acts considered the maximization of a company's value as an additional indicator of success in protecting the creditors' interests.<sup>111</sup>

Art. 120 of the I.C.A. 1997 and Art.17(6) of the P.B.A. 2004 do not, however, answer the question of whether the company's interests include supporting other companies having a legal connection to it (such as the parent company) or with an economic nexus that has an impact on its stability. The formulation of the aforementioned Articles gives an impression that a director is obliged to serve the interests of his company solely, even if the latter exists within a group of companies. This argument is bolstered by Art.27 of the I.C.A. 1997, which emphasizes that the company's capital '... shall be allocated to carry out the business specified in the company's contract and to fulfil its obligations. It is impermissible to dispose of the capital in any other way.' This finding contradicts the economic reality of parent companies with control over other small companies, and economic phenomena that have recently become widespread in the Iraqi market.

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<sup>106</sup> Ghada Ahmed Issa, *the Agreements between Shareholders in the Joint Stock Companies* (first edn, the Modern Institution of Book 2008) 145.

<sup>107</sup> Mustafa Ibrahim Alzlamy, *The Origins of Islamic Jurisprudence in its New Fabric* (5<sup>th</sup> edn, Khansaa publisher 1999) 119.

<sup>108</sup> See Art.4 (Third-1) of the I.C.A. 1997, concerning the duty of the majority shareholders towards the company. It can be applied by analogy to the directors as they also participate in the management of the company.

<sup>109</sup> *Fusion Interactive Communications Solutions Limited v Venture Investments Placement Ltd* [2005] EWHC 224 (Ch), 2005 WL 460715. See also Sarah Worthington, 'Corporate Governance: Remedy and Ratifying Directors' Breaches' (2000) 116 Oct L Q R 638, 662-663.

<sup>110</sup> See I.C.A. 1997, Art.74 which will be discussed in this Chapter, para. 3.3.3.

<sup>111</sup> See the P.B.A. 2004, Arts.2, 16(1), 46, 84(1); the I.B.R.A. 2005, Art.2 (Twenty).

English common law, by contrast, has established that ‘each company in the group is a separate legal entity and the directors of a particular company are not entitled to sacrifice the interest of that company’<sup>112</sup> Greater flexibility, however, has been added to this rule by other authorities. The common law has recognised the legitimacy of the director’s decision to support the parent company or another firm within a group, as long as the latter’s collapse leads to the collapse of the company concerned. Accordingly, the decision to guarantee a loan and the liabilities of the group are considered to be valid when the director ‘...reasonably believed that the transactions were for the benefit of the company...’.<sup>113</sup> The above principle should be applied to the parent company in dealing with the interests of its subsidiary company.<sup>114</sup>

Thus, the position of the I.C.A. 1997 towards this issue involves a restriction of the concept of a company’s interests and in this respect provides the director with unsatisfactory guidance. Accordingly, it is necessary to add greater flexibility to the Iraqi Companies’ Acts so as to assimilate economic realities and to shield the director from responsibility.

On the other hand, Art.17(6) of the P.B.A. 2004 requires the directors to achieve ‘the best interests of the bank.’ This differs from what is stated in the I.C.A. 1997 and the C.A. 2006. Indeed, this requirement, as a standard of conduct, relates to the duty of care rather than to a fiduciary duty, which requires the director to focus on the merits of a particular transaction.<sup>115</sup> The C.A. 2006, by its failure to mention this requirement, has drawn a clear line between the duties mentioned. However, the nexus between the duty to act in the company’s interests and the duty of care is that two duties remains robust, since a fiduciary duty is crucial to ensure the best performance of non-fiduciary duties.<sup>116</sup> If a director has been forbidden to engage in a transaction in which he has a personal interest, it is likely, for example, that he would act to obtain the best price for

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<sup>112</sup> *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62, 74 (CH); *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BC L C 218 (CH).

<sup>113</sup> *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62, 74 (CH). The court had applied this test in *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218, 228-229 (CH); *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (CH) [103].

<sup>114</sup> *Nicholas v Soundcraft Electronics Ltd* [1993] BCLC 360 (CA).

<sup>115</sup> Robert Flannigan, ‘Fiduciary Duties of Shareholders and Directors’ (2004) May JBL 277, 288; Rebecca Lee, ‘Rethinking the Content of the Fiduciary Obligation’ (2009) 3 Conv P L 236, 251.

<sup>116</sup> Matthew Conaglen, ‘The Nature and Function of Fiduciary Loyalty’ (2005) 121(Jul) L Q Rev 452, 461.

his company in a transaction.<sup>117</sup> Hence, the interlocking of these duties cannot be ignored. What is evident, however, is that there has been a misunderstanding on the part of Iraqi lawmakers of the concept of fiduciary duty. This can be discerned from the combination of the two distinct duties in one Article.<sup>118</sup>

Finally, the director's duty under Iraqi law is to exercise efforts to promote the company's interests, but he is not guaranteed to succeed in gaining this objective.<sup>119</sup> Obviously success depends on many factors not necessarily connected with management, such as the financial position of the company, the general economy and the nature of the competition between economic entities.

### **3.3.2 Fostering the Interests of a Company's Members**

The I.C.A. 1997 deemed that serving the interests of shareholders is the ultimate objective of the company, and that it is achieved by means of the collective exercise of trade. This finding is bolstered by several arguments. For example, Art.4 (First) of the I.C.A. 1997 defines the company as a 'contract binding two or more persons, wherein each person shall subscribe to the economic project by a quota of the capital or service in order to share the resulting profit or loss'.<sup>120</sup> Moreover, Art.1(3) of the I.C.A. 1997 stated that its objectives were to 'protect shareholders from all prejudicial activities such as conflicts of interest and related abuses by company officials.' Finally, the I.C.A. 1997, by virtue of describing a company's members as 'the owners of the company'<sup>121</sup> gives further evidence of the adoption of the traditional approach.

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<sup>117</sup> Ibid, 468.

<sup>118</sup> See formulation of Art.120 of the I.C.A. 1997, which has been mentioned previously.

<sup>119</sup> Kamil Abdul-Hussain Al-Baldawi & Aliya Yonis Al-Dabbagh, 'The Civil Liability of the Board of Directors' (2007) 27(8) *Al-Rafidain of Rights J* 13, 31

<sup>120</sup> This definition is the prevalent one in some Companies' Acts of the Arabic civil law countries. See, for example, the Saudi Arabian Regulation of Companies (Art.1); the Companies' Act of the United Arab Emirates No.8 1984 (Art.4); the Commercial Companies' Act of Bahrain No.28 1975 (Art.1); the Commercial Companies' Act of Qatar No.5 2002 (Art.2).

<sup>121</sup> See Arts. 1(4), 4(Third) of this Act. See also 62 (Third-a) of Chapter 24 (the Rules of Sound Management) of the M.O.F.E.P.B.A. 2010.

S. 172 (1) of the C.A. 2006 states with even greater clarity that a director must act ‘...to promote the success of the company for the benefit of its members’. This provision replicates the approach taken by the common law in this area.<sup>122</sup>

The focus on the shareholders in the Iraqi and English jurisdictions is attributable to the fact that shareholders are the first participants in the firm and the residual beneficiaries,<sup>123</sup> who may lose their investments in the case of a company’s insolvency.<sup>124</sup> It is fair therefore to give their interests priority over any others. But the main difference between these jurisdictions is that s.172(1) of the C.A. 2006 and Art.17(6) of the P.B.A. 2004 impose an affirmative duty on the director to have regard to the shareholders’ interests; whereas neither Art.4 (First), nor Art.120 of the I.C.A. 1997 has imposed such a clear-cut duty on a director when he is pursuing the company’s interest. This in turn gives rise to another problem: that of finding a legal basis for a director’s liability for any abuse of shareholders’ rights.

The abuse of shareholders rights may stem from a director. Iraqi law has failed to regulate this matter, which may be attributed to the following reasons:-

Firstly, the I.C.A. 1997 delineates the relationship between the company bodies precisely. The law thus assumes that the control exercised over managerial activities by the general assembly (by virtue of it being the highest body in the company) is a sufficient safeguard against any abuse.

Secondly, the Iraqi market has until recently not dealt with significant transactions that create a direct relationship between groups of shareholders and the directors, such as takeover bids.<sup>125</sup> This position creates a need to formulate particular rules for governing these relations

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<sup>122</sup> See *Gaiman v National Association for Mental Health* [1971] Ch 317, 330 (CH) (Megarry J). The best description of a company’s interests may have been given by Nourse L.J in *Brady v Brady* [1987] 3 B C C 535, 552 (CA). He emphasized that ‘The interests of a company, an artificial person, cannot be distinguished from the interests of the persons who are interested in it. Who are those persons? Where a company is both going and solvent, first and foremost come the shareholders, present and no doubt future as well’.

<sup>123</sup> Fraser Dobbie, ‘Codification of Directors’ Duties: An Act to Follow?’ (2008) 11 Trinity C L Rev 13.

<sup>124</sup> Usha Rodrigues, ‘Corporate Governance in an Age of Separation of Ownership from Ownership’ (2010-11) 95 Minn L Rev 1822, 1829.

<sup>125</sup> This fact is attributable to the influence of the Socialist regime. For more details of this issue see Chapter 2, para 2.2.1.

By contrast, the C.A. 2006 addressed this matter by designing general rules to shield the shareholders from this eventuality. These are: (i) Considering the company's members as a whole (ii) Dealing with them fairly (iii) Adopting a long-term strategy. The aim of the following discussion is to explore the extent to which Iraqi law has implicitly embraced these rules.

### 3.3.2.1 Considering the Company's Members as a Whole

This rule laid down in s.172(1) of the C.A. 2006 means that a director must regard the company's members as a whole, rather than as a group of individuals, or a *fortiori* as individual shareholders.<sup>126</sup> The rule is based on the argument that to ignore the interests of a group of shareholders means that the interests of the shareholders as a whole have been disregarded,<sup>127</sup> and implies depriving those group of their membership rights.

By contrast, the I.C.A. 1997 lacks an explicit rule which explains to the director how to deal with the interests of a group of shareholders. It is also envisaged that a director may take decisions contradicts the company's interests, for two reasons:-

First, the I.C.A. 1997 does not adopt completely the principle of separation between ownership and management. This is an expedient to ensure a director's impartiality in his conduct of a company's interests, and to avoid conflict of interests.<sup>128</sup> The incumbency of a directorship post in the board of directors requires the possession of not less than 2000 shares.<sup>129</sup> This requirement is justified by the desire to create an interest in the company for a director,<sup>130</sup> thus motivating him to exert care in managing

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<sup>126</sup> For more analysis of the root of this rule in English law, see: Sen Hwei Chan and Larelle Law, 'Interests of the Company as a Whole: An Economic Appraisal of Fiduciary Controls' (1999) 20 U Queensland L J 186, 189; Robert Langton and Lindsay Trotman, 'Defining the Best Interests of the Corporation': Some Australian Reform Proposals' (1999) 3 Flinders J L Reform 163; Alastair Hudson, *Understanding Company Law* (1 edn, Routledge P 2012) 127.

<sup>127</sup> See *Alexander v Automatic Telephone Company* [1900] 2 Ch 56, 60 (CA); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 All ER 1126 (PC).

<sup>128</sup> Eric M. Fogel & Andrew M. Geier, 'Strangers in the House: Rethinking Sarbanes-Oxley and the Independent Board of Directors' (2007) 32 Del J Corp L 33, 42.

<sup>129</sup> The I.C.A. 1997, Art.106(3). But it is permissible for the managing director to be one of a company's members or from outsiders (not a member in the company) (Art.121).

<sup>130</sup> Lateef Jabr Commanee, *the Commercial Companies* (First edn, Mustansiriyah University 2008) 138.

its interests.<sup>131</sup> This requirement may motivate a director to acquire gradually a substantial amount of shares over the coming years by virtue of his familiarity with the company's affairs, and later becomes a principal shareholder. However, this rule may also have adverse consequences, such as a director may be motivated to pursue his personal interests, regardless of whether the decisions he takes are commensurate with other shareholders' interests. A director, for instance, if he is the principal shareholder in the firm, could seek to change the company's interests by means of the general assembly to secure an opportunity that falls within the company's line of business for himself to avoid his own liability in the future.<sup>132</sup>

Second, a director might be subject to the pressure of the majority of shareholders as a result of conflict of interests between groups of them. This status can be envisaged when, for example, institutional investors, such as the State Sector (in Iraqi law<sup>133</sup>) prefer to retain their profits for use in longer term investments, whereas individual shareholders may favour receiving their profits immediately.<sup>134</sup> It is worth noting that Art.4 (Third) of the I.C.A. 1997 solved this problem by preventing the dominant shareholders from 'harm(ing) or disadvantage the company to benefit themselves or those associated with them at the expense of other owners of the company.'<sup>135</sup> But this provision does not solve the problem of the pressure that may be practised by the

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<sup>131</sup> Mowafaq Hassan Raza, *the Company Law: Its Goals, Basis and its Content* (the Legal Research Centre 1985) 129; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *the Commercial Companies* (first edn, Baghdad University 1986) 267-268.

<sup>132</sup> For more details of this matter see Chapter 4, para 4.2.2.1 of this thesis.

<sup>133</sup> The I.C.A. 1997, Art.7.

<sup>134</sup> Justice Joseph T. Walsh, 'The Fiduciary Foundation of Corporate Law' (2002) 27 J Corp L 333, 337.

<sup>135</sup> Art. 1(Third-1) of the I.C.A. 1997.

This provision binds shareholders to respect the company's interests when taking any decision. This approach is comparable to the approach taken by American law, but is in contrast to the prevailing principle in English law. Under English law, a shareholder does not bind himself to act on behalf of or for the interest of another shareholder, and subsequently he does not owe a fiduciary duty to another shareholder. He is free to use his vote as a proprietary right, according to his belief and his personal interest. At any event, this form of abuse is beyond the scope of the present thesis.

In English common law see *Pender v Lushington* (1877) 6 Ch D 70, 75 (CH); *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 W L R 1133, 1144 (CH); *Re Astec* (BSR) plc [1998] 2 BCLC 556, 584 (CH).

For more details about this issue see: P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 10, para 16; Robert Flannigan, 'Fiduciary Duties of Shareholders and Directors' (2004) JBL 277, 285-287; Ji Lian Yap, 'Reforming Ratification' (2011) May 40 Com L World Rev 1, 2; J. A. C. Hetherington, 'Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities' (1987) 22 Wake Forest L Rev 9, 12; Zipora Cohen, 'Fiduciary Duties of Controlling Shareholders: A Comparative View' (1991) 12(3) U Pa J Int'l Bus L 379, 380-382; Hans C. Hirt, 'Ratification of Breaches of Directors' Duties: the Implications of the Reform Proposal Regarding the Derivative Actions' (2004) 25(7) Comp Law 197, 200.

majority on a director to pursue their personal interests at the expense of the company. This pressure is often stems from two sources:-

Firstly, the general assembly is entitled to determine what is subsumed within the company's interests.<sup>136</sup> The Act provides the majority with an indirect means to interfere with a company's management. The shareholders, for instance, are empowered to 'discuss and approve the proposed annual plan and the budget for the following year in other than joint-stock companies' (in which the budget must be prepared by the directors).<sup>137</sup> A simple majority of shareholders is empowered either to reject the management's plans or to put forward alternative suggestions.<sup>138</sup> This power, if used for personal purposes, may result in hampering the directors' strategies to maximize the company's interests.

The second reason is that the majority has the right to dismiss a director without the need to give a reason.<sup>139</sup> The failure of the law to delineate the nature of a director's relationship with his company is a factor that is liable to make him into a puppet in the hands of those who dominate a company's affairs. While regulating the company's relationship with a director under the contract of service (as the case under English law) will give him protection against any improper influence and help insulate him consequently from the pressure that could be wielded by the shareholders.

The results of the situation described above are that:-

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<sup>136</sup> The I.C.A. 1997, Art.102.

<sup>137</sup> The I.C.A. 1997, Art. 102(Fifth).

<sup>138</sup> Under Art.98 of the I.C.A. 1997, the decisions in the general assembly '...shall be made on the basis of the majority of the votes of shares or quotas represented in the meeting, unless the company's contract requires a higher proportion...' This provision may not provide an effective protection to the minority, especially when shareholders' apathy in attending such meetings has been taken into account.

Bushra Najm Abdullah Al-Mashhadani, the Importance of Corporate Governance in confronting the Financial and Accounting Corruption: An Analytical Study of the Legal and Supervisory Framework that Regulates the Activities of Joint Stock Companies in Iraq (Date unknown) <[www.nazaha.iq/body.asp?field=news-arabic &i d =470](http://www.nazaha.iq/body.asp?field=news-arabic&i d =470)> accessed 15 October 2012, 12.

<sup>139</sup> Art.102 (Second) of the I.C.A. 1997. Free dismissal is based on the rules of agency, which permit the exercise of this power at any time (see the Civil Code 1951, Art.947(1)). See also Ghada Ahmed Issa, *the Agreements between Shareholders in the Joint Stock Companies* (first edn, the Modern Institution of Book 2008) 88-89.

(i) A director will in practice act in the interests of the majority rather than in the interests of the shareholders as a whole.

(ii) The conflict of interests between shareholders will move from the general assembly to the boardroom, and a director will no longer be an impartial guardian of the firm's interests.

By contrast, a director under English law is bound to act in the interests of the shareholders as a whole. Such approach inevitably serves to eliminate the above contradictions produced by the I.C.A. 1997 legislation, for the following reasons. First, this approach will provide a director with an appropriate legal basis to free him from pressures that could be exercised by majority shareholders. Second, it enables the director to challenge any decision involving prejudice to minority interests, while at the same time it renders him potential liable for any harm that affects those interests. Thirdly, this regulation is the best means of mitigating the fears of new investors regarding the predominance of majority shareholders' influence on the company's affairs. Thus, a transplantation of the English regulation into Iraqi law would kill three birds with one stone!

It is worth noting that the M.O.F.E.P.B.A. 2010 incorporates this rule via its Art. 64, which deems the directors to be 'representatives of the shareholders as a whole'. A director is bound under Art.63 (First) of this legislation to 'protect shareholders' rights irrespective of the ratio of their ownership in the bank' as one of the foundations of sound management. However, this rule cannot be applied outside the jurisdiction of the P.B.A. 2004, and thus there is a need to incorporate it in the I.C.A. 1997 in order to eliminate the aforementioned conflicts of interests that may occur in non-banking companies.

### **3.3.2.2 Fairness towards Shareholders**

S.172(1-f) of the C.A. 2006 imposes on a director the duty to 'act fairly in dealing with members of a company',<sup>140</sup> and avoiding any discrimination against them that is not

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<sup>140</sup> The term "fairly" is used where there are different classes of shareholders, while "equality" refers to the fairness that should be operative within a particular class of shareholders. For more details of



based on legal or contractual considerations. For instance, the directors must ensure the right of ready access to information for all members of a company.<sup>141</sup> Also they must not deprive any group of its legal rights, for example by failing to summon any shareholders to attend a general meeting.<sup>142</sup> However, taking a decision that coincides with the interests of one group of the company's members is valid as long as the director honestly believed that the decision was consistent with the interests of the members as a whole.<sup>143</sup>

The I.C.A. 1997 lacks any explicit provision equivalent to the above rule. However, it can be inferred through extrapolation of the provisions of the I.C.A. that the principle is reflected in this Act, particularly in certain of its provisions.<sup>144</sup>

It might be argued that the failure to mention the above rule is due to the fact that, under this Act, shares must be issued at a nominal value of one Dinar. Thus, the amount of the shareholder's subscription will determine the extent of his shareholder rights, and consequently his duties. The rule is presupposed in the I.C.A. 1997, simply because there are no different classes of shares to create differing interests. This rationale is unconvincing, however, because it ignores the diversity of the shareholders to be found within the same class of shares. The I.C.A. 1997, for example, refers to various types of shareholder. Besides the ordinary shareholders there are the

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this principle, see P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 56-74, paras 117-154.

<sup>141</sup> *Re a Company* [1986] BCLC 382, 389 (CH). See also: Mark S. Schwartz, Thomas W. Dunfee and Michael J. Kline, 'Tone at the Top: An Ethics Code for Directors?' (2005) 58 *Journal of business ethics* 85, 94; Andrew Keay, 'Formulating a Framework for Directors' to Creditors: An Entity Maximisation Approach' (2005) 64(3) *C L J* 614, 625.

<sup>142</sup> However, in *Mutual Life Insurance Co. of New York v The Rank Organisation Ltd* [1985] BCLC 11 (CH), the directors had decided to distribute shares to their shareholders, but had excluded the American and Canadian shareholders in order to avoid dealing with the onerous conditions imposed by the Securities Acts in these countries. The court held that this exclusion was valid as long as the company's interests had been taken into account in good faith.

<sup>143</sup> P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 57, para 121; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 158, para 6.128.

<sup>144</sup> The above rule takes account of certain provisions, such as the distribution of information to all shareholders (Arts.1(4), 30); the responsibility of a company's members for losses (Art.6); issuing equal value shares (Art.2(First)); re-payment of the prices of shares sold to all shareholders if their number has exceeded the number of shares offered (Art.44(Second)); the right to receive shares certificates (Art.50); the fair distribution of newly paid-up shares to all company members by using the legal reserve (Art.55 (First)); the cancellation of shares for each member in case of a reduction of a company's capital (Art.59 (First)); and the right to transfer the ownership of shares to another person (Art.64) etc.

See also the M.O.F.E.P.B.A. 2010, Art.63, which refers to most of these rules as examples of the application of the principle of equality between shareholders.

institutional shareholders, such as: insurance companies, pension funds (Art.8(2) the State Sector (Art.7); the investment companies (Art.9); and national and international investors.<sup>145</sup> Each of these groups has the same right to have their interests dealt with fairly.

The M.O.F.E.P.B.A. 2010 has embraced this rule under Art. 63(First), which declares that one of the foundations of sound management is to ‘deal with each class of shares equally and homogenously, by keeping them [the shareholders] aware of all information about the bank, its position and its achievements’.<sup>146</sup>

The above provision does not, however, obviate the need to enshrine in Iraqi law an explicit and general provision of what was stipulated in s.172 (1-f) of the C.A. 2006 for dealing with every conceivable situation which might result in unfairness. There is likewise a need to provide a director with clear and adequate guidelines, since the I.C.A. 1997 entirely fails to do so.

### **3.3.2.3 Adoption a Long Term Strategy**

S.172(1-a) of the C.A. 2006 states that a director must give regard to ‘the likely consequences of any decision in the long term’. This provision stems from the fact that it is indispensable for any commercial project to be premised on a clear plan for ensuring its stability. It must also provide a clear conception of what should be expected from a director to do in the future.

Art.117 (Sixth) of the I.C.A. 1997 empowers directors to ‘prepare studies and statistics with a view to developing the company’s business’. There is uncertainty as to whether this provision meets with the rule mentioned in the analogous U.K provision, s.172 (1-A) of the C.A. 2006. That is because the formulation of Art.117 (Sixth) of the I.C.A. 1997, which employs the terms “studies” and “statistics”, suggests that this power does not impose a clear duty in this regard.

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<sup>145</sup> See the Investment Act No.13 2006, Art.11 (Second), which authorizes international investors to deal in the shares and bonds of Iraqi companies.

<sup>146</sup> [Illustration added].

From another point of view, it may be asked: if the director's duty is confined to preparing the strategy, who will take the decision on whether to adopt it? According to Art. 102 of the I.C.A. 1997, it is the general assembly that is qualified to take this decision, by virtue of its power to determine the company's interests. Whereas the director is the most appropriate person to take this decision, by virtue of being professional in making commercial decisions, which can also result to make him liable for any faults that subsequently occur. The dispersion of liability between more than one body will result in difficulty in determining the person or persons who will be answerable for any failure in implementing a company's strategy.

Conversely, if Art.117 (Six) of the I.C.A. 1997 indicates a long term strategy, then it does not give discretionary power to a director to adopt a short term strategy when the company's interests require it. It is possible, for example, that the company was intended to exist for only a short term, perhaps in order to perform a certain project.<sup>147</sup> It is possible also that the decision in question has a narrow scope. It could be taken in connection with a takeover bid, in which the interests of the current shareholders are at stake.<sup>148</sup> Therefore discretionary power needs to be a cornerstone of company strategy, as stipulated in s.172(1-a) of the C.A. 2006. In accordance with the above observations, it is suggested that the latter provision of the C.A. 2006 should be incorporated into Iraqi law.

It is worth noting that the adoption of a long term strategy allows several legal advantages. First, it is a means of freeing the director from the pressure that may be exercised by some shareholders with a view to engaging in some profitable short term business,<sup>149</sup> which may nonetheless imperil the company.

Second, it is a good means of fostering the interests of future shareholders, by drawing the director's attention to the fact that the company's "interests" are not confined to

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<sup>147</sup> Len Sealy and Sarah Worthington, *Sealy's Cases and Materials in Company Law* (9th edn, OUP 2010) 319-320.

See also: the Iraqi Board of Accounting Standards (herein after I.B.A.S) vol. 2, 2011, Rule 6(7).

<sup>148</sup> Stefan J. Padfield, 'In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries' (2004) 10(1) *J C F L* 79, 105; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 149, para 6.101.

<sup>149</sup> The C L R S G, 'Modern company law for a Competitive Economy: The Strategic Framework' (1999) <[www.bis.gov.uk/files/file23279.pdf](http://www.bis.gov.uk/files/file23279.pdf)> accessed 15 July 2012 para 5.1.12; Deryn Fisher, 'The Enlightened Shareholder- Leaving Stakeholders in the Dark -Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of their Decisions on Third Parties?' (2009) 20(1) *I C C L R* 10, 14.

the current shareholders. The long term strategy thus operates to explain to future members ‘...that the interest of members at any time consists of an interest in the value of the enterprise as a revenue-generating entity in the future.’<sup>150</sup>

Third, a long term strategy has become one of the pillars of modern company law and corporate governance.<sup>151</sup> It is aimed at creating economic entities premised on stable bases that will be capable of confronting any economic crisis. Such a long strategy will inevitably lead to an enhancement of the stakeholders’ interests. Long term strategy and promoting the stakeholders’ interests should be seen as two sides of the same coin.

In a nutshell, it has been demonstrated that the I.C.A. 1997 has failed to provide for the examples provided by English law regarding the extent to which a director must take the interests of the shareholders into account in his decision-making. Consequently an Iraqi director is granted a safe-harbour for the abuse of his powers. It is therefore of the greatest importance that the English rules described above should be transplanted into Iraqi law. Such measures will ensure that a director invariably gives precedence to the interests of a company’s members.

### **3.3.3 Fostering the Stakeholders’ Interests under Iraq Law: A Blot on Iraqi Corporate Governance?**

The company is no longer<sup>152</sup> viewed as an expedient for maximizing its members’ profits. There are other participants in its activities, i.e., the stakeholders, who are affected and influenced by the company's activities.<sup>153</sup> These are the employees,

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<sup>150</sup> The C.L.R.S.G., ‘Modern Company Law for a Competitive: The Strategic Framework’ (1999) < [ww w.bis. Gov. uk /files / file23279 .pdf](http://www.bis.gov.uk/files/file23279.pdf)> accessed 15 July 2012, p. 40, fn. (31).

<sup>151</sup> Deryn Fisher, ‘The Enlightened Shareholder-Leaving Stakeholders in the Dark- Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of their Decisions on Third Parties?’ (2009) 20(1) I C C L R 10, 13.

<sup>152</sup> Jingchen Zhao, ‘Promoting More Socially Responsible Corporations Through UK Company Law After the 2008 Financial Crisis: The Turning of the Crisis Compass’ (2011) 22(9) I C C L Rev 275, 277.

<sup>153</sup> Deryn Fisher, ‘The Enlightened Shareholder-Leaving Stakeholders in the Dark Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of their Decisions on Third Parties?’ (2009) 20(1) I C C L R 10, 12; Andrew Keay, ‘Section 172(1) of the Companies Act 2006: an Interpretation and Assessment’ (2007) 28(4) Comp Law 106, 107; Sen Hwei Chan and Larelle Law, ‘Interests of the Company as a Whole: An Economic Appraisal of Fiduciary Controls’ (1999) 20 U Queensland L J 186, 194.

creditors, suppliers, and customers etc., who must also be taken into consideration. The stakeholders represent the intangible assets<sup>154</sup> of every company, and fostering their interests is vital for the attainment of the company's interests,<sup>155</sup> which in turn is conducive to a maximisation of the shareholders' benefits.

However, the I.C.A. 1997 remains far removed from modern developments in modern company law. Indeed, the rights of stakeholders did not attract the attention of the legislators who formulated the I.C.A. 1997. It is not intended in this section to discuss this theme intensively, since it merits a separate study. Instead, the focus will be on the position of stakeholders under the I.C.A. 1997, and particularly on the factors that may bring about a conflict of interests between different entities, such as creditors, employees, the community and the environment.

The reference to the creditors' interests was made within the context of the Act's objectives, which contain measures that aim to prevent any tendency on the part of a company's owners (its members) to 'jeopardize the rights of creditors by causing withdrawal of capital or transfer of assets when insolvency is imminent or when prohibited by law'.<sup>156</sup>

Two observations can be made concerning this provision: Firstly, this provision imposes on the shareholders the duty to have regard for creditors' interests. While the director possesses powers that may endanger creditors' rights more seriously than those entrusted to shareholders. This is because directors are empowered to design policies for loans, mortgage and securities, and these may conduce to incurring additional debts for the company.<sup>157</sup> Interestingly, Art.722(2) of the Commerce Act No. 149 1970<sup>158</sup> reinforces the aforementioned argument, by imposing on a director the liability for a company's insolvency. Secondly, the current provision gives an impression that the creditors' interests would not be taken into account unless a

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<sup>154</sup> C.L.R.S.G., 'Modern Company Law for a Competitive Economy: The Strategic Framework' (1999) <[www.bis.gov.uk/files/file23279.pdf](http://www.bis.gov.uk/files/file23279.pdf)> accessed 15 July 2012, para 5.1.10.

<sup>155</sup> Deryn Fisher, 'The Enlightened Shareholder-Leaving Stakeholders in the Dark Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of their Decisions on Third Parties?' (2009) 20(1) I C C L R 10; John Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure' (2009) 68(3) C L J 607, 616.

<sup>156</sup> Art.4 (Third-2) of this Act.

<sup>157</sup> The I.C.A. 1997, Art.117 (Seventh).

<sup>158</sup> This Act has been abolished, except for the provisions of insolvency, which are still in force under Art.331 (First) of the Commerce Act No.30, 1984.

company is on the verge of bankruptcy, i.e., after a total collapse. This liability, however, should exist at all times in order to maintain a company's reputation. However, the creditors have an additional protection in the form of the legal reserve. The latter is to be used for repaying their debts at rate of not more than 50%, and 'any increase over that limit shall be subject to the approval of the Registrar'.<sup>159</sup> So it seems that the I.C.A. 1997 gives the creditors' rights precedence over the rights of shareholders and other stakeholders, since the legal reserve involves a deduction from the shareholders' share in the dividends belonging to them. This reserve is used for various social purposes, as it will be seen shortly.

The same observation can be about other Iraqi special Companies' Acts. These pieces of legislation point out that the primary objective is to protect the interests of its creditors,<sup>160</sup> although they do not lay down a specific duty to be followed by a director in this respect. Seemingly, the only protection given to creditors in these Acts is through legal procedures that must be followed by the company to maintain its sustainability, without a director incurring liability for failure to repay the debt.<sup>161</sup>

Concerning the employees' relationship with the company, this nexus was fixed in two phases: firstly at the stage of the pre-reforming of the I.C.A. 1997 (by Order No.46 2004 issued by the C.P.A.): employees' rights were protected in the I.C.A. 1997 via conferring a company's employees' the right of appointing their nominees in the board of directors to represent their interests. However, it is suggested that this representation does not prevent decisions being taken that are prejudicial to employees' interests, because their representatives may possess at best only one or two votes. The voting right, therefore, may not be adequate to challenge a decision that is detrimental to employees. It seems that the only benefit of this approach is that it gives a possibility for the representatives to persuade the other directors that a particular decision is contrary to the employees' interests. The effective protection therefore takes the form of a clear duty imposed on a director to regard this interest in any decision taken. After the C.P.A.'s reform of the Act, the right of appointing the representatives of employees

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<sup>159</sup> The I.C.A. 1997, Art.74 (Second).

<sup>160</sup> See the P.B.A. 2004, Art.2(1); the I.B.R.A. 2005, Art.6 (First).

<sup>161</sup> See for example the I.B.R.A. 2005, Arts.6 (First); 38(Seven); 56; 70; the P.B.A. 2004, Arts.46 (4), 56(b), 61(2), 82(8) and 91(1).

in the board has been repealed.<sup>162</sup> No alternative rights were provided to employees, except for a simple mention to the right of use legal reserves for ‘improving the conditions of ...workers’,<sup>163</sup> although no details were given as to how this improvement was to be undertaken. This situation is contrary to the principles of corporate governance, which stipulates that safeguarding the employees’ interests is of great importance in protecting the intangible assets of the company, the success of which depends on sustaining a good relationship with this category of stakeholders.

Other factors, such as the protection of the environment and social and welfare programmes, have been mentioned within the context of the financial support for these aspects from the legal reserve.<sup>164</sup> Again, no details are given of the methods by which these considerations are to be supported. Financial support for these considerations has in fact less significance, unless a specific duty is imposed on a director to avoid prejudice against these considerations. Finally, the Act does not mention the interests of customers and suppliers.

By contrast, the C.A. 2006 has progressed beyond the above traditional approach of advancing the shareholders’ interests as the company’s sole objective.<sup>165</sup> Instead it espouses the “Enlightened Shareholder Value” (E.S.V.). According to this unique approach, s. 172 (1) of the C.A. 2006 states that ‘a director of a company must act... to promote the success of the company for the benefit of its members as a whole, and *in doing so have regard (amongst other matters) to...*’<sup>166</sup> The section goes on to indicate six factors, namely the interests of employees, suppliers, customers, the community, the environment, the reputation of the company and long term strategy. It is left to the common law to develop the director’s duty towards the interests of creditors.<sup>167</sup>

The addition of the phrase “amongst other matters” to the six factors cited above imply that the latter are non-exhaustive and that others can be added according to the nature

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<sup>162</sup> Seemingly, the reason for espousing the new approach is the desire to link the right of selecting the directors with the owners of the company only, viz, its members.

<sup>163</sup> See the I.C.A. 1997, Art.74 (First).

<sup>164</sup> The I.C.A. 1997, Art.74(First).

<sup>165</sup> The Explanatory Notes of the Companies Act 2006, para 325.

<sup>166</sup> [Emphasis added].

<sup>167</sup> The Explanatory Notes of the Companies Act 2006, para 332.

of the company's activities. However, all these factors should be regarded as being within the ambit of respect for the shareholders' interests. If there should be a conflict of interests between the two named categories of participants, it is the shareholders' interests that must be given priority.<sup>168</sup> This conclusion can be gleaned from the phrase "in doing so", i.e., when the directors are acting to maximise the shareholders' profits; and from the phrase "have regard", which means "paying attention" to these factors. It also means the phrase "think about them" and "give proper consideration to" are used.<sup>169</sup> Generally speaking, this Act does not give a separate weight to each, and regards them all as of equal significance.<sup>170</sup>

The above developments in the C.A. 2006 overshadow the P.B.A. 2004. The Ministerial Order for facilitating this legislation in 2010 adopted the principle of protecting and respecting 'the rights of shareholders and other stakeholders' interests apart from the ratio of their subscription in the bank',<sup>171</sup> as an ingredient of sound management. This principle must be observed in conjunction with the principle of 'providing appropriate proceeds to the owners'.<sup>172</sup> Seemingly, the I.F.E.P.B.A., 2010 did not give weight to any particular one of these factors over any other. But the resort to the definition of the company as set out in Art.4(First) of the I.C.A. 1997, as the general Act,<sup>173</sup> is conducive to giving the interests of the shareholders a predominance over any other interests. This finding makes the P.B.A. 2004 take the same line with the approach espoused by the C.A. 2006.

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<sup>168</sup> For more details see Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet & Maxwell 2008) 506-510, Para 16.24; John Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure' (2009) 68(3) C L J 607, 617; Charlotte Villiers, 'Director' Duties and the Company's Internal Structures under the UK Companies Act 2006: Obstacles for Sustainable Development' (2010) <<http://ssrn.com/abstract=1712791>> accessed 15 July 2012, 10; Mark S. Schwartz, Thomas W. Dunfee, and Michael J Kline, 'Tone at the Top: An Ethics Code for Directors?' (2005) 58 *Journal of Business Ethics* 85, 3-4.

<sup>169</sup> For more details See Margaret Hodge, Commons Report, 17 October 2006, column 789 mentioned in the D.T.I: 'Companies Act 2006, Duties of Company Directors: Ministerial Statements' <[www.berr.gov.uk/files/file40139.pdf](http://www.berr.gov.uk/files/file40139.pdf)> accessed 24 February 2013, 9; Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (2007) 29 *Syd LR* 577, 597; Arad Reisberg, & Ian Havercroft, 'Directors' Duties Under Companies Act 2006 and the Impact of the Company's Operations on the Environment' (2010) <<http://ssrn.com/abstract=1274567>> accessed 15 May 2012, 9 fn (30).

<sup>170</sup> Jin Zhu Yang, 'International Company and Commercial Law Review' (2006) 17(11) *I C C L R* 318, 323.

<sup>171</sup> The M.O.F.E.P.B.A., Art.62 (Third-b).

<sup>172</sup> The M.O.F.E.P.B.A., Art.62 (Third-a).

<sup>173</sup> The P.B.A. 2004, Art.107.



The above developments in the C.A. 2006 and the P.B.A. 2004 offer convincing evidence of the failure of the I.C.A. 1997 to deal with stakeholders' interests. Apparently, the I.C.A. 1997 adopted the long-held approach of English law, that of maximizing the shareholders' value as the company's sole objective.<sup>174</sup> This finding can be inferred from the legislative definition of a company as a contract for engendering the profits to its members.<sup>175</sup> Although some protection has given to creditors, the other stakeholders are still without actual legal protection. In other words, the I.C.A. 1997 provides a poor guide to the director with regard to the scope of a company's interests and the means of assimilating stakeholders into his strategy.

The result of this inadequacy is that it jeopardizes the company as a going concern, and also creates a conflict of interests between shareholders (including a director as one of that number). It is envisaged that a director, by virtue of possessing shares in a company, will take decisions in favour of the interests of shareholders rather than of creditors. It will be in a director's interest, for example, to take a decision to distribute dividends, even if the company is approaching the edge of insolvency and regardless of the employees' interests in obtaining a healthy work environment, etc.

This shortcoming raises the need for a review of this area of company law, first of all by a recognition of stakeholders interests and, secondly, by imposing on the director a duty to foster these interests. It would be irrational to effect a fundamental change in Iraqi law by allowing a sacrifice of the shareholders' interests in favour of other stakeholders, in cases where there is a blatant conflict of interests among them (the pluralistic approach). Such an approach could also have drastic effects on the general economy. This is because the community is accustomed to considering the company as a means of engendering profits for shareholders and not as an independent entity. Thus, adopting the approach of English law, which is premised on turning the directors' attention towards fostering interests other than the company's members

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<sup>174</sup> This approach is called the 'contractual agency' approach or the 'inclusive approach.' See for example: *Hutton v West Cork Railway Company* (1883) L R 23 Ch D 654, 672 (CA); *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258 (CA). For more details of this approach, see: C.L.R.S.G, 'Modern Company Law for a Competitive: The Strategic Framework' (1999) < [www.bis.gov.uk/files/file23279.pdf](http://www.bis.gov.uk/files/file23279.pdf)> accessed 15 July 2012, para 5.1.20; Sarah Kiarie, 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' (2006) 17(11) I C C L R 329. For more details of this concept see: Janice Dean, 'Stakeholding and Company Law' (2001) 22(3) Comp Law 66, 67.

<sup>175</sup> The I.C.A. 1997, Art.4(First).

when making decisions (the inclusive approach), would seem to offer a pragmatic solution.

### **Conclusion**

It has been demonstrated throughout this chapter that the duty to act in the company's interests is the principal duty. This duty is premised on a broad concept that is manifested in a variety of situations involving conflicts of interests not necessarily covered by other proscriptive duties. Its significance also stems from its declarative role which constrains a director to pursuing the interests of the company solely, and then provides a guide to a director on how to fulfil his duty, as well as subjecting him to effective accountability. For this reason, this duty has been occasionally equated with the doctrine of a director's loyalty to the company, although the latter concept is based on a broader notion that governs diverse sorts of conflict of interests. However, the term "loyalty" has not been used in Iraqi law, or by courts and legal commentators. Whereas this notion is inherent in the general principles of agency, this inference is less comprehensible by the director who is not familiar with deduction of specific rules from general legal principles. Importing this concept into the company law has a declarative role by showing the extent of the director's allegiance to the company.

However, Iraqi law has lost the opportunity to get the above legal advantages by obliging a director to act in pursuing the company's interests within a comprehensible and comprehensive duty. The statutory provisions of Iraqi law conflate the duty to act in a company's interests and the duty of care in a single formulation, expressed in one Article. This conflation, under Art. 120 of the I.C.A. 1997, leads to an attenuation of the duty of care, a duty which ought to be applicable whatever the director's state of mind (if it were otherwise, the errant director would always be free to claim that he had acted in what he believed to be the company's best interests). Art. 120 also serves to obscure the importance of a director's duty to further the company's interests, which ought to be his main duty, and the one for which he was appointed.

Art.17(6) of the P.B.A. 2004 does in fact refer explicitly to the director's duty to act in good faith in the interests of the company. However, this duty is subordinated to the duty of care, by virtue of its adoption of the objective standard. The latter involves a substantial degree of contradiction with the principle of good faith, as it is held to be

an expression of the individual's state of mind. This position is conducive also to the generation of an onerous accountability that is inconsistent with commercial activities, which are premised on the considerations of initiative and venture.

Resolution of the above contradictions in Iraqi law could be achieved by following the example of English law, that is to say, *by separating the duty of care and the duty to act in the company's interests*. More flexibility should be added to Iraqi law concerning the test used for ascertaining whether a director has acted in good faith: while *the subjective standard* should be considered as a cardinal test, *the objective test* should be applied as an alternative in cases where the court is able to infer that a director's behaviour was unreasonable, or where there are indications of bad faith, or where gross negligence can be shown.

The company's interests necessarily involve the interests of the participants in the firm, such as its founders (the shareholders), as well as the persons whom are affected by the company's activities (the stakeholders). It is worth noting that the I.C.A. 1997 did not adopt a general principle of separation between ownership and management, and this leads to the possibility of conflicts of interest within the company. It is possible that a director, who possesses shares in the firm, may be inclined to take decisions in his own interests, instead of pursuing his duty. He could, for example, be subject to the influence of a group of shareholders, who appointed him precisely so that their own interests would be served. The I.C.A. 1997, unlike the C.A. 2006, does not delineate special rules for the resolution of clashes of interests within the company's tent. The English law necessitates that a director must act in the interests of the shareholders as a whole; he must also act for them fairly, and pay attention to a long term corporate strategy. The failure to mention any equivalent rules in the I.C.A. 1997 may make it easier for a director to abuse his powers instead of acting on behalf of all the shareholders. The legislative failure to embrace the interests of all the stakeholders, including employees and creditors, is another flaw that is liable to bring about further conflicts of interest. A director in this situation may be inclined to favour the interests of members of the company (of which he is one), to the detriment of the stakeholders. Such a factional bias will inevitably have its effect upon the company's sustainability as a going concern. It is for this reason that stakeholders are included in s.172(1) of the C.A. 2006.

To sum up, the current position of the I.C.A. 1997 is that it does not bind a director with a clear duty to promote the company's interests. On the contrary, it provides an appropriate environment for selfish activities. It is evident that the C.P.A., in its overhaul of the I.C.A. 1997, failed to recognize the importance of transplanting this duty into Iraqi law. Given the situation described above, the following provisions are offered as solutions appropriate to Iraqi legal realities, viz:

### **Art.2: The Duty to Act in the Company's Interests**

1. A director must be loyal to his company through compliance with the duties set out in this Article and in the subsequent Articles.<sup>176</sup>
2. A director must act in good faith in a manner that likely to lead to the attainment of the objectives of the company for the benefit of its members as a whole.<sup>177</sup> This duty includes the disclosure of any harmful activities perpetrated by a director himself or by others.
3. A director, despite his good faith, may be held liable for any unreasonable behaviour or behaviour associated with gross negligence.<sup>178</sup>
4. Having regard to the foregoing sub-paragraph (1) above, the director in carrying out this duty must have regard for other factors, including:-<sup>179</sup>

A- Dealing equally with all members of a company.

B- Adopting a long term strategy with a view to sustaining the company as a going concern.

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<sup>176</sup> It has been shown that Iraqi law does not mention to the concept of loyalty. Transplanting this concept is vital for showing the extent of a director's compliance with his duties.

<sup>177</sup> It has been mentioned earlier that Iraqi law has conflated the duty to act in the company's interests with the duty of care within one statutory formulation, despite that each of them represents independent duties. This confusion leads to irrational legal results, as it has been shown in this Chapter. The above formulation may assist in solving these contradictions.

<sup>178</sup> There is uncertainty as to whether the principle of good faith must be assessed subjectively or objectively. The above proposal furnishes the court with leeway to apply an objective test whenever the results of a director's behaviour make it difficult for the court to consider that this conduct has been in a good faith.

<sup>179</sup> Iraqi law does not encompass provisions which give consideration to the stakeholders' interests. The law currently applies the traditional approach of promoting the shareholders' interests only. The above proposal adopts *the inclusive approach* of the C.A. 2006, which is called "The Enlightened Shareholder Value".

C- Safeguarding the environment and the community.

D- Acting in compliance with the law and with the accepted standards of ethical behaviour in order to maintain the company's reputation.

E- Maintaining good relationships with suppliers, customers, clients and other stakeholders.

F- Protecting the employees' interests, particularly in the area of providing them with appropriate employment conditions, and building sustainable relationships with them.

E- Protecting the creditors' interests and maintaining a company's financial stability so as to ensure its continuous ability to repay its debts. This includes taking appropriate decisions and designing effective policies to sustain these interests, particularly when a company is on the verge of insolvency.

## Chapter Four

### The Duty to Avoid Conflicts of Interest

**Introduction:** In the common law jurisdictions, a director must not place himself in a position under which his duty might conflict with his personal interests or with his duty to another company, except after obtaining prior consent from his company. This duty is usually called the no-conflict rule, which is the term that will be used throughout this chapter.<sup>1</sup> Generally, s.175 of the U.K Companies' Act (herein after the C.A. 2006) has codified the majority of the common law principles under a general rule,<sup>2</sup> which is of great significance as it represents one of the substantial principles of the fiduciary obligation.<sup>3</sup>

By contrast, the Iraqi Companies' Act (herein after the I.C.A.) 1997 failed to enshrine an explicit duty as in the C.A. 2006, except for a brief statement stating

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<sup>1</sup> There are two kinds of rules governing managerial duty: the no-conflict and the no profit rules. The no-conflict rule addresses the above issue, while the no-profit rule relates to the situation under which the director obtains a benefit from his position without putting himself in a position of a conflict of interest. For more details about this issue see Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 SALJ 714, 738-740; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 270, para 9.7.

<sup>2</sup> S.175 of the C.A. 2006 prohibits a director from putting himself in a position of a conflict of interests. It is worth noting that this section put an end to the long debate in the common law about whether this rule is a duty or a disability rule. See *Movitex v Bulfield* [1988] BCLC 104 (CH) (Vinelott J); *Gwembe Valley Development Co v Koshy* [2003] EWCA Civ 1048.

This rule has been described as a negative (proscriptive) duty, under which a director is obliged to avoid placing his duty in conflict with his interests. A director's desire to exploit the company's opportunity leads to triggering the duty of disclosing his interests (the positive duty).

Hans C. Hirt, 'The Law on Corporate Opportunities in the Court of Appeal: Re Bhullar Bros Ltd' (2005) J B L (Nov) 669, 678-678; Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) 45 Irish Jurist 82, 89.

This interpretation has been supported by Iraqi law commentators: see Ahmed Ibrahim Al-Bassam, *The Commercial Companies in Iraqi Law* (Second edn, Al-Zammaan publisher 1967) 180; Mustafa Nasser Nasrallah, the *Commercial Companies* (Coaching publisher 1969) 243; Akram Yamulki & Bassem Mohammed Saleh, *the Commercial Companies: Part.2* (Baghdad University Publisher 1983) 244; Suleiman Barrak Dayeh, 'the Role of the Compensation in the Contractual Liability' (2009) 1(1) Journal of the College of Law -Al-Nahrain University 69.

Alternatively, describing the no-conflict rule is a positive duty leads to confining its scope to situations in which a director had found himself in a conflict of interests incidentally. Cf with Burges Salmon, 'The Companies Act 2006' <[www.burges-salmon.com](http://www.burges-salmon.com) /...> accessed 24 February 2013, 1.

<sup>3</sup> For more details of this theme, see Rebecca Lee, 'Rethinking the Content of the Fiduciary Obligation' (2009) 3 CONVPL 236, 242.

the Act's objectives, which reflects an aspiration to prevent such misbehaviour. While the Insurance Business Regulating Act, (herein after I.B.R.A.), 2005 has codified this duty under a vague general formulation.<sup>4</sup> The deficiency in dealing with this duty represents a serious threaten to the interests of the company and its members, as well other stakeholders, because it motivates dishonest directors to make personal profits at the expense of the company by exploiting this legal gap. Moreover, the inadequacy of Iraqi law in tackling this duty extends also to identifying the concept of a corporate opportunity, which is crucial to the determination of a director's liability. Finally, the above legislative shortcoming makes it difficult to identify the boundaries of the director's permissible entrepreneurial activities, such as his freedom to engage in competitive business activities with the company within the period of his serving in it or subsequently.

This problem poses questions about the extent to which Iraqi law, under the recent amendments made to the I.C.A. 1997, has adopted a concept comparable to that under English law. Questions concerning possible points of weakness in this legal regulation also arise.

To answer the above questions, this Chapter will be divided into three sections. In the first section, the investigation will be directed to the adequacy of the rules governing conflict of interests under Iraqi law and the rules addressing the director's opportunism. The identification of the meaning of conflict of interests and the definition of a corporate opportunity will be the focus of the second section. Finally, section three will investigate the effect of the no-conflict rule on restricting the director's behaviour within the period of his service in the company, and afterwards.

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<sup>4</sup> Art.42 (Second-2) of the I.B.R.A. 2005 prohibits a director from any activity conducive to a conflict of interests with the company. See the discussion about this point in the following Section, para 4.1.1.2.

## Section I

### **The Adequacy and Efficiency of the Provisions of Iraqi Law in Addressing the Director's "Self-interest"**

**Introduction:** This issue necessitates an examination of the current provisions for addressing the conflict of interests and its level of capability in restraining directorial abuse. These considerations will be discussed in the following sections.

#### **4.1.1 Formulating the Conflict of Interests in Iraq Companies' Acts: 'The Devil is in the Detail'**

Iraqi law (and its commentators<sup>5</sup>) do not give a definition of the concept of conflict of interests. It can be derived from the formulation of s. 175 (1) of the C.A. 2006 that a conflict of interests is any factual or legal position under which a director, by virtue of controlling the company's affairs, becomes potentially able to influence on its interests by placing his own interests ahead of the company's interests.

There are two references to the phrase "conflict of interests" in Iraqi law: in the I.C.A. 1997, and in the Insurance Business Regulation Act (herein after the I.B.R.A.) 2005. Only a brief reference to this duty is to be found in these Acts, which results in several practical problems, as will be seen in the following sections.

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<sup>5</sup> See for example Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn, Alani Publisher 1972) 240-243; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986); Lateef Jabr Commanee, *the Commercial Companies* (First edn, Al-Mustansiriya University 2008) 245.



#### 4.1.1.1 Conflict of Interests under the I.C.A. 1997

The I.C.A. 1997 does not contain an explicit provision setting out a general duty of no-conflict, except for a brief mention in Art.1(3) thereof, setting out the objectives of the Act.<sup>6</sup> One of these objects is to ‘protect shareholders from conflicts of interest’. But the law did not enshrine a general duty to prohibit no-conflict rule. The author is of the view that the reason may attributed to the legislator’s belief that the following rules are adequate to confront any abuse by a director to his office: first, the I.C.A. 1997 regulated a director’s duty to declare his interest in a transaction by way of Art.119:<sup>7</sup> but this duty only covers a part of the possible conflict of interests concerning the situation in which a director has an interest in a deal to be concluded with his company, and does not cover other situations of conflict of interest (misappropriation of a corporate property, its opportunity, etc). In contrast, the C.A. 2006 dealt with these duties as independent obligations, setting the no-conflict rule (s.175) to be a general duty and the duty to avoid secret profit (s177) as a special application of this broader rule<sup>8</sup> in order to regulate the latter duty under special rules.<sup>9</sup>

Second, the I.C.A. 1997 prevents a director from taking up the post of director in another company, except after obtaining the company’s approval.<sup>10</sup> This provision ignores the difference between personal competition and institutional competition, which may be exercised via another company in which the involved person

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<sup>6</sup> This Article states that:

The objectives of this law are to:

(3) Protect shareholders from conflicts of interest and related abuses by company officials, majority owners, and others with practical control over the affairs of the company.

<sup>7</sup> This Article states that ‘It is impermissible for the chairman or a member of the board to have direct or indirect interests in deals that are concluded with the company, except after obtaining the permission of the general assembly...’. This provision is equivalent to s.177 of the C.A. 2006.

<sup>8</sup> *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [55].

<sup>9</sup> This view is premised on the formulation of s.175(1), which provides a general duty accommodates all situations of no-conflict. While s.175(3) has excluded from its scope ‘... a conflict of interest connected with a transaction or arrangement with the company’, which is subject to s.177. See also Geoffrey Morse, *Palmer's Company Law: Annotated Guide to the Companies Act 2006* (2th edn, Sweet & Maxwell 2009) para 8.2904, fn(2); Brenda Hannigan, ‘Reconfiguring the no Conflict Rule: Judicial Strictures, a Statutory Restatement and the Opportunistic Director’ (2011) 23 SAcl J 714, 725, 739.

<sup>10</sup> Art.110 of this Act, which will be reviewed in this Chapter, para 4.3.1.1.

exercises the role of director. A director may compete with his company illegally either individually, by way of a partnership, or by founding another company in which he does not occupy the post of a director. The position of the I.C.A. 1997 regarding this matter is much more limited in scope than the approach adopted in s.175 of the C.A. 2006, which imposes a general rule prohibiting all aspects of the conflict of interests. Under s.175(1) '(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company'.

Accordingly, the sole "legal advantage" that can be shown from the formulation of Art.1(3) of the I.C.A. 1997 is that the conflict of interest is illegitimate behaviour, but it is limited scope. This illegality give rise to a director's liability under tort rules, as will be shown shortly.<sup>11</sup>

#### **4.1.1.2 Conflict of Interest under the I.B.R.A. 2005**

Art.42 (Second)<sup>12</sup> of the I.B.R.A. 2005 states:

Members of the Insurers board of directors, the managing director and any principle employees are prohibited from  
[.....]  
B- *Competing against the Insurer* or carrying out any work or activity that results in *a conflict of interest* with the Insurer.<sup>13</sup>

Although this provision is better than the formulation of Art.1(3) of the I.C.A. 1997 in imposing an obvious duty to avoid conflicts of interest, several criticisms can be made concerning the drafting of this provision, viz:- First, the jurisdiction of this Act *is confined to insurance companies*, and does not address the problem of conflict of interests in other kinds of companies.

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<sup>11</sup> See para 4.1.2 of this Chapter.

<sup>12</sup> It is worth noting that two ways of numbering the paragraphs of Articles are used in Iraq legislations: the numbering written as it is shown in the above Act, and the normal numbering adopted by the C.P.A. in its amendments to the I.C.A. 1997.

<sup>13</sup> Italics lines have been added by the author.

Second, the I.B.R.A. 2005, like the I.C.A. 1997, does not give any clear guidance to directors and courts about the content or scope of this duty. In particular, it is not certain whether the generic drafting of these provisions connects with *the no-conflict rule* or with the *no-secret profits rule*, because all of them address the problems of conflicts of interest.

Third, Art.42 of the I.B.R.A. 2005 requires that the director plays a positive role in creating the conflict, whereas the conflict of interests may occur incidentally (e.g., by a director having shares in a competitive company by way of inheritance). Moreover, Art.42 of the I.B.R.A. 2005, as well as Art.1 (3) of the I.C.A. 1997, does not impose on the director a positive duty *to withdraw from* the position that caused the conflict of interest.

Fourth, the formulation of Art. 42 (Second) refers to two situations: the prohibition of competition by the director with his company, and the conflict of interests. The Article, however, has placed the duty to avoid competition with the company ahead of the conflict of interests; while the latter duty constitutes the substance of the no-conflict rule, from which a subset of applications of this duty can be extracted, such as: prohibiting a director from being a competitor to the company, or being a multiple director. The above analysis is premised on the fact that the existence of a conflict of interests is sufficient to give rise to a director's liability.<sup>14</sup> Whereas *legitimate competition* with the company *per se* is insufficient to attract the application of this rule, unless abuse of office is established.<sup>15</sup> It may be attributed also to the fact that this rule is derived from the company law of some Arabic civil law jurisdictions, which focus on preventing a director from engaging in competitive activities with his company, rather than preventing conflicts of interest.<sup>16</sup> Seemingly, the formulation of Art. 42 (Second) of the I.B.R.A. 2005, by virtue of conflation between the legitimate and illegitimate competition, reflects a misunderstanding of the content of the duty of conflict of interest on the

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<sup>14</sup> See s.175 of the C.A. 2006; Art.1(3) of the I.C.A. 1997.

<sup>15</sup> Basem Mohammed Saleh, *the Commercial Law: Part 1* (University of Baghdad, 1987) 166-168, paras 139-141.

<sup>16</sup> See for example the Egyptian Companies' Act No.159 1981 (Art.98); the Commercial Companies' Act of the United Arab Emirates (Art.108);The Saudi Arabian Regulation of Companies' No.6 1965 (Art.70); the Syrian Companies' Act No.29 2011 (Art.152(4)); Jordanian Companies' Act No. 22 1997 (Art.74(a)).

part of the lawmaker. If the reason behind prohibiting the competition is to avoid any potential conflict of interests that may stem from such activity, then it would be better for the legislator to require from the director to obtain prior approval from the company to engage into legitimate competition, rather than by imposing absolute prohibition. This matter will be considered in-depth in section three.<sup>17</sup>

Fifth, the enforcement of this duty must be made under the rules of tort liability, particularly Art. 204 of the Civil Code 1951, because the I.B.R.A. 2005 does not develop special rules for enforcing this duty, as is the case with the I.C.A. 1997.

In conclusion, the brief formulation of Art.1(3) of the I.C.A. 1997 and the ill-defined formulation of Art.42(Second) of the I.B.R.A. 2005 are consequently conducive to *creating a gap* that may motivate the opportunist director to abuse his office. Consequently, the question arises could Art.204 of the Civil Code 1951<sup>18</sup> be capable of filling this legislative gap? The effectiveness of the rules of Civil Law in restraining a director's abuse is still questionable, because the existence of liability necessitates demonstrating its conditions by a company, as will now be considered in the next section.

#### **4.1.2 Does Art.204 of the Civil Code 1951 have English Teeth?**

Tort liability under the Civil Code 1951 is premised on three elements: *fault, damage and causal link*.<sup>19</sup> The burden of proving these elements lies on the plaintiff (the company).<sup>20</sup> By contrast, the duty to avoid conflicts of interest under English law is often described as a strict <sup>21</sup> (rigid<sup>22</sup>) rule, which confronts the

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<sup>17</sup> See para 4.3.1.3 of the above Section.

<sup>18</sup> This Article states that 'every assault which causes other than injuries mentioned in the preceding Articles [which deal with special sorts of faults] entails payment of compensation' (illustration added).

<sup>19</sup> Burke Faris Hussein & Manar Mohsen Abdul Ghani, 'The Compensation and the Penalty: their Legal Nature' (2010) 2(6) Tikrit University J L & Pol S 78, 82.

<sup>20</sup> The Evidence Act 1979, Art.7(First).

<sup>21</sup> *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [2].

<sup>22</sup> Rod Edmunds & John Lowry, 'The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolution' (2000) Mar J B L 122; Professor David Milman, 'Directors' Duties: Present Interpretations and Future Specifications' (2003) 1 Co L N 1; David

director's behaviour in an uncompromising manner. *Regal (Hastings) Ltd v Gulliver*<sup>23</sup> presents a good example of this rigor. In order to decide whether the rules of Iraqi law concerning a director's civil responsibility involve the same strictness as English law, however, it will be necessary to review the foregoing elements of tort liability, as follows.

#### 4.1.2.1 Fault

In order to establish fault, the company must establish that a director is guilty of wrongdoing: the violation of a legal duty takes the form of prejudicing the rights of others, when perpetrated by a person who is able to discriminate between right and wrong behaviour.<sup>24</sup> The fault will be measured according to an objective standard (the conduct of the ordinary person).<sup>25</sup> It is not difficult for director to establish that he has not committed a fault, in the light of his control over the company's affairs and his ability to conceal the facts. The result of this status quo is that the director will be attempt to fend off his liability. This is the reason why a director's liability under English law is not premised on proving a fault on his part, but rather on the fact that by merely placing himself in a conflict of interests without receiving a prior consent from his company to arise, he will have violated

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Kershaw, 'Lost in the Translation: Corporate Opportunities in Comparative Perspective' (2005) 25(4) O J L S 625.

<sup>23</sup> [1967]2 AC 134 (HL). For more details of the facts of this case see Chapter 3, fn (64).

About the strictness of this rule see also: *Re Bhullar Ltd v Bhullar* [2003] EWCA Civ 424 [2003] B C C 711P.

<sup>24</sup> For more details of this element in Iraqi law see: Professor Hassan Ali Al-Znon, *The General Theory of Obligations* (Al-Sanhoori Publisher 1976) 233 para 249; Abdul Majid Al-Hakim, Abdul Baqi Al-Bakri and Mohammed Taha Al-Bashir, *The Brief in the Obligation Theory* (the Ministry of the Higher Education and Scientific Research 1980) 215; Nawaf Hazem Khalid, 'the Role of the Gravity of Fault in the Evaluation of Compensation' (2010 ) 3 Al-Huqooq Magazine 150.

<sup>25</sup> The Civil Code 1951, Art.251(1). See also Hassan Ali Al-Znon, *The General Theory of Obligation* (Al-Sanhoori Publisher 1976) 233, para 249. It is suggested that the scope of applying the subjective test mentioned in Art.120 of the I.C.A. 1997 is confined to a director's duty in pursuing a company's interests, rather than other duties.

Abdul Majid Al-Hakim, Abdul Baqi Al-Bakri and Mohammed Taha Al-Bashir, *The Brief in the Obligation Theory* (the Ministry of the Higher Education and Scientific Research 1980) 215-216.

his duty.<sup>26</sup> The point of convergence between Iraqi and English law is that the absence of fraud or bad faith is immaterial for causing the director's liability.<sup>27</sup>

#### 4.1.2.2 Damage

Damage is any prejudice to the company's right or legitimate interest that has occurred as a result of the director's conduct.<sup>28</sup> Accordingly, the damage under the Civil Code 1951 must be actual (real). It is worth noting that Iraqi law does not regard potential conflicts of interest as a general rule<sup>29</sup> as a trigger of a director's liability. This position is in contrast to the position under the C.A. 2006,<sup>30</sup> which makes it *clear that potential conflict* is, in itself, sufficient to give rise to liability. Moreover, it is immaterial, under English law, whether the company has suffered damage as a result of the defendant's conduct,<sup>31</sup> or whether

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<sup>26</sup> *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 147 (HL) (Lord Russell). See also: Hans C. Hirt, 'The Law on Corporate Opportunities in the Court of Appeal: Re Bhullar Bros Ltd' (2005) (Nov) J B L 669, 670.

<sup>27</sup> *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144 (HL) (Lord Russell); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [54]; *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [10] (Mummery L.J.); *Breitenfeld UK Ltd v Harold John Harrison, John George Harrison, Gemma Lucy Harrison, Harrison Special Steels Ltd* [2015] EWHC 399 (Ch), 2015 WL 685420 (Norris J.) [70].

The exclusion of these elements in English law is attributed to a difficulty in proving bad faith in the light of the director's control over a company's affairs. Gerard M. D. Bean, 'Corporate Governance and Corporate Opportunities' (1994) 15(9) Comp Law 266, 271; Pearlie Koh, 'Once a Director, Always a Fiduciary?' (2003) 62(2) CLJUK 403, 424.

<sup>28</sup> Professor Hassan Ali Al-Znon, *The General Theory of Obligation* (Al-Sanhoori Publisher 1976) 226-227, para 246; Abdul Majid Al-Hakim and Abdul Baqi Al-Bakri and Mohammed Taha Al-Bashir, *The Brief in the Obligation Theory* (the Ministry of the Higher Education and Scientific Research 1980) 212.

<sup>29</sup> See the I.C.A. 1997, Art.1(3); the I.B.R.A. 2005, Art.42(Second-b). See the following discussion about this issue in para 4.2.1.1 of this Chapter.

<sup>30</sup> See s.175(1) of the C.A. 2006, which uses the phrase 'possibly may conflict'.

<sup>31</sup> See s.175(2) of the C.A. 2006. See also *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144 (HL) (Lord Russell); *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162, 176 [Assizes]; *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201 [50] (Rix LJ); *Murad v Al-Saraj* [2005] EWCA Civ 959, [2005] All ER (D) 503 (Jul) [67] (Arden L.J.); *Foster Bryant Surveying Ltd v Bryant* [2007] EWCA Civ 200, [2007] 2 BCLC 239 [77] (Rix LJ); *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [10] (Mummery L.J.).

Rod Edmunds & John Lowry, 'the No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolution' (2000) Mar J B L 122; Barney Hearnden & Simon Howley, 'Directors' Conflicts under the Companies Act 2006 Considered' (2008) 239 Co L N 1; Michele Havenga, 'Company Directors-Fiduciary Duties, Corporate Opportunities and Confidential Information' (1989)1 S Afr Mercantile L J 122, 131.

a transaction has been concluded outside its own line of business<sup>32</sup> This approach “disables” to block the director from alleging that a company lacked an adequate source to finance a corporate opportunity, and that it was his duty to provide it.<sup>33</sup> Under the Civil Code, the damage element of tort liability provides a director with a means of avoiding his liability, because he can claim that the company was not harmed by his fault.

The usurped opportunity will be subjected to the court’s assessment to ascertain whether there was an actual (a real) chance, not just a hope, which could have been conducive to the company achieving a profit. The probability ratio<sup>34</sup> will affect the amount of the compensation, which will increase or decrease accordingly.<sup>35</sup> If a fault on the part of the director has been proven, the compensation must be commensurate with the actual damage that a company has incurred, rather than the profit that has been gained by the director. This is a major divergence from the approach taken under English law, which will be considered in-depth in Chapter Seven.<sup>36</sup>

#### 4.1.2.3 Causal link

The requirement for a causal link, under the Civil Code 1951, means that the damage has occurred as a result of a defendant’s fault.<sup>37</sup> A causal relationship *cannot be established* when the director succeeds in proving that a company did

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<sup>32</sup> Robert Flannigan, ‘The Fiduciary Obligation’ (1989) 9 Oxford J Legal Stud 285, 299; Stephen Griffin, ‘The Regulation of Directors under the Companies Act 2006’ (2008) 224 Co L N 1, 3.

<sup>33</sup> Michael Hadjinestoros, ‘Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to their Companies’ (2008) 19(2) I C C L R 70, 76.

<sup>34</sup> Ibrahim Dessouki Abu Al-Laeel, ‘Compensation for Losing an Opportunity’ (1986) 10(1) R J, para 20.

Conversely, the court in *Industrial Development Consultants v Cooley* [1972] 2 All ER 162, held that the director must account to his company for all of the profits that he has gained, while the ratio of the claimant’s success in securing the opportunity was not to exceed 10%.

<sup>35</sup> Ibrahim Dessouki Abu Al-Laeel, ‘Compensation for Losing an Opportunity’ (1986) 10(1) R J, para.19.

<sup>36</sup> See para 7.2.3 of this Chapter.

<sup>37</sup> For more details about this element see Profesor Hassan Ali Al-Znon, *The General Theory of Obligations* (Al-Sanhoori Publisher 1976) 244-245, para 261; Abdul Majid Al-Hakim, Abdul Baqi Al-Bakri and Mohammed Taha Al-Bashir, *The Brief in the Obligation Theory* (the Ministry of the Higher Education and Scientific Research 1980) 239.

not have a financial<sup>38</sup> or legal capacity<sup>39</sup> to exploit the opportunity, or when the director can establish that the opportunity was outside the scope of the company's current business.<sup>40</sup> He may also be able to prove that he had been approached by a third party, who had not been interested in dealing with the company directly, to act with him. This argument may, in turn, break the causation link.<sup>41</sup> This plea has been rejected by the English common law, as in the case of *Industrial Development Consultants Ltd v Cooley*.<sup>42</sup> Rejecting this allegation is aimed to avoid a director's evasion from the liability by making complicity with a third party, who may have not been interested in dealing with his company.<sup>43</sup> Causation, therefore, is an irrelevant element under English law, since the director's fault and the establishment of harm to a company are also irrelevant for incurring this liability. It is also immaterial in English law whether the company itself was able to exploit the opportunity.<sup>44</sup> By contrast, under Iraqi law, such pleas can lead to a severance of the causal link between fault and damage.<sup>45</sup>

To sum up, there are differences between Iraqi tort law and the fiduciary rules of English law in terms of their purpose and in their results. While tort liability is aimed at recovering the damage and returning the aggrieved to his *status quo ante*, fiduciary duty operates to inhibit a director *in advance* from violating his duty, and to play a *preventive*, rather than a remedial or restitutory role.<sup>46</sup> So, any threat

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<sup>38</sup> Struan Scott, 'The Corporate Opportunity Doctrine and Impossibility Arguments' (2003) 66(6) Mod L Rev 852, 867.

<sup>39</sup> The Civil Code 1951, Art.48(4) which will be clarified in para 4.2.2 of this Chapter.

<sup>40</sup> The I.C.A. 1997, Art.13(Third).

<sup>41</sup> In this context, Art. 211 of the Civil Code 1951 states that 'a person who has established that the injury had arisen from a cause beyond of his control such as by ...the act of a third party... shall not be liable for damage ...'

<sup>42</sup> [1972] 2 All ER 162 (Assizes). In this case, the defendant, who was a director in the plaintiff's company, had delegated to negotiate with a third party in order to secure a transaction for his company. The director, however, accepted an offer from a third party (who was not interested in concluding the transaction with the plaintiff) to work with him in the performance of its project. The court held that the director was accountable to his company for his entire gains.

<sup>43</sup> William Lynch Schaller, 'Corporate Opportunities and the Third Party "Refusal to Deal" Defence: Policy and Practice Lessons from Illinois' (2013) 47(1) J Marshall L Rev 1, 21-13.

<sup>44</sup> See s.175(2) of the C.A. 2006. See also *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144 [HL] (Lord Russell); *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 (CH) [26] (Rimer J); *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201 [71] (Brooke LJ); *Ultraframe (UK) Ltd v Fielding (No.2)* [2005] EWHC 1638 (Ch), [2006] F S R 17 [55]; *O'Donnell v Shanahan* [2009] EWCA Civ 751, [2009] B C C 822 [70] [Rimer L J].

<sup>45</sup> See the Civil Code 1951, Art.425.

<sup>46</sup> *Murad v Al-Saraj* [2005] EWCA Civ 959, [2005] All ER (D) 503 (Jul) [108] (Jonathan Parker J); Rod Edmunds & John Lowry, 'The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolution' (2000) Mar J B L 122; John Lorry and Arad Reisberg, *Company Law* (1th edn, Pearson Education Ltd 2012) 164; Pearlie Koh, 'The



to a company's interests, even if merely potential, is sufficient to give rise to the director's liability. This cannot be achieved under Iraqi law unless the elements of the tort fixed under the common law are abandoned. It might seem that '...the rule is stringent and absolute...', but '...the safety of mankind...' <sup>47</sup> requires it to be absolutely observed in the fiduciary relationship.

Having regard to the aforementioned legal realities, it is unlikely that the rules of tort liability are appropriate to provide a company with reasonable protection from a director's abuse, and for two reasons: First, the provisions of the I.C.A. 1997 and the I.B.R.A. 2005 are less strict and contain less effective protection for the company than those equivalent rules under English law. Second, the requirements of establishing the elements of tort liability, makes proving the director's abuse a difficult task in some circumstances. Eventually, a company may be reluctant for the aforementioned reasons to bring an action against the delinquent, because it cannot ascertain whether the action will be successful. The fear of a counterclaim brought by the director on the grounds of prejudice to his reputation, may reinforce the above probability.<sup>48</sup>

This result undoubtedly contradicts the norms of commercial activity, which is based on "confidence" and "honesty",<sup>49</sup> and everyone involved in this activity, including the company directors, who are the company's masterminds, should comply with the rule. To ensure a director's compliance with his duty, rigid rules should be applied to uphold this goal.<sup>50</sup> It is irrational to subject commercial instruments, such as a cheque or a bill of exchange, to strict rules, while leaving the rules that govern the director's conduct (could be the drawer) towards his company to a more lenient legal regime.

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Director's Fiduciary Obligations - a Fresh Look?' (2003) 62(1) CL JUK 42; Alan Dignam & John Lowry, *Company Law* (4th edn, OUP 2006) 308-309, para 14.27; Barney Hearnden & Simon Howley, 'Directors' Conflicts under the Companies Act 2006 Considered' (2008) 239 Co L N 1; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 272, para 9.15.

<sup>47</sup> *Parker v McKenna* (1874-75) L R 10 Ch App 96, 124 (Sir W. M. James L.J); *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144 and 177 (HL) (Lord Macmillan); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [70].

<sup>48</sup> Matthew Conaglen, 'The Extent of Fiduciary Accounting and the Importance of Authorisation Mechanisms' (2011) 70(3) C L J 548, 555-558

<sup>49</sup> The Commerce Act 1984, Art.3.

<sup>50</sup> Jie Li, 'the Peso Silver Case: an Opportunity to Soften the Rigid Approach of the English Courts on the Problem of Corporate Opportunity' (2011) 32(3) Comp law 68, 73.

Despite the strict approach of English law in this area, the law has not escaped various criticisms from the courts and legal commentators,<sup>51</sup> the reform to which Iraqi law should aspire in this area needs to involve a degree of strictness in keeping with the following considerations. It should (i) restrain a director in advance from abusing his post; (ii) facilitate the burden of proving this misconduct; and (iii) strike a balance between the above considerations and fend off the imposition of excessive restrictions on a director's entrepreneurial activity, so that the general economy will not be deprived of the business skills of talented directors. This matter acquires particular significance in Iraq, a third world country in urgent need of skilled directors. Drawing a new legal framework for Iraqi law depends also on determining the effect of the no-conflict rule on a director's financial freedom, as will be exhibited in Section three of this Chapter.

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<sup>51</sup> On this point see: *Murad v Al-Saraj* [2005] EWCA Civ 959, [2005] All ER (D) 503 (Jul) paras [82], [121] (Arden and Jonathan Parker LL JJ); *Foster Bryant Surveying Ltd v Bryant* [2007] EWCA Civ 200, [2007] 2 BCLC 239 [49] (Rix LJ).

For the English literature, see Professor David Milman, 'The Rise of the Objective Concept of "Unfairness" in UK Company Law' (2010) 286 C L N 1, 2; Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 246, para 11-3; Tony Singla, 'The Fiduciary Duties of Resigning Directors' (2007) 28(9) Comp Law 275, 276; Michael Hadjinestoros, 'Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to their Companies' (2008) 19(2) I C C L R 70, 71; Hans C. Hirt, 'The Law on Corporate Opportunities in the Court of Appeal: *Re Bhullar Bros Ltd*' (2005) (Nov) J B L 669-970; David Kershaw, *Company Law in Context: Text and Materials* (2th edn, OUP 2012) 535; Michele Havenga, 'Company Directors-Fiduciary Duties, Corporate Opportunities and Confidential Information' (1989) 1 S Afr Mercantile L J 122, 128; Rod Edmunds & John Lowry, 'The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolution' (2000) Mar J B L 122, 123-124; Churk Shue Sing, 'Avoidance of Loss, Regal Hastings and the No Conflict Rule' (2013) 34(3) Comp Law 73, 77; Fraser Dobbie 'Codification of Directors' Duties: an Act to Follow?' (2008) 11 Trinity C L Rev 13, 25; Jie Li, 'the *Peso Silver* Case: an Opportunity to Soften the Rigid Approach of the English Courts on the Problem of Corporate Opportunity' (2011) 32(3) Comp law 68.

For another advocate of the strict approach, see Matthew Conaglen, 'The Extent of Fiduciary Accounting and the Importance of Authorisation Mechanisms' (2011) 70(3) C L J 548, 555-556.

## Section II

### The Content of the No-Conflict Rule under Iraqi Law

**Introduction:** It has been mentioned above that Iraqi law refers to conflict of interest but does not give a definition of it. It is therefore to be expected that some mystery will surround the concept of the duty, and likewise of the meaning of a corporate opportunity. The following discussion will be focused on identifying the above concepts.

#### 4.2.1 The Aspects of the Conflict of Interest under Iraqi Law

According to the C.A. 2006, several kinds of conflict can be envisaged: it may be direct or indirect, potential or actual, or it may be conflict that occurs as a result of using a corporate property. This section aims to discover whether Iraqi law has referred to the same aspects of conflict of interests as to those shown under English law.

##### 4.2.1.1 Potential Conflict

Under English law, a director is obliged to avoid placing his own interests in a position that “possibly may conflict”<sup>52</sup> with his duty. This phrase refers to potential conflict, and a *fortiori* to actual conflict. This strictness aims to inhibit a director from causing any threat to a company, because ‘...both common sense and equity indicate that it is not necessary to wait for a breach giving rise to a remedy before the possibility of intervention arises.’<sup>53</sup> Whether the potential conflict has occurred is to be assessed objectively, according to the belief of a reasonable person.<sup>54</sup>

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<sup>52</sup> S.175(1) of this Act.

<sup>53</sup> *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201 [85] (Sedley LJ).

<sup>54</sup> The C.A. 2006, s.175(4-a). See also *Boardman v Phipps* [1967] 2 AC 46,124 (HL); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [55]; *Cobden Investments Ltd v RWM Langport Ltd, Southern Counties Fresh Foods Ltd, Romford*

*Re Bhullar v Bhullar*<sup>55</sup> offers an obvious example of potential conflict and its significance. In this case, the relation between two brothers, Mohan and Sohan, had broken down to a degree that they agreed to separate their business and the process of acquiring additional property. Amid these circumstances, one of directors representing Sohan found a property adjacent to the company's investment property and acquired it for Sohan. The court found that Sohan's family was in a position of potential conflict of interests. The reason is that the geographical adjacency of the two properties '...would have been commercially attractive to the company...' <sup>56</sup> and would have led it to cancel its former decision to cease acquiring additional property, if it had been aware of this opportunity.

By contrast, under Iraqi law, the law's "coverage" is only partial: generally, the concept of prohibiting potential conflict, as a general principle, is absent in Iraqi law, except in three kinds of situation: (i) in the case of Mixed Sector Companies, which are subject to the jurisdiction of the R.C.E.S.M.S.C. 2006, which prohibits potential conflicts of interest by the directors of these companies;<sup>57</sup> (ii) cases involving a multiple director;<sup>58</sup> and (iii) in cases where a director is in competition with the company.<sup>59</sup>

The failure to mention potential conflict of interests under a general rule represents a serious flaw in Iraqi law: under the current position, the director eschews his responsibility by, e.g., alleging, for example that the board's suggestion of widening the company's actual business or its activities has not yet entered into force, particularly when a certain opportunity seems *prima facie* to be outside the company's current line of business or sphere of interest. The general principles of the Civil Code 1951 reinforce this peril, because it is built on a remedial basis,

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*Wholesale Meats Ltd* [2008] EWHC 2810 (Ch), [2008] WL 4923175 [53] (Warren J); *O'Donnell v Shanahan* [2009] EWCA Civ 751, [2009] B C C 822 [70] (RimerLJ).

<sup>55</sup> [2003] EWCA Civ 424, [2003] BCC 711.

<sup>56</sup> [2003] EWCA Civ 424, [2003] BCC 711 [41] (Jonathan Parker LJ).

<sup>57</sup> Rule 4 of the R.C.E.S.M.S.C. 2006. It is worth noting that this legislation is only applicable to the directors of Mixed Sector Companies, according to the clarification presented by the Integrity Commission directed to the author by its email dated on 7<sup>th</sup> of December 2014.

<sup>58</sup> The multi-director means simply a director who acts for more than one company. For more details of this theme see para 4.3.1.1 of this Chapter.

<sup>59</sup> See para 4.3.1.2 of this Chapter.

that is, as long as there is no actual damage to a certain interest, no relief shall be granted to the plaintiff.

#### **4.2.1.2 Direct and Indirect Conflict of Interests**

A direct conflict of interest occurs when a director fails to void the conflict,<sup>60</sup> which arises from: the director's personal exploitation of the company's opportunity for his own benefit, diverting it either to his own company or to a partnership or when he competes with the company.

The I.C.A. 1997 does not refer explicitly to indirect conflict, which can occur when a director has a personal interest that might conflict with his company, such as being the major shareholder in a competitor company (or its customer or its supplier).<sup>61</sup> The conflict can also arise from any person connected with the director,<sup>62</sup> e.g., family relationships, such as a director's wife, adult children, a person close to him e.g. stepchildren, or other close family members.<sup>63</sup>

However, by analogy<sup>64</sup> when there is a duty requiring the director to declare his interests in a deal to the company,<sup>65</sup> it can be inferred that a director is bound to avoid indirect conflict. With respect to family relations, by analogy with the director's duty of deploying an annual report which requires the disclosure of transactions relevant to his family,<sup>66</sup> a director is in a position whereby he is obliged to declare a conflict of interests. The R.C.E.S.M.S.C. 2006 (which applies to the directors of Mixed Sector Companies), refer to the family relation, such as

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<sup>60</sup> Mark Hsaio, 'A Sprouting Duty of Honesty and Loyalty? Companies Act 2006' (2009) 20(9) I C C L R 301, 304.

<sup>61</sup> Burges Salmon, 'The Companies Act 2006' <[www.burges-salmon.com](http://www.burges-salmon.com) /...> accessed 24 February 2013, 1.

<sup>62</sup> Ibid, 2; Neil Harvey & Ian Yeo, 'Duties and Liabilities of Directors of a Private Limited Company under English Law' (1996) I B L J 749, 755.

<sup>63</sup> Burges Salmon, 'The Companies Act 2006' <[www.burges-salmon.com](http://www.burges-salmon.com) /...> accessed 24 February 2013, 1.

<sup>64</sup> See the Civil Code 1951, Art.3.

<sup>65</sup> The I.C.A. 1997, Art.119.

<sup>66</sup> The I.C.A. 1997, Art.134(First).

the interests of the director's wife and his relatives,<sup>67</sup> including the director's personal and pecuniary interests.<sup>68</sup> This matter will be given further consideration at 6.1.2.2 below. But it is sufficient, at this stance, to say that the law failure to identify the meaning and the scope of direct and indirect interests adds another *lacuna* in Iraqi law, and gives a director a chance to exploit this legislative gap to exercise his selfish activities.

#### 4.2.1.3 Exploiting the Company's Property, Information or Opportunity

One of the gaps in Iraqi law is the failure to regulate the director's duty to safeguard the company's property, information or its opportunity, which can be exploited by a director in breach of his duty. By contrast, s.175(2) of the C.A. 2006 makes it clear that the conflict of interests 'applies in particular to the exploitation of any property, information or opportunity'.<sup>69</sup>

The aforementioned *lacuna* in Iraqi law does not mean that a corporate property is not protected by relevant Iraqi legislation. It has previously been mentioned<sup>70</sup> that the Civil Code 1951, like English law,<sup>71</sup> deems a director to be a trustee of company property that is delivered to him.<sup>72</sup> The above legal position is conducive to prohibiting him from using corporate property or dealing with it without the company's approval,<sup>73</sup> or enabling another person to use it.<sup>74</sup> A director, accordingly, will be liable for any damage resulting from the breach of the above rules.<sup>75</sup> The concept of corporate property includes the expropriation of money

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<sup>67</sup> Rule 4 of these Rules.

<sup>68</sup> Rule 15 of these Rules.

<sup>69</sup> Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) *Irish Jurist* 82, 99.

<sup>70</sup> See Chapter 2, para 2.3.4 of this thesis.

<sup>71</sup> *Gwembe Valley Development Company Ltd v Thomas Koshy* [2003] EWCA Civ 1048, [2003] WL 21729210 [113].

<sup>72</sup> See the Civil Code 1951, Art.950. For more details about this point see Abdul Razzaq Ahmed Al-Sanhoori, *The Intermediary in Explaining the Civil Law: Part 7(1)* (Al-Maarif 2004) 262, para 350.

<sup>73</sup> The Civil Code 1951, Art.956.

<sup>74</sup> Abdul Razzaq Ahmed Al-Sanhoori, *The Intermediary in Explaining the Civil Law: Part 7(1)* (Al-Maarif 2004) 680, para 359.

<sup>75</sup> See the Civil Act 1951, Art.956. For more details of this matter see Chapter 7, para 7.2.2 of this thesis.

that should be paid to the company by its client,<sup>76</sup> as well as intellectual property, such as the company's name<sup>77</sup> or its commercial mark.<sup>78</sup>

Likewise, Iraqi Company law does not provide protection to corporate information. The sole Iraqi legislation for protecting information is the "Act of Patents, Industrial Models, Undisclosed Information, Integrated Circuits and Plant Varieties", No.82, 2004. Art.30 of this Act identifies the meaning of "undisclosed information" by enumerating its conditions as follows: (i) It must be confidential (unknown to the public) (ii) have a commercial value.(iii) It should be kept securely by its possessor in order to maintain confidentiality.

Accordingly, the above concept includes trade secrets, industrial secrets and databases.<sup>79</sup> But it does not expand to general business information, which should be considered as part of the public domain<sup>80</sup> that enables any person to avail of it.

The above concept of information is narrow enough for it to be inconsistent with the nature of a company's activities and the role of the director. Apparently, the above legislation provides a protection with regard to the information that falls within the company's possession. But information acquired by the director, before it is communicated to the company, falls outside the jurisdiction of this legislation, and is thus unprotected by it. An example of unprotected information would be the announcement of a public auction that must be communicated to a company, even if that information might be known by other dealers in the market. The gap in the "Act of Patents, Industrial Models, Undisclosed Information, Integrated Circuits and Plant Varieties", 2004 makes it difficult for the company to hold its director to account for exploiting the information. Here, s.175(2) covers all types of information, and it is left to the court to ascertain whether it belongs to a

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<sup>76</sup> Al-Karada First Instance Court, Case No. 137/B/83 (mentioned in the Judicial J Rev (1986) (1, 2) 230.

<sup>77</sup> See the Commerce Act No.30 1984, Arts.21-25.

<sup>78</sup> The Commercial Marks Act No.21 1957, Art. 4 (First-1)).

<sup>79</sup> *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [72] (Paul Morgan QC).

<sup>80</sup> See the Civil Code 1951, Arts.61(2);71 (1). See the same approach in: *Island Export Finance v Umunna* [1986] BCLC 460 (QB) (Hutchinson J.); *Wilkinson v West Coast Capital* [2005] EWHC 3009 (Ch), [2007] BCC 71 [265]; *Crown Dilmun, Dilmun Investments Ltd v Nicholas Sutton, Fulham River Projects Ltd* [2004] EWHC 52, [2004] WL 62020 [185].

See also Mark Hsaio, 'A Sprouting Duty of Honesty and Loyalty? Companies Act 2006' (2009) 20(9) I C C L R 301, 305.

company. This general formulation reflects the degree of protection from directorial misuse that has been given to the company's information and its sophistication in drafting this issue. The current position of Iraqi law ignores the role of information in commercial life at a time in which it became a means of engendering any profitable opportunity.<sup>81</sup> This reality necessitates the protection of corporate information from various aspects of the misuse.<sup>82</sup>

In relation to a corporate opportunity, this matter will be discussed intensively in Chapter Seven of this thesis,<sup>83</sup> which concerns the enforcement of managerial duty. It is sufficient to mention here that the general principles of the Civil Code 1951 considers a corporate opportunity to be a potential gain, and the loss of it through the misbehaviour of a wrongdoer makes the latter accountable for damage. Therefore, a corporate opportunity is not part of a company's assets, and then Iraqi law takes a position that is different to English law with regard to this matter.<sup>84</sup>

The failure to embracing the corporate opportunity doctrine in the I.C.A.1997 represents one of the serious weaknesses of the law, at a time in which the opportunity could represent a commercial lifeline. To ensure the company's success, providing legal protection to this element is a vital issue.

In conclusion, it has been demonstrated throughout this section that the resort to analogy or to extrapolation from Iraqi legislation to find legal solutions of the

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<sup>81</sup> *Re Bhullar v Bhullar* [2003] EWCA Civ 424, [2003] BCC 711 [41] (Jonathan Parker LJ).

<sup>82</sup> On the other hand, the A.P.I.M.U.I.I.C.P.V. 2004, like the C.A. 2006, does not determine the information's legal nature, and whether it should be considered as property. The reason for this is that the focus is on the matter of exploiting the information and the breach of duty, rather than on the legal nature of the information.

<sup>83</sup> See para 7.2.3.1 of this Chapter.

<sup>84</sup> *Cook v Deeks* [1916] 1 AC 554 (PC); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC [96] (CH) (Lawrence J); *Shepherds Investments Ltd v Walters* [2006] EWHC 836, [2007] F S R 15 (CH) [134]; *Crown Dilmun, Dilmun Investments Ltd v Nicholas Sutton, Fulham River Projects Ltd* [2004] EWHC 52, [2004] WL 62020 [202]; *Kingsley IT Consulting Ltd v McIntosh* [2006] EWHC 1288 (Ch), [2006] BCC 875 [53].

While in *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 [96] (CH), the opportunity was '...to be treated as if it were property of the company'. The phrase "as if" indicates the differences between an "opportunity" and other types of property, as it is cannot be assigned, transferred, conveyed by will or by tracing and following it before it is declared a constructive trust for the company by the court. See *FHR European Ventures LLP v Mankarious* [2013] EWCA Civ 17, [2014] Ch 1 [57]-[58] (Lewison LJ).



problems of conflict of interests evidences a legislative deficiency in sourcing such a duty. This is because the individual pieces of Iraqi legislation may be either inconsistent with the nature of managerial duty, or could raise uncertainty for the director and also for the courts. While the general principles of the law prohibit the misuse of a corporate property or the expropriation of its property or its opportunities, the legislative failure to refer to the above aspects, implies a misunderstanding of the content of this rule. Conversely, the mention of these aspects renders a director be aware of these important aspects of conflict of interests. It has also legal significance in the area of determining the content of the no-conflict rule, and in the area of distinguishing this rule from the duty to avoid making a secret profit in a transaction, by showing the distinctive nature of the no-conflict rule. The last observation represents the main *lacuna* of drafting of Art.42(Second-b) of the I.B.R.A. 2005. So, codifying this duty within a framework involving detailed rules, drafted with the same sophistication as that found in s.175, would serve to bridge the above gaps in Iraqi law and remove any uncertainty in this regard.

#### **4.2.2 The Concept of Corporate Opportunity**

The Iraqi law and the C.A. 2006 did not define a corporate opportunity in order to avoid restricting its meaning, and in order to allow the courts and legal commentators freedom of interpretation in the future. Whereas the common law and its commentators have addressed this matter, as will be shown shortly, uncertainty in tackling this matter is the prevailing position in Iraqi law. Settling this issue is of great importance in enabling a director to be aware of both prohibited and permitted behaviour<sup>85</sup> so that he can comply with his duty. By giving a clear definition of this concept, the court's arbitrariness in identifying this concept can be avoided.<sup>86</sup>

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<sup>85</sup> Ben Pettet, John Lowry and Arad Reisberg, *Company Law* (1th edn, Pearson Education Ltd 2012) 162; Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 S A L J 714, 729.

<sup>86</sup> Hwa-Jin Kim, Seung Hwan Lee and Stephen M. Woodcock, 'Favoritism and Corporate Law: the Confused Corporate Opportunity Doctrine in the Hyundai Motor Case' (2013) 3 Mich J Private Equity & Venture Cap L 41, 62.

But what is the test that should be used in identifying a corporate opportunity under Iraqi law, a test that in turn reflects the extent of the protection given to the company by the law?

The position in Iraqi law, by virtue of its use of the unhelpful phrase “conflict of interests”, seems vague. It is suggested nevertheless that the line of company business is a touchstone in identifying the boundaries of a director’s liability. In other words, a corporate opportunity is any chance that *falls within the company’s current business*. This view is premised on the following arguments:

1-The I.C.A. 1997 prohibits a director from engaging (in this capacity) in serving a competitor company which exercises “similar business”,<sup>87</sup> that is, in the same line of the company’s activity.

2-The I.B.R.A. 2005 prevents a director absolutely from engaging in competition with his company, irrespective of whether that competition is legitimate or illegitimate.<sup>88</sup> Competition presupposes the similarity in the nature of the business of the competitors.

3- The third argument stems from the nature of a company, as a legal person, that exercises a commercial activity associated with its capacity, which in turn derives from its objects, and for which managerial powers are vested in a director for the achievement of this goal.<sup>89</sup> Given that the company becomes disqualified to exercise any business falls outside its legal capacity, it is fair for a director to exercise entrepreneurial business activity that falls outside of that corporate ambit.

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<sup>87</sup> See the I.C.A. 1997, Art.110(Second); the P.B.A. 2004, Art.17(5-a); the I.B.R.A. 2005, Art.42(Second, Third). This theme will be discussed intensively in this Chapter, para 4.3.1.1.

<sup>88</sup> See Art.42(Second) of this Act.

<sup>89</sup> In this regard, pursuant to Art.13(Third) of the I.C.A. 1997, one of the obligatory statements that must be mentioned in the company’s contract is ‘the purposes for which the company is established and the general nature of the business to be transacted’. Furthermore, Art.48(4) of the Civil Code 1951 states ‘it has [ the legal person] a capacity under the borders set out in the contract of its establishment which is imposed by law’. This approach have been adopted by other Companies’ Acts, such as: Art.5 of the Agricultural Companies’ Act No.116 1980; Art.12(Second) of the Act of Establishing the Private Hospitals, No.25 1984.

4-It is also submitted that liability under Iraqi law in this context is based on damage as its main element, that is, damage that flows from the loss of a corporate opportunity. So, if damage is not proven, the director will be excluded from liability, whatever the degree of his fault: Damage presupposes that a certain opportunity falls within a company's line of business, and has been lost by reason of a director's fault.

To sum up, the director's liability under Iraqi law is based on the presence of three conditions: (1) A director's capacity; and, (2) The existence of an opportunity that falls within the company's line of business and in accordance with its objects, including any change of strategy adopted by the general assembly<sup>90</sup>; and (3) that there is proof of damage arising from the diversion of the opportunity to the director.

On the other hand, since Iraqi law has not adopted a general duty of avoiding a potential conflict of interest, a director would not be liable for any expected change in the company's strategy in future that could bring about a conflict of interests situation.

By contrast, the English courts apply three separate tests for determining what a company opportunity is. These tests apply according to the case-facts, the common sense assumption being the existence of '...a real sensible possibility of conflict...'<sup>91</sup> and the exigencies of inhibiting a director from abusing his post. These are:-

1. The *capacity-based* test, a stricter test under which a director, by virtue of his capacity, must not be allowed to make personal profit by exploiting the company's property, its information or its opportunities, which have been accessed by virtue

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<sup>90</sup> The I.C.A. 1997, Art.102.

<sup>91</sup> *Cranleigh Precision Engineering Ltd v Bryant* [1964] 3 All ER 289, 296 (QB); *Boardman v Phipps* [1966] [1967] 2 AC 46, 123-124 (HL) (Lord Upjohn). This general test has been cited by Roskill J. in *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162, 173 (Assizes); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [55].

of his office without its consent.<sup>92</sup> This test is applicable regardless of whether the opportunity falls within the same line of the company's business.

2. The test concerning *the scope of a company's business*, whereby a director is barred from exploiting any opportunity which falls within the actual, expected line of the company's business<sup>93</sup> or where a director is delegated to find a particular opportunity.<sup>94</sup>

3. The *maturing opportunity test*, under which a corporate opportunity is regarded as any opportunity that has actually been accessed, negotiated or pursued by the company with a third party,<sup>95</sup> thus prohibiting a director from exploiting it for himself.

S.175 of the C.A. 2006 espoused the capacity test as the main test, by virtue of utilising the term a "director".<sup>96</sup> *The line of a company's business* represents

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<sup>92</sup> See for example *Regal v Gulliver* [1967] 2 A.C.134; *Boardman v Phipps* [1967] 2 AC 46, 156 (HL); *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162 (Assizes); *Re Bhullar v Bhullar* [2003] EWCA Civ 424, [2003] BCC 711; *O'Donnell v Shanahan* [2009] EWCA Civ 751, [2009] B C C 822.

See also Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (9th edn, OUP 2010) 357; Nicholas Collins, 'In-depth, The No-Conflict Rule: the Acceptance of Traditional Equitable Values?' (2008) *Trusts & Trustees* 213, 218; Michael Hadjinestoros, 'Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to their Companies' (2008) 19(2) *I C C L R* 70, 75; Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 *SALJ* 714, 735.

<sup>93</sup> See for example: *Aas v Benham* [1891] 2 Ch 244 (CA); *Dean v Macdowell* [1878] LR 8 Ch D 345 (CA); *Salston v Headline Filters Ltd* [1991] FSR 385.

See also: Nicholas Collins, 'In-depth, The No-Conflict Rule: the Acceptance of Traditional Equitable Values?' (2008) *Trusts & Trustees* 213, 218; John Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) <<http://www.qscience.com/doi/pdf/10.5339/irl.2012.5>> accessed on 21 September 2012, 10; Ernest Lim, 'Directors' Fiduciary Duties: a New Analytical Framework' (2013) 129 *L Q Rev* 242, 251.

<sup>94</sup> D. D. Prentice & Jenny Payne, 'The Corporate Opportunity Doctrine' (2004) 120 (Apr) *L Q R* 189, 199.

<sup>95</sup> See for example *Aas v Benham* [1891] 2 Ch 244 (CA); *Cook v Deeks* [1916] 1 AC 554 (PC); *Island Export Finance Ltd v Umunna* [1986] BCLC 460 (QB); *Balston v Headline Filters Ltd* [1991] FSR 385 (CH); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC [96] (CH); *Wilkinson v West Coast* [2005] EWHC 3009 [2007] BCC 717(Ch).

For more details see also David Kershaw, 'Does it Matter How the Law Thinks about Corporate Opportunities?' (2005) 25(4) *L S* 533, 555; Rehana Cassim, 'Post-Resignation Duties of Directors: The Application of the Fiduciary Duty not to Misappropriate Corporate Opportunities' (2008) 125 *S African L J* 731; D.D. Prentice & Jenny Payne, 'The Corporate Opportunity Doctrine' (2004) 120 (Apr) *L Q R* 189,199.

<sup>96</sup> See s.175(1) of this Act. See also: Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) *Ir Jur* 82, 100;

another test, which can be gleaned from the reference to the company's 'property, information or opportunity'<sup>97</sup> that use in its activities. It abandoned the *maturing opportunity test* because '...it is immaterial whether the company could take advantage of the property, information or opportunity'.<sup>98</sup>

The status quo in Iraqi law, by virtue of the adoption of the "line of business test", raises several problems in identifying the concept of a corporate opportunity, such as: the adequacy of a company's line of business test in addressing the director's self-interest. The limited role of the company in identifying the meaning of the corporate opportunity before, and after, the occurrence of the conflict of interests is another ancillary factor in this regard. All these problems will be discussed in the following sections.

#### **4.2.2.1 The Inadequacy of a Single Test in Addressing the Director's abuse in the Sole Owner Company**

The line of business of a company is an inadequate criterion for identifying a director's self-interest. Its inadequacy obvious in certain situations, such as that of a Sole Owner Company.

In a Sole Owner Enterprise Company, the general assembly is replaced by the sole owner, who, dominating its affairs, is entitled to combined ownership and

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Jie Li, 'the Peso Silver Case: an Opportunity to Soften the Rigid Approach of the English Courts on the Problem of Corporate Opportunity' (2011) 32(3) Comp Law 68, 74.

<sup>96</sup> S.175(1) of C.A. 2006. See also John Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) <<http://www.qscience.com/doi/pdf/10.5339/irl.2012.5>> accessed on 21 September 2012, 16-17.

<sup>97</sup> See s.175 (2) of the C.A. 2006. See John Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) <<http://www.qscience.com/doi/pdf/10.5339/irl.2012.5>> accessed on 21 September 2012, 16-17. Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) 45 Irish Jurist 82, 100.

<sup>98</sup> The C.A. 2006, s.175(2). See also John Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) <<http://www.qscience.com/doi/pdf/10.5339/irl.2012.5>> accessed on 21 September 2012, 16-17; Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) Ir Jur 82,100.

However, this test occupies a significant role in a situation involving a director's resignation for securing the opportunity for himself, as it will be seen later. See para. 4.3.2 of this Chapter.

management.<sup>99</sup> The owner (a director) accordingly will be able to determine the company's objectives and to change them. As a result of the failure to draw a line between the management of the company as a legal person on the one hand, and his personal interests as the sole shareholder on the other, a director may fail to avoid a conflict of interests.<sup>100</sup> In such a situation, the exploitation of an opportunity by the director seems easier, particularly when a company is on the verge of insolvency. Although the expropriation of a corporate opportunity does not cause harmful effects to the shareholders' interests in this type of company, the director still has a motivation to exploit the opportunity for his personal benefit in order to extricate himself from creditors, stakeholders and others. This problem gives rise to the question of how to safeguard the interests of those stakeholders.<sup>101</sup>

It might be said that this anxiety involves exaggeration, since the sole owner incurs personal responsibility for the firm's debts in the case of its insolvency.<sup>102</sup> In addition, the I.C.A. 1997 prevents the owner (a director) from taking decisions that could jeopardize the creditors' interests.<sup>103</sup> However, the owner's insolvency may render his unlimited liability (as a means to protect the creditors) worthless.

The scene may seem more complex in the Sole Owner Limited Liability Company.<sup>104</sup> In this company, the owner's liability is limited, and the independence of its personality from the personality of its founder can be clearly shown. The proof of the abuse as a condition of holding a director liable is not always plain in this company. This difficulty lies in the absence of the oversight role of shareholders in the light of combination between ownership and management into the hands of one person in this type of company. Moreover, the

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<sup>99</sup> The I.C.A. 1997, Art.121.

<sup>100</sup> See for example Fraser Dobbie, 'Codification of Directors' Duties: An Act to Follow?' (2008) 11 *Trinity C L Rev* 13, 15; D.D. Prentice & Jenny Payne, 'The Corporate Opportunity Doctrine' (2004) 120 (Apr) *L Q R* 189.

<sup>101</sup> Cf with Struan Scott, 'The Corporate Opportunity Doctrine and Impossibility Arguments' (2003) 66(6) *Mod L Rev* 852, 858 who believes that '...questions of corporate opportunity do not really arise, at least between the owners and the operators (i.e. managers), for they are one and the same'.

<sup>102</sup> See the I.C.A. 1997, Arts.35, 37.

<sup>103</sup> The I.C.A. 1997, Art.4(Third-1).

<sup>104</sup> See the I.C.A. 1997, Art.8(Second-1). For more details of this company in Iraqi law, see Mustafa Natic, 'the Sole Owner Enterprise (the One Person Company) According to the Recent Developments' (2008) 10 (36) *Al-Rafidain Law Journal* 128.

creditors must challenge the misconduct within a period when a company's insolvency is imminent,<sup>105</sup> precisely after losing everything.

Accordingly, applying the test of the *line of the company's business* does not provide the stakeholders with a reasonable safeguard in the above situations.<sup>106</sup> In English courts, by contrast, these forms of misconduct can be challenged under the *capacity-based test*, because the director had acquired the information linked with the opportunity by virtue of his capacity, and he will have been liable to communicate it immediately to the company. In other words, the director's duty to avoid a conflict of interests arises, before taking any subsequent corporate decision that might affect the company's interests.

#### **4.2.2.2 The Inadequacy of the Single Test in Addressing a Director's Abuse in the Civil Law Jurisdictions**

The court under Iraqi law, as a court in a civil law jurisdiction, is bound to apply the provisions of law in its wording or in its tenor.<sup>107</sup> Hence, while the wording of the statutory provisions only permits certain interpretations of a finite, but fraudulent actions exercised by a director are non-finite in their possibilities. As the finite cannot cover the infinite, it can be inferred from this analysis that the statutory provisions, by virtue of espousing a single test, may fail to achieve its object in restraining directorial abuse, unless the court is equipped with multiple tests to address the director's misbehaviour according to the circumstances of the case.

#### **4.2.2.3 The Inadequacy Inherent in the Test Itself**

The *line of the company's business*, as the sole test under Iraqi law, is not exempt from criticism. Despite the fact that this approach is crucial in order to avoid

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<sup>105</sup> The I.C.A. 1997, Art.4(Third-2).

<sup>106</sup> See for example: *Cook v Deeks* [1916] 1 AC 554 (PC).

<sup>107</sup> See Iraqi Civil Code 1951, Art.1.

irrational broadening of the company's interests,<sup>108</sup> the test requires from the court the interpretation of the company's business and its ambitions which, in some circumstances, raises more difficulties.<sup>109</sup> One of these difficulties is that posed by a company's objectives, which are often drafted broadly<sup>110</sup> in order that they be more flexible and responsive to the future variability of the markets, rather than its contracts being amended, which may take time and involve unwarranted costs. This reality will result in making this test inadequate, because it may not reflect necessarily the actual (current) business of the company, and involves unjustified restriction of the director's activities.

#### **4.2.2.4 The Problems Connected with Identifying a Corporate Opportunity by a Company**

There are two ways of identifying a corporate opportunity: *ex-ante* and the *ex post*. According to the *ex-ante* identification of the opportunity, the company is entitled to define its current or expected interests in its articles, by enumerating its opportunities (the positive identification), or giving a general definition of these interests (the negative identification). However, it has been previously observed<sup>111</sup> that Iraqi companies are not authorised to modify or improve the statutory provisions by their constitutions (its Articles) in order to define their objects for which they were set up, or to elaborate rules about how to deal with matters conflict of interests by its directors. The company, consequently, will be unable to identify its interests, and in particular, to define its opportunity under

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<sup>108</sup> Ernest Lim, 'Directors' Fiduciary Duties: A New Analytical Framework' (2013) 129 L Q Rev 242, 256.

<sup>109</sup> Bryan Clark, 'UK Company Law Reform and Directors' Exploitation of "Corporate Opportunities"' (2006) 17(8) I C C L R 231, 237.

<sup>110</sup> Ibid, 237; David Kershaw, 'Lost in the Translation: Corporate Opportunities in Comparative Perspective' (2005) 25(4) O J L S 625; Michael Hadjinestoros, 'Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to their Companies' (2008) 19(2) I C C L R 70, 75.

<sup>111</sup> In this context see Chapter 2, para 2.2.3.2 of this thesis.

It is worth noting that laying down special rules of conflict of interests in the company's contract is ineffective in this regard, because the contract's clauses have been exclusively set out by the law (Art.13 of the I.C.A. 1997), which should be formulated succinctly. So, the company will not be able to rely on this legal document in giving details about its interests, or vis any other matter connected with that.



detailed clauses in its Articles. Consequently, this problem adds another difficulty in the area of identifying a corporate opportunity.

The second way is the *ex post* identification, under which a director, who seek to exploit a certain opportunity, must obtain a prior authorisation from its company. The authorisation of a conflict of interests means that the director concerned will be able to exploit a certain opportunity, even if it falls within the company's line of business. The authorisation is conducive to legitimizing his conduct. The exploitation of the authorised opportunity cannot be challenged, unless a violation of the law is established and associated with the grant of approval.<sup>112</sup>

Numerous legal advantages can be gained from giving the company such power: First, a clear obligation to communicate the opportunity to the board<sup>113</sup> will be incurred by a director.<sup>114</sup> Second, it is a means to exclude a director from liability, and gives him a chance to exercise entrepreneurial activity legitimately. It is also a means to avoid the liability on the part of a third party, who will be able to demand the company's approval as a condition of dealing with the director. The third, and perhaps the most important advantage, is in identifying the concept of a corporate opportunity. This procedure enables the company to focus on the merits of the opportunity, and on whether it falls within the scope of its activities. Ultimately, the company will be able to take an informed decision to exploit the identified opportunity if it is in its interests. Having regard to the above reasons, the C.A. 2006 empowered the company to grant its approval to conflicts of interest, as it will be seen shortly.

However, as mentioned previously, there is no an explicit provision in Iraqi Companies' Acts enshrining the duty to communicate the corporate opportunity to the company. Does this mean that the law give the director a license to exploit

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<sup>112</sup> See s.175(4) of the C.A. 2006 which states 'This duty is not infringed:(b) if the matter has been authorised by the directors'. The authorization is distinct from the ratification which must issue after the wrongdoing has arisen.

<sup>113</sup> See *Cranleigh Precision Engineering Ltd v Bryant* [1964] 3 All ER 289 (QB); *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162, 175 (Assizes) (Roskill J); *Re Bhullar Ltd v Bhullar* [2003] EWCA Civ 424, [2003] BCC 711 [41].

<sup>114</sup> For more details of this duty see Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and Opportunistic Director' (2011) 23 SAL J 714, 718-720.

any opportunity that has been discovered by him? But, on the other hand, other Iraqi legislation requires the company's approval for any exploitation of its property,<sup>115</sup> or its information, by the director<sup>116</sup> or in the case of the director's service in another competitive firm.<sup>117</sup>

It could be argued, by analogy with the provisions of the above legislation,<sup>118</sup> that the company is entitled to give its approval for other situations of conflict of interests, including the exploitation of a corporate opportunity. The similarities between the situations that have been covered by the above legislation from a hand, and the situation of the exploitation of a corporate opportunity on the other hand, is that all of these situations relate to conflict of interests. However, the resort to analogy is not always the ideal solution to legal problems, because:-

First, the analogy will be controversial, because it depends on the legal expertise of professional persons and the courts, rather than it being incumbent upon the company's directors. The result of this ambiguity is that a director would be able to exploit the opportunity without the company's consent in the belief that his conduct is consistent with the law, as long as there is no statutory requirement that imposes on him an obligation to communicate the opportunity to the board. Conversely, the director may also think that the law prohibits him entirely from exploiting the opportunity, and that it would be better for him to conceal this matter from the company's eyes and to depend on this *lacuna* in the law to shield him from liability.

Secondly, this analogy does not eliminate further problems, such as whether the director is obliged to give a full and correct disclosure about a situation that gives rise to a conflict of interests in order to ensure that the approval should be informed approval.

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<sup>115</sup> The Civil Code, Art.956.

<sup>116</sup> The the Act of "Patents, Industrial Models, Undisclosed Information, Integrated Circuits and Plant Varieties" 2004, Art.30.

<sup>117</sup> The I.C.A. 1997, Art.110 (Second).

<sup>118</sup> Namely, the Civil Code, Art.956; the Act of "Patents, Industrial Models, Undisclosed Information, Integrated Circuits and Plant Varieties" 2004, Art.30; the I.C.A. 1997, Art.110 (Second). The analogy is a means of interpreting the statutory provisions in Iraqi law. See Abdul Baqi Al-Bakri and Zuhair Al-Bashir, *the Entrance for Studying the Law* (The Wisdom House 1989) 126.

The above problems have been eliminated by s.175(5) of the C.A. 2006,<sup>119</sup> which adopts an obvious approach, under which the directors are empowered to give their approval, and which abandons the traditional approach, that necessitates the shareholders' approval.<sup>120</sup> This innovation<sup>121</sup> is justified by the desire to avoid stifling the entrepreneurial activity of the director in situations in which the company seems uninterested in exploiting opportunity it has been offered. However, this is a default rule and applies to private companies. These companies consist of a small number of shareholders, where the roles of ownership and management are often combined<sup>122</sup> (particularly in family companies). It is up to the shareholders subsequently to retrieve this authority for themselves. In public companies, however, which are characterized by the apathy of its shareholders and the difficulty of formulating a collective decision, the company's constitution should contain a reference to this power; otherwise resort should be made to the former rule (the shareholders consent).<sup>123</sup> The decision under the C.A. 2006 must be made by disinterested (unbiased) directors,<sup>124</sup> at a meeting in which 'the matter was agreed to without their voting [the interested director] or would have been agreed to if their votes had not been counted'.<sup>125</sup> The latter case refers to the absence of the director from the meeting,<sup>126</sup> which means tacitly that the interested director is entitled to attend the meeting.<sup>127</sup>

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<sup>119</sup> This Section states:

Authorisation may be given by the directors:-

(a) where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or

(b) Where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.

<sup>120</sup> See for example: *Cook v Deeks* [1916] 1 AC 554 (PC); *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL).

<sup>121</sup> The Explanatory Notes of the Companies Act 2006, para 342.

<sup>122</sup> Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 280, para 9.38.

<sup>123</sup> Paul Davies, Sarah Worthington Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 569, para 16-69; Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 263, para 11-51; Bryan Clark, 'UK Company Law Reform and Directors' Exploitation of "Corporate Opportunities"' (2006) 17(8) I C C L R 231, 239; Gerard M. D. Bean, 'Corporate Governance and Corporate Opportunities' (1994) 15(9) Comp Law 266, 270.

<sup>124</sup> Ernest Lim, 'Directors' Fiduciary Duties: a New Analytical Framework' (2013) 129 L Q Rev 242, 249.

<sup>125</sup> S.175 (6-b) of this Act [illustration added].

<sup>126</sup> The Explanatory Notes of the Companies Act 2006, para 343.

<sup>127</sup> Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 281, para 9.43; Barney Hearnden & Simon Howley, 'Directors' Conflicts under the Companies Act 2006

The C.A. 2006, however, does not address the case of the company that is founded by one member. It is suggested that the approval for the conflict of interests should be vested in a special committee that consists of the company's director and its creditors and employees. This suggestion is based on the reality that the stakeholders in this company will be the principal aggrieved parties if the authorization is conducive to the loss of a profitable opportunity, which may otherwise have assisted in improving its financial position.

To summarize, it is suggested that transplanting into Iraqi law the solutions of the C.A. 2006 with regard to empowering the board of directors to give authorization for a director's conflicts of interest will bring the aforementioned legal advantages. It also removes the contradictions associated with the interpretation of the law.

In a nutshell, it is noted that the I.C.A. 1997, concerning the corporate opportunity, does not adopt the strict approach adopted under English law. The strictness of English law stems from the adoption of the potential conflict, and the broad discretion conferred on the court to provide the utmost degree of protection for the company's interests.<sup>128</sup> It is suggested that the pragmatic reform of Iraqi law in this area should be premised on equipping the court with a broad discretion for ascertaining whether there is a real sensible conflict of interests, by offering numerous tests<sup>129</sup> to be applied according to the case-circumstances.

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Considered' (2008) 239 Co L N 12; Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 266, para11-60.

<sup>128</sup> See Brenda Hannigan, 'Judicial Strictures, a Statutory Restatement and the Opportunistic Director' (2011) 23 SacLJ 714, 742.

<sup>129</sup> Such as the capacity test, the company's line of business, the maturing opportunity, as set out under English law. These tests have been mentioned earlier in this Section

## **Section III**

### **The Effect of the No-Conflict Rule in Restricting the Director's Business Activity**

**Introduction:** The prevailing doctrine in the capitalist system is that human liberty is a paramount principle, and that its restriction is an exception. Hence, restricting a person's liberty to freely contract with others should not lead to overriding his freedom entirely for a long term.

Fiduciary duties are restrictions on a director's freedom, but what is the nature and the extent of this restriction, within or outside the period in which he discharges the duty? In other words, what is the standard to be followed in order to strike a balance between the company's right to ensure that the director will not abuse his powers, and the director's right to exercise commercial activities as a professional person in trade? The answer to this question involves a review of two themes under Iraqi and English law: the director's competition with his company within the period of his service therein, and the time following the termination of that service.

#### **4.3.1 The Director's Competition with his Company within the Period of his Service**

The overriding principle in English and Iraqi law is that a director is allowed to act for other companies under this capacity, or to undertake commercial activities within the period of his service, in accordance with specific restrictions. The aim of this section is to illustrate these situations, and then to evaluate the rationality of the approach adopted.

### 4.3.1.1 Multi-Directorships

#### 4.3.1.1.1 The Meaning of Multi-Directorships

Under Iraqi and English law,<sup>130</sup> it is permissible for the director to act for other companies, irrespective of whether or not they are rivals, provided that the company's consent is given in the first instance before his engagement, so as to avoid any potential conflict of duty and divided loyalties.<sup>131</sup>

However, the I.C.A. 1997 discriminates between two situations:-

(i) If the relevant companies are exercising different businesses, the I.C.A. 1997 prohibits a director from serving on the board of more than six companies simultaneously. A director also is authorized by law, however, to be a chairman of two companies simultaneously.<sup>132</sup> The first restriction (six companies) is justified by the desire to ensure that a director will devote his efforts to serving the company and to mitigate the domination of a small number of senior capitalists on the general economy.<sup>133</sup> The reason behind the second limitation (a director as a chairman) is to give the largest possible number of directors the opportunity to take up this post, and as far as possible to increase the number of skilled chairman. It is suggested that this rule is more rational than allowing a director to engage in an unlimited number of companies (as the case under English law), unless the contract of his service provides otherwise.

(iii) If the related companies are exercising similar business, Art.110 (Second) of the I.C.A. 1997, states that a director is forbidden to take up a post, whether as a director or chairman, in the other company 'unless he has been authorized by the

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<sup>130</sup> See the C.A. 2006, s.175(7).

<sup>131</sup> Martin Day, 'Fiduciary Duties' (2009) 15(6) *Trusts & Trustees* 447, 450.

<sup>132</sup> Art.110 (First) of this Act states that 'a person cannot be a member in the boards of directors of more than six companies at the same time. But, he can also assume the chairmanship of one or two other boards at the same time'.

<sup>133</sup> Mustafa Nasser Nasrallah, *The Commercial Companies* (Coaching publisher 1969) 203; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Mustansiriya University 2008) 239.

general assembly of his company.<sup>134</sup> Likewise, s.175(7) of the C.A. 2006 forbids generally any position which involves “a conflict of duties”.<sup>135</sup> The reason for the prohibition is to avoid the occurrence of a potential conflict of interests, since the director may put the interests of one company ahead of the interests of the other.<sup>136</sup> By obtaining this approval, a director’s liability under English law for the potential conflict of interests will be changed to liability for actual conflict,<sup>137</sup> and this must be proven by the plaintiff (the company). It is notable that the authorization under Iraqi law could be given for one or more similar companies, provided that the service in other companies should not exceed six companies as mentioned above.

#### **4.3.1.1.2 Multi-Directorships and the Conflict of Duties?**

Pursuant to the I.C.A. 1997, for the purpose of determining a potential conflict of interests, regard should be given to the similarity in the current business of the concerned companies, not to their main objectives.<sup>138</sup> The similarity in business does not mean a complete symmetry (absolute) in their activities. The production of nylon fibre, for example, may be in competition with the production of cotton. But uncertainty envelops the case of when the term “similarity” is used to include complementary activities which could be the source of a conflict of interests. Apparently, settling this difficulty should depend on the case-facts and the court’s sense of the existence of the conflict of interests.

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<sup>134</sup> Art.110(Second) of this Act.

<sup>135</sup> S.175(7) of this Act.

<sup>136</sup> Khalid Al-Shawi, *Explain the Iraqi Commercial Companies’ Act* (First edn., Al-Shaap publisher 1968) 478; Aziz Al-Okkaily, *The Mediator in the Commercial Companies* (the Culture House 2007) 294; Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (the Culture House publisher 2006) 432.

<sup>137</sup> D. E. Mclay, ‘Multiple Directorates and Loss of Corporate Opportunity: Bases and Remedies’ (1980) 10 *Victoria U Wellington L Rev* 429, 144.

<sup>138</sup> Art.161(2) of the Commercial Companies’ Act 1957 (abrogated) was more clearer in this regard by prohibiting the engagement with similar or competing companies. See also Khalid Al-Shawi, *Explain the Iraqi Commercial Companies’ Act* (First edn., Al-Shaap publisher 1968) 478; Akram Yamulki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Second edn., Alani Publisher 1972) 241. By contrast, see Edward Eid, *the Commercial Companies* (Al-Najwa Publisher 1970) 527.

The type of the second company or the nature of the director's activity therein is irrelevant.<sup>139</sup> The general formulation of Art.110 (Second) of the I.C.A. 1997 includes the nominee director of another company (the parent company).

For the same reason, Art.121 (Second) of the I.C.A. 1997 prevents the managing director from being able to:

...combine the post of chairman or deputy chairman of the board of directors of a joint-stock company with the post of managing director in it. It is also impermissible for a person to serve as managing director in more than one joint-stock company.

This Article gives rise to numerous observations: first, the prohibition is limited to the combination of the post of managing director and membership of the board of directors in *a Joint-Stock Companies*. This limitation is justified by the desire to maintain effective supervision over the activities of the managing director by the board. Second, the individual in question is otherwise free to engage in serving companies in the capacity of: managing director in companies other than the Joint Stock Companies, as a member of the board or as an employee.<sup>140</sup> Art.121 (Second) of the I.C.A. 1997 therefore contains a bizarre rule, because the risk involved in an individual's engagement in the management of other types of companies, which may be rival, is still present, and constitutes a notable conflict of duties.

Special legislation have adopted stricter rules than those set out under the I.C.A. 1997, by stripping the general assembly of its power to authorize a director to serve similar companies. This position can be evidently shown in the Private Banks Act (herein after the P.B.A.) 2004, which prohibits a director, who subject

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<sup>139</sup> Ahmed Ibrahim Al-Bassam, *The Commercial Companies in Iraqi Law* (Second edn., Al-Zammaan Publisher 1967) 181; Akram Yamulki & Bassem Mohammed Saleh, *The Commercial Companies: Part.2* (Baghdad University Publisher 1983) 244.

<sup>140</sup> This situation could seem strange. But it is instructive to mention that this situation often occurs in Iraqi, where the State employees may prefer to serve on board of companies outside their worktime with a view of improving their livelihood, when the circumstances of their work at the State bodies enable them to do so. For this reason, the law has prohibited this phenomenon in order to avoid any potential conflict of duties may occur as a result of any possible dealing between these companies with the State body. For more details of this issue see Raad Hashim Ameen, *the Legal System of Contract of Procurement: A Legal Study in a view of the Public Contracts' Act* (Sanhoury Publisher, 2012) 44-45.



to the jurisdiction of this legislation, from serving in this capacity at the board of another bank.<sup>141</sup>

The I.B.R.A. 2005 forbids the managing director and other board directors from serving on the board of other insurers. This prohibition refers to other insurers (rather than companies), irrespective of whether the relevant insurers exercise a rival activity.<sup>142</sup> The aforementioned Act went further, by preventing the director from ‘practicing the business of an agent or intermediate’.<sup>143</sup> This strictness seems irrational, because a life insurance company can hardly be said to be in competition with a marine insurance company.

A director in an investment company is forbidden also from being a director or managing director of another company that exercises the same business, or from being a director in a licenced bank.<sup>144</sup> The director of a company that falls under the jurisdiction of the Ministerial Order of Regulating the Business of the Companies Financing Small and Medium-Sized Projects No.3, 2010, is prohibited from being a managing director or a member of the board of other similar companies, or from being a director of any bank.<sup>145</sup>

This strictness extends also to State employees, who are also precluded from exercising commercial business or from engaging with the boards of companies. This harshness is aimed to prevent a conflict of interests arising from any deal that occurs between their companies and the State, and the consequent abuse of power.<sup>146</sup> This rule, however, raises a question about the legal status of the

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<sup>141</sup> See Art.17(5-a) of this Act. The sole exception to this rule is when ‘...the bank is a subsidiary of such other bank or both banks are under common control, provided that, in that case, such members may not constitute a majority of the members of the bank’s board of directors’. The prohibition, according to Art.18 (4-c) of this Act, extends also to the managing director who is barred from being ‘...an administrator or employee of another bank’.

<sup>142</sup> Art.42(Second, Third) of this Act. It is worth noting that the Act permits individuals to engage in insurance activities. See Art.4 (Third) of this Act.

<sup>143</sup> Art.42(Second-c) of this Act.

<sup>144</sup> The Regulation of the Financial Investment Companies No.6 2011, Art.9 (Second). The prohibition is based on the existence of a close relation between the activities of the aforementioned companies.

<sup>145</sup> Art.7 (Second-e) of this Ministerial Order.

<sup>146</sup> Mustafa Nasser Nasrallah, *the Commercial Companies* (Coaching publisher 1969) 233; Mohamed Farid Arini, *The Commercial Companies* (the New University House 2003) 251; Aziz Al-Okkaily, *The Mediator in the Commercial Companies* (the Culture House 2007) 284.

situation under which State employees may act as nominees of the State on the boards of Mixed Sector companies?<sup>147</sup> No answer can be given to this question. It would be better if the above situation had been excluded from the disenfranchisement of the combination between employment in the State and service in other companies.

Three comments can be made about the Iraqi legislation described above. First, the above provisions reflect a degree of inconsistency between the Iraqi Companies' Acts: while the I.C.A. 1997 allows the director to act under this capacity for other similar companies, the pieces of other legislation prevent him from doing so. This discrepancy will inevitably bring negative consequences. Preventing the director of an insurance company from acting in this capacity in another company within the jurisdiction of the I.B.R.A. 2005, for example, will motivate him to engage with other companies that fall outside the scope of this strict Act, thus creating confusion in economic life.

Second, the aforementioned Acts point to a conflict of duties on the grounds that a director is acting as a "multi- director." The justification for the prohibition is that it will ensure both the confidentiality of the company's information and the continuing loyalty of the director. However, a need for undivided loyalty and confidentiality would exist in *any* position that the director might occupy (e.g., employee, auditor, accountant, solicitor, etc.). It is hard to see the difference between a situation in which the director of a company specializing in producing a certain medicine founds his own rival company and then becomes its director, and the situation in which he establishes a partnership for producing the same medicine. Likewise, a conflict of interests is presupposed where the director acts in an investment company and acts concurrently as a trustee or a guardian for a property which has invested therein.<sup>148</sup> However, Iraqi law obliges a director to disclose the conflict of interest when *serving only in a rival company*, rather than to include *all situations of conflict of duties*. The reason behind that is attributed to the fact that conflict of duties under Iraqi law is defined in a *narrow sense*, in

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<sup>147</sup> This matter will be discussed in more depth in Chapter 5, Section one.

<sup>148</sup> Arthur B. Laby, 'Resolving Conflicts of Duty in Fiduciary Relationships' (2004) 54 American University L Rev 75, 85.

that it (in this context) *only covers the conflict of duties between the companies that exercise similar activities.*

The above difficulties relating to the narrow approach of Iraqi law concerning the conflict of duties, and the complexities connected with the interpretation of a company's interests, have been settled under English law in an obvious and comprehensive manner. Pursuant to s.175 (7) of the C.A. 2006 'any reference ... to a conflict of interest includes ... a conflict of duties'. A director is bound to disclose the conflict and to obtain a prior consent from the company. The breach of this duty is assessed objectively,<sup>149</sup> and not according to a director's belief that there was no conflict between the duties owed by him to his multiple principals.

The reason for this narrow approach in Iraqi law could be because it has fallen under the influence of the companies' Acts of other Arabic civil law jurisdictions which adopt this approach.<sup>150</sup> The above position of Iraqi law, by virtue of this partial regulation of "conflict of duties", constitutes a notable threat to a company, because it gives a director licence to owe another duty outside the above legislative constraints and could therefore be conducive to a divided loyalty.

Third, approval under the I.C.A. 1997 does not include the disclosure of any increase in the potential conflict of interests, and this will prevent the company from re-evaluating the new situation according to its interests, whereas the authorization under the C.A. 2006 is limited to certain "matters," and giving an absolute authorization is unnecessary. Thus, any increase in the probability of harming the company's interests in the future will require a further approval.<sup>151</sup>

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<sup>149</sup> See the C.A. 2006, s.175(4-a).

<sup>150</sup> See for example the Egyptian Companies' Act No.159 1981(Arts.94, 95); Kuwaiti Commercial Companies' Act No.15 1960 (Art.151); the Commercial Companies' Act of the United Arab Emirates No.8 1984 (Art. 98); the Syrian Companies' Act No.29 2011, Arts.143, 147(3), 152(4); Jordanian Companies' Act, No.22 1997, Art.74 (a-b).

<sup>151</sup> Paul Davies, Sarah Worthington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 572, para 16-72.

#### 4.3.1.2 A Director's Competition with his Company

A case can be envisaged where a director competes with his company in an individual line of business individually, via a partnership, or by founding a company in which he does not act as a director.

Iraqi law has espoused two different approaches towards allowing a director to be a competitor to his company. The first approach can be shown in the I.C.A. 1997, whereby a director is not precluded from competing with his company. This finding is inferred from Art.110 of the I.C.A. 1997, which requires the company's authorisation only in the case of the director's engagement in rival companies. This freedom is derived also from the general principles of the law.<sup>152</sup> This approach is consistent with English law which for many years has enshrined the director's liberty in this respect,<sup>153</sup> provided that the competitive activities do not involve the breach of a covenant<sup>154</sup> or a fiduciary duty.<sup>155</sup>

The I.C.A. 1997 is similar to English law, insofar as the company's approval for the director's engagement in competitive activities is not required. This position nevertheless represents a potential conflict of interests,<sup>156</sup> as in the multi-directorship case.

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<sup>152</sup> Iraqi Constitution 2005, Acts.16, 25, 26 which enshrined the principle of the individual's economic liberty; the Competition and Antitrust Act No.14 2010, Art.10.

It is worth mentioning that main objective of enactment the order No.64, 2004 issued from the Coalition Provisional Authority (C.P.A.), which amended the I.C.A. 1997 is 'to improve the conditions of life, technical skills, and opportunities for all Iraqis to fight unemployment with its associated deleterious effect on public security...'.

<sup>153</sup> *Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165 (CH); *Bell v Lever Ltd* [1932] AC 161, 195-196 (HL) (Lord Blanesburgh); *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201 [72] (Brooke LJ); *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] EWHC 466 (Ch), 2003 WL 21236540 [82] [Hart J.].

<sup>154</sup> *Island Export Finance Ltd v Umunna* [1986] BCLC 460, 482 (QB). See also: Davis Kershaw, *Company Law in Context: Text and Materials* (2th edn, OUP 2012) 561-562.

<sup>155</sup> *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch), [2007] F S R 15 [107].

<sup>156</sup> See Sedley L J's comment in *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201 [86]; Davis Kershaw, *Company Law in Context: Text and Materials* (2th edn, OUP 2012) 578; Robert Goddard 'Competing Directorships' (2004) 25(1) Comp Law 23, 24; Michael Christie, 'The Director's Fiduciary Duty not to Compete' (1992) 55 Mod L Rev 506, 250; Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn, Jordan Publishing Ltd 2011) 318-319, para 6.129.

The second approach is represented by the I.B.R.A. 2005, under which a director is prohibited from ‘...competing against the Insurer...’.<sup>157</sup> According to the interpretation of the rules of Iraqi law, the special provision mentioned under the I.B.R.A. 2005 should be given primacy over the general Acts mentioned above.<sup>158</sup> The scope of application of the I.B.R.A. 2005 includes both legitimate and illegitimate competition.

#### **4.3.1.3 Evaluating the Extent of the Rationality of Iraqi and English Law Regarding the Situations Described**

To summarize the position of Iraqi law towards the director’s engagement in other competitive activities as a director or a competitor: the I.C.A. 1997 has adopted a liberal approach comparable with that of English law. Whereas the special Companies’ Acts<sup>159</sup> espoused a stricter approach by prohibiting these activities. Each of the above approaches involves its own “pros and cons”.

The liberal approach might involve a threat to the company’s interests. This is due to the fact that it is difficult in the circumstances to expect the director to act fairly towards the company.<sup>160</sup> It seems however that the law, by virtue of permitting such competition, has given economic considerations primacy over legal principle.<sup>161</sup> The economic advantages can be summarized as follows: skilled non-executive directors who are not acting full-time may take part in competitive activities, and thus ensure that the community is not deprived of their talent; and

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<sup>157</sup> Art.42(Second-b) of this Act. This approach is consistent with Islamic Al-Sharia, which prevents a director from competing his company without its permission. Any such breach will give the other partner the right to put the company into liquidation. Legitimate competition, however, is acceptable under Al-sharia in order to prohibit monopoly in trade, as long as it has not caused substantial damage to the company. Abdul Aziz Al-Khayat, *The Companies in the Islamic Al-Sharia: Part 1* (Al-Risala publisher 1994) 281-282.

<sup>158</sup> Mustafa Ibrahim Al-Zlama, *Origins of Islamic Jurisprudence in its New Fabric* (5th edn, Al-Khansa publisher 1999) 352-385.

<sup>159</sup> The P.B.A. 2004, Art.17(5-a); I.B.R.A. 2005, Art.42(Second, Third); The Regulation of the Financial Investment Companies No.6 2011, Art.9 (Second); the Ministerial Order of Regulating the Business of the Companies Financing Small and Medium-Sized Projects No.3, 2010, Art.7 (Second-e).

<sup>160</sup> Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn., Jordan Publishing Ltd 2011) 318-319, para 6.129.

<sup>161</sup> Paul Obo Idornigle, ‘Interlocking Directorates and Corporate Governance’ (2004) 32(April) Int’l Bus Law 75, 80.

also the remunerations that would have to be paid to them as a result of imposing a legal prohibition are in fact reduced. Furthermore, allowing a director to exercise his entrepreneurial activities may be in the company's interests, because it leads to a widening of his experience and knowledge of markets. If the company concludes that these activities are against its interests, it will be able to restrain this risk by preventing the competition or the multi-directorship under a clause in its constitution or in the director's contract of service. In addition, if the director found himself in a position of conflict, albeit coincidentally, it is his duty to '...regularize or abandon it...'.<sup>162</sup>

On the opposite side, the restrictive approach of Iraqi special legislation<sup>163</sup> is conducive to narrowing the scope of entrepreneurial activities, and to reducing the power that was given to the General Assembly under Art.110 of the I.C.A. 1997.<sup>164</sup> The *restrictive approach* adopted by the special legislation may result in negative economic consequences. By expanding the list of directors prohibited from managing rival projects, the companies may experience difficulty in finding skilled and reliable directors within the realm of its activities, since Iraq is a third world country, and is assumed to suffer a deficit of talented personnel. This problem generates the following results: (i) it causes a rise in the remuneration of the current directors, and thus the cost of management activities increases. (ii) Companies, particularly international holding companies, might be forced to avail themselves of the services of foreign, rather than Iraqi directors, who are less familiar with the circumstances of Iraqi markets and the rules governing it. This would also lead to Iraqi society being prevented from developing the skills of its national directors, and to an increase in dependence on foreign expertise, which is not always available, particularly in times of crisis. Thus, it is noted that an

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<sup>162</sup> *Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2002] 2 BCLC 201 [86] (Sedley L J).

See also Barney Hearnden & Simon Howley, 'Directors' Conflicts under the Companies Act 2006 Considered' (2008) 239 Co L N 1, 2; Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn., Sweet and Maxwell 2008) 574, para 17-74.

<sup>163</sup> The P.B.A. 2004, Art.17(5-a); I.B.R.A. 2005, Art.42(Second, Third); The Regulation of the Financial Investment Companies No.6 2011, Art.9 (Second); the Ministerial Order of Regulating the Business of the Companies Financing Small and Medium-Sized Projects No.3, 2010, Art.7 (Second-e).

<sup>164</sup> This Article empowers the general assembly to grant its approval for the director's service on the board of other rival companies.

absolute prevention (by operation of law) may result in a vicious circle of problems.

However, these justifications do not offer a solution to the potential threat to the company stemming from a director's entrepreneurial activities.<sup>165</sup> For example, where the director may not withdraw from a conflict of interests, preferring instead to sacrifice the company's interests in favour of his personal interest in another project: This position is conceivable where conflict of interests could be more profitable for him through his utilisation of the company's confidential information,<sup>166</sup> as long as he employs skill in concealing the violation. Moreover, this liberal approach is in total contrast to the strict approach of English law.<sup>167</sup>

Thus, the problem of potential conflicts of interest under Iraqi law should not be dealt with by imposing excessive restrictions on directorial entrepreneurial activities, which might lead to the negative consequences described above. A director should not be given uncontrolled freedom. Rather the director's liberty should be regulated according to the following suggestions:-

First of all, it is crucial to remove all provisions enunciated by special Acts that prevent the director from acting in that capacity for other rival companies. Instead, Art.110 of the I.C.A. 1997 should be applied as a general rule to fend off the aforementioned negative results stemming from espousing the *restrictive approach* adopted by some Iraqi legislation. Moreover, it is crucial to expand the restrictions set out under that Article to include engagement in competitive activities, as these constitute a potential conflict of interest.<sup>168</sup> For this reason, several Arabic Companies' Acts prevent the director from competing with his

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<sup>165</sup> Professor David Milman, 'Directors' Duties: Present Interpretations and Future Specifications' (2003) 3 Co L N 1, 2.

<sup>166</sup> Davis Kershaw, *Company Law in Context: Text and Materials* (2th edn, OUP 2012) 578; Robert Goddard, 'Competing Directorships' (2004) 25(1) Comp Law 23, 24; D. E. McLay, 'Multiple Directorates and Loss of Corporate Opportunity: Bases and Remedies' (1980) 10 Victoria U Wellington L Rev 429, 144.

<sup>167</sup> John P. Lowry, 'Regal (Hastings) Fifty Years on: Breaking the Bonds of the Ancient Regime?' (1994) 45 N Ir Legal Q 1, 12.

<sup>168</sup> Professor David Milman, 'Directors' Duties: Present Interpretations and Future Specifications' (2003) 3 Co L N 1, 2.

company.<sup>169</sup> Thus, the company's consent in this respect should be taken into account.<sup>170</sup>

Second, it is important to give the company the right to oversight over the director's competitive activities. Sustaining this control, however, depends upon the information that is available concerning any abuse on the part of the director, and such information is difficult to obtain in these circumstances.<sup>171</sup> There could, however, be certain indicators which do not amount to complete evidence. The problem, therefore, is how to transform these indicators into complete evidence. It has been suggested that the company should be given statutory power to collect information about any doubtful activities on the part of the director, in order to bring him to account at a later date. But the investigation should be conducted without prejudicing the confidentiality of the information. Therefore, applying this mechanism properly requires that power should be vested in an independent body, (e.g., The Companies' Registrar under Iraqi law).<sup>172</sup> This matter is vital to maintain confidential trade information which the director may reveal when exercising the right to defend himself against the company's allegation. Moreover, the company's suspicions should be founded on reason, so as to avoid using this power for an improper purpose. If the neutral body discovered that the company's information, property or business interests had been used in the alleged competitive activity. The company should also be informed about the final results of the investigation, so as to be able to challenge the director's misconduct later. Applying this mechanism provides an adequate means of inhibiting the director

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<sup>169</sup> See for example the Egyptian Companies' Act No.159 1981 (Art.98); the Commercial Companies' Act of the United Arab Emirates (Art.108); The Saudi Arabian Regulation of Companies' No.6 1965 (Art.70); the Syrian Companies' Act No.29 2011 (Art.152(4)); Jordanian Companies' Act No. 22 1997 (Art.74(a)).

<sup>170</sup> There need be no anxiety about the effect of this proposal on directorial entrepreneurial activities, because the company will take account of the negative results of rejecting the director's request, such as: the increase of a director remuneration; the confidence accorded to him and the benefits conferred by his experience which will be lost by leaving the company.

<sup>171</sup> D. E. McLay, 'Multiple Directorates and Loss of Corporate Opportunity: Bases and Remedies' (1980) 10 Victoria U Wellington L Rev 429, 431.

<sup>172</sup> It is instructive to mention that the Companies Registrar under Iraqi law is in charge of exercising the oversight role over the companies, under Arts.140-146 of the I.C.A. 1997, and the Act of Ministry of Trade No.37 2011, Art.2 (Second), 3 (Tenth). So, the author suggests to consider the above sort of surveillance to be another application of this oversight.



from exercising selfish activities, since he will know in advance that any misconduct could be discovered at any time.

Third, a director should be obliged to disclose his financial interests at the commencement of his service in the company, and regularly thereafter. Any non-explicable inflation of his fortune could provide evidence of possible illegitimate use of tangible or intangible assets of the company for his personal interests. This requirement has been mentioned under the P.B.A. 2004,<sup>173</sup> and under the Integrity Commission Act No.30 2011<sup>174</sup> concerning the directors of the Mixed Sector Companies. But the jurisdiction of these pieces of legislation is confined only to the companies covered by them, and does not extend to other kinds of companies that fall outside their scope.

#### **4.3.2 A Director's Competition with the Company after the Termination of his Service**

The director's relationship with the company ceases at the end of the specific period<sup>175</sup> in the service contract (under English law), or by the end of the legal duration specified in Iraqi law.<sup>176</sup> This status leads to the annulment of a director's powers thereafter. In some circumstances, the termination of the service might be by the director's own request. The company might subsequently allege that an opportunity that was owed to it had been exploited by a director, and that the purpose of his resignation was to shield himself from liability. The no-conflict rule should aim to prohibit the use of resignation as a ploy for avoiding fiduciary liability.<sup>177</sup> The question is: to what extent does Iraqi law provide rules that effectively prevent the use of such a manoeuvre?

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<sup>173</sup> See the P.B.A. 2004, Art.21(1).

<sup>174</sup> Arts. 16-20 of this Act.

<sup>175</sup> John M. Sjovall, 'What Duty Do Company Directors Owe to Banks and Other Creditors?' (2004) 121 *Banking L J* 4, 17.

<sup>176</sup> Which is three years and renewable (Art.106 (Third) of the I.C.A. 1997)).

<sup>177</sup> Pearlie Koh, 'Once a Director, Always a Fiduciary?' (2003) 62(2) *CL JUK* 403, 421.

1- Resignation is one of a director's rights under Iraqi law, and he is entitled to leave his office after obtaining the company's consent.<sup>178</sup> Likewise, resignation does not constitute a breach of a fiduciary duty under English law.<sup>179</sup> The director thus is entitled to resign at any time, which should lead to the termination of his fiduciary duties in the future.<sup>180</sup> This freedom is justified by the desire for ensuring the use of the director's expertise in trade, which indirectly serves the public interest.<sup>181</sup>

2- Under English law, a director is entitled to exercise '...preliminary steps towards the commencement of his competing business...',<sup>182</sup> to discuss the matter with his family and friends, for example, or with a professional person. This liberal approach has been vindicated by the desire to give a director leeway for organising his future after leaving the company.<sup>183</sup> This practice is legal under Iraqi law, as long as the person's behaviour does not constitute a prejudice to the firm's interests.

3- According to Art.7 of the Civil Code 1951, right must be exercised without abuse, and the person concerned in using his right must avoid any prejudice to the others interests. Thus, a director's resignation, according to the above scenario, is subject to the doctrine of abuse of right, which has been dealt with in Chapter two of this thesis.<sup>184</sup> So, for example, if the director's intention, (his motivation), was to harm the company by acquiring a maturing opportunity of that company, then the resignation will have been exercised in an abusive manner.<sup>185</sup> This analysis seems closer to what has been espoused by the common law, which draws the line

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<sup>178</sup> The I.C.A. 1997, Art.107(Second).

<sup>179</sup> *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 [95] (CH). See also D.D. Prentice & Jenny Payne, 'The Corporate Opportunity Doctrine' (2004) 120 (Apr) L Q R 189, 199.

<sup>180</sup> *Balston Ltd v Headline Filters Ltd* [1987] FSR 330 (CH); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC paras [106-109]; *Thermascan v Norman* [2009] EWHC 3694 (Ch) para [14].

<sup>181</sup> Rehana Cassim 'Post-Resignation Duties of Directors: The Application of the Fiduciary Duty not to Misappropriate Corporate Opportunities' (2008) 125 S African L J 731, 749.

<sup>182</sup> *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749 (CH) [96] (Robert Reid QC); *Balston Ltd v Headline Filters Ltd* [1987] FSR 330, 340 (CH); *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch), [2007] FSR 15 [108].

<sup>183</sup> For more details about the approach of English law towards this issue see: Peter Watts, 'the Transition from Director to Competitor' (2007) 123(Jan) L Q R 21; Professor David Milman, 'Directors' Duties: Present Interpretations and Future Specifications' (2003) 3 Co L N 1, 2.

<sup>184</sup> For more details about this doctrine see Chapter 2, para 2.3.6 of this thesis.

<sup>185</sup> See the Civil Code 1951, Art.132, which considers the reason as an element of any obligation.

between the purpose behind the resignation (the motivation) and the existence of a mature opportunity that was exploited afterwards<sup>186</sup> by the director. The restricted scope of this approach avoids any widening in the director's liability. Therefore, '...where resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself [a director] any maturing business opportunities sought by the company...' <sup>187</sup> the liability arises.

However, this analysis of the provisions of Iraqi law is less accessible by a director, because it is premised on the author's interpretation of legal principles of Iraqi law. In addition, Art.7 of the Civil Code 1951 addresses the exploitation of an opportunity which was the reason behind the director's resignation rather than providing the company with a long-term safeguard against further abuses of the former post that go beyond the concept of a current opportunity.

At present, imposing a contractual obligation on the director to avoid the conflict of interests after his resignation may constitute the sole way of addressing the problem. There are two kinds of convention in Iraqi law in this regard: the director is *obliged* to sign such a convention (or promise) at the time of his engagement when serving one of the Mixed Sector Companies, or he may freely agree to restrict his own freedom.

Concerning the mandatory convention, under the Rules of Behaviour of the State Employees' and Mixed Sector Companies issued from the Integrity Commission No.1 2006, a director is foreclosed from acting for the private sector if it has a connection with his former post.<sup>188</sup> This prohibition shall continue for two years from the date of his resignation. It should be noted that this prohibition is sufficiently broad to include all competitive activities, whether legal or illegal. So, the restriction on a director's will does not address the substance of the problem,

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<sup>186</sup> See *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC (CH) [96] (Lawrence J); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [73]; *Foster Bryant Surveying Ltd v Bryant* [2007] EWCA Civ 200, [2007] 2 BCLC 239 [69] (Rix); *Thermascan v Norman* [2009] EWHC 3694 (Ch), [2011] B C C 535 [16].

<sup>187</sup> *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162 (Assizes) (illustration added); *Thermascan v Norman* [2009] EWHC 3694 (Ch), [2011] B C C 535 [14].

It seems that the reliance in these cases is on the director's good or bad faith. But the investigation of the motivation validity in presenting the resignation is not always easy, and this depended on the court's common sense. See John Lowry & Jen Sloszar 'Judicial Pragmatism: Directors' Duties and Post-Resignation Conflicts of Duty' (2008) J B L 83, 89.

<sup>188</sup> See this Regulation, Rule 21.

which is to prevent the misuse of the company's information or property in other economic activities in the absence of prior consent by the firm. From another aspect, this provision is restricted to Mixed Sector Companies, and does not include other types of companies, or cases where individual competition is exercised. It seems that this prohibition will inevitably affect the director's future and his livelihood.

Apart from the rules of the Integrity Commission, the general principles of law do not prevent the company from protecting its own interests after the director's resignation by concluding an agreement with him. The scrutiny in the Competition and Antitrust Act 2010 and Art.910 of the Civil Code 1951,<sup>189</sup> would be helpful in delineating the conditions of this agreement, as follows:-

1- Preventing the ex-director from competing with his former company is null and void as long as the purpose of that prevention is to prejudice fair competition.<sup>190</sup> The subject-matter of this agreement is the avoidance of competition with the company, rather than the avoidance of the conflict of interests.<sup>191</sup> Thus the imposition of this restriction is aimed at protecting the legitimate interests of the company and is connected with the director's capacity to be familiar with the company's secrets and those of its customers.<sup>192</sup>

2- This restriction should be limited to a certain time and place and the nature of the forbidden activity should be specified in order to avoid the negative effect of this obligation upon the director's future.<sup>193</sup> Thus, those restrictions which extend throughout the life of the director and apply throughout the country's territory (even though the company is active only within a limited province) are deemed null and void.

3- The director should be indemnified for these restrictions on his freedom of action.<sup>194</sup>

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<sup>189</sup> This provision connects with the contract of the employment, which is applied to the managing director. But it may include the other directors by analogy.

<sup>190</sup> The Competition and Anti-Trust Act 2010, Art.10.

<sup>191</sup> The Civil Code 1951, Art.910(1).

<sup>192</sup> The Civil Code 1951, Art.910.

<sup>193</sup> The Civil Code 1951, Art.910(2-b).

<sup>194</sup> The Civil Code 1951, Art.910(2-d).

On the other hand, s.170 (2-a) of the C.A. 2006 provides a pragmatic solution to the above problem by prohibiting a director from ‘...the exploitation of any property,<sup>195</sup> information or opportunity of which he became aware at a time when he was a director’.

The application of the above provision depends on the existence of two conditions: first, the scope of this duty is limited to the situations mentioned in this section, rather than to the broad concept of this duty set out under s.175 of the C.A. 2006.<sup>196</sup> Secondly, the conflict of interest does not occur if a director is unaware of the information, opportunity or property at the time of his serving as a director of the firm. This approach is logical since it avoids imposing an excessive restriction on the director’s future. But there is a need to improve this provision by determining the temporal scope for lapse this duty. It is suggested therefore that the commencement of the duty should be restricted to a reasonable period after the termination of service, say two years. This would be more in accord with the U.N Convention against Corruption 2004.<sup>197</sup> This proposal does not lead to any diminution of protection to the company, because it is unlikely that the party who offers the opportunity will wait a long time for a response from the company. In addition, the information will become outdated according to commercial standards. Furthermore, the expiry of the proposed period gives a presumption that a company is unwilling to exploit the opportunity in question. So, the expiry of this period should result in lapse the company’s right of exploiting the opportunity, and return it back to the community to be part of public domain.

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<sup>195</sup> Generally speaking, a director, after terminating his service, will lose actually his power over the company’s material property, but he might be able to dispose of the intellectual property, e.g. its patent, as was established in *Cranleigh Precision Engineering Ltd v Bryant and Another* [1964] 3 All ER 289 (QB).

<sup>196</sup> The Explanatory Notes of this Act explain the reason for imposing this duty by stating, at para 309 as follows:-

This is necessary to ensure that a director cannot, for example, exploit an opportunity of which he became aware while managing the company’s business without the necessary consent simply by resigning his position as director. The closing words of section 170(2) provide that these duties apply to a former director subject to any necessary adaptations. This is to reflect the fact that a former director is not in the same legal position as an actual director.

<sup>197</sup> This Convention, Art.12(2-e). But the Convention has not settled the matter of determining temporal limitation that must be imposed on the director in this regard. Seemingly, this matter has been left to the national legislation that will be enacted by the contracting countries in this concern. It is worth noting that Iraq joined this Convention via the Act of Accession No.35 2007(Art.1).

The differences between Iraqi and English law concerning this matter reflect a degree of confusion surrounding Iraqi law and its misunderstanding of the difference between conflict of interests and competition: The first is illegitimate behaviour *per se*, with results prejudicial to the company. Thus, under the C.A. 2006,<sup>198</sup> any misuse of the company's information, or opportunities, or its property is sufficient to result in directorial liability. While prevention of competition *per se* does not give rise to the director's liability, unless a breach of the competition rules has been demonstrated. Therefore, the clauses of prevention of competition under Iraqi law must include the indemnification of the director.

Hence, the above remarks on the position of Iraqi law towards this issue support the sound approach espoused by the C.A. 2006. They represent a call to Iraqi lawmakers for the transplantation of s.170 (2-a) of the C.A. 2006 into the I.C.A. 1997 in order to remove any uncertainty surrounding this issue and to avoid the complexities, explained above, regarding the interpretation of the rules governing the issue.

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<sup>198</sup> S.175 of this Act states that:

(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

## Conclusion

By extrapolation of general principles Iraqi law, the duty to avoid conflict of interests means simply that a director must not place himself in a position of a conflict of interests. This general framework, however, lacks adequate rules that are capable of confronting several legal problems. It has been shown in this Chapter that there is a failure on the part of the C.P.A. to incorporate into the law a comprehensive clear duty to avoid the conflict of interests that may occur between a director and his company. It has been demonstrated elsewhere in this Chapter that the I.C.A. 1997 lacks a general duty to prevent a director from placing himself in a position of conflict between his personal interests and his duty to the company. The reason for this lacuna could be the legislators' belief that the duty to declare an interest in a deal under Art. 119 of the I.C.A. 1997, together with the obligation to avoid conflict of duties under Art. 110 of that Act, is sufficient to prevent any conflict of interests. The reference to the above duties reinforces the belief of Iraqi legislators that these rules are sufficient to prevent conflicts of interest. While the I.B.R.A. 2005 contains a general duty to avoid conflict of interests, there is a need for further determination of its content and its scope. The current formulation seems to be a "cake without sugar", because its generality renders it less comprehensible to the director. The confusion surrounding these Acts leads to an increased threat to the company's interests and motivates a director to take advantage of this inadequacy.

To address this legislative shortcoming, resort is made to the rules of tort liability under the Civil Code 1951. However, the onerous conditions that have to be proved under this liability, (fault, damage and causation), makes it unsuitable. Its unsuitability stems from the fact that tort rules are designed for *remedial* rather than *preventive* purposes. It is well known that the commercial environment is premised on confidence, and it is important to support this principle by designing strict rules to ensure that the firm will receive the maximum benefits from the services of its director. This reality has been recognized in English law, which deals with this socio-economic phenomenon, (directorial self-interest), by

adopting a strict rule (both in common law and recently in statute), and is thus able to play a preventive role in this regard.

Uncertainty surrounding the no-conflict duty under Iraqi Company law has created other difficulties in the area of identifying the meaning of conflict of interests and misappropriation of a corporate opportunity, which is the subject of directorial opportunism. For example, there is no explicit and comprehensive treatments in Iraqi Company Law for several issues related to this duty, such as: the concept of indirect conflict, potential conflict of interests and the rules that protect a firm from the misuse of its information, its property or its opportunities. So, resort has been made either to other legislation, or even to analogous rules in order to fill the gap in the statutory provisions of Iraqi Company Law. It has been established in this Chapter that resort to these sources of law may not provide the company with effective and comprehensive safeguard, nor does it give a clear guide to a director in order to avoid his liability.

This ambiguity includes also the concept of the company's opportunity. By extrapolating the general principles of the I.C.A. 1997 and the tort liability it can be inferred that the company's opportunity consists of the combination of three elements: the director's capacity, an expropriation of an opportunity that falls within the company's line of business, as well as the existence of damage to the company's interests. But this sole test is not adequate to protect the company from various dishonest actions that may be exercised by the director. For this reason, English law, by contrast, has deemed all these elements as separate tests, and confers on the court a wide discretion in applying the appropriate test according to a case's circumstances, and adopts a common sense approach to the existence of a conflict of interests. By contrast, Iraqi company law "increases" the difficulty of identifying the meaning of corporate opportunity. For example, Iraqi law neither authorizes the company to regulate the conflict of interests in its articles, nor imposes on the director a duty of communicating the opportunity to the firm and then leaving it to the company to determine whether the opportunity lies within its business sphere.



The confusion extends to the effects of imposing this duty on the director's liberty in exercising competitive business within the period of his service in the company and afterwards. The I.C.A. 1997 has followed the English law approach in giving the director liberty to exercise a rival activity, either personally or by being a director in other rival companies. But the special companies' Acts<sup>199</sup> have removed this liberty by preventing the director from exercising these activities. These different approaches inevitably affect the coherence of Iraqi legislation with regard to certain issues. The shortcomings of the Iraqi Acts extend also to the rules governing the director's abuse of his former office after his resignation. Notably, there are no comprehensive rules imposing on the ex-director a duty not to exploit that which he had accessed prior to his resignation.

To sum up, it appears from the above analysis that the regulation of Iraqi law by way of the no-conflict rule contains several legislative imperfections which may be exploited by a dishonest director. Reform would require a comprehensive codification of this duty and a detailed assimilation of rules. The following Article, which contains some provisions that are currently absent from Iraqi law, would constitute a response to the above deficiencies.

### **Article 3: The Duty to Avoid Conflict of Interests:**

1-A director must avoid placing himself in a position in which his duty to a company may potentially conflict with his direct or indirect interests. This applies in particular to cases of exploitation of a corporate property, a corporate opportunity or relevant information.<sup>200</sup>

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<sup>199</sup> The P.B.A. 2004, Art.17(5-a); I.B.R.A. 2005, Art.42(Second, Third); The Regulation of the Financial Investment Companies No.6 2011, Art.9 (Second); the Ministerial Order of Regulating the Business of the Companies Financing Small and Medium-Sized Projects No.3, 2010, Art.7 (Second-e).

<sup>200</sup> Iraqi law does not enshrine a general and comprehensive rule to avoid the conflict of interests. The current provisions encompass are either incomprehensible to a director, or cover partial treatments of this duty. The above proposal involves a comprehensive treatment of the problems of the conflict of interests within a general formulation.

2-A director's liability for infringing subparagraph (1) arises by reason of his capacity as a director, or by reason that the exploitation falls within a company's line of business, or by reason of a certain opportunity has been accessed by the company.<sup>201</sup>

3-Liability does not arise in the following situations:-<sup>202</sup>

- (a) If a situation does not give rise to a conflict of interests.
- (b) If a situation is authorized by a company, according to the following subparagraph.

4- (i) The authorization<sup>203</sup> must be based on a full and correct disclosure of the circumstances of the conflict.

(ii) The authorization is to be given by the general assembly, or by the board of directors if it has been authorized to do so.

(iii) If a company is insolvent or is on the verge of being insolvent, the authorization must be given by a majority of the company's creditors, including the stakeholders who hold fixed debts owed by the company.

(iv) The decision shall be taken by disinterested persons, who do not have a direct or indirect interest in the conflict and are not connected with the director concerned, in a meeting that must not be attended by the director concerned.

5-This duty includes any ex-director in matters regarding the exploitation of corporate property, opportunity or information that had been accessed by him within the terms of his prior service. This duty is to continue for two years from the time of his leaving office.

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<sup>201</sup> Iraqi law does not refer to the basis of the director's liability for the exploitation of a corporate opportunity. This proposal refers to those principles, which have been extracted from English common law.

<sup>202</sup> Iraqi law does not refer to exceptions to the no-conflict rule. This proposal assists the director in an understanding of the permitted and prohibited behaviour.

<sup>203</sup> Iraqi law does not refer to a director's duty to communicate the opportunity to the company, which could facilitate the abuse of office, and thereby creating a difficulty in defining the concept of a corporate opportunity. The above proposal does not solve the aforementioned problems only, but also sets out the mechanism for granting the approval and identifies the body competent in granting the authorization.

6-(a) Any reference to the conflict of interests includes the conflict of duties,<sup>204</sup> under which a director must avoid owing duties that may be potentially conflicted. This includes the engagement to serve a rival company.

(b) But it is permissible for a director to serve no more than six companies simultaneously, having regard of the provisions of avoiding conflicts of interest set out in this Article.

7-(a) Any authorization of a conflict of interests or duties includes empowering the company of the right of inquiry into any illegitimate activities exercised by its director via the companies' Registrar.<sup>205</sup>

(b) The Registrar is empowered to investigate a director regarding any allegation of the abuse of office, and to collect the available information, including inquiry into any unjustified increase in his fortune.

(c) The results of the inquiry and any related evidence about the breach (if any) shall be delivered to the company, while preserving the confidentiality of information concerning the business.

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<sup>204</sup> Iraqi law mentioned to the "conflict of duties" within a narrow scope, which is limited to prevent the incumbency of the post of a director in other rival company. The above proposal lays out a general rule to avoid the conflict of duties.

<sup>205</sup> The suggested paragraph above gives the company (via a neutral body) the right of investigation of any competitive activities, which involves a breach of managerial duty. This suggestion plays a deterrent role, because it brings a director's attention that he will always be under the company's surveillance even after he is granted the right of competition with it. This right enables the company to discover any misuse of corporate assets. It is notable that the right of investigation, concerning the above situation, has no comparable rules in the laws of Iraq and the U.K.

## Chapter Five

### **Question of Divided Loyalty: the Nominee Director, and Directors who Accept Benefits from a Third Party**

**Introduction:** Reference has been made in the previous Chapters to some aspects of the director's duty of loyalty to his company, and his obligation to avoid a conflict *between his duty and his own interests*.

In this Chapter, two aspects of a director's loyalty to his company will be examined to assess the extent of applicability of the no-conflict rule to these situations in Iraqi law. These aspects are: the position of nominee director, and the duty not to accept a benefit from a third party.

In the first situation, the Iraqi Companies' Acts have given shareholders the right to nominate representatives to uphold their personal interests. This raises the problem of multiple loyalties.

Concerning the second situation, the Iraqi Companies' Acts do not indicate whether a director is prohibited from accepting a bribe or from making any secret profits by virtue of his position in the boardroom. Does non-regulation in this area give a hint of whether such behaviour is legal or prohibited under the general principles of law, and further, what degree of protection is provided to the company by the rules of Iraqi law?

The question that will be considered in this Chapter is: Do the above-mentioned cases represent exceptions to the no-conflict rule? Do these situations give a license to the director to put his interests or the interests of another person ahead of his company's interests; or is the no-conflict rule the prevailing precept in all cases?

To answer the above questions, this Chapter will be divided into two sections: the first Section will be devoted to discussing the problem of the multiple loyalties of nominee directors. Discussion in the Second section will focus on finding a rule that governs the acceptance of benefits from a third party.

## Section I

### **The Nominee Director in Iraqi Law: Divided or Undivided Loyalty?**

Introduction: A nominee director is any person appointed to the company's board of directors to safeguard the interests of another party. It has become a general practice in the English corporate world that third parties, such as: creditors,<sup>1</sup> minority shareholders,<sup>2</sup> employees,<sup>3</sup> debenture holders or a group of shareholders<sup>4</sup> will seek to appoint nominees to protect their interests in the company. Such phenomenon aims not only to safeguard the interests of the aforementioned persons, but also to implement their wishes and their strategies in conducting the firm's business.<sup>5</sup>

This development has been described by Lord Denning in *Boulting and Another v Association of Cinematograph, Television and Allied Technicians* as follows:-

There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful... or if he agrees to subordinate the interests of the company to the interests of his patron....<sup>6</sup>

However, the Iraqi Companies' Acts went further towards regulating this phenomenon as a legal fact, as follows:-

1. Under Art.103(First) of the Iraqi Companies' Act 1997 (herein after the I.C.A. 1997), the board of directors of the Mixed Sector Companies (the members of which must not exceed 7 persons) shall consist of two groups of directors: the first group consisting of directors elected by the shareholders and the second group

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<sup>1</sup> Paul Davies, *Introduction to the Company Law* (2th edn, OUP 2010) 183.

<sup>2</sup> Ibid, 183; Deirdre Ahern, 'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy' (2011) 127(Jan) L Q R 118.

<sup>3</sup> Ben Pettet, John Lowry and Arad Reisberg, *Company Law* (3rd edn, Pearson Custom Publishing 2012) 168.

<sup>4</sup> Elizabeth Boros, 'The Duties of Nominee and Multiple Directors: Part 1' (1989) 10 (11) Comp Law 211; Deirdre Ahern, 'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy' (2011) 127(Jan) L Q R 118.

<sup>5</sup> Deirdre Ahern, 'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy' (2011) 127(Jan) L Q R 118.

<sup>6</sup> [1963] 2 QB 606, 626-627 (CA).

representing the State sector. Pursuant to Art.103 (First) of the I.C.A. 1997, the State nominees are selected according to the following method:-

Two members *representing the state sector* are appointed under a decision by the competent minister or his deputy in the sector to which the company belongs unless, at the time of the selection, the state sector's share in the mixed company's capital exceeds 50%. In such a case, the competent minister or his deputy in the sector to which the company belongs shall appoint three members representing the state sector.<sup>7</sup>

This type of company represents an instrument of the State to interfere into the economic life, and one of manifestations of Socialist regime. The nominee director in the Mixed Sector Company is often being one of its employees. The nominee, in implementing his duty, may often receive regular instructions from a State entity which subscribed in founding the company.

2. The Private Banks Act 2004 (hereinafter the P.B.A.) allows the acquisition of shares of one company by another (which is called the holding company). The acquisition may be conducive either to legal control, which arises from possession of 50% or more of the shares, or to an actual control through the possession of 25% or more of the shares of the subsidiary company. Such control enables the holding company to elect the majority of the directors of the subsidiary firm.<sup>8</sup>

Pursuant to Art.17 (5-a) of the P.B.A. 2004, it is impermissible for a director to be:-

An administrator or employee of another bank, unless the bank is a subsidiary of such other bank or both banks are under common control, provided that, in that case, *such members may not constitute a majority of the members of the bank's board of directors.*<sup>9</sup>

In addition, Art.17 (5-a) of the P.B.A. 2004 prevents the nominee directors of the holding company from constituting a majority of directors in the subsidiary company.

3. Likewise, Art.49 (Third)<sup>10</sup> of the Insurance Business Regulation Act 2005 (herein after the I.B.R.A.) allows also the acquisition of another Insurance Company, with the

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<sup>7</sup> [Emphasis added].

<sup>8</sup> See Art.1 of this Act. About the meaning of "control" see: Zipora Cohen, 'Fiduciary Duties of Controlling Shareholders: A Comparative View' (1991) 12(3) U Pa J Int'l Bus L 379, 393; Hans C. Hirt, 'The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interests' (2005) Mar JBL 159, 171.

<sup>9</sup> [Emphasis added].

<sup>10</sup> This Article states that 'the parent company shall appoint *representatives* to the Board of Directors of the subsidiary according to its shareholding' [emphasis added].

result that the parent company shall appoint its *representatives* to the board of directors of the subsidiary according to its shareholding.

4. Although the Iraqi Companies' Acts do not mention the possibility of creditors nominating a director to safeguard their interests, it is suggested that the law does not prevent such agreements, as long as they do not offend against the law or general order.<sup>11</sup>

The provisions of Iraqi legislation set forth in the above paragraphs, by virtue of using phrases like “representing the state sector”,<sup>12</sup> or “its representatives”,<sup>13</sup> may imply one of two likelihoods: it may refer to the membership of the legal person in the board, which is represented by his nominee therein, as has been suggested by some commentators on Iraqi law.<sup>14</sup> It may also mean that the purpose of the nomination is to represent the personal interest of one shareholder in the boardroom, which gives rise to a potential conflict of interests,<sup>15</sup> as suggested at common law. In other words, do the above provisions involve the endorsement of the divided loyalty of the director, or does the principle of undivided loyalty nonetheless govern the above situations?

Support for the first likelihood (a director is a representative of the nominator's interests) leads to the creation of numerous problems for a company, as well as a difficulty for the nominee director in carrying out his duty to his firm and his nominators simultaneously. Lord Denning in *Scottish Co-Operative Wholesale Society Ltd v Meyer*, recognized the existence of this difficulty when he stated:-

So long as the interests of all concerned were in harmony, there was no difficulty. The nominee directors could do their duty by both companies without embarrassment. But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position. Thus, when the realignment of shareholding was under discussion, the duty of the three directors to the textile company was to get the best

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<sup>11</sup> See the Civil Code 1951, Art.131.

<sup>12</sup> The I.C.A. 1997, Art.103 (First).

<sup>13</sup> The P.B.A. 2004, Art.17 (5-a); the I.B.R.A. 2005, Art.49 (Third).

<sup>14</sup> Yasser Bassem Thanon & Irfan Omar Khalid, 'Litigations Relating to liability of the Board Directors and other Directors for Debts of the Joint-Stock Company Insolvent, and its Effects' (2009) 1(4) Tikrit University Journal of Legal & Political Science 206, 218.

<sup>15</sup> John De Lacy, 'the Concept of a Company Director: Time for a New Expanded and Unified Statutory Concept?' (2006) May J B L 267, 285.

possible price for any new issue of its shares... whereas their duty to the co-operative society was to obtain the new shares at the lowest possible price-at par, if they could.<sup>16</sup>

Finding a solution to this problem is not an easy task, and it has given rise to a long debate by the courts and law commentators which has still not produced a uniform view or a clear consensus. This is due to the interlocking and overlapping relations that create the nomination, which could be conducive to a conflict of interests between the nominator and the company as a result of divided loyalty: loyalty on the one hand to the person who selected the director and owns the right to control him or remove him at any time,<sup>17</sup> and on the other hand to the company, to which the nominee also owes a duty.

Addressing this problem depends upon an understanding of the dimensions of the director's respective relationships with his elector and with the company. A review of these relationships will pave the way to allow the author to offer some appropriate proposals in this Chapter.

### **5.1.1 The Relation between the Director and his Nominator**

The influence of the nominator derives from the nomination, which sets out his rights in relation to the nominee. The aforementioned provisions<sup>18</sup> of Iraqi legislation concerning the nomination use the term "representation," which logically assumes the existence of a *legal relationship* between the nominator and his appointor. The nomination may stem from a formal or informal agreement, an understanding between a company and the nominator, or by a clause stipulated in the company's articles (in U.K Law).<sup>19</sup>

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<sup>16</sup> [1958] 3 W L R 404 [1959] A C 324, 366 (HL).

<sup>17</sup> Khalid Al-Shawi, *Explain the Iraqi Commercial Companies' Act* (First edn, Al-Shaap publisher 1968) 478; Aziz Al-Okkaily, *The Mediator in the Commercial Companies* (the Culture House 2007) 472; Teh Tai Yong and Mohammad Rizal Salim, 'Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors' (2008) 50 *International Journal of Law and Management* 168, 169.

<sup>18</sup> The I.C.A. 1997, Art.103 (First); the P.B.A. 2004, Art.17 (5-a); the I.B.R.A. 2005, Art.49 (Third).

<sup>19</sup> Teh Tai Yong and Mohammad Rizal Salim, 'Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors' (2008) 50 *International Journal of Law and Management* 168, 169.



The affiliation of the nominee, by virtue of his appointment, distinguishes his case from the case of a *multi-directorship*.<sup>20</sup> With the multi-directorship, a fiduciary seeks to act for more than one company to improve his livelihood. It is assumed, therefore, that he exercises an open-ended discretion in management. Whereas the nominee acts in the company to fulfil his obligations towards another person. But an overlap between the two scenarios is conceivable; for example, where a director, (C) is acting to serve the interests of (A) or (B) as a multi-director, and then (A) acquires (B).<sup>21</sup> In this case the director (C) may act as a multi-director and nominee director at the same time. In any event, the two scenarios converge at the point where the fiduciary may give more weight to certain interests other than those of the company.

This case is also distinct from that of a *shadow director*, who exercises his influence on the majority of boards of directors<sup>22</sup> without having to be nominated. The two cases could overlap, however, when the shadow director uses the appointment of a nominee as a means of exercising his influence by issuing instructions to him. For this reason, creditors often hesitate to appoint their own directors, for fear that these might be considered as a shadow director, with the result that the creditors will incur liability accordingly.<sup>23</sup> Thus, it is not possible to describe a general framework to distinguish the role of the nominee director from the ones cited above. Consideration should be given to the facts of each case in order to find the correct legal description of the nominee.

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<sup>20</sup> This element is essential also for discriminating between this function and that of the conservatorship, which is mentioned in some Iraqi Acts. Under these legislation, the State bodies have been given the right of nominate a director as a part of the company's rescue plan for the creditors' interest, as an alternative to a declaration of insolvency (see the I.B.R.A. 2005, Arts.53, 54; the P.B.A. 2004, Art. 59(1)). In this situation, it cannot be said that the nominee director is acting in the creditors' interests, because the latter lacks control over him and thus over his decisions. Also, the conservator cannot be considered as a nominee of a state body entity, because the purpose of the conservatorship is to rescue the company and by extension safeguard the creditors' interests, rather than to achieve the particular interests of the State body.

<sup>21</sup> Elizabeth Boros, 'The Duties of Nominee and Multiple Directors: Part 1' (1989) 10(11) Comp Law 211.

<sup>22</sup> For more details of this area of law see Evaripides Hadjinestoror, 'Stigmata of Fiduciary Duties in Shadow Directorship' (2012) 33(11) Comp Law 331, 332.

<sup>23</sup> See the C.A. 2006, s.170(5). See also Elizabeth Boros, 'The Duties of Nominee and Multiple Directors: Part 1' (1989) Comp Law 211.

Although Iraqi law has not laid down the rules governing shadow director, it is not impossible to envisage the occurrence of this situation in the practical arena. However, if it is possible to apply the concept of shadow director under English law in the context of Iraqi legal reality, the nominators (the State body) in Mixed Sector Companies cannot be considered as shadow directors, because the State control does not extend to the majority of the company's directors, and thus it is not able to affect their decision.

The nature and the scope of the subordination of the nominee to his nominator is determined by the nomination instrument. In this instance, distinction should be made between two situations: a nominee of the State in the Mixed Sector Company, and the nominee of other nominators.

With regard to the representative of the State Sector, who is often one of its employees, Iraqi administrative law has delineated the relationship between the nominator and nominee.<sup>24</sup> The law imposes on the nominee a harsher duty than that which governs those in the private sector. This strictness may reach a degree whereby any breach by the employee of orders from the State body may lead to him incurring a criminal sanction.<sup>25</sup> This position may render the nominee of the State sector merely a puppet (stooge), his duty being confined to communicating the wishes of his nominators to the board and vice versa. There are commentators who believe that this position may not absolve the nominee from exercising his own discretion,<sup>26</sup> or consequently absolve him from liability. According to this view, the nominee should recognize his responsibility to exercise an independent discretion and ignore any provisions or agreements to the contrary.

Concerning the second situation, namely: the relationship between the nominator from the Private Sector and his nominee: this relationship is governed by *the contract of employment, or contract of agency*. Whether a nominee under this contract will be a

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<sup>24</sup> See the State Employees Disciplining Act No.14, 1991, Art.4 (third).

<sup>25</sup> Art. 240 of the Penal Act 111 1969 states:-

Any person who contravenes an order issued by a public official or agent, municipal council or official or semi-official body in accordance with their legal authority or who disobeys an order issued by those entities in accordance with their legal authorities is punishable by a period of detention not exceeding 6 months or by a fine not exceeding 100 dinars. This is without prejudice to any greater penalty stipulated by law.

<sup>26</sup> J. J. Du Plessis, 'Nominee Directors Versus Puppet, Dummy and Stooge Directors: Reflections on these Directors and their Nominators or Appointors' (1995) J S Afr L 310, 311.

puppet, or he will wield a reasonable discretion, is a matter that should be settled by the instrument of his appointment. Generally, the Civil Code 1951<sup>27</sup> recognizes the legitimacy of an agreement that imposes a restriction on the person's discretion as long as it does not clash with the provisions of the general principles of law. But any agreement that involves a person giving a promise in order to make a third party (the firm) approve of a certain matter, obliges the promisor, rather than the third party (the company).<sup>28</sup> However, the Civil Code may contradict with Art.117 of the I.C.A. 1997 and Art.17(1) of the P.B.A. 2004, which entrusts broad powers to a director, and is also contrary to the duty to act in the company's interests. These provisions, which are mandatory rules, must predominate over any agreement, even if the company itself entered into it. Therefore such an agreement is deemed void. These contradictions between the provisions of Iraqi law reflect a degree of confusion and inadequacy in addressing this issue, and gives rise to the need to establish a legal cover for these agreements.

English law takes the following approach: s.173(1) of the C.A. 2006 prevents the director from restricting his discretion. But sub-section 173(2-a) of the C.A. 2006 gives a hint that such restriction on a director's discretion is permissible if it is made 'in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors'. The agreements covered by this provision includes those concluded between a company with a third party, like a partnership. It extends also to agreements that conclude with a group of shareholders as well. But the last agreement must not contradict with a nominee duty to act in the company's interests as a whole.<sup>29</sup>

### **5.1.2 The Relationship between the Nominee and the Company**

It goes without saying that the nominee director is subject to the same duties as other directors. The Iraqi and English Companies' Acts do not enshrine special rules to govern this legal position. But the nature of the nominee director makes carrying out

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<sup>27</sup> See the Civil Code 1951, Arts.127-131.

<sup>28</sup> The Civil Code 1951, Art. 151. See also: Ghada Ahmed Issa, *the Agreements between Shareholders in the Joint Stock Companies* (first edn, the Modern Institution of Book 2008) 181.

<sup>29</sup> The C.A. 2006, s.172(1).

the above duties more complex, particularly with regard to questions about whom the nominee owes loyalty to, and how to safeguard company information in the case of multiple loyalties.

### **5.1.2.1 To Whom Should a Director be Loyal?**

This matter creates a problem in both of the countries mentioned above, because the director in each case would be placed in a position where he must serve the interests of two masters concomitantly.

Arts.120 of the I.C.A. 1997<sup>30</sup>; 17(5) of the P.B.A. 2004<sup>31</sup>; and 172 of the C.A. 2006<sup>32</sup> (concerning the duty to act in the company's interests) involves a general formulation that does not lay down special provisions for this case. These Articles, however, cannot ignore the provisions for nomination, and use the term "representation"<sup>33</sup> for the appointer's interests, reflecting a preponderance of commercial considerations over legal principles. The legal provisions, then, should be regarded collectively, as each of them complements the other. This raises the question of whether any single provision should prevail over the others.

The Ministerial Order for Facilitating the Enforcement of the Private Banks Act 2004, No.4, 2010 (herein after the M.O.F.E.P.B.A.) contains a helpful statement for answering the above question. A director, including the nominators, who is subject to this legislation must represent the shareholders as a whole.<sup>34</sup> However, this Ministerial order perhaps conflicts with the earlier analysis of Art.17 (5-a) of the P.B.A. 2004,<sup>35</sup> which has superiority over the M.O.F.E.P.B.A. 2010.<sup>36</sup> This matter acquires particular

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<sup>30</sup> This Article states that 'the chairman and members of the board of directors shall do their best to serve the interests of the company as they would serve their own personal interests...'

<sup>31</sup> This Article provides that 'the members of the board of directors shall act honestly and in good faith with a view to the best interests of the bank'.

<sup>32</sup> This Section states that 'A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole...'

<sup>33</sup> See the I.C.A. 1997, Art.103 (First-1); the P.B.A. 2004, Art.17(5-a); the I.B.R.A. 2005, Art.49(Third).

<sup>34</sup> See Art.64 (First) of this Ministerial Order, which is enacted in accordance with Art.104(1) of the P.B.A. 2004.

<sup>35</sup> It has argued earlier in the introduction of this Section that this Article gives to the nominee director the license of holding divided loyalty.

<sup>36</sup> Moreover, this provision does not address the problem of a nominee violation of his duty towards his nominator, which arises by reason of the failure to represent the latter's interest in the boardroom.

significance in the light of the legislative recognition of the nominator's right in appointing his nominee. From another angle, this legislation does not eliminate the ambiguity surrounding the position of the nominee director under other Iraqi legislation<sup>37</sup> that did not lay down provisions similar to that mentioned in the 2010 Order, which requires from a director to act in the interests of shareholders as a whole.

Apart from the above legislation, Iraqi courts and Iraqi commentators provide no answer to this question. The interpretation of statutory provisions to resolve the conflict of provisions is the key to the problem. Seemingly, there are two likelihoods may result from construing the above conflicted provisions, viz:

1-The provision that involves a special rule should be predominant over a provision that encompasses a general rule. The first provision is called the restricted provision.<sup>38</sup> Accordingly, the nominee director should act in the interests of his company according to what is enunciated in Art.120 of the I.C.A. 1997 and Art.17(6) of the P.B.A. 2004, since these provisions encompass a special rule which outweighs the provisions of the nomination. In other words, the provisions of nomination governing the relationship between the nominator and the nominee should be observed in so far as these do not involve a violation of the director's duty to the company. This means that a director owes an undivided loyalty to his company. However, this interpretation may contradict another rule, viz:

2- The court must consider the wisdom of enacting any legislation: one of the objectives of the Evidence Act 1979 is to 'oblige the judge to adopt the advanced interpretation of law and in observance of the wisdom of its enactment...'.<sup>39</sup> The "wisdom" refers to the justification for enacting any rule, which is to obtain a benefit for, or to avoid a harm to, another person.<sup>40</sup>

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<sup>37</sup> The I.C.A. 1997; the P.B.A. 2004; the I.B.R.A. 2005.

<sup>38</sup> Giving weight to the special provision is traceable to the fact that it involves a special reason (wisdom) that gives it a preponderance over the general provision. For more details of this matter see: Professor Mustafa Ibrahim Alzlamy, *Origins of Islamic Jurisprudence in its New Fabric* (5<sup>th</sup> edn, Al-Khansa publisher 1999) 369.

<sup>39</sup> Art.3 of this Act No.107 1979.

<sup>40</sup> Professor Mustafa Ibrahim Alzlamy, *Origins of Islamic Jurisprudence in its New Fabric* (5<sup>th</sup> edn, Al-Khansa publisher 1999) 99.

Having regard to this principle, the justification for the nomination is that it represents the nominator's interests, and not that it makes the director an independent member of the board. This argument derives from the following considerations:

(a) The I.C.A. 1997 singles out a special method for selecting the State's directors.

(b) The purpose behind the incorporation of the State Sector in companies was to tame the private sector into serving the goals of the socialist regime. This political-economic reality applied in Iraq for a long time, and overshadowed the formulation of Art.114 (Second) of the I.C.A. 1997, (before its amendment). This Article stated that any decision, even by a majority of directors, cannot be passed unless it obtains the approval of the State representatives. This meant that the interests of the public sector were given primacy over the company's interests. Fortunately, this provision was abrogated in 2004 by the Coalition Provisional Authority (C.P.A.) when it reformed this Act. But Art.1 of the Commerce Act 1984 (which is still in force) reiterates socialist notions of the dominance of the State Sector over other sectors. Art.1(2) of the Commerce Act 1984 described the objectives of this Act as 'making the role of the Mixed and Private Sectors complementary to the socialist sector'.

(c) Art.17(5-a) of the P.B.A. 2004 allowed for the holding company to appoint its representatives as "an exception" to the prohibition of multi-directorships in the company, and with the restriction that a conflict of duties should be avoided. However, the foregoing provision stipulates that nominee directors 'may not constitute a majority of the members of the bank's board of directors'. This provision aimed to give the subsidiary company a degree of independence from the holding, or parent, company, by prohibiting the nominee directors from constituting a majority on the board. This provision cannot be understood, unless it is assumed that the nominee represents primarily the holding company's interests solely.

(d) Finally, the use of the term "representation" in the Iraqi legislation cited above is further evidence that the nominee represents the interests of his appointor, in accordance with the rules of agency.<sup>41</sup>

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<sup>41</sup> See the Civil Code 1951, Arts.727, 733 concerning the contract of agency.

Accordingly, it seems that *the second interpretation is correct*, which means that the interests of the nominator, as well as the interests of the company must be regarded, if a reconciliation between them is to be conceived. But if it is impossible to reconcile these conflicting interests, the question posed will be: which interest should be given precedence over the others? Answering this question depends on striking a distinction between the two scenarios: the nominee of the State Sector, and the nominee of the Private Sector.

#### **5.1.2.1.1 The Nominee Director in Mixed Sector Companies**

It should be noted that the nominee of the State Sector, (who is assumed to be one of its employees), does not place himself in a position of a conflict of interests. Rather, circumstances place him in this position, because the occupancy of this post is part of his duties towards the State Sector, and he is bound to obey his superior's instructions. Furthermore, a director in this case could be exposed to a criminal sanction as a result of refusing to implement the wishes and instructions of his appointor.<sup>42</sup> In this context, Art.4(Third) of the State Employees Disciplining Act No.14 1991 provides that:-

An employee is obliged to:-

...respect his superiors in the employment ...and obey their orders within the limits of the Acts, Regulations and Instructions. If these orders involve a violation, the employee must explain the case in writing, and shall not implement these orders without written confirmation from his superior, whereupon the superior will be responsible.<sup>43</sup>

It can be discerned from the above provision that the nominee must explain the situation that causes his uncertainty to his nominator (the State Sector) and set out the point of contradiction with the law, namely: the conflict between the appointor's

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<sup>42</sup> The Penal Act No.111 1969, Art. 240 which has been mentioned in fn (25) of this Chapter.

<sup>43</sup> The above provision suggest that the superior officer will be liable personally for any instruction directed to the junior employee which involves an infringement to the the law. But it should bear in mind the fact that the superior employee is deemed a representative of the State body in question, and any legal action is undertaken by him, will be taken on behalf of that legal person and for his interests (Art.48(1)). For this reason, Art.219 of the Civil Code 1951 pointed out to the vicarious liability of the legal person, deeming it vicariously liable for any fault committed by its employees, in the course of implementing their duties.

instructions to the nominee and the company's interests according to Art.120 of the I.C.A. 1997 / Art.17(5) of the P.B.A. 2004. The director must continue to pursue the firm's interests, unless he has received a written confirmation from the appointer to implement his wishes. Afterward, any prejudice to the firm's interests resulting from the implementation of the instruction of the appointor (the State Sector) renders the latter liable for that. However, this rule is limited to Mixed Sector Companies.

#### **5.1.2.1.2 The Nominee Director in Private Sector Companies**

The nominee in these companies has less guidance as to how to handle such a conflict. Therefore, a resort to English common law might be helpful in finding a solution to the problem. English law has espoused three approaches in this respect.

The first and oldest approach has emphasized the orthodox principle of fostering the interests of the company, to which the nominee director owes his duty without regard to other interests. Lord Denning in *Scottish Co-Operative Wholesale Society Ltd. v Meyer* expressed this approach by emphasising on the fact that:-

It is plain that, in the circumstances, these three gentlemen [the nominees] could not do their duty by both companies, and they did not do so. They put their duty to the co-operative society [the nominator] above their duty to the textile company [the company] in this sense, at least, that they did nothing to defend the interests of the textile company against the conduct of the co-operative society. They probably thought that "as nominees" of the co-operative society their first duty was to the co-operative society. In this they were wrong. By subordinating the interests of the textile company to those of the co-operative society, they conducted the affairs of the textile company in a manner oppressive to the other shareholders.<sup>44</sup>

However, this strict approach has been mitigated subsequently by a second approach, which implies a recognition of the nominator's interests, *but within the ambit of respecting the company's interests*. *Neath Rugby Ltd* represents the leading case of

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<sup>44</sup> [1958] 3 WLR 404, [1959] AC 324, 367 (HL) [Illustrations added]. See in this line *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 2 Q B 606, 626 -627 (CA) (Lord Denning).



English common law embodying this approach. In this case Stanley Burnton L.J. emphasized that:-

...an appointed director, without being in breach of his duties to the company, may take the interests of his nominator into account, provided that his decisions as a director are in what he genuinely considers to be the best interests of the company; but that is a very different thing from his being under a duty to his nominator by reason of his appointment by it.<sup>45</sup>

The third approach has gone beyond the above approaches towards the attenuation of the duty to act in the best interests of the company by subordinating the company's interests to the appointor's interests. This approach is shown in *Cobden Investments Limited v RWM Langport Ltd*, *Southern Counties Fresh Foods Limited*, and *Romford Wholesale Meats Limited*.<sup>46</sup> Warren J. expressed the possibility of attenuating a fiduciary duty, provided that: (i) the unanimous consent of the shareholders is given. (ii) A written agreement must be signed by all the shareholders. (iii) the burden of proving the attenuation and its extent lies on the party who alleged it. However, Warren J. also raised doubts about the possibility of undertaking such an attenuation.<sup>47</sup>

Seemingly, there is a blatant discrepancy between Iraqi law and English law concerning a director's obligations of loyalty. The Iraqi Companies' Acts have admitted the commercial realities by allowing a director to represent the interests of his appointor. English law generally renders the director liable for any breach of loyalty, as if he enjoyed an independent discretion. While evaluating the rationality of each approach will be discussed in the coming section of this section, there is another problem facing nominee directors, and that is: how to protect the company's information. This problem will be the subject of the section that follows.

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<sup>45</sup> EWCA Civ 291, [2010] BCC 597 [33].

<sup>46</sup> [2008] EWHC 2810 (Ch), 2008 WL 4923175. This approach has been espoused earlier by several Australian authorities that mentioned in the above English case, such as: *Levin v Clark* [1962] NSW 686 and *Japan Abrasive Materials Pty Ltd v Australian Fused Materials Pty Ltd* [1998] WASC 60.

<sup>47</sup> [2008] EWHC 2810 (Ch), 2008 WL 4923175 [67].

For more details about these approaches under the common law, see: Elizabeth Boros, 'The Duties of Nominee and Multiple Ployees: Part 1' (1989) *Comp Law* 211; Deirdre Ahern 'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy' (2011) 127(Jan) *L Q R* 118; Philip Crutchfield, 'Nominee Directors: the Law and Commercial Reality' (1991) 12(7) *Comp Law* 136; Pey-Woan Lee, 'Serving two Masters - the Dual Loyalties of the Nominee Director in Corporate Groups' (2003) *Sep J B L* 449; Ross Grantham, 'Liability of Parent Companies for the Actions of the Directors of their Subsidiaries' (1997) 18(5) *Comp Law* 138, 142-145.

### **5.1.2.2 Protecting the Company's Confidential Information**

The nominee will often consult his appointor when there is uncertainty as to whether or not a matter is favourable to the appointor's interests. The information that emerges from this consultation could involve a prejudice to the company's interests: for example, the nominee might divulge the results of negotiations between the company and a third party, or divulge valuable information (such as sensitive information affecting the share price). The State Employees Disciplining Act 1991 imposes on the state nominee (who is often a state employee) a duty of retaining information that belongs to the entity in which he is acting.<sup>48</sup> But this rule does not prevent the nominee from consultation with his appointor over a factual problem.<sup>49</sup> Such a contact could place the nominee in a complex position: does he carry out his duty to keep the company's information secret, or does he communicate the information to his nominator, as part of his duty towards him? Seemingly there is a legislative gap with regard to determining the nominee's obligations of loyalty, hence the following suggestions.

### **5.1.3 How to Solve the Plight of the Nominee Director in Iraq**

The uncertainty surrounding Iraqi law in relation to this matter could lead to the conclusion that the law has adopted a new approach of divided loyalty. In other words, the statutory provisions of the nomination imply exemptions from the duty of furthering a company's interests, as set out under Art.120 of the I.C.A. 1997<sup>50</sup> and Art.17(5) of the P.B.A. 2004.<sup>51</sup> However, this is inconsistent with the objectives of the I.C.A. 1997, set out under Art.1(3) thereof, concerning the protection of shareholders from conflict of interests and the abuse by those with control over the company's

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<sup>48</sup> Art.4 (Seventh) of this Act.

<sup>49</sup> See in the same context the R.C.E.S.M.S.C. 2006, Rule 8. It is worthwhile to mention that these rules includes all directors of Mixed Sector Companies.

<sup>50</sup> This Article states that 'the chairman and members of the board of directors shall do their best to serve the interests of the company as they would serve their own personal interests...'

<sup>51</sup> This Article provides that 'the members of the board of directors shall act honestly and in good faith with a view to the best interests of the bank'.

affairs. This approach reflects a degree of threat to the company and a misunderstanding of the concept of fiduciary duty, which should be based on the principle of giving the firm's interests primacy over all others.

English courts have espoused different approaches in interpreting the concept of the nominee's loyalty. But the point of convergence between the various English approaches seems to be the attribution of all liability to the nominee, rather than to his nominator. This interpretation is connected with the prevailing principle under English law, which is to consider the nominee a fiduciary with a duty to avoid a conflict of interests with his company. Furthermore, to adopt a contrary view would mean that the nominator bore the liability, which would often mean that the liability would be borne by a group of shareholders. This result would be conducive to transforming limited liability of a shareholder into an unlimited one, thus inhibiting them from investing their money in the company. It could also lead to revelations of the company's confidential information.

Balancing the views described above, it is suggested that the best solution is not to ignore commercial realities by insisting on the orthodox principle of the primacy of the director's loyalty to the company, but to recognize these realities and create a special legal regulation to govern the issue.

It is suggested that the solution adopted by Iraqi law in the case of the nominee director for Mixed Sector Company is more rational than that set out under English law,<sup>52</sup> which attributes the entire liability to the nominee and not the nominator.<sup>53</sup> Consequently, the author suggests that the nominator should incur the liability for prejudice to the company's interests. This suggestion will be an exception to the doctrine of the shareholders' limited liability.<sup>54</sup> This proposal is premised on the following arguments:-

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<sup>52</sup> See in this line the New Zealand case *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 3 All ER 404, 423.

<sup>53</sup> Teh Tai Yong and Mohammad Rizal Salim, 'Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors' (2008) 50 *International Journal of Law and Management* 168,173.

<sup>54</sup> For more details of this doctrine see Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet and Maxwell 2008)193-209, paras 8-1-14.

Firstly, the approach to the problem in English law needs to be re-considered. It is well known that the limited liability of shareholders derives from their limited role in managing the company. Therefore, any broadening in this role by their securing indirect involvement in company management should logically entail an additional liability. This additional liability looks more pronounced when the director informs the shareholders that their wishes do not coincide with the company's interests. Any insistence on furthering their private interests constitutes a bad faith, which qualifies as the basis for the suggested liability.

Secondly, the suggested liability of the nominator could lead to one of the following possibilities: First, the nominator *may reject* the use of nomination as an instrument for safeguarding his interests with a view to avoiding the results of this proposed liability. This result would be welcome, since it has been shown that nomination attracts numerous legal problems. The second possibility is that the nominee director could be given an *open-ended discretion* to pursue the firm's interests and to avoid the *nominator liability*, which would also be beneficial.

Thirdly, the proposal assists in removing any overlap between the concept of the *nominee director* and that of the *shadow director*, as they meet at one point: a director's subordination to the instructions of the nominee/shadow director. So, why we should not impose on the appointor the same responsibility that a shadow director incurs?<sup>55</sup> For the appointor to incur the liability is beneficial to the company, because it will deal with such problems as the nominee's insolvency or his abscondence.

Fourthly, the nomination reflects a conflict of interests between the nominator and the company. It has shown that s.175 of the C.A. 2006 and the provisions of Iraqi law relating to the duty to avoid the conflict of interests govern the director's liability only towards his company. Why then should this duty not be altered to include the disclosure of the conflict of interests to the nominator and not only to the company, instead of this being done secretly and perhaps in an improper manner? It should be

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<sup>55</sup> See the C.A. 2006, s.170(5).

noted that s.175(2) of the C.A. 2006 is limited to situations of exploitation of a company's information, (directly or indirectly), rather than to situations where information is passed to another person for other purposes.

However, in some circumstances, the nominee cannot consult with his nominator, either because the shareholders are dispersed, or because sensitive information prejudicial to the company's interests may be revealed as a result. In these circumstances the director should be given the freedom to take an open-ended decision in accordance with the company's interests. Moreover, in support of this freedom, it is suggested that any penalty imposed under special agreements as a result of breaching such restrictions, (e.g., dismissing the nominee, or paying the amount of the penalty clause), should be invalidated by law.

Having regard to all considerations mentioned above, it is suggested that the provisions of the nomination under Iraqi Acts should be removed, and that this matter should be left to special agreements, as an additional protection for the nominators, rather than it being a general application. To bring these suggestions into effect, this area is required to be regulated by the law, as opposed to being dealt with by special agreements.

## Section II

### Be Vigilant when Accepting a Benefit from Strangers

Introduction: Accepting a benefit such as a bribe from a third party is an outrageous and dishonourable practice, involving the profound betrayal of a beneficiary who depends on a fiduciary to promote his interests, and involves the notion of trafficking in his powers.<sup>56</sup> For this reason the bribe has been described as ‘...an evil practice which threatens the foundations of any civilized society...’<sup>57</sup>

Despite these realities, the Iraqi Companies’ Acts does not explicitly prevent a director from receiving a benefit from a third party, even though Iraq experiences a high level of corruption in all its sectors.<sup>58</sup>

By contrast, s.176 of the C.A. 2006 states that:-

(1) A director of a company must not accept a benefit from a third party conferred by reason of:-

(a) His being a director, or

(b) His doing (or not doing) anything as a director.

The reason behind the singling out of a separate provision of duty, alongside the rules of non-conflict and the avoidance of receiving secret profits, is the legislators’ desire to bring to the director’s attention the illegitimacy of this misbehaviour; to give him clear guidance in this respect; and to impose stricter rules than those fixed under other duties.<sup>59</sup> This does not mean, however, that this duty is completely independent and distinct from other duties. It is contained within the duty to avoid a conflict of interests, in that by taking a bribe the director will place himself in a position of conflict between

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<sup>56</sup> Alaa Qahtan Obaid, ‘The Bribe’ (2011) <[http://www.nazaha.iq/pdf\\_up/1423/rsh.pdf](http://www.nazaha.iq/pdf_up/1423/rsh.pdf)> accessed 5 July 2013, 2.

<sup>57</sup> The New Zealand case *Attorney-General for Hong Kong v Charles Warwick Reid* [1994] 1 AC 324, 331 (Lord Templeman). See also Ali Al-Rubaie, *Bribery Rules between Al-Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation for Iraqi book 2009) 116.

Whereas the court in *European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015], A.C 250 has described the acceptance of a “commission”, at para [42], as ‘...also objectionable as they inevitably tend to undermine trust in the commercial world...’.

<sup>58</sup> Alaa Qahtan Obaid, ‘the Bribe’ (2011) <[http://www.nazaha.iq/pdf\\_up/1423/rsh.pdf](http://www.nazaha.iq/pdf_up/1423/rsh.pdf)> accessed 5 July 2013, 4.

<sup>59</sup> The director, under the no-conflict and avoidance of secret profits rules, will be able to avoid his liability by disclosing his interests to the board. While s. 167 of the C.A. 2006 did not regulate this matter as it will be seen in this section, para 5.2.1.2.3.

his interests with his duty towards his company.<sup>60</sup> It is also linked with the “rule of avoiding a secret profit” when a surreptitious benefit connects with a transaction for facilitating its conclusion.<sup>61</sup> But the difference between these duties nonetheless exists. Secret profits and bribes are linked to the concept of divided loyalty, because the bribe-giver’s purpose is to induce the director to foster his interests rather than those of the company. In other words, the bribed director, under these circumstances, will bear two loyalties: legal or ostensible loyalty to his company, and *de facto* loyalty to the bribe-giver who will demand of the director certain acts of commission or omission.

The absence of any mention of this duty in the Iraqi Companies’ Acts reflects a lack of clear understanding on the part of Iraqi legislators of the fiduciary doctrine, which is premised on a notion that a fiduciary must avoid placing himself in a position under which the beneficiary’s interests might be exposed to a threat. Interestingly, the Companies’ Acts of the Arabic Civil law countries do not refer to this duty.<sup>62</sup>

But the failure of the Iraqi legislature in tackling this problem does not imply that this rule does not exist impliedly in folds of Iraqi law, and that a director is free to accept a benefit without being accountable. It can be discerned from a review of the general principles of civil and criminal liability that such conduct is illegal. The following discussion aims to examine the ability of these rules to deter such behaviour.

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<sup>60</sup> See s.176(4) of the C.A. 2006. See also the Explanatory Notes of Companies Act 2006, para 344. See also Geoffrey Morse, *Palmer’s Company Law: Annotated Guide to the Companies Act 2006* (2th edn, Sweet & Maxwell 2009) para 8.3002; Andrew Keay, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 341, para 11.1.

<sup>61</sup> The I.C.A. 1997, Art.119 which is equivalent to s.177 of the C.A. 2006, states that ‘It is impermissible for the chairman or a member of the board to have direct or indirect interests in deals that are concluded with the company, except after obtaining the permission of the general assembly with full disclosure of the nature and extent of such interests...’. This duty will be analysed extensively in chapter six.

<sup>62</sup> See for example: The Egyptian Companies Act No 159, 1981; the Kuwaiti Commercial Companies’ Act No.15 1960; the Commercial Companies’ Act of the United Arab Emirates No. 8, 1984; the Saudi Arabian Regulation of Companies’ No.6 1965; The Jordanian Companies Act No. 22, 1997; the Syrian Companies’ Act No.29, 2011.

### 5.2.1 Civil Liability

The illegality of obtaining a benefit from a third party by reason of holding the office of a director can be ascertained from a review of the general principles of Iraqi law. For example:

1-Art.120 of the I.C.A. 1997 mentions the director's duty to run his company in a sound and legal manner. Obtaining a benefit from a third party would be contrary to this provision. "Legality" means compliance with the law in its broader meaning, which includes Acts, Regulations and Ministerial Orders.

2-The other Companies' Acts pointed out the director's obligation to avoid illegal activities<sup>63</sup> and conflict of interests,<sup>64</sup> which would include the illegal conduct described.

3- Art.35(Seven) of the Labour Act, No.71 1987, also prevents the employee from borrowing from agents and contractors of the employer. This Article applies to the managing director, who acts under the supervision of the board of directors.<sup>65</sup>

4- The special legislation which governs nominee directors in Mixed Sector Companies also prevents them from receiving a benefit from a third party.<sup>66</sup> However, the scope of jurisdiction of these provisions is confined to State nominees, while directors of private sector companies remain outside its scope of application.

5- The above misconduct is a type of conflict of interest, as has been shown in the previous Chapter,<sup>67</sup> which is prohibited by Iraqi law.

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<sup>63</sup> The I.P.B.A. 2004, Art.2 (1); the I.B.R.A. 2005, Art.35.

<sup>64</sup> The I.C.A. 1997, Art. 1(3); the I.B.R.A. 2005, Art. 42(Second).

<sup>65</sup> See the I.C.A. 1997, Art.123 (Second). The above provision is narrow, however, as it does not include other, more serious, secret benefits, for example, bribes and other secret commissions.

<sup>66</sup> Art.4 (Ninth) of the State Employees Disciplining Act No.14 1991 imposes on the employee 'to refrain from exploiting the office to gain a benefit or personal profit for himself or for another'. Art.5(Eleven) of this Act also prevents him from 'borrowing or accepting any reward, gift or benefit from the dealers, contractors, entrepreneurs within his administration or any person who has a relation with him by reason of the employment'. The R.C.E.S.M.S.C. 2006 indicated to the same principle in Rule 9, which states that a director must refrain from 'accepting gifts or demanding benefits which aim to influence his neutrality, integrity, or to affect the performance of his duties, or any omission of them, or that may be channelled to one of his family members or his relative until fourth degree, as long as it is for the above purpose'.

<sup>67</sup> See Chapter 4, para 4.1.1 of this thesis.



6- Finally, the Islamic Sharia, which is the third source of the I.C.A. 1997,<sup>68</sup> also regards bribery as prohibited conduct. It can be inferred from verses of the Koran and the sayings of the Prophet Muhammad<sup>69</sup> that bribery is an illegitimate form of behaviour, and the benefit acquired from it is illegitimate “*haram*”. This inference gives a legal ground for instituting civil liability for this misconduct.

However, the extrapolation of the above rule from general principles of law gives unclear guidance and leads to certain problems: first, it does not offer an obvious guide for the director, who is frequently assumed to be unfamiliar with the general rules of law. The omission of regulating this theme may encourage a director to believe that the law does not prevent him from receiving a benefit. Second, the general principles of law are not always the best means of finding legal solutions to certain specific problems. The last point will be the subject of further discussion in the following sections.

#### **5.2.1.1 Tort Liability is Unable to Provide the Company with Protection from the Director’s Betrayal**

It has been mentioned previously<sup>70</sup> that tort liability, under Art.204 of the Civil Code 1951, is a legal means to address a director’s abuse of his powers in the case of the lack of a special legal regulation applicable to a particular situation.<sup>71</sup> This liability is premised on establishing three elements, fault, damage and causation, among the elements mentioned. The company could encounter many difficulties in proving the above elements in the case of bribes and secret commissions.

With regard to *fault*, it is evident that the bribe or any secret commission is an agreement between the giver and the receiver of the bribe. Thus, it is presupposed that it is a deliberate act, which is difficult to prove, because the parties concerned will be vigilant when committing this wrongdoing. Moreover, the tort rules did not address

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<sup>68</sup> For more details about the sources of the I.C.A. 1997 see Chapter 2, Section 3 of this thesis.

<sup>69</sup> The Koran (the holy book of the Islamic religion) and the sayings of the prophet Muhammad represent the main sources of Islamic Jurisprudence, and so for the Civil Code 1951. For more details on the theme, see Mustafa Ibrahim Alzami, *Origins of Islamic Jurisprudence in its New Fabric* (5<sup>th</sup> edn, Al-Khansa Publisher 1999) 17-46.

<sup>70</sup> See Chapter 4, para 4.1.2 of this thesis.

<sup>71</sup> For more details of these elements see Chapter 4, para 4.1.2.

the problem of determining a temporal instant in which a certain conduct should be considered a fault. In other words, will a director be in breach of this obligation for merely receiving an offer, and then be refrained from informing his company about that; or he must accept this offer in order to be liable for that acceptance, as can be discerned from the formulation of s.176 of the C.A. 2006<sup>72</sup>? The author supports the position of the C.A. 2006, because the accepting a benefit reflects irrevocable determination of the director to violate his duty. Answering the above question has considerable importance in determining not only whether or not a director has committed a fault, but also in identifying the period of declaring a conflict of interest to the company for avoiding his liability.

It is also hard, in some circumstances, to establish *damage* to a company's interests if the benefit is paid in return for a service, which may be subsumed within the director's duty (a valid action), to encourage him to perform his duty, or to avoid any delay in doing so. In the last resort, the sole basis for suing a director may be that his conduct has injured the company's reputation.

Concerning the *causation link*, both Iraqi legislation and Islamic Sharia require the existence of a link between accepting a benefit and an action performed pertaining to the director's office. Indeed, the donor's motivation in offering a benefit is often inspired by the director's powers, which attract the efforts to influence his decisions. However, it is envisaged that the third party could present a benefit as a courtesy, without requesting a service in the near future. Notwithstanding, the company has an interest of knowing of this matter, to avoid the possibility of the director becoming accustomed to receiving rewards from strangers, and that the company will be capable adjusting its relationship with the payer accordingly. However, it is difficult to prove the causation link in the above case.

Apparently, civil liability is unhelpful in addressing this scenario, because it is built, as has shown previously,<sup>73</sup> on a restitutory (remedial) basis, and so civil liability cannot provide an effective safeguard to the company.

The above complexities in proving liability under Iraqi law justify the unique regulation of this duty by English law. Under English law, the director's liability is

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<sup>72</sup> This Section states that 'a director of a company must not accept a benefit from a third party...'.

<sup>73</sup> See Chapter 4, para 4.1.2 of this thesis.

premised on a sole element: accepting a benefit by virtue of his directorship without disclosing its receipt to the company.<sup>74</sup> Accordingly, the liability arises irrespective of the motivation of the third party and the director<sup>75</sup>; or the presence or absence of corrupt motivation<sup>76</sup>; or whether a director's mind was influenced by the bribe<sup>77</sup>; or whether the payer is aware or unaware of the director's intention to conceal the gift received from the eyes of the company, or whether the company has suffered a harm<sup>78</sup>; or the fairness or unfairness of the action that was required to be done. Furthermore, the causal connection between receipt of a benefit and prejudice to a company is irrelevant. The formulation of s.176 of the C.A. 2006 enshrines the above rules.<sup>79</sup>

To achieve the above purpose, English common law established unchallengeable presumptions, which were expressed by Slade J. in *Industries & General Mortgage Co Ltd v Lewis*:-

...once it is established that one of the parties to a contract makes a secret payment to the person whom he knows to be the agent of the other, the law will presume against him that he has acted corruptly, that the agent has been influenced by the payment to the detriment of his principal, and that the principal, the defendant in this case, has suffered damage to at least the amount of the bribe.<sup>80</sup>

In *Towers v Premier Waste Management Ltd*, Mummery L.J. held that:-

The absence of evidence that the company would have taken the opportunity, or has in fact suffered any loss, or that Mr Towers or Mr Ford had any corrupt motive or that, if there had been no free loan, Mr Towers would have hired that sort of equipment in the market; the fact that the value of the benefit to Mr Towers was small and that Mr Ford received no benefit from it; the fact that Mr Rafter and not Mr Towers

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<sup>74</sup> See the C.A. 2006, s. 176 (1-a). See also Pual L. Davies, Sarah Wrothington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> Sweet & Maxwell 2008) 575-576, para 16-75; Kenneth W. Nielsen, 'Directors' Duties under Anglo-American Corporation Law' (1966) 43 U Det L J 605, 653.

<sup>75</sup> *Shipway v Broadwood* [1899] 1 QB 369 (CA); *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119 [53].

<sup>76</sup> *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [51] (Mummery L.J).

<sup>77</sup> *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119 [53].

<sup>78</sup> Pual L. Davies, Sarah Wrothington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup> edn, Sweet & Maxwell 2008) 576, para 16-75.

<sup>79</sup> Again, this Section states that:-

(1) A director of a company must not accept a benefit from a third party conferred by reason of-

(a) His being a director, or

(b) His doing (or not doing) anything as director.

<sup>80</sup> [1949] 2 All ER 573, 578 (KB); *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119 [53].

dealt directly with Mr Ford and was the prime mover: none of those matters supported the contention that there was no breach of the duty of loyalty or the no conflict duty.<sup>81</sup>

It is suggested that the position of the English law in this area of law is more rational, because it operates to facilitate the proof of a breach of duty and to eliminate any possibility for the director to fend off his liability.

### **5.2.1.2 Extrapolating the Duty from the General Rules is an Inadequate Means of Resolving Various Issues**

Establishing the duty to avoid accepting a benefit from a third party by deriving it from general principles of law is also an unfruitful means of finding legal answers to many questions: for example, what does it mean to receive a benefit? What are the exceptions to the scope of the duty and what are its temporal limits? and how to shield a director from liability?

#### **5.2.1.2.1 What is the Meaning of a Benefit?**

No clear answer to this question is to be found in the general principles of Iraqi law. However many terms are often used to describe a benefit accepted like: a bribe,<sup>82</sup> a “commission”<sup>83</sup> or “surreptitious payment”. The Commonalities of these benefits is that they represent a reward in return for a service offered, or will be performed by the

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<sup>81</sup> [2011] EWCA Civ 923, [2012] B C C 72 [51]. On the same line see *Novoship (UK) Ltd v Vladimir Mikhaylyuk, Wilmer Ruperti, Sea Pioneer Shipping Corporation, PMI Trading Inc, Yuri Nikitin, Amon International Inc, Henriot Finance Ltd* [2012] EWHC 3586 (Comm), 2012 WL 6151801(Christopher Clarke) [106]

<sup>82</sup> The Penal Act 1969, Art.310. In *Novoship (UK) Ltd v Vladimir Mikhaylyuk, Wilmer Ruperti, Sea Pioneer Shipping Corporation, PMI Trading Inc, Yuri Nikitin, Amon International Inc, Henriot Finance Ltd* [2012] EWHC 3586 (Comm), 2012 WL 6151801, Christopher Clarke described bribe at [106] by stating: The essential character of a bribe is, thus, that it is a secret payment or inducement that gives rise to a realistic prospect of a conflict between the agent’s personal interest and that of his principal.

<sup>83</sup> *European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] A.C 250, [34].

However, there is a slight difference between a commission on the one hand, and other sorts of benefits on the other hand, in terms of that a commission is often associated with certain transaction with a view of facilitating its conclusion. For this reason, the Regulation of Commercial Agency Act No.51 2000, described the “consideration” to be given in return for the service offered by the agent as a “commission”. See Art. 10 (Second, Fourth).

director sooner or later. Also, these sorts of secret benefits may conducive to prejudice the company's interests,<sup>84</sup> or at least to its reputation by virtue of showing it in the market in a position of breaking the law. For example, the secret commission leads to an inflation of the transaction price as a result of the vendor adding its price to the total amount.<sup>85</sup> Moreover, the director's loyalty becomes questionable, because he will owe loyalty to the donor of the commission or bribe, rather than to his company. As a result of the resemblance between these terminologies in terms of its effects, some authorities have conflated between them.<sup>86</sup>

The benefit offered by the briber may mixes with the concept of an interest that must be declared by a director to his company, when this benefit is accompanied with a transaction (deal). The legislative failure in enshrining this duty under an explicit provision may help the director to avoid his liability by declaring his interests in a transaction. While there is a difference between accepting a benefit from a third party on one hand, and where that a director have an interest in a transaction on the other hand: the bribed director will often play a positive role in creating a conflict of interests, by asking for or accepting the benefit as a condition of breaching his duty. This would be unlike the breach of a duty to declare an interest in a transaction, in which the interest may arise incidentally. This difference clarifies the seriousness of the violation of duty which is involved in accepting a benefit from a third party and vindicates the codification of the duty separately from other duties enunciated in the C.A. 2006. The seriousness of the behaviour requires the wrongdoer to be subjected to stricter rules, for example: he may be prevented from exercising supervision over the deal in question. Also the approval for a conflict of interest should be granted by the shareholders. Thus, the enactment of an explicit duty not to accept a benefit from a third party in Iraqi Company Law will serve multiple purposes: first, it will assist to remove the confusion between the above duty, with the duty of declaration of a

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<sup>84</sup> *Kaye v Croydon Tramways Company* [1898] 1 Ch. 358, 375-376 (CA) (Vaughan Williams L J); *EuropeanVentures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] A.C 250, [43].

<sup>85</sup> *Grant v The Gold Exploration and Development Syndicate Ltd* [1900] 1 Q B 233 (CA); *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119.

<sup>86</sup> In *Industries & General Mortgage Co Ltd v Lewis* [1949] 2 All ER 573, 575 Slade J avoid giving a definition to different terms often used in explaining the meaning of a benefit by stating that '...Sometimes the words "secret commission" are used, sometimes "surreptitious payment", and sometimes "bribe"...'. See also the dictum of Lord Templeman in *Attorney-General for Hong Kong v Charles Warwick Reid* [1994] 1 AC 324, 330.

director's interests in a deal, because it directs the practitioners' attention to the fact that there is a benefit that did not arise incidentally, and which must be disclosed to the company. Second, it is the opportunity to surround the practise of accepting a benefit, as a serious behaviour, with more rigorous rules.

On the other hand, Art.42 (Second-d) of the I.B.R.A. 2005 prohibits a director from 'receiving a commission for any insurance work'. Seemingly, this Article has created an irrational blend between the legal and illegal commission, by preventing the director from receiving commissions, apart from those associated with a conflict of interests! A director of a life Insurance Company, pursuant to Art.42 (Second-d), is prohibited from accepting a commission in return for his intermediation in concluding a fire insurance policy, as he is foreclosed from doing so regarding a life insurance policy. The broad formulation of Art.42 (Second-d) of the I.B.R.A. 2005 could place the company in an awkward position, because it will be included within its ambit. The firm, for example, could delegate the director to perform an additional task, outside the frame of his original duty, of finding another contractor in a transaction in return for a commission. Thus, the current provisions impose a restriction on directorial entrepreneurial activities. This irrational approach reflects a degree of misunderstanding of fiduciary duties, which are based on the notion of confronting the risks that threaten the firm's interests solely.

#### **5.2.1.2.2 Does Iraqi Law Encompass Exceptions to the Application of this Duty?**

In view of the non-regulation of this duty in the Iraqi Companies' Acts, there is doubt as to whether there are exceptions to its ambit. It is irrational to consider the acceptance of any benefit from any person as a bribe, and such an inference may put a heavy burden on a director, and expose him to an open-ended liability: whereas the purpose of imposing this duty is to address threats to a company's interests.

For this reason, s.176 (2, 3) of the C.A. 2006 defines exceptions to this duty, for example, receiving a benefit from from an associated corporate body; or a person

acting on behalf of the company or the associated corporate body.<sup>87</sup> The exceptions include ‘benefits received by a director from a person whose services (as a director or otherwise) are provided by the company and are not regarded as conferred by a third party’.<sup>88</sup> The latter exception includes any salary received by a director in exchange for his services<sup>89</sup> to the nominator, or from other companies in which he was previously authorized to act. Thus, the third party is any person other than the aforementioned persons. The reason behind the enactment of the above exceptions is that they do not give rise to a conflict of interests and the consequent civil liability.

It can be said that the judicial standard of “the ordinary person,” which applies to the determination of the director’s liability<sup>90</sup> under the Civil Code 1951, can accommodate the above exceptions under s.176 (2, 3) of the C.A. 2006. This standard accords with s.176 (4) of the C.A. 2006, which states ‘this duty is not infringed if the acceptance of a benefit cannot reasonably be regarded as likely to give rise to a conflict of interest’. Therefore, a small donation at Christmas and other occasions,<sup>91</sup> commercial hospitality, such as the offer of a meal, tickets for entertainment, a free hotel booking, etc.,<sup>92</sup> for facilitating convening a negotiation should not give rise to a conflict of interests.<sup>93</sup>

The same due regard should be given to custom and the Islamic Al-Sharia, as the formal sources of Iraqi law.<sup>94</sup> Concerning the custom, the Civil Code, 1951 states that

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<sup>87</sup> For determining the associated bodies corporate see s.156 of the C.A 2006. See also *Imageview Management Ltd v Jack* [2009] EWCA Civ 63, [2009] Bus L R1034.

<sup>88</sup> The C.A. 2006, 176(3).

<sup>89</sup> Ben Pettet, John Lowry and Arad Reisberg, *Company Law* (3th edn, Pearson Custom Publishing 2011) 170.

<sup>90</sup> See the Civil Code 1951, Art.251(1).

<sup>91</sup> Nicolas Bourne, *Bourne on Company Law* (fourth edn, Routledge-Cavendish 2008) 158; Breda Hannigan, *Company Law* (second edn, OUP 2009) 272, para 11-80; Susan McLaughlin, *Unlocking Company Law* (first edn, 2009) 348; Andrew Keay, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 345, para 11.17.

<sup>92</sup> Susan McLaughlin, *Unlocking Company Law* (first edn, 2009) 348.

<sup>93</sup> Lord Goldsmith stated in the Lords Grand Committee, 9 February 2006, column 330 said: ‘...I...draw attention to the fact that benefits are prohibited by the duty only if their acceptance is likely to give rise to a conflict of interest’. Referred to in the Department of Trade and Industry (D.T.I): ‘Companies Act 2006, Duties of company directors’ Ministerial statements <[www.berr.gov.uk/files/file40139.pdf](http://www.berr.gov.uk/files/file40139.pdf)> accessed 24 February 2013, 12.

<sup>94</sup> About the rank of the custom and Sharia as sources of Iraqi law see Chapter 2, Section Three.

‘what is customary between traders is just like what is stipulated among them’.<sup>95</sup> The Civil Code 1951 has codified one of customs related to this issue: Art.709 (1) of the Civil Code 1951 (concerning the employment contract and its application to a managing director) considers granting a gift by a customer to express his satisfaction and regard for the managing director as a legality permitted act, and are not one that creating a conflict of interests. This exception can be applied to directors other than the managing director by analogy.

The Islamic Al-Sharia allows generally for the receipt of gifts. It has shown by the behaviour of the Prophet Mohammed and his sayings that giving a gift *devoid of any pressure* from the donor,<sup>96</sup> or for reasons other than the abuse of power is legitimate, as long as it offered for the purposes of gifting, loving-kindness or providing assistance.<sup>97</sup> *Islamic jurisprudence* draws a distinction *between a bribe and a gift* by ruling that if there is a concomitant request by the giver for a benefit, then what is given constitutes a bribe, not a gift.<sup>98</sup> The discrimination between these matters depends on the circumstances, and should be judged objectively (reasonably) according to the standard of the ordinary person, as mentioned above.

However, the reference to the above exceptions in Iraqi law seems useful in offering clear-cut exceptions, instead of resorting to the above rules, which can be accessed only by professional persons in law. Moreover, the standard of the “ordinary person” which is used for assessing the errant behaviour<sup>99</sup> is the judicial standard used by the court when reviewing a dispute between litigants. The mention of obvious exceptions under the I.C.A. 1997 is crucial in assisting the director to avoid liability, and enables other directors to take a rational and informed decision about whether to sue the director over the alleged wrongdoing.

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<sup>95</sup> The Civil Code 1951, Art.163(2). It is worth noting that the courts often resort to the Iraqi Federation of Chambers of Commerce and Industry in order to identify the context of a particular custom when considering a dispute, according to the Federation’s Act No. 34 2002, Art.9 (Second).

<sup>96</sup> Ali Al-Rubaie, *Bribery Rules Between Al-Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation For Iraqi books 2009) 19.

<sup>97</sup> Alaa Qahtan Obaid, ‘The Bribe’ (2011)<[http://www.nazaha.iq/pdf\\_up/1423\\_rsh.pdf](http://www.nazaha.iq/pdf_up/1423_rsh.pdf)> accessed 5 July 2013, 40; Ali Al-Rubaie, *Bribery Rules Between Al- Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation For Iraqi books 2009) 14-19.

<sup>98</sup> Ali Al-Rubaie, *Bribery Rules Between Al-Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation For Iraqi book 2009) 21.

<sup>99</sup> The Civil Code 1951, Art. 251(1).



### 5.2.1.2.3 Does Iraqi Law Contain a Safe-Harbour to Protect a Director from Liability?

There is no mention in Iraqi legislation of the possibility of the director's retention of the benefit after declaring his interests to the company. This is due to the policy adopted by the legislature when handling this matter, under which a bribe is deemed always to be an illegitimate profit that should be forfeited by the judicial authority, rather than owed to the company or its director.<sup>100</sup>

This view may be consistent with religious and ethical considerations, but the rules of law should be built on the interests for which the law was enacted. The religious and ethical considerations on the one side, and the general interest in fighting corruption and protecting the company's interests from the director's abuse on the other, can meet at a certain juncture. At this point, the director who seeks to avoid his liability must disclose his interests as a condition of retaining the benefit. Adopting a contrary view may lead to an adverse motivation towards the non-disclosure of interest, as the fiduciary will lose the benefit in the end.

The seriousness of the matter of benefits throws its shadow over the formulation of s.176 of the C.A. 2006, which does not empower the other directors to authorize conflict of interests, in contrast to the stipulations of ss.175(4)<sup>101</sup> and 177<sup>102</sup> of the C.A. 2006.<sup>103</sup> The majority of scholars are of the view that the power is vested in the

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<sup>100</sup> See the Panel Act 1969, Art.314. See also Ali Al-Rubaie, *Bribery Rules Between Al-Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation For Iraqi book 2009) 20.

<sup>101</sup> S.175(4) of this Act states that: This duty is not infringed: ... (b) if the matter has been authorised by the directors'.

<sup>102</sup> This Section states 'if a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors'.

<sup>103</sup> The Explanatory Notes of the Companies Act 2006, paras 344- 345. See also Geoffrey Morse, *Palmer's Company Law: Annotated Guide to the Companies Act 2006* (2th edn, Sweet & Maxwell 2009) para 8.3007. c.f with Breda Hannigan, *Company Law* (second edn, OUP 2009) 271, para 11-75, who thinks that singling out a separate duty in s.176 of the C.A 2006 is attributable to the legislator's desire to strike a distinction between a "benefit" and "bribe", and then to build legal consequences from this distinction. One of these consequences is the prohibition of granting the approval for the conflict of interests under s.176.

shareholders, pursuant to 180(4) of the C.A. 2006, unless the company's articles state otherwise.<sup>104</sup> This provision is suggested to be adopted in Iraqi law.

#### **5.2.1.2.4 Does this Duty Extend to the Stage Following the Director's Resignation or Dismissal?**

It has been mentioned that the director's duty ceases after his resignation,<sup>105</sup> and that the Iraqi law recognizes a link between receiving a benefit and undertaking to do something, or omitting to do something. After the director's resignation the loss of office will hinder his ability to implement the desires of a third party, and he should not be bound to disclose his interests afterwards. However, the Iraqi law did not take into account the possibility of the director concluding an agreement involving the abuse of his powers while in office and shielding himself from liability by receiving a benefit *after* his resignation.

In contrast, s.170(2) of the C.A. 2006 takes account of the above probability by subjecting a director to the duty set forth under s.176 of the C.A. 2006 concerning '...as regards things done or omitted by him before he ceased to be a director...'.<sup>105</sup>

To summarize, it has been shown by the above discussion that resort to the general principles of law does not provide protection to the company by deterring the director's abuse, nor does it provide a clear and helpful guide to the director in every case. Therefore, it will be necessary to explore the rules of criminal liability to see whether they provide any better deterrence for this kind of misconduct.

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<sup>104</sup> Alistair Alcock, John Birds, Steve Gale, *Alcock, Birds, Gale on the Companies Act 2006* (Jordan Publishing Ltd 2009) 187, para 13.30; Pual L. Davies, Sarah Wrothington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8<sup>th</sup>, Sweet & Maxwell 2008) 575, para 16-75; Ben Pettet, John Lowry and Arad Reisberg, *Company Law* (3<sup>th</sup> edn, Pearson Custom Publishing) 170; Geoffrey Morse, *Palmer's Company Law: Annotated Guide to the Companies Act 2006* (2<sup>th</sup> edn., Sweet & Maxwell 2009) para 8.3007; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 342, para 11.7.

<sup>105</sup> See Chapter 4, para 4.3.2 of this thesis.

### 5.2.2 The Criminal Consequences of Accepting a Benefit

It is to be hoped that the criminalization of bribery in the Private Sector as part of Iraq's obligation under the U.N Convention against the Corruption 2004, which Iraq joined by virtue of Act No.35, 2007, will be comparable to the U.K Bribery Act 2010, which criminalizes this misbehaviour. Pending the enactment of this legislation, the current rules of the Penal Act No.111 1969 serve to cover the matter partially. It is worthwhile to highlight the anticipated role of criminal liability in inhibiting directorial abuse, and to enquire whether it provides a protection comparable to that set forth under the C.A. 2006 and the common law.

Art. 307 of the Penal Act, No.111 1969, criminalizes the receipt of a benefits by a State employee, or by a person delegated to perform a public service, in return for carrying out, or omitting to carry out, an action subsumed within his duty, or for contravening such a duty. The accused will be exposed to the sanction of a term of imprisonment not exceeding 10 years, or by detention plus a fine, which must not be less than the amount that he had sought, or was given, or was promised, but should not exceed 500 Iraqi dinars.

The criminalization extends to the receiver of a commission. Under Art.319 of the Penal Act:-

Any public official or agent who benefits directly or through the mediation of another from a transaction, contract or agreement, the preparation, assignment, implementation or supervision of which is in the hands of such public official or agent is punishable by a term of imprisonment not exceeding 10 years. The same penalty applies if he receives for himself or for another a commission in respect of such activity.

These penalties include explicitly the directors of Mixed Sector Companies, whether they are acting as nominees of the State Sector or have been elected by the shareholders of the private sector.<sup>106</sup> But the above provisions *do not cover* the directors of Private Companies. Apparently, the aim of the above Articles is to provide the protection of criminal law within the public domain. There is however no equivalent protection for private companies in this Act or in other Acts. The reason for this *lacuna* connects

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<sup>106</sup> See the Penal Act 1969, Art.19. See also the clarification presented by the Commission of Integrity that addressed to the author dated on 7<sup>th</sup> of September 2014.

with the historical background of the socialist regime that gave priority to protecting public funds and created a belief that fighting corruption in the public and the mixed sectors gave adequate protection to the general economy. However, this belief is no longer consistent with the principles of free trade recently adopted in Iraq.

The answer to the question posed at the beginning of this section relates to the nature of criminal law. The strictness of penalties enunciated in Art.307 of the Penal Act 1969 *could* result in achieving the objective. However, there are several difficulties and negative consequences that may reduce the effectiveness of these measures.

In the first place, it is not easy to prove this kind of crime, because bribery is always perpetrated surreptitiously. Needless to say, the standard of evidence required for criminal liability must be beyond reasonable doubt, which is a standard not required in establishing civil liability.<sup>107</sup>

Secondly, the intention (*the mens rea*), that is, the corruption<sup>108</sup> as an element of the criminal liability, must be proved by the plaintiff. Such a proof, in some circumstances, may be difficult to establish, because it relates to the director's state of mind,<sup>109</sup> and any doubts over the parties' intentions should be construed in favour of the director.<sup>110</sup>

Moreover, the intention of the payment could be to create a friendly relationship, which could affect the director's impartiality in future, rather than demanding him to do an immediate service. Whereas Art.307 of the Penal Act 1969 requires the existence of a direct link between the receipt of the bribe and the undertaking of some act or omission.

Thirdly, the benefit would be confiscated by the State as revenue for the public treasury.<sup>111</sup> Whereas the benefit will be confiscated by the company under English law. This result means that all the exertions of the company to bring a criminal action, and

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<sup>107</sup> For this reason, Art.206 (2) of the Civil Code 1951 does not restrict the civil court in following the rules of the criminal liability, or the judgment of the criminal court. See also Emile Van Der Does De Willebois & Jean-Pierre Brun, 'Using Civil Remedies in Corruption and Asset Recovery Cases' (2013) 45 Case W Res J Int'l L 615, 641-642; David Sugarman, 'Is Company Law Founded on Contract or Regulation? The Law Commission's Paper on Company Directors' (1999) 20(6) Comp Law 162, 170.

<sup>108</sup> P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 215, para 500.

<sup>109</sup> Ali Al-Rubaie, *Bribery Rules Between Al- Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation for Iraqi Books 2009) 118.

<sup>110</sup> *Ibid*, 118.

<sup>111</sup> See the Penal Act 1969, Art. 314.

the accompanying risk of failure,<sup>112</sup> will not result in any benefit to it. By contrast, English law gives the company a right to recover the amount of the bribe from the fiduciary.<sup>113</sup> Thus an English company has a more robust incentive to sue its director than an Iraqi company, and this will assist in fighting corruption.

Fourthly, criminal liability arises by virtue of law, and the company has no role in conducting or halting the criminal proceedings. So, the judgment that involves the imposition of a penalty of imprisonment will result not only in preventing the director from exercising his duties in the company during the term of imprisonment,<sup>114</sup> but also afterwards,<sup>115</sup> since he will be disqualified from resuming his post. This result will be harmful to the public interest by reducing the number of skilled directors in Iraq, which is often described as a third world country, and which suffers a shortage of professionally qualified people. The substitution of a strict civil liability would be helpful in avoiding the outcomes described above.

The difficulties related to proving criminal liability and the absence of pecuniary benefit in instigating criminal proceedings could inhibit a company from bringing a criminal action, and lead them instead to expel its director. It should not be forgotten that the company's aim in instituting any claim is to achieve its own interests, rather than the public interest in combating corruption. Such a negative consequence enables directors to retain bribes without effective accountability.

To answer the question posed at the outset of this section: criminal liability may inhibit abuse, but it is not adequate in itself to play a complete preventative role, and needs to be bolstered by clear and strict civil liability.

It is time for Iraqi lawmakers to reconsider the measures for the prevention of such abuse through inserting an explicit provision in the I.C.A. 1997, and abandoning the belief that this abuse is a solely criminal offence. Civil liability is no less significant than criminal liability in addressing this form of misbehaviour,<sup>116</sup> and in creating a

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<sup>112</sup> This includes the probability of suing the company by the defendant by reason of prejudice to his reputation.

<sup>113</sup> *The Mayor, Aldermen, and Burgesses of the Borough of Salford v Lever* [1891] 1Q B 168, 173 (CA); *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119; *Corporacion Nacional Del Cobre de Chile v Interglobal Inc* [2003] 5 ITEL R 744.

<sup>114</sup> See the Penal Act 1969, Art.96(3).

<sup>115</sup> See the I.B.R.A. 2005, Art.42 (First-1); the P.B.A. 2004, Arts.1, 17(3-1).

<sup>116</sup> Emile Van Der Does De Willebois & Jean-Pierre Brun, 'Using Civil Remedies in Corruption and Asset Recovery Cases' (2013) 45 Case W Res J Int'l L 615, 618.

legal relationship as a basis for redressing the wrongdoing.<sup>117</sup> Thus, the solution to these problems in Iraqi law is for the I.C.A. 1997 to regulate the duty to avoid accepting a benefit from a third party. The combination of civil and criminal sanctions against this form of misbehaviour would serve the public interest by reducing the number of economic entities vital to the national economy<sup>118</sup> from collapsing as a consequence of a breach of this duty. Furthermore, enacting this reform will help to combat corruption and to attract international investment to Iraq, which is often described as one of the most corrupt countries in the world.<sup>119</sup>

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<sup>117</sup> Ibid, 622-623.

<sup>118</sup> Saleh Hassan Kadhim, 'Corruption in the Private Sector' (2011) <[http:// www. nazaha.iq/ pdf\\_ up / 1527/pp-1.pdf](http://www.nazaha.iq/pdf_up/1527/pp-1.pdf)> accessed 4 July 2013, 13.

<sup>119</sup> Ibid, 42.

## Conclusion

In this Chapter, two facets of conflict of interests have been examined under Iraqi law: the first facet (the nominee director) represents a conflict of duties: one duty is owed by a director to his company, with another duty owed to another person (the nominee director). While the second facet (the duty not to accept a benefit from a third party) is an example to a conflict between a personal interest with the duty.

Iraqi legislation reflects attitudes which support the argument that Iraqi law may not recognize the principle of undivided loyalty as it appears in English law: for example, Iraqi law allows a group of shareholders to nominate their representatives to the membership of the board of directors. In addition, there is no statutory duty to avoid accepting a benefit from a third party.

Concerning the first issue, whereas the existence of nominee directors reflects commercial realities, by which special agreements may give a party the right to nominate directors to represent his interests. However, the Iraqi Companies' Acts changed this reality to a legal fact, by facilitating the appointment of some directors to the board to represent certain types of shareholder. This legal regulation raises a question as to whether Iraqi law gives private interests primacy over a company's interests (e.g., promotes divided loyalties).

It can be discerned from a review of the provisions of the Iraqi Companies' Acts that the law has adopted an eccentric rule which constitutes a risk to a company's interests, that is: the nominee may be allowed by the law to put the interests of his nominator ahead of the company's interests. Whereas English law, by contrast, has adopted a different approach, by which the company's interests must take precedence over other interests, and be the sole interest respected by the director. This approach, however, has been subject to more flexibility recently, to the degree that English courts are coming to recognize a nominator's interests inside the boardroom, although within the bounds of respecting the company's interests.

It is suggested that the only way forward is not to deny reality by preventing commercially motivated nominations, nor by giving prominence to the appointor's interests (resulting in a clash between the latter's interests and the company's), but

rather by regulating the matter by law. This confusion in the law can be solved by removing from Iraqi law all provisions pertaining to the nomination, and instead leaving this matter to special agreements. Consultation between a nominee and his nominator, which result in revelation of a company's information to outsiders, should also be regulated, by compelling the nominee to obtain the approval from the other directors. In addition, making the appointor liable for any detriment to the company's interests resulting from his pursuit of his personal interest in the company is another pragmatic solution to the above problems. Such an innovation will assist in mitigating the problems caused in this respect by nominations, and will also ease the pressure that might be exercised on the nominee by the nominator in the furtherance of the latter's interests. Consequently, there is a need to review the I.C.A. 1997 by regulating the situation of the nominee director in accordance with the above suggestions.

The second issue relates to the duty to avoid accepting a benefit from a third party. This matter is dealt with by the C.A. 2006, but all Iraqi Companies' Acts are devoid of any reference to this duty. This does not mean, however, that this practice is legally permissible behaviour, because the general provisions of Iraqi legislation, as well as the Islamic Sharia, (one of the sources of Iraqi law), forbid bribery. This extrapolation paves the way to establish directorial liability under the Civil Code 1951. However, deriving the above principle from the general principles of law does not provide a sufficient safeguard to a company. The difficulty of proving the elements of civil liability affects a company's ability to address this misbehaviour, and makes it difficult for it to play a preventive role. In addition, the general principles of law do not offer solutions to other problems, such as the question of whether there are exceptions to the scope of this duty in Iraqi law; and whether this duty applies to the ex-director. The difficulties of proving the criminal liability of a director as it is set out in the Iraqi Penal Act, as well as the narrowness of its scope represent a further dilution of the role of this liability in restraining this aspect of directorial abuse.

It has been demonstrated in this Chapter that the current position under Iraqi law, by virtue of the existence of aforementioned legislative loophole, encourages the director's pursuit of divided loyalties. This situation, which constitutes a threat to the company's interests, raises the need to review the I.C.A. 1997 by setting out a duty not to accept a benefit from a third party, on the basis of the unique model offered by the C.A. 2006. This formulation will assist also to remove the confusion that may occur



in some circumstances between this duty from one hand, and the duty to declare an interest in a transaction on the other hand, and enables the directors, his company and the courts to determine whether there is a conflict of interest in the case of accepting certain benefit.

**Proposal by the Author to the Iraqi legislator:**

**Art.4:<sup>120</sup> Nomination of a Director for Representing Private Interest**

- (1) Any agreement or understanding giving a person the right to nominate a nominee director to represent his interests in the company must not contravene with the nominee director's duty to act in the interests of the company.<sup>121</sup>
- (2) A nominee director is entitled to avoid his liability that set out in the foregoing paragraph by disclosing to his nominator any matter that is likely to give rise to a conflict of interest, including his recommendations about the conflict of interests, after receiving an authorisation from the board of directors of the company.<sup>122</sup>
- (3) Any prejudice to the company's interests arising as a result of implementing the nominator's mandatory instructions that occur after the disclosure mentioned in paragraph (2) will render the nominator liable, and no liability on the part of the nominee director.

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<sup>120</sup> The forthcoming provisions are supplementary for the proposed Articles mentioned in the previous Chapters.

<sup>121</sup> It has been indicated in this Chapter that although Iraqi law has referred to situations in which a director may represent the private interest of a third party, a group of shareholders etc., the law failed to enshrine a rule containing an answer as to: which interest the nominee must act to pursue? Will it be the company's interests or the interests of another person? The above proposal contains an answer for this question.

<sup>122</sup> The law of Iraq has failed in formulating a legal regulation concerning the conflict of duties that could arise between the nominator and the company. The above mechanism contains the regulation of the director's duty to disclose a conflict of interests to his nominee, as well as to the company. The outcomes of the disclosure is that the liability will be attached afterward to the nominator rather than to the nominee. This result is in contrast to English law which involves that the nominee will incur liability on the part of the nominee.

(3) If the resort to the nominator is impossible, onerous, harmful to the company's interests or the company's permission has not been given under subparagraph (2) of this Article, a nominee director must take his decision in the light of the company's interests.

#### **Art.5: Duty not to Accept a Benefit from Third Party**

1- A director must avoid accepting a benefit from third party by reason of his office, or by reason of undertaking either an action or omission.<sup>123</sup>

(2) This duty is not infringed:-

(i) If receiving a benefit was in return for service presented by the director in accordance with a prior authorisation given by the company.

(ii) If a situation is unlikely to give rise to the conflict of interests.

(iii) If a situation has been authorised by general assembly of a company prior to accept the benefit.

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<sup>123</sup> Iraqi law does not encompass a rule prohibiting a director explicitly from accepting a benefit from a third party. This situation raises several questions about: the existence of such a duty; the conditions for raising the liability, exceptions to this duty and so forth. The above suggested provision contains a proposal for dealing with these questions.

## Chapter Six

### The Duty of Declaring Interests in a Transaction with the Company

**Introduction:** The traditional approach of English law has been to preclude a director from taking advantage of an interest in a transaction to be concluded with his company.<sup>1</sup> Lord Cranworth in *Aberdeen Rail Co v Blaikie Brothers* has expressed the inflexibility that encapsulates the rule of “avoid achieving secret profits ” by stating that:-

[N]o one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect...<sup>2</sup>

This principal is premised on the fact that there is always a potential risk that a director might prefer his own interests or the interests of another party in a transaction over the interests of his principal.<sup>3</sup>

However, s.177 of the C.A. 2006<sup>4</sup> has added some flexibility to the above equitable rule by allowing a director to be interested in a transaction, provided that he declares his interests in it. The same approach has been espoused by Art.119 of the Iraqi Companies’ Act 1997, under the reform conducted by the Coalition Provisional Authority 2004 (hereinafter the C.P.A.) to be compatible with s.177 of the C.A. 2006. Art.119 of the I.C.A 1997 states:

It is impermissible for the chairman or a member of the board to have direct or indirect interests in deals that are concluded with the company, except after obtaining the permission of the general assembly with full disclosure of the nature and extent of such interests.

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<sup>1</sup> Zohar Goshent, ‘The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality’ (2003) 91 Cal L Rev 393, 401.

<sup>2</sup> [1843-60] All ER Rep 249, 252 (HL). In the same approach see *North-West Transportation Company, Ltd, and James Hughes Beatty v Henry Beatty* (1887) 12 App Cas 589,593-594 (PC).

<sup>3</sup> Sarah Worthington, ‘Corporate Governance: Remediating and Ratifying Directors’ Breaches’ (2000) 116 L Q R 638, 664.

<sup>4</sup> S.177(1) states that ‘If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors’.

Nonetheless, the new formulation of Art.119 was accompanied by numerous shortcomings which created a degree of ambiguity in tackling certain matters related to a director's duty of declaring his interest. For example, there is a degree of uncertainty concerning the definition of those transactions which fall within the duty's scope; determining the concept of the interested director; the time of the disclosure of interests; deciding which party is responsible for giving approval to the transaction, and so forth. The shortcomings in this formulation extend also to the procedures of declaring the interest in a deal. Here doubt also surrounds the question of whether Art.119 of the I.C.A. 1997 involves a strict rule in addressing the director's divided loyalty in a way that similar to the approach taken by English law. Answering this question has particular significance because the I.C.A. 1997 ignored the regulation of important transactions that often attract a conflict of interests.<sup>5</sup>

To discuss the above problems, this Chapter will be divided into three sections. The focus in the first section will be on the nature and the conditions of applying the above rule. In the second section, the procedures for giving the approval will be discussed; and in the third section the author will attempt to answer the following question: does Iraqi law encompass strict rules to avoid the director from having a divided loyalty concerning the conclusion of a transaction in which he is "interested"?

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<sup>5</sup> Such as: transactions of lease, tenancy, servitudes, usufructs, and granting a loan or a credit. This issue will be considered in section 3 of this Chapter, para 6.3.2.

## Section I

### The Conditions that Cause the Director's Duty of Declaring the Interest

**Introduction:** As mentioned above, not all transactions concluded by a director with his company involve a threat to the company's interests. On the contrary, it could be more profitable for the company than contracts concluded with third parties. This may take a long time and be accompanied by additional costs.<sup>6</sup> Moreover, if the prohibition is absolute, it is not impossible for a director to deal with the company indirectly (via another person) without revealing his identity, and this may motivate him to infringe the law by using fraudulent actions. Therefore it may be asked why a director should not be allowed to deal with his company in a legitimate manner, particularly since he is in a position to protect the firm's confidential information and is familiar with its needs.<sup>7</sup>

For these reasons, it is not surprising that Iraqi law has concerned itself with the above rule over a long period of time. Art.161(1) of the Commercial Companies Act No.31, 1957, had contained a rule similar to Art.119 of the I.C.A. 1997. However, this rule was replaced in subsequent Acts<sup>8</sup> by another rule: the director was entitled to contract with his company, even if the contract involved an injustice in favour of the director that did not exceed 10% of the transaction's total value. This rule raised a question about the legal basis for legitimizing a contract that encompasses such unfairness. The C.P.A. subsequently replaced this rule by the current formulation under the Order No.64 of 2004. The current provision requires the interested director in a deal to declare his interests, making it clear that this rule extends not only to the board of directors, but also to the managing director.<sup>9</sup>

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<sup>6</sup> David Kershaw, *Company Law in Context* (2th edn, OUP 2012) 478.

<sup>7</sup> Paul Davies, *Introduction to the Company Law* (2th edn, OUP 2010) 163; Tan Lay Hong, 'Family-Owned Firms in Singapore Legal Strategies for Constraining Self-Dealing in Concentrated Ownership Structures' (2011) 23 Sac LJ 890, 897.

<sup>8</sup> See the Companies Act No.36 1983 (repealed), Art.111; the Companies Act No.21 1997, Art.119 (before its amendment).

<sup>9</sup> Art.124 of the I.C.A 1997 states that:-

Presenting a clear picture of the general framework surrounding this old-new duty in Iraqi law depends upon clarifying the conditions of applying it. But it would be best to first determine the nature of this rule: does it constitute a duty or a disability?

### **6.1.1 Does the No-Profit Rule under the I.C.A. 1997 Constitute a Disability or a Duty?**

The answer to this question is associated with the formulation of Art.119 of the I.C.A. 1997, which has not labelled the rule spelt out in this Article as a “duty”. It might therefore be said that this rule is a disability rather than a duty, as has been mooted by some English authorities.<sup>10</sup> The legal effect of the difference between duty and disability<sup>11</sup> is that duty is enforceable and will be subject to the time-bar rather than a disability rule.<sup>12</sup> However, the matter has lost its significance in the light of the C.A. 2006, which has deemed that this rule, enunciated in s.177, is explicitly a duty. But this doubt still persists under Iraqi law.

It is suggested that Art.119 (First) of the I.C.A. 1997 involves a duty, for the following reasons: first, the formulation of the Article, begins with the phrase: ‘It is impermissible for the chairman or a member of the board to have direct or indirect interests in deals that are concluded with the company...’ suggests that a negative duty is indicated. Under this formulation a director shall avoid placing himself in a position of conflict of interest with the company. But where he is interested in a transaction, the declaration of his interest represents a safe harbour for avoiding his liability. Hence, a positive duty (of declaring the interest)<sup>13</sup> arises.

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In the exercise of his jurisdictions and powers, the managing director is subject to the provisions of Articles 119 and 120 of this Law...

<sup>10</sup> *Movitex Ltd v Bulfield* [1988] BCLC 104 (CH).

<sup>11</sup> The disability means that a person is incapable to do a certain action, while a duty involves the imposition a proscriptive obligation to avoid doing a certain action.

<sup>12</sup> See the criticisms addressed to this distinction stated in *Gwembe Valley Development Company Ltd v Thomas Koshy* [2003] EWCA Civ 1048, [2003] WL 21729210.

<sup>13</sup> Hans C. Hirt, ‘The Law on Corporate Opportunities in the Court of Appeal: Re Bhullar Bros Ltd’ (2005) J B L 669, 678-678; Deirdre Ahern, ‘Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail’ (2010) Irish Jurist 82, 89; Arthur B. Laby, ‘Resolving Conflicts of Duty in Fiduciary Relationships’ (2004) 54 A U L Rev 75, 108-109.

This description have been supported by Iraqi commentators: see Ahmed Ibrahim Al-Bassam, *the Commercial Companies in Iraqi Law* (Second edn, Al-Zammaan Publisher 1967) 180; Mustafa

However, the above drafting of Art.119 of the I.C.A. 1997 involves less emphasis on the core of this duty, namely “avoidance of the conflict of interest” to which this provision applies. For greater precision, a re-casting of this provision is suggested, as follows: ‘the director must avoid the conflict of interests by disclosing his interests...’. Such a suggested draft lays a positive duty on the director to avoid the occurrence of any such situation via the declaration of the interests.

Secondly, it will be seen in this Chapter that the infringement of Art.119 of the I.C.A. 1997 gives rise to the director's civil liability. It is submitted that the existence of liability presupposes the existence of a duty, as being a basis for the accountability of the director.

### **6.1.2 The Conditions that Cause the Director’s Duty of Disclosing his Interest to Arise**

To invoke the director's duty of declaring his interests in a deal with his company, there are three conditions that must be established. The first condition concerns the meaning of the transaction; the second requires that the director must have an interest in a deal; and the third requires that the director’s declaration must be directed to the shareholders or to the directors.

#### **6.1.2.1 The Nature of the Transaction**

The existence of a transaction is vital to trigger the director’s duty of disclosing his interest, and is an element which distinguishes between this duty (to disclose a conflict) and the duty of avoiding the conflict of interests. Art.119 (First) of the I.C.A. 1997 uses the term “deal” in connection with the powers of the general assembly in giving its approval to the conflict, and “matter” in Art. 119 (Second) and Art.21 (2) of the P.B.A. 2004, which concerns disclosure to the other directors. The Act does not

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Nasser Nasrallah, *the Commercial Companies* (Coaching Publisher 1969) 243; Akram Yamulki & Bassem Mohammed Saleh, *the Commercial Companies: Part.2* (Baghdad University Publisher 1983) 244.

contain a definition of these terms, which are used for the first time in this Act. This could give rise to uncertainty about the meaning of these terms and their scope. The Arabic translation of this Act has used a term equivalent in its meaning to the term “transaction,” (a term used by the C.A. 2006<sup>14</sup>). Accordingly, it is suggested that a deal means any transaction that has contractual effects, regardless of its nature. This includes, but is not limited to, transactions such as sale of both tangible and intangible property, buying, leasing, hiring, and so forth.<sup>15</sup>

However, the term deal does not include taking a decision to engage in a negotiation. The C.A. 2006 chose rather to employ the term “arrangements”. This term ‘...is widely used by Parliament to include agreements or understandings having no contractual effect...’,<sup>16</sup> which includes negotiation with a third party.

Moreover, decisions taken by the company’s unilateral will, (in Iraqi law), without the necessity of acceptance by the other party, are not subsumed within the meaning of a deal. It can be exemplified in actions such as the waiver of a mortgage,<sup>17</sup> bail,<sup>18</sup> a security, or the exoneration of a debtor,<sup>19</sup> etc. It includes cede of some rights *in rem*, for example, the wave of servitude rights, etc., which, when undertaken by the unilateral will of the company. But these actions cannot be labelled as “transactions,” because they do not bring a potential benefit to the company. However, these legal actions might be subsumed within the term “matter,” mentioned in Art.117, (Second), of the I.C.A. 1997, as it involves a broader meaning than “deal.” It will be seen shortly<sup>20</sup> that the distinction between the above terms has legal significance in determining the powers of the general assembly and the directors.

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<sup>14</sup> Luca Enriques, ‘The Law on Company Directors’ Self-Dealing: a Comparative Analysis’ (2000) 2 *Kluwer Law International* < [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=135674](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=135674)> accessed 20 March 2013 297, 299.

According to Peter Collin (ed), *Dictionary of Law* (Second edn, 1998) 94, a deal means ‘Business agreement or affair or contract’.

<sup>15</sup> Tahir Ashraf, ‘Directors’ Duties with a Particular Focus on the Companies Act 2006’ (2012) 54(2) *Int J L M* 125, 132.

<sup>16</sup> *Re Duckwari plc (No 2), Duckwari plc v Offerventure Ltd (No 2)* [1998] 2 BCLC 315, 319 (CA) (Nourse LJ).

<sup>17</sup> See the Civil Code 1951, Art.1318.

<sup>18</sup> The Civil Code 1951, Art.1041.

<sup>19</sup> The Civil Code 1951, Art.420.

<sup>20</sup> See para 6.1.2.3.2 of this Chapter.



### 6.1.2.2 A Director Must Have an Interest in a Deal (Transaction)

Like s.177 (1) of the C.A. 2006, Art. 119 of I.C.A. 1997 covers the director's direct and indirect interests in a transaction, but without giving a definition or example of these terminologies. What makes the picture unclear is that the aforementioned terms were used for the first time in Iraqi legislation, so adding further to the uncertainty.

In the light of this uncertainty, resort to English law provides helpful guidance.<sup>21</sup> According to English law, a direct interest means that the manager owns a personal (pecuniary)<sup>22</sup> interest, that is, a proprietary right in a certain transaction or deal,<sup>23</sup> e.g., being the owner of the company; a partner in the partnership;<sup>24</sup> a buyer or a seller of a property, or a lease, and so forth. Indirect interest means that the director has an interest in a third party, for example, when a director owns shares in the third party;<sup>25</sup> or acts as a director therein;<sup>26</sup> or is a trustee of the shares that were invested.<sup>27</sup>

Although s.253 of the C.A. 2006 articulates the meaning of family relationships<sup>28</sup> that attract a conflict of interests, these relationships by themselves may not automatically raise a conflict of interests: all depends upon the case-circumstances.<sup>29</sup>

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<sup>21</sup> Since the C.P.A has amended the I.C.A. 1997 to be consistent with American and English legal notions.

<sup>22</sup> *Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company* [1914] 2 Ch 488, 503 (CA).

<sup>23</sup> *Transvaal Lands Co v New Belgian Land Co* [1914] 2 Ch 485(CA); *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch), [2008]1 BCLC 46. See also Andrew Griffiths, 'Interlocking Directorships and the Danger of Self Dealing: The Duties of Directors with a Conflict of Interest' (1999) 10(9) I C C L R 280; Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96, 98.

<sup>24</sup> *Aberdeen Rail Co v Blaikie* [1843-60] All ER Rep 249 (HL); *Gwembe Gwembe Valley Development Company Ltd v Thomas Koshy* [2003] EWCA Civ 1048, [2003] WL 21729210.

<sup>25</sup> See for example *Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company* [1914] 2 Ch 488 (CA).

<sup>26</sup> Andrew Griffiths, 'Interlocking Directorships and the Danger of Self Dealing: The Duties of Directors with a Conflict of Interest' (1999) 10(9) I C C L R 280.

<sup>27</sup> *Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company* [1914] 2 Ch 488, 503.

<sup>28</sup> These relations under the above Section are exemplified: the director's spouse or civil partner, his children, step-child etc.

<sup>29</sup> *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch), [2008]1 BCLC 46 [237]. See also Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L R 96, 98.

More uncertainty on this point persists under the I.C.A. 1997,<sup>30</sup> concerning whether the indirect interest means the director's financial interests with a spouse (the wife or husband), or whether moral or social relationships are sufficient to constitute the connection.<sup>31</sup> According to Art.134 (First) of the I.C.A. 1997 (which relates to the contents of the annual report), the disclosure must include the '... interests of their [directors] families, entities under their control and any other interest that would render the transaction a related party transaction ...'.<sup>32</sup> However, the aforementioned provision does not determine the nature and the degree of the family relationship, (whether it includes the grandfather and grandmother, the spouse's relatives etc.).

The same uncertainty is found in Art.61 of the Insurance Business Activities Act, 2005 (hereinafter the I.B.A.), which refers to "affiliated" persons. But as this Article is limited to the context of the liquidator's authority to abrogate agreements concluded before declaring the liquidation, it cannot be used outside the jurisdiction of that Act.

By contrast, Art.1 of the P.B.A. 2004 has defined "related" persons to include: the director himself or any person whom a director has an interest or undertaking. Concerning family relationships, a broad definition has been given, so as to include any person who is related to an administrator (director) by marriage, blood or kinship up to the second degree. This list includes the adopted children or foster children of the administrator and any other person residing in the administrator's household. This broad definition of relatives<sup>33</sup> makes the director responsible for disclosing the interest of persons in cases where that interest is not known to him, perhaps because his relationship with them had broken down before their interests in the deal arose.<sup>34</sup> This broad meaning given to relations consequently renders the director responsible for disclosing a long list of interests of which he may in reality be unaware. Surprisingly, Art.21(2) of the P.B.A. 2004 restricted the scope of the duty of disclosure to include only "the significant personal financial interests" of a director and "other individuals in the administrator's household". Seemingly, this narrow concept of interests gives to a director a license to refrain from declaring some sorts of interests that may affect his

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<sup>30</sup> In Art.4(Third-1) of this Act there is a simple indication to the term the "associated" persons but its meaning is not identified.

<sup>31</sup> Professor Eddy Wymeersch, 'Current Reform Initiatives: Challenges and Opportunities' (2000) <A AUSTRIA-europeanfamilybusinesses.eu> accessed 28 April 2013, 24 para 40.

<sup>32</sup> [Illustration added].

<sup>33</sup> See in the same meaning s.252 of the C.A. 2006.

<sup>34</sup> *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch), [2008]1 BCLC 46.

impartiality in taking a decision in the light of a company's interests. The "family relationships", for instance, do not include the engagements, love, and sexual relationships, which might be more influential on a director's impartiality than family relationships. Moreover, this limitation involves an apparent contradiction with the aforementioned provisions of the P.B.A. 2004 which give a wider definition to the direct and indirect interests.

To sum up, it is apparent that the I.C.A. 1997 involves a degree of vagueness in determining the meaning of the concepts of direct and indirect interests and connected persons. There is inconsistency between the I.C.A. 1997 and the I.B.A. 2004 in tackling this theme. This problem opens the door to contradictory interpretations in the attempt to clarify these concepts. It should be noted also that the family relationship in Iraqi society is defined by two features: firstly, it tends to be interrelated to a degree that the *moral relationships* have a robust effect on the director's impartiality.<sup>35</sup> Second, by virtue of the influence of the Islamic legal system, the spouse (male and female) is subject to the regime of "*the separation of property*". Under this regime, the spouse is entitled to exercise trade without the approval of the other spouse.<sup>36</sup> This might make the director less aware of commercial activities exercised by his spouse. The present author's suggestion is to define the direct and indirect interests in the I.C.A. 1997 as mentioned under the P.B.A. 2004 and English law.<sup>37</sup> But these relations should be considered as merely assumptions, and their influence on a director's impartiality can be refuted by him.

### **6.1.2.3 The Disclosure Must be Directed to the Bodies Determined by the Act**

Art.119 of the I.C.A. 1997 has identified two bodies to whom a declaration of interest must be made: the general assembly, and the board of directors; while ss.117 and 182

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<sup>35</sup> Under the influence of Islamic religion, the family and Kinship relationships in the Eastern communities takes very robust shape, to a degree that all members of the family may continue in living at the same household, even after children marriage. In hard times, kin, cousins and Nephews may live in the individual's house. Relatives may receive a financial support from each other, and may prefer to engage into financial transactions with each other.

<sup>36</sup> Professor Basem Mohamed Saleh, *the Commercial Law: Part I*(University of Baghdad 1987) 102-103, para 84.

<sup>37</sup> See ss.252-256 of the C.A. 2006.

of the C.A. 2006 made it clear that the approval of other directors is required in all cases.<sup>38</sup> This is a default rule, and the company is entitled to modify these rules in its constitution by resorting to the old common law, by which the shareholders' approval was required.<sup>39</sup> The shareholders' approval is also required with regard to particular transactions<sup>40</sup> concluded under chapter 4 of this Act, in addition to the declaration of interest to the other directors.<sup>41</sup> This means that the latter transactions require multi-procedures (the disclosing to the board and the shareholders' approval). The rationality of the approach adopted by the I.C.A. will be the subject of the discussion which follows.

#### **6.1.2.3.1 The Shareholders' Approval**

The I.C.A. 1997 requires that the shareholders' approval be given to the director having an interest in a "deal" (transaction), and this represents the approach of several Arabic Companies' Acts.<sup>42</sup> Conferring on the shareholders such a power has its "pros" and "cons": such approval is the best way<sup>43</sup> to ensure that the decision is taken by those who have a greater incentive than the director to safeguard the company, who may own few shares therein.

However, numerous "cons" could stem from empowering this body to give the approval. First, summoning the general meeting, particularly in large companies which consist of dispersed shareholders, entails loss of time and significant costs. This can be observed clearly in the case of Iraqi law, under which the general assembly of the joint-stock company must hold its general meeting once each year, and each six months at least with other types of companies.<sup>44</sup> Second, the lack of adequate

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<sup>38</sup> Deborah A. DeMott, 'The Figure in the Landscape: A Comparative Sketch of Directors' Self-Interested Transactions' (1999) 62 *Law and Contemp Probs* 243, 254.

<sup>39</sup> The C.A. 2006, s.180 (1).

<sup>40</sup> Such as substantial property transactions, credit transactions, the director's service contract. For more discussion about this point see para. 6.3.2 of this Chapter.

<sup>41</sup> The C.A. 2006, s.180(3).

<sup>42</sup> The Syrian Companies' Act No.29 2011, Art.152(1); the Kuwait Commercial Companies' Act No. 15 1960, Art.151; the Saudi Arabian Regulation of Companies' No.6 1965, Art.69.

<sup>43</sup> David Kershaw, *Company Law in Context* (2th edn, OUP 2012) 480.

<sup>44</sup> The I.C.A. 1997, Art.86.

information and experience<sup>45</sup> concerning the subject of the transaction,<sup>46</sup> as well as the possibility of the shareholders' apathy in exercising their control of the company's affairs,<sup>47</sup> represent challenges to the shareholders as decision-makers. All these factors lead to a slow-down of the decision-making associated with the transaction concerned.<sup>48</sup> In addition, the aforementioned obstacles may lead to the loss of the transaction itself, if the third party could not wait until the general meeting was held. Therefore, reliance on the shareholders to take a commercial, informed and rational decision in this regard with a view to protecting the interests of company is questionable.

To address the problem of the lack of expertise of shareholders leading to an unsound decision, the degree of cooperation between the general assembly and the Board of Directors needs to be delineated in law. It would be better, for example, to oblige the board to give its recommendation about the feasibility of the transaction concerned, together with any useful information. However, the I.C.A. 1997 did not deal with this matter, and so, to confer such a power on disinterested directors of large companies, such as Joint Stock Companies, would be a pragmatic method of overcoming these problems.

#### **6.1.2.3.2 The Approval of Board of Directors**

It was shown earlier that the general assembly is empowered to give its permission on the subject of conflict of interests concerning a "deal". While the board of directors is also entitled to give the same authorization concerning other "matters".

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<sup>45</sup> David Kershaw, *Company Law in Context* (2th edn, OUP 2012) 480.

<sup>46</sup> Such as whether it is in the company's interest to accept or reject the transaction, what is a fair price etc.).

<sup>47</sup> John Lowry and Rod Edmunds, 'Reflection on the English and Scottish Law Commissions 'Proposals for Directorial Disclosure' (2000) 5(1) Deakin L Rev 1, 10.

<sup>48</sup> Fraser Dobbie, 'Codification of Directors' Duties: An Act to Follow?' (2008) 11 Trinity C L Rev 13, 21.

Conferring the above power on the directors<sup>49</sup> is justifiable since they are subject to fiduciary duties,<sup>50</sup> particularly the duty to act in the interests of the company.<sup>51</sup> This power creates an incentive for the directors to focus on the merits of the decision, and also avoids the difficulties of holding a general meeting.<sup>52</sup> Accordingly, the directors are better qualified to give a rational and informed decision. Under Art.119 (second):-

It is impermissible for the chairman or a member of the board to vote upon or participate in a matter in which he or she has direct or indirect interests without disclosing the nature and extent thereof to disinterested members and receiving the permission of a majority of them. If no members are disinterested, all may act.

The disinterested director means any person who has no interests in the transaction and is not connected with the director involved or with a third party associated with the proposed transaction. However, the I.C.A. 1997 and Art.21 (2) of the P.B.A. 2004 have some shortcomings when it comes to tackling this matter, such as the following:-

First, the method of distributing this power between the board of directors and the general assembly seems odd. As has been shown, the general assembly is empowered to authorize the conflict of interest with regard to a deal, whilst the board is empowered to give its approval in more serious matters, even those which do not involve any financial return to the company. Such actions could include, for example, decisions relating to matters such as a waiver of a security, or a mortgage connected with a loan, or exoneration from a debt in which a director has an interest. The director, in these instances, has an interest manifested in improving the financial position of the third party. The waiver of debts of the third party (in which a director owns shares) may result in an increase in the value of his shares, which constitutes for him a significant interest. In the light of this analysis: while the I.C.A. 1997 sought to provide the utmost degree of safeguard from a conflict of interest to a company by requiring the

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<sup>49</sup> See ss. 177, 182 of the C.A. 2006. *See also Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 WLR 1133 Ch D, 672 per Walton J.

<sup>50</sup> Despite Art.4 (Third) of the I.C.A 1997 imposed on company's members duties similar to those imposed on directors, but without incurring the shareholders the civil liability.

<sup>51</sup> Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L R 96, 79; Luca Enriques, 'The Law on Company Directors' Self-Dealing: A Comparative Analysis' (2000) 2(1) Kluwer Law International <[http:// papers.ssrn.com/ sol3/papers.cfm? abstract\\_id=135674](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=135674)> accessed 20 March 2013 297, 324

<sup>52</sup> Under Art.112(First) of the I.C.A. 1997 'The board of directors shall meet at least once every two months at the invitation of its chairman or at the request of any of its other members'.

shareholders' approval, the board of directors is empowered to give the authorization for matters more serious than those entrusted to the shareholders. Why therefore does the law not give the board the entire power to authorize the decision regarding the conflict of interests in a transaction?

Second, the I.C.A. 1997 requires from the director of a Sole Owner Enterprise, and a Sole Owner Limited Liability Company,<sup>53</sup> to comply with this duty, just like the directors of other types of companies.<sup>54</sup> It is permissible therefore for the company's sole owner also to be its sole director simultaneously.<sup>55</sup> This will raise a question about the feasibility of requiring a director, as a matter of law, to inform himself about a matter that already is known by him.<sup>56</sup> What is the safeguard offered by this to the company's stakeholders (e.g. its creditors)?<sup>57</sup> Seemingly, they are unable to challenge the director's (the owner's) decisions, as long as he can allege that he has obtained an approval from himself and has taken a decision in the light of the company's interests. No answer to this question can be found in Iraqi law.<sup>58</sup>

Although equity imposes a fiduciary duty on a director to avoid any position that would be conducive to a conflict of interests,<sup>59</sup> the C.A. 2006 did not impose on the sole owner a general duty to declare his interests,<sup>60</sup> and limited it to two cases: first, where a company is managed by one director while it should be administered by more than one person. In this case the declaration issued by the sole director must be recorded in a written manner, and be part of the next meeting of the directors. Second, where a

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<sup>53</sup> For further information about these types of companies, see Chapter 2, para 2.2.2.1.

<sup>54</sup> The I.C.A. 1997, Art.124.

<sup>55</sup> The I.C.A. 1997, Art.121 (First).

<sup>56</sup> Vinelott J. in *Movitex Ltd v Bulfield* [1988] BCLC 104, 116 (CH) has expressed the anomaly encapsulated in this situation by stating:

I think it can be argued with some force that the articles contemplate that there will be at least one independent member of the board who will, in effect, act as watchdog for the company. In the extreme case it cannot sensibly be asked whether a sole director has made the disclosure to himself of his interest in a contract which he enters into on behalf of Movitex. Disclosure imports the concept of informing someone of something of which he would not otherwise be aware. Similarly, if there is more than one director and both are interested under the same contract or dealing with the company, it must be doubtful whether the articles would be satisfied by formal disclosure by each to the other. However, this point does not arise for decision, and I express no final conclusion on it.

<sup>57</sup> *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch 274, 283 (CH).

<sup>58</sup> [1988] BCLC 104, 116 (CH).

<sup>59</sup> Peter Watts, 'Some Aspects of the Operation of the Conflict of Interest Principle in Company Law' (1987) 3 *Canta LR* 239.

<sup>60</sup> The Explanatory Notes of the Companies' Act 2006, para 352.

company consisting of a sole member enters into a contract which falls outside the ordinary course of the company's business. The contract must be set out in a written memorandum, or must be recorded in the minutes of the first meeting of the directors following the making of the contract.<sup>61</sup>

Such a shortcoming in Iraqi and English law may cause a weakness in exercising control over the company's affairs, especially in the case of its insolvency, and creates a situation of ineffective corporate governance. The best way to remove all these complexities is by obliging the director to prepare a statement of his personal interest to be recorded in the company's books in all cases, in order to ensure his accountability in the future by the firm's creditors, or indeed future shareholders.

Third, the problem of the directors' impartiality is still at stake. Assuming that the majority of directors are disinterested, their collective work over the long term may lead to creating a friendly environment or economic relationship between them. This status may conducive to decisions involving a "courtesy" to the conflicted director, the so-called "back-scratching" practice.<sup>62</sup>

To solve the above problems, it is suggested that the alternative directors be empowered to take the approval decision. Such a suggestion would be compatible with the I.C.A. 1997, which requires the reserve (alternative) directors to be nominated to the Joint-Stock Companies '...chosen in the manner and ratios used in the case of the original members...'.<sup>63</sup> So, why should the company not avail itself of the service in the circumstances mentioned above?<sup>64</sup> This view is appropriate also for the C.A. 2006, though the latter has left the matter of nomination of alternative directors (and their number) to the company. It is better if the alternative directors take the decision in these circumstances, as it ensures the issuing of an informed impartial decision. This suggestion may assist in diluting a probability of "courtesy" to the concerned director as much as possible, particularly as it will be assumed that the friction between the alternative and the original directors will be, in this case, in the lowest possible degree.

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<sup>61</sup> The C.A. 2006, s.231.

<sup>62</sup> Paul Davies, *Introduction to the Company Law* (2th edn, OUP 2010) 168; Fraser Dobbie, 'Codification of Directors' Duties: An Act to Follow?' (2008) 11 *Trinity C L Rev* 13; Tan Lay Hong, 'Family- Owned Firms in Singapore. Legal Strategies for Constraining Self-Dealing in Concentrated Ownership Structures' (2011) 23 *SAC L J* 890, 922.

<sup>63</sup> See the I.C.A. 1997, Art.103 (Second).

<sup>64</sup> Art.104 (Second) of this Act.



Fourth, Art.119 (Second) of the I.C.A. 1997 made it clear that the declaration must be directed to the company's shareholders, or to all disinterested directors, and not to part of them, nor to other administrative committees. Nonetheless Art. 21(2) of the P.B.A. 2004 has permitted a partial declaration to be addressed to the members of '... any other committee or working group of the bank...', provided that such bodies have a decision-making authority. This approach meets with the requirements of the C.A. 2006, which deems the declaration to part of the directors to be insufficient.<sup>65</sup> However, under the C.A. 2006, the disclosure to the 'committee of the directors appointed for the purpose under the company's constitution' concerning the terms of his service contract is sufficient.<sup>66</sup> The above provisions suggest that liability will only be attached to those directors who take part in these committees. However, the approach of the P.B.A. 2004 and the C.A. 2006 is irrational, because it contradicts the legal reality that the board of directors should address all matters that threaten the company's interests<sup>67</sup> collectively,<sup>68</sup> in order to holding them liable for any decision taken.

Seemingly, the approval is unlimited and absolute; whatever body gives it, even when the contract continues for a long time. However, the approval could be limited to a period of time, e.g., one year, in order to address conflictual issues that could arise in long term contracts.<sup>69</sup>

It can be seen from the above discussion that the declaration of an interest in a transaction is the best way to shield the director from liability. Fulfilment of this duty will be subject to specific rules, which will be discussed in the next section.

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<sup>65</sup> C.A. 2006, s.177. See also *Guinness Plc v Saunders* [1990] 2 AC 663 (HL).

<sup>66</sup> S.177(6-c-ii) of this Act. This provision has codified the common law in *Runciman v Walter Runciman plc* [1992] BCLC 1084 (QB).

<sup>67</sup> See the I.C.A. 1997, Art. 117. See Stephen Girvin, Sandra Frisby & Alastair Hudson, *Charlesworth's Company Law* (18<sup>th</sup> edn, Thomson Reuters 2010) 366, para 17-058; Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 535, para 16.44; Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 278, para 11-97.

<sup>68</sup> Deborah A. DeMott, 'The Figure in the Landscape: A Comparative Sketch of Directors' Self-Interested Transactions' (1999) 62 *Law and Contemp Probs* 243, 260.

<sup>69</sup> See Iraqi Commercial Companies' Act 1957(abolished), Art.161(First). There is no mention of this matter in the current Acts. However, the above inference is consistent with the general rules of law.

## Section II

### Mechanism for the Declaration of Interests in a Deal: Problems and Solutions

**Introduction:** Obtaining the company's approval is a way to legitimize the director's self-interest in dealing with his company<sup>70</sup> and shields him from liability.<sup>71</sup> Art. 117 of the I.C.A. 1997 contains only a brief statement about this matter. By contrast, the C.A. 2006 contains detailed provisions for complying with this duty before the company enters into the transaction.<sup>72</sup>

It is to be expected that such a brief statement of the duty in Iraqi law will generate uncertainty about how to fulfil that duty. Several questions therefore need to be answered, concerning such matters as: the time and methods of complying with the duty; the contents of the declaration; and the procedures for giving the approval/rejection decision, as follows.

#### 6.2.1 The Time of Disclosure of Interests

There is a deficiency in the I.C.A. 1997 relating to the non-stipulation of the time at which a conflict is to be disclosed. Pursuant to Art.119 (First) of the I.C.A. 1997, a director is forbidden from having '...direct or indirect interests in deals that are concluded with the company...'. By contrast, s.177(4) of the C.A. 2006 made it clear that the duty must be fulfilled '... before the company enters into the transaction or arrangement' and this is an example of the potential conflict of interests.<sup>73</sup> It is logical to give the company an opportunity to evaluate the transaction's merits in the light of this information before taking an appropriate and informed decision<sup>74</sup> either to reject

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<sup>70</sup> See for example: *Don King Productions Inc v Warren* [2000] Ch 291, 340-342 (CA); *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch), [2008]1 BCLC 46. See also the Australian case *Zacharia Chan v Zacharia* [1984] 154 C L R 178, 199.

<sup>71</sup> *Hely-Hutchinson v Brayhead Ltd* [1968] 1 Q B 549, 585 (CA); *Movitex Ltd v Bulfield* [1988] BCLC 104, 116 (CH). See also Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 353, para 12.1.

<sup>72</sup> The C.A. 2006, s.177.

<sup>73</sup> Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96, 100.

<sup>74</sup> Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (9th edn, OUP 2010) 413-414.

or conclude it, according to its interests.<sup>75</sup> The current formulation of Art.119 of the I.C.A. 1997 stipulates that the director is entitled to make the performance of his duty coincide with the implementation of the obligations stemming from the transaction.

It may be said that the transaction's effects (viz a director's interest) arise at the instant of its conclusion. Declaration of the interest should therefore precede or coincide with the conclusion of the deal. However, in some cases the effects of the transaction could arise at a time after its conclusion, because its parties have agreed to defer the fulfilment of their duties for a period of time.<sup>76</sup> Is a director thus entitled to discharge his duty at the time of implementation of these obligations? If this interpretation is valid, it would mean that the law could strip the company of its most significant means of safeguarding its interests.

However, it can be inferred from Art.119 (Second) of the I.C.A. 1997 and Art.21(2) of the P.B.A. 2004 that the director cannot contribute to a meeting, or vote in a matter in which he has an interest, before declaring his interests therein. So, the declaration must precede the decision-taking. But the ambiguity remains encapsulated in the current drafting of Art.119 (First), causing it to be in serious need of reformulation, so that it identifies the time at which a director should disclose an interest.

There is yet another problem connected with the *ex post* disclosure (the actual conflict). In some cases, a director may fail to declare his interest, or he has only become interested afterwards by virtue of purchasing shares in the third party,<sup>77</sup> e.g., being a director in a third party after the latter has entered into the transaction concerned. The question then arises: is the director, under Art.119 of the I.C.A. 1997, obliged to disclose his interests in these circumstances? The I.C.A. 1997 did not deal with this matter. Therefore, the director is not obliged to do so.

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<sup>75</sup> Lord Goldsmith, Lords Grand Committee, 9 February 2006, column 334 in the Department of Trade and Industry (herein after the D.T.I): 'Companies Act 2006, Duties of Company Directors: Ministerial Statements' <[www.Berr.gov.uk/files/file4\\_0139.pdf](http://www.Berr.gov.uk/files/file4_0139.pdf)> accessed 24 February 2013, 12.

<sup>76</sup> This transaction is called under the Civil Code 1951 "the suspended obligation". For more details of this theme see Abdul Majid Al-Hakim, Abdul Baqi Al-Bakri and Mohammed Taha Al-Bashir, *The Civil Law: the Rules of the Obligations* (the Ministry of Higher Education and Scientific Research 1980) 157-193.

<sup>77</sup> Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 281, para 11-105.

By contrast, pursuant to s.182 of the C.A. 2006, a director in the above situation is bound to declare his interest as soon as reasonably possible,<sup>78</sup> and should perform this disclosure within a reasonable time. Breaching this duty will result in a criminal sanction (fine). Compliance with s.177 (concerning the disclosure of an interest before the company's entry into a transaction) will absolve a director from the requirements of s.182 (which relates to the disclosure of an interest in the existing transactions).<sup>79</sup> While the *ex post* disclosure of interest by reason of the failure to comply with s.177 under s.182 will result in exempting a director from a criminal sanction rather than a civil liability, based on s.177.<sup>80</sup>

The imposition of the *ex post* declaration is vindicated by the argument that, although a company is foreclosed from rescinding the contract (because the interests of a *bona fide* third party should be protected), the company still has an interest in knowing about its director's interest therein.<sup>81</sup> This matter acquires significance in the case of extension or renewal of the contract. In addition, a director's annual report must indicate to important contracts in which he has an interest.<sup>82</sup> This report will be circulated to all shareholders, and could spread to the stock exchange markets. The failure to oblige the director to declare his existing interests necessitates correspondingly that the report will not refer to this matter, which may give an impression of the company's non-compliance with the law. It can be conceived that a director, e.g., may defer the creation of his interest in the third party until the conclusion of the concerned transaction with his company (e.g., deferring the purchase of shares in a third party until the conclusion of transaction concerned).

## 6.2.2 The Methods of Disclosing the Interests

Neither Art.119 of the I.C.A. 1997 nor Art.21 of the P.B.A. 2004 contain a reference to the methods of declaring the director's interests in a deal with the company, and thus this matter is left to the general rules of Iraqi law. By extrapolation from these

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<sup>78</sup> S.182(1, 4) of this Act.

<sup>79</sup> The Explanatory Notes of the Companies Act 2006, para 365.

<sup>80</sup> Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96, 100.

<sup>81</sup> Brenda Hannigan, *Company Law* (2th edn, OUP 2009) 276-277, para 11.93.

<sup>82</sup> The I.C.A. 1997, Art.134(First).

rules, the declaration can be made orally, though this may raise a problem in proving its occurrence and its contents, because any legal action with a value exceeding 5000 Iraqi Dinar must be proved by written evidence.<sup>83</sup> The best method of protecting the director therefore is through a declaration of his interests by means of a written notice or any other material means, such as email.<sup>84</sup> Moreover, the declaration could be directed via a Notary,<sup>85</sup> although this is a slow means of discharging the duty, and is not commensurate with the pace of commercial transactions, which often require speed in decision-making. It does not, however, represent a sound method of proving the fulfilment of the duty.

By contrast, although the C.A. 2006 did not restrict the duty of declaration to specific methods,<sup>86</sup>ss.177(2), 182(2), 184 have employed ways similar<sup>87</sup> to those mentioned above. The purpose of giving these details is to avoid any uncertainty about how to discharge this duty and to provide a clear guide to the director in this respect.

However, Art.119 of the I.C.A. 1997 does not specify the general declaration mentioned in s.185 of the C.A. 2006. According to this procedure, a director must declare the nature and the extent of his interests or his connection with another person. This is an interesting way of avoiding repetition of the declaration about the same situation, as well as being consistent with the principle of good faith.<sup>88</sup> Art.119 of the I.C.A. 1997, by virtue of using the terms “a deal” or “a matter”,<sup>89</sup> which impliedly refers to specific situations, negates any possibility of adopting the general declaration in the disclosure, while this method also leads to a saving of time and effort, particularly in cases where there is frequent dealing between the concerned parties. Caution should be employed in using the general declaration, which could be forgotten by the other directors, or where the information becomes obsolete over the years and

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<sup>83</sup> The Evidence Act 1979, Art.77(First).

<sup>84</sup> The Act of Electronic Signature and the Electronic Transactions No.78 2012, Art.1(Sixth), 3(b).

<sup>85</sup> See the Notaries Act No.33 1998, Art.11.

<sup>86</sup> This can be caught from the phrase “but need not” set forth in s.177 (2). See The Explanatory Notes of the Companies Act 2006, para 349.

<sup>87</sup> Which are mentioned by ss.117(2), 182(2) of the C.A. 2006 can be undertaken: orally, by written notice or by general notice.

<sup>88</sup> Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn, Jordan Publishing Ltd 2011) 315, para 6.109.

<sup>89</sup> For more details about the meaning of these terminologies under the I.C.A. 1997, see para 6.1.2.1 of this Chapter.

then needs to be updated.<sup>90</sup> So, there is a necessity to compel a director to update the disclosed information regularly, as soon as reasonably possible.

### 6.2.3 The Contents of the Disclosure

Basically, the declaration should include all matters connected with any interests that might lead to a change of the directors' decision, either in entering into the transaction concerned, or in amending their conditions of entry. This disclosure takes the shape of that which appears in *uberrimae fidei* contracts.<sup>91</sup> Thus, the material facts depend on the deal's circumstances.

Under Art.119 of the I.C.A. 1997, which is analogous to s.177 (1) of the C.A. 2006, a director must present a 'full disclosure of the nature and extent of such interests'. According to the common law, the disclosure must encompass '... full disclosure ... of all material circumstances...' <sup>92</sup> to enable the other directors see '... what his interest is and how far it goes...' <sup>93</sup> It is insufficient for the director to say that he is interested in a transaction,<sup>94</sup> rather he must determine the extent of his interests (its size). This includes '...the source and scale of the profit made from his position...' <sup>95</sup> In *the Liquidators of the Imperial Mercantile Credit Association v Edward John Coleman and John Watson Knight*,<sup>96</sup> the court held that the manager had failed to discharge his duty because he did not mention the amount of his commission, so as to enable the other directors to determine the conditions of the transaction.

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<sup>90</sup> Fraser Dobbie, 'Codification of Directors' Duties: An Act to Follow?' (2008) 11 Trinity C L Rev 13; Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn, Jordan Publishing Ltd 2011) 315, para 6.109.

<sup>91</sup> *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549, 585 (CA).

<sup>92</sup> *Adams v R* [1995] 2 BCLC 17, 30 (PC); *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch. 274, 282 (CH); *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch), [2008]1 BCLC 46 [226].

<sup>93</sup> *Movitex Ltd v Bulfield* [1988] BCLC 104, 121 (CH) Vinelott J.

<sup>94</sup> *Costa Rica Railway Company, Ltd v Forwood* [1901] 1 Ch 746, 753 (CA) (Vaughan Williams L.J.); The Explanatory Notes of the Companies Act 2006, para 351.

<sup>95</sup> *Gwembe Valley Development Company Ltd v Thomas Koshy* [2003] EWCA Civ 1048, [2003] WL 21729210 [65]; *Costa Rica Railway Company, Ltd v Forwood* [1901] 1 Ch 746, 761 (CA) (Williams L.J).

<sup>96</sup> (1873) LR 6 HL (HL).

There is another question concerning whether a director is obliged to update his declaration if the deal's *circumstances subsequently change*; for instance, where it has been discovered that the contents of the former declaration were incorrect or incomplete. There is no explanation of this question under Iraqi law. Although the Act requires full disclosure, this does not replace the need to impose a clear duty to make the director's declaration identical with the current reality by ensuring that the firm has a degree of knowledge equal to the director's own. Although the C.A. 2006 removed this ambiguity by imposing such a requirement whenever the previous declaration became incorrect or incomplete (s.177(3)), this requirement, according to the Explanatory Notes of the Companies Act 2006, para 351 is:-

...only necessary if the company has not yet entered into the transaction or arrangement at the time the director becomes aware of the inaccuracy or incompleteness of the earlier declaration (or ought reasonably to have become so aware).

This matter raises a further question: are there further obligations that must be undertaken by a director beyond the disclosure of the nature and the extent of his interests, such as providing the firm with information about the surrounding circumstances of the deal or the transaction according to the principle of good faith? Scrutiny of Art.119 of the I.C.A. 1997 and s.177 of the C.A. 2006 suggest that a director is merely obliged to declare his interests, as opposed to revealing other matters, for example: whether the deal is in the best interests of the company, or whether there are flaws in the bargain or in the goods such that it would be better for the company either to abandon the transaction or to improve its conditions. The approach of both Iraqi and English law is justifiable and consistent with common sense, because the matter is not devoid of three likelihoods:-

The first is that the director might be a third party, or acting as a co-partner with a third party, and the disclosure of everything could be against his interests.<sup>97</sup> Such a disclosure would be equivalent to a confession by the director against his own interests, and may lead to inhibiting him from dealing with his company so as to avoid incurring additional obligations.

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<sup>97</sup> Andrew Griffiths, 'Interlocking Directorships and the Danger of Self Dealing: The Duties of Directors with a Conflict of Interest' (1999) 10(9) I C C L R 280, 283.

The second prospect is one where the director is acting in this capacity with a third party, and the duty of loyalty necessitates that he not pass on any information that is contrary to his company's interests.

A third possibility is that the director owns shares in the third party, and it cannot be expected of him to know the merits of the bargain. Prior to this is the duty of other directors to investigate the profitability of the transaction, and particularly the existence of their colleagues' interests therein, which should induce them to be more cautious in this respect.

Moreover, the rules governing the concerned transaction will provide a fair protection to the company. If this analysis is true, a director is not obliged to disclose information more than that which the law requires him to reveal.

#### **6.2.4 The Procedures of Taking a Decision**

Concerning the powers of the general assembly to give its approval to a transaction, the I.C.A. 1997 fails to delineate special procedures for decision taking, leaving this matter to the general provisions of the Act. According to Art.89 of the I.C.A. 1997, any general meeting must be preceded by an invitation, coupled with an agenda. The ambiguity is that which surrounds the contents of the agenda concerning the deal. While the common law makes it clear that such a summons must fulfil its purpose fairly and avoid any misleading information,<sup>98</sup> it is obvious that these conditions are absent in Iraqi law. The shareholders accordingly might be surprised when viewing the matter in the meeting. This will limit their ability to gather valuable information about it for more informed discussion. It is therefore suggested that the disclosure content should be identified briefly and obviously in the meeting agenda as a means of achieving the above purpose.

It is necessary to pose another question about the entitlement of the director (who must simultaneously be a shareholder) to participate in and vote at the general meeting. Art.119 (first) of the I.C.A. 1997 gave an implicit answer to this question by stating

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<sup>98</sup> *Kaye v Croydon Tramways Company* [1898] 1 Ch 358, 370 (CA).



that ‘compliance with this Article shall not exclude liability under Article 4, paragraph third’. Art.4 (Third-1) of the I.C.A. 1997 made it clear that the shareholder must avoid ‘...harm or disadvantage [to]<sup>99</sup> the company to benefit themselves or those associated with them at the expense of other owners of the company’. However, it is suggested that this Article is unlikely to be conducive to preventing the interested director, or the connected shareholders (who have appointed the interested director) from participating in the general meeting, and from voting in favour of any decision connected with a deal in which a director has an interest, on the following grounds:-

First, such a provision is *ad hoc*, to protect the minority shareholders from harmful decisions exercised by the majority. Therefore, applying the aforementioned provision requires it to be established that damage could occur to the company’s interests as a result of entering into the transaction concerned according to the rules of the Civil law. It has been shown <sup>100</sup> that the existence of an interest in a deal on the part of the director is not necessarily always conducive to harming the company. Therefore, the director’s right to vote in the general assembly is likely to be maintained, as long as that damage to the company and its shareholders has not been established.

Secondly, the above provision involves uncertainty as to whether the interested director is prohibited entirely from using his voting right, since the phrase “may not exercise” is employed. Likewise, it should be noted that the interested director is not precluded from participation in the board meeting and giving his vote under Art.119 (Second) of the I.C.A. 1997, provided that he obtains the approval of disinterested directors, as will be seen shortly.

The result of scrutiny of the above provisions reveals that there is no provision under the I.C.A. 1997<sup>101</sup> to prevent the interested director or any connected person from exercising his voting right in this matter after disclosing his interests. This result raises the question of legal safeguards to be given to the company to avoid selfish behaviour on the part of the director.

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<sup>99</sup> [This word has been added to the original text by the author to make it more understandable].

<sup>100</sup> See the introduction of Section 1 of this Chapter.

<sup>101</sup> That is contrary with the P.B.A. 2004, Art.21 (2) as it will be seen shortly.

With regard to approval given by the disinterested directors, Art.119 (Second) of the I.C.A. 1997 and Art.21(2) of the P.B.A. 2004 determine the approval procedures, as follows:-

Firstly, permission for participating and voting on a matter must be given by other directors. This permission gives a hint that a formal meeting must be held to discuss the matter. The formulation of ss.177, 182 of the C.A. 2006 suggests that this requirement has been abandoned. In other words, the declaration of an interest to the disinterested directors is the sole requirement to render the director in the position of complying with this duty, without the need of obtaining the board's approval. Each approach has its pros and cons and one should be balanced against the other. The formalism might interfere with commercial activities which require speed in concluding transactions. Moreover, other directors may not see any necessity for holding a meeting.<sup>102</sup> Furthermore, the circumstances of the transaction may render it difficult to secure this requirement.

Second, it can be inferred from Art.119 (Second) of the I.C.A. 1997 that a director, after disclosing his interests and obtaining the approval of the majority of disinterested directors, is entitled to participate and exercise his voting rights in a matter in which he has interests. By contrast, Art.21 (2) of the P.B.A. 2004 lays absolute prohibitions on the director. He shall not:

...Participate in the discussion, shall withdraw himself from the meeting while discussions on the matter are ongoing, and shall take no part in the decision on such matter; and the administrator's presence shall not be counted for the purpose of constituting a quorum.<sup>103</sup>

It is worth noting that the C.A. 2006 has left matters relating to the director's participation and voting in a meeting to the company's articles. Art.16 of the English Model Articles for the Public Companies (hereinafter the M.A.P.C.), and Art.14 of the

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<sup>102</sup> However, the company's interests must not be ignored in this regard. The formal meeting to discuss the director's interests will help to ensure that the final decision is taken with collective diligence by the disinterested directors, after an exchange of opinions and in accordance with the company's interests. See Deborah A. Demott, 'The Figure in the Landscape: A Comparative Sketch of Directors' Self-Interests' (1999) 62 *Law and Contemp Probs* 243, 260-261.

In other words, holding a formal meeting would be conducive to bringing to the directors' attention the seriousness of any decision that will be taken. It is like writing the word "poison" on a can of medicine to draw attention to its dangers. Accordingly, it is suggested that holding a formal meeting should be considered as a general rule, unless the circumstances of the transaction make it difficult for the directors to secure this meeting, which could be recorded later.

<sup>103</sup> Even if the director has disclosed his interests.

English Model Articles for Private Companies Limited by Guarantee (herein after M.A.P.C.L.G.) provide that a director ‘...is not to be counted as participating in that meeting, or part of a meeting, for quorum or voting purposes...’. But there are exceptions to this rule, such as: where a resolution is issued by the company not to apply such a provision of the articles; the matter does not reasonably raise a conflict of interests; or the conflict is permitted by the company.<sup>104</sup> The above Model articles have left the matter of deciding whether the interested director should participate in the meeting to the board chairman, or to the other directors if the latter has an interest.<sup>105</sup>

It is suggested that the I.C.A. 1997 should not follow the flexible approach of the C.A. 2006. Rather, it should *prevent* a director entirely from attending the meeting and using his voting rights as a director or shareholder in these situations, because it will be seen in this Chapter that the rules of Iraqi law are not of the same level of strictness as in English law. So, to ensure that the company’s interest is protected entirely, stripping the director of the use of his voting rights is a significant way to safeguard the company’s interests. More strictness is required in this respect. Preventing a director from attending the meeting is also vital to avoid any pressure that may be applied by him on his colleagues to take a decision that supports his interests.

At any event, taking a decision about a conflict of interests in a deal raises three likelihoods: The first likelihood is where all members of the board are interested in a matter, and here the I.C.A. 1997 permits all to participate in the decision-making. This may lead to conflict with Art.21(2) of the P.B.A. 2004, which requires the disinterested director (after revealing his interests) to withdraw from the meeting, since if all the directors are interested, all of them should leave the boardroom. This matter raises the question: who should take the decision about the deal? To remove this contradiction,

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<sup>104</sup> See the M.A.P.C., Art.16(2,3); the M.A.P.C.L.G., Art.14(2, 3).

<sup>105</sup> See the M.A.P.C., Arts.16(5,6); the M.A.P.C.L.G., Art.14(5, 6).

Notably, s.175(6) of the C.A. 2006 (concerning the duty to avoid conflict of interests), prevents the director absolutely from voting in situations of conflict of interests. This means that the law considers a breach of s.175 more serious than a breach of s.177 of the C.A. 2006 (concerning the duty to avoid conflict of interests in a transaction), and governing rules are accordingly strict. A review of the above Model articles for Public and Private Companies reveals that these provisions do not entirely prevent the director from participating and giving his vote, which seems, from the point of view of one commentator, an unwise approach to providing a satisfactory safeguard for the company’s interests.

Fraser Dobbie, ‘Codification of Directors’ Duties: An Act to Follow?’ (2008) 11 Trinity C L Rev 13.

Art. 119 (Second) of the I.C.A. 1997, as the general Act,<sup>106</sup> should be applied in this situation to the directors of a bank, who are thereby entitled to contribute to the meeting and to participate in the decision-making.

The last rule, however, raises the question of whether it provides a safeguard for the company's interests. Assuming that all the directors are interested in the transaction, the decision will be taken by a non-neutral body, and it is expected that this decision may not be in the company's best interests. In other words, this provision encompasses an implicit permission to the directors to act against their duty to the company by allowing them to vote to further their own interests.

The second likelihood is where the directors' views (regarding the grant of the approval for conflict of interests) are divided between the opponents and the proponents of a decision. It has been mentioned that a director's participation in the meeting and his exercise of his voting right depends on obtaining approval from the disinterested directors. The time-honoured rule under Iraqi company law is that '... in the case of a tie, the side supported by the board chairman shall prevail' as a casting vote.<sup>107</sup> Supposing that *the chairman is interested in a certain matter*, and there is a tie between the votes of the opponents and the proponents about his participation and his voting in the meeting. In this case, applying s.119 (Second) of I.C.A. 1997 leads to preventing the chairman from using his vote in taking a decision about his participation in the meeting, since he would be interested in this decision. The deputy chairman will replace the chairman in case of his absence,<sup>108</sup> but the situation under discussion does not allow the chairman to be categorized as "absent." Therefore the decision cannot be passed, because Art.119 (Second) of the I.C.A. 1997 simply does not deal with such a situation.

The third likelihood is where all but one of the directors are interested in the concerned transaction. Art.119 (Second) of the I.C.A. 1997 explicitly points out that the decision regarding the other directors' participation and vote must be taken by "the majority" of directors. It is clear that just one director could not constitute the majority. This is another aspect of the confusion involved in the drafting of this Article.

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<sup>106</sup> See this Act, Art.3.

<sup>107</sup> The I.C.A. 1997, Art.114 (First). See also the P.B.A. 2004, Art.17(7).

<sup>108</sup> See Art.111 of this Act.

Again, the best way to overcome the above problems is to avail of the service of reserve directors. This can be achieved either by obliging them to join the meeting or by shifting the power to take the decision from the original to the *reserve directors*.<sup>109</sup>

At any event, pursuant to Art.119 (Second) ‘...the details of the matter shall be recorded in the minutes of the board and made available to the general assembly and the company’s external auditors’. This is a vital point, since it is concerned with enabling the shareholders, the company’s auditors and the other bodies to exercise their control over the decisions taken, and to ensure that the applied procedures in the meeting are consistent with the law. However, this provision does not include the general assembly, and leads to a dilution of the controlling influence over the decision by the minority shareholders and the auditors, and gives a hint that directors are less reliable than shareholders. It is worth noting that such a transaction must be indicated in the annual report.<sup>110</sup>

To sum up, a review of the above provisions concerning the rules that govern the fulfilment of duty reveals a degree of contradiction and a lack of homogeneity in those Iraqi Acts that govern one duty. This raises a need for a re-formulation of these provisions in order to achieve coherence and harmony between legislations and to provide a clear guide to directors in this respect.

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<sup>109</sup> See this Chapter, para 6.1.2.3.2.

<sup>110</sup> The I.C.A. 1997, Art. 134 (First).

## Section III

### **Does the No-Secret Profit Rule under Iraqi Law have the same Sharp Teeth as under English Law?**

**Introduction:** It is trite law that the level of respecting any legal rule connects with its ability in compelling the concerned person to observe it. English law has realised this fact and surrounded the no-conflict rule concerning a transaction by strict rules, in two ways: first, by the harshness inherent in the rule itself; second, by regulating substantial transactions, which are often concluded with the director and that involve a high degree of threat to the company's interests.

The purpose of this section is to explore whether Iraqi law encompasses harsh rules comparable to those appearing in English law, by reviewing both the merits of the duty of declaration of an interests in a deal (transactions), and the rules associated with important transactions involving a director.

#### **6.3.1 Is the Rule for Avoiding Secret Profits under Iraqi Law an Effective Deterrent Rule?**

Art.119 (First) of the I.C.A. 1997 provides that ‘...The chairman or board member shall be liable to the company for any damage to it arising from violation of this Article...’. This formulation is clear enough: breaching the duty leads to raising the director's civil responsibility, which is premised on establishing its elements: fault, damage, and a causal link between these elements, which alleviate the strictness of this duty. These elements have been discussed in a previous Chapters,<sup>111</sup> and there is no need to repeat them (it will be demonstrated in the next Chapter that the failure to establish damage, as an element of civil liability, may result in the director avoiding liability<sup>112</sup>).

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<sup>111</sup> For more details of these element see Chapter 4, para 4.1.2 Chapter 5, para 5.2.1.1 of this thesis.

<sup>112</sup> See Chapter 7, para 7.2.3.1.

From another hand, Art.119 of the I.C.A. 1997 contains no reference to the *potential conflict of interests*, which represents a brainchild of equity, based on the idea of protecting the company from any threat to its interests *ex ante*, rather than the focus being on *ex post* enrichment of the director.<sup>113</sup> The non-mention of the potential conflict in Iraqi law could lead to the creation of a practical problem: for example, the director, according to the *actual conflict of interests*, is not bound to disclose his interests to the company until the parties become close to concluding the transaction (and then the transaction conditions become extremely difficult to amend, and this can lead to a slow conclusion). In this context, the *potential conflict of interests*, burdening a director with the duty of informing his company about his interests in any potential transaction (e.g., arrangements) with a third party in the near future is not effectively legislated for.

By contrast, under the strict approach of English law towards this duty,<sup>114</sup> matters such as the absence of fraud,<sup>115</sup> corruption,<sup>116</sup> the fairness of the transaction conditions,<sup>117</sup> or the transaction being very beneficial to the company<sup>118</sup> are all irrelevant considerations: conflict must be avoided and is not permitted. This harsh U.K rule applies even if the transaction has been concluded by auction.<sup>119</sup>

The discussion of the rules governing the duty to avoid conflicts of interest under Iraqi Civil law has revealed several difficulties concerning proof of liability, and these can allow the wrongdoer to avoid liability, thus stripping the duty of its significance.<sup>120</sup> Whereas the imposition of the fiduciary duty should aim to restrain the director from breaching the duty *ex ante*, rather than acting in a merely remedial or *restitutory* purpose.

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<sup>113</sup> John Lowry, 'Directorial Self-Dealing: Constructing a Regime of Accountability' (1997) 48(3) N Ir Legal Q 211. 671.

<sup>114</sup> See for example *Aberdeen Rail Co v Blaikie* [1843-60] All ER Rep 249, 252 (HL) (Lord Cranworth); *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch 274, 279 (CH).

<sup>115</sup> *Costa Rica Railway Company, Ltd v Forwood* [1901] 1 Ch 746, 753 (CA) (Rigby L.J). For more details of this point see Mathew D J Conaglen, 'Equitable Compensation for Breach of Fiduciary Dealing Rules' (2003) 119 L Q R 246, 263.

<sup>116</sup> *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606, 635 (CA) (Upjohn L J); *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923, [2012] B C C 72 [51] Mummery L.J.

<sup>117</sup> *Movitex Ltd v Bulfield* [1988] BCLC 104, 123 (CH) (Vinelott J).

<sup>118</sup> *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch), [2008]1 BCLC 46 [218].

<sup>119</sup> *Ibid*, [222].

<sup>120</sup> For more details of this theme see Chapter 4, para 4.1.2.

However, some manifestations of strictness under Iraqi law can be shown, as follows:-

First, Legislative Decision<sup>121</sup> No.841, 1995, has criminalized any undeclared participation in any contracting, subscription to a company, or any interests, if it has been stipulated within the transaction, or under the Act which governs it, that the participation must be declared. The sanction for infringing this legislation is confinement for a term of not less than three years and not more than five years.

Numerous observations can be made concerning this legislation:-

1-Its scope is *confined to situations* in which a director has an *interest in partnerships*, leaving other situations of conflict (e.g. where a director has direct or indirect interest in a deal outside the concept of the partnership) to be dealt with under civil liability grounds.

2-It has been demonstrated previously<sup>122</sup> that the aforementioned criminal penalty (confinement) has disadvantages seems in a difficulty proving its elements and its effects on the director's service in the company. So, replacement of this penalty with a fine such as levied by s.183 of the C.A. of 2006,<sup>123</sup> is a better way to avoid negative consequences resulting from the imposition of such penalty.<sup>124</sup>

Second, the I.C.A. 1997 does not refer to exceptions to the director's duty to declare his interests in a transaction. By contrast, s.177(6) of the C.A. 2006 refers *explicitly* to exceptions to this duty, which are (i) where the director is unaware or ought not reasonably to be aware of his interests; (ii) if the situation cannot reasonably be regarded as likely to raise a conflict of interest (s.177 (6-a)). This situation is exemplified, where, for example, a director purchases furniture from the company's production at its ordinary sale price<sup>125</sup>; or where the company accepts property (in

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<sup>121</sup> During the reign of Saddam Hussein's regime, the Revolutionary Command Council was empowered (under Art.42 of Iraqi Constitution 1970) to take decisions that have legislative nature effects, such as the above Decision. This decision remains in force.

<sup>122</sup> See Chapter 5, para 5.2.2 of this thesis.

<sup>123</sup> This Section governs the director's non-compliance with the duty of disclosure the interests in existing transaction or arrangements.

<sup>124</sup> For further details of this issue, see Chapter 5, para 5.2.2 of this thesis.

<sup>125</sup> Hugh Fraser, 'Directors' Interests in Contracts: Fair and Foul Dealing' (1994) 15(2) Comp Law 46, 49.



which a director has a share) as a gift; (iii) or where the other directors are already aware of the interests, or ought reasonably to be aware (s.177(6-b)).<sup>126</sup>

It might be said that the standard of an ordinary person,<sup>127</sup> (equivalent to the reasonable person under English law), which is applied by the Iraqi court for determining whether the defendant has committed a fault deserving the imposition of civil liability, can accommodate the above exceptions mentioned by the C.A. 2006. For example, the director's *unawareness of his interests*, or the interests of the others who are connected with him, may prevent his liability.<sup>128</sup> However, this is the judicial standard used by the court in its scrutiny of the facts of the case.<sup>129</sup> The mention of these exceptions in the I.C.A. 1997, however, seems helpful in identifying the concept of conflict of interests in a deal, and in enabling the interested director to know whether, or not, he should disclose his interests. It also enables the board of directors, and other bodies, to assess whether the law has been infringed, and then to take a decision on whether to bring an action. Finally, laying out exceptions to the scope of the duty leads to attenuation of the strictness of this duty in situations that do not constitute a danger to the firm's interests. Seemingly, all of the above advantages have been lost by virtue of the law's failure to determine exceptions to the imposition of this duty.

However, Art.21(1) of the P.B.A. 2004 implicitly indicates one exception to the duty of the declaration of an interest, namely where the personal interests are less significant. In other words, the declaration of interest must be restricted to a "significant personal financial interest", which implies conversely that he is not

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<sup>126</sup> An example of the last exception would be where the director is authorized to act in another company recently, (Burgess Salmon, 'The Companies Act 2006' (2008) accessed <[www.burgess-salmon.com/...](http://www.burgess-salmon.com/)> accessed 24 February 2013, 5); where he asks the board's approval of granting him a credit (the P.B.A. 2004, Art. 31); or where the director engages in the negotiations about his contract of service (John Lowry and Rod Edmunds, 'Reflections on the English and Scottish Law Commission' Proposals of Directorial Disclosure' (2000) 5 (1) Deakin L Rev 1). In the latter case, the disclosure seems to be merely a technical issue (*Runciman v Walter Runciman plc* [1992] BCLC 1084, 1096 (QB); *Liquidator of Marini Ltd v Dickenson* [2003] EWHC 334 (Ch), [2004] BCC 172, 33). In addition, the company's articles may exclude certain transactions from the requirement of disclosure (Kenneth W. Nielsen, 'Directors' Duties under Anglo-American Corporation Law' (1966) 43 U Det L J 605, 629). All these situations are measured under an objective test (reasonableness), for the purpose of providing a reasonable protection to the company (Robin MacDonald, 'The Companies Act 2006 and the Directors' Duty to Disclose' (2011) 22(3) I C C L Rev 96, 97).

<sup>127</sup> The Civil Code 1951, Art.207 (1).

<sup>128</sup> The Civil Code 1951, Art. 424.

<sup>129</sup> Darinam M. Ibrahim, 'Individual or Collective Liability of Corporate Directors?' (2008) 93 Iowa L Rev 932, 948.

compelled to declare less significant interests. This exception, which is restricted to the banks, raises numerous uncertainties:

First, it renders the director irresponsible for disclosing less significant interests, which may yet provide him with the same motivation to violate his duty.<sup>130</sup>

Second, this exception transfers the role of evaluating the seriousness of the undeclared interests of the firm from the board to the director himself. The director in this instance will always be able to allege that he believed that his interest did not involve a threat to the company. Alternatively, the application of an objective standard in determining the meaning of the above term will be conducive to the court's intervention in determining the company's interests. Seemingly, this exception needs a further explanation by identifying who will assess this situation to show whether a material conflict of interests has occurred and, if this is the case, what test should be applied. However, it would have been better to make the director bound to disclose his interest, whatever its value, and to give the company the power to assess its impact on its interests, as is the case under the I.C.A. 1997 and the C.A. 2006.<sup>131</sup>

To sum up, it can be said that Iraqi law has adopted harsh rules in places that require flexibility, for example, the criminal sanctions that are imposed on breach of duty, and the failure to mention the exemptions from the discharge of this duty. The law, however, embraced a diluted rule in other places where it should be applied harshly, such as applying the rules of civil liability when enforcing the duty. All these observations reinforce the writer's argument that the fiduciary duty, as a doctrine premised on equity, is a vague notion in Iraqi law.

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<sup>130</sup> What will increase the mystery that shrouds this exception is that the meaning of phrase "significant interest", is not defined by the law. Does it mean the less important interest of its pecuniary value? Or does it mean any interests that do not involve a high level of threat to the company? Or perhaps the meaning of "significant interests" can be understood in the sense that the director is obliged only to disclose the situation which give rises to a sensible conflict of interests, as described in s.177(6-a) of the C.A. 2006.

<sup>131</sup> See in this respect *Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company* [1914] 2 Ch 488, 503; *Movitex Ltd v Bulfield* [1988] BCLC 10, 122(CH).

### **6.3.2 Regulating Particular Transactions with the Director: an Incomplete Protection of a Company's Interests in Iraqi Law?**

There are numerous transactions, involving a high degree of threat to the company's interests, that make the normal method of shielding the company (declaring the interest), insufficient. For example, in the contract of sale, while the company is interested in acquiring material from a director at the lowest possible price, the interest of the latter requires selling it at the highest possible price.<sup>132</sup>

For the above reason, the C.A. 2006, in its Fourth Chapter, has singled out for special protection these types of transactions in order to be commensurate with the aforementioned threat. The Act requires the shareholders' approval for the following transactions' validity: the director's long-term service contract (ss.188-189); transactions involving substantial property (ss.190-196), loans to the director (s.197); quasi-loans (ss.198-200); credit transactions (ss.201-202), etc.<sup>133</sup>

Nevertheless, Iraqi law regulates two transactions that may be concluded between a director and his company: the contracts of sale or purchase of a company's property; and granting a banking credit. The above transactions will be reviewed shortly to gauge the extent to which their special regulation is adequate for safeguarding the company.

#### **6.3.2.1 A Director's Contract of Sale and Purchase with the Company**

Primarily, under Iraqi civil law, it is impermissible for any person to enter into a transaction as a representative of all of its parties, or by virtue of one's personal capacity on one side, and as a representative of the counterparty on the other side simultaneously. In these cases there is always a degree of doubt that a director might be swayed by his own interests, rather than by his duty.<sup>134</sup>

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<sup>132</sup> Sarah Worthington, 'Corporate Governance: Remediating and Ratifying Directors' Breaches' (2000) 116 L Q R 638, 665.

<sup>133</sup> See the C.A. 2006, Chapters 4, 5, 6 of Part.

<sup>134</sup> *Al-Tameez* Court, Case No. 276/C 1/81/87 on 29/12/1987, mentioned in *Al-Qahda J Rev* 43(1, 2) 1988, 326. See also Saleh Hassan Kadhim, 'The Conflict of Interests' (date unknown) <[http://www.nazaha.iq/pdf\\_up/1105/Conflict %20of% 20Interest. pdf](http://www.nazaha.iq/pdf_up/1105/Conflict%20of%20Interest.pdf)> accessed 4 July 2013, 17.

However, the Civil Code 1995 has an exception which permits a director to deal with his company as a seller or buyer. Pursuant to Art. 592(1) of the Civil Code 1951 states:

1. It is impermissible...for the company's directors and their equivalents to buy the property which they have been delegated to sell, or where the sale is in their hands... and it is impermissible for any of them, even if by way of a public auction, by him or by pseudonym, to purchase that which he is prohibited for each of them to purchase.
2. But the purchase in the situations enumerated in the previous paragraph are deemed valid if they are ratified by a party on whose account the purchase was made. However, if the ratification has not been issued, and the property is re-sold once more, the first buyer shall bear the expenses of the second sale and the depreciation which might have occurred in the value of the thing sold.

There are two observations to this provision: first, it implies that the purchase is amenable to ratification, or a *fortiori* capable of being authorised. Second, the harshness of this rule flows from a company's capability to retrieve its property, even if it was transferred to a *bona fide* third party. In other words, a company's right to retrieve its property, as a result of that the transaction has been concluded in a contravention of the law, has a primacy over the interests of a *bona fide* third party. While, under English law, a *bona fide* third party is entitled to retain the property that has conveyed to him by the director.<sup>135</sup> This matter will be considered in-depth in Chapter Seven of this thesis.<sup>136</sup> However, in this stance, there are numerous observations to this provision:-

First, the Civil Code 1951 treats the director as being the sole contractor in the transaction, without indicating any others connected with him, or his connection with another party (the seller or buyer), which is in contrast to the position adopted by the C.A. 2006.<sup>137</sup> While Art.119 (First) of the I.C.A. 1997 covered this apparent

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This principle is gleaned implicitly from Art.73 of the Civil Code 1951, which defines the contract as 'the unison between an offer made by a contractor with the acceptance of another party...'. See also: Abdul Majid Al-Hakim, Abdul Baqi Al-Bakri, and Mohamed Taha Al-Bashir, *The Brief in the Obligation Theory* (The Ministry of Higher Education and Scientific Research 1980) 60-61.

<sup>135</sup> See the C.A. 2006, S.195(2-c).

<sup>136</sup> See Chapter 7, para 7.2.1 of this thesis.

<sup>137</sup> S.190 of this Act.

inadequacy via the reference to “direct or indirect” interests, Art.592 of the Civil Code 1997 does not govern a director when he is not being the principal contractor.<sup>138</sup>

The suspension of the deal under the Civil Code 1951 covers all properties, whatever their value, including barter.<sup>139</sup> Thus, transactions concerning the sale of a computer depend on the shareholders’ approval (where the director has an interests in the transaction) just as much as does a sale of land. This absolutist rule leads to slowing down the conclusion of low-value transactions, which do not constitute a threat to the company’s interests. For this reason, s.191(2) of the C.A. 2006 requires the shareholders’ to give their approval to transactions where the value of the asset exceeds 10% of the company’s asset value and is more than £5,000, or it exceeds £100,000.

Furthermore, a transaction involving the sale of a property in contravention to Art.592 of the Civil Code 1951 will be suspended, even if it has been conducted via a public auction, a liquidator or any other professional person, such as a broker. The inclusion of public auctions that managed by the company itself within the ambit of Art.592 of the Civil Code 1951 is justifiable, since the director, under this method, could has an influence over the decision of selling the property and the auction conditions.<sup>140</sup> But the conducting of the sale by a professional and impartial person, (the liquidator), insures only a minimal possibility of prejudice to a company’s interest. It therefore seems unreasonable to include the forgoing methods within the ambit of this Article. It is worth noting that the C.A. 2006 had excluded the latter two cases from the requirement to obtain the shareholders’ approval due to the aforementioned reasons.<sup>141</sup>

Second, Art.592 of the Civil Code 1951 is limited to situations of the sale or purchase of property, and does not include the following transactions:-

1. Tenancy, lease, mortgage, usufructs, servitudes and so forth, though these transactions are no less serious and harmful to the company’s interests than the

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<sup>138</sup> It is worth noting that there is a difference between the “connection” and the owner of the “pseudonym”, as mentioned by Art.592 of the Civil Code 1951. In the latter case, the ostensible person is just an agent for another, who obliges afterward to transfer the effects of the contract to the director. While the benefits associated with the transaction will go to the connected person, directly or indirectly.

<sup>139</sup> The Civil Code 1951, Art.507.

<sup>140</sup> Edward Eid, *The Commercial Companies* (Al-Najwa Publisher 1970) 522-523.

<sup>141</sup> See ss.193, 194 of this Act.

contract of sale. In contrast, s.192 of the C.A 2006 regulates all substantial property transactions, whatever their kind. Thus, this represents a *substantial lacuna* in Iraqi law.

2. Intellectual property transactions (e.g., the company's name, its trademark, etc.), are also excluded from this provision, by virtue of their being subject to special Acts.<sup>142</sup>

It is worth noting that the shareholders' approval by an ordinary majority is required for authorising the above transaction.<sup>143</sup> However, if the transaction involves the sale of '...more than half its assets in a transaction outside company ordinary business...', the approval must be given by a majority of the company's members, rather than by those who participated in the general meeting.<sup>144</sup>

To sum up, it has been observed through the examination of Art.592 of the Civil Code 1951 that it has numerous shortcomings pertaining to the regulation of sale and purchase transactions, and this could lead to a limitation of the required protection for the company: the scope of its application is, on the one hand broad enough to include low-value property but, on the other hand, it is sufficiently narrow to exclude some transactions that could involve a significant threat to the company's interests. This is attributable to the fact that the regulation of the matter has fallen outside the jurisdiction of the Companies' Act and refers to a number of persons apart from company's directors, and so it is conceivable that some aspects of this issue have not been covered properly by the legislation. Hence, regulating this essential transaction in the Company Law represents a crucial issue.

### **6.3.2.2 Providing a Credit to the Director**

The I.C.A. 1997 made no mention of any financial assistance to the director, such as loans, quasi- loans or guarantees, unlike the position of the C.A. 2006 that mentioned

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<sup>142</sup> The Civil Code 1951, Art.70.

<sup>143</sup> The I.C.A. 1997, Art.119 (First).

<sup>144</sup> The I.C.A. 1997, Art.98 (Second).

earlier.<sup>145</sup> This gap is attributable to the fact that some of these transactions may fall outside the ambit of the company's normal business. Therefore the company's involvement in such transactions might imply, according to *Al-Tameez Court*,<sup>146</sup> a substantial threat to the company's interests, which gives rise to anxiety about the likelihood of these transactions being used as a means of withdrawing the company's capital. This fear was mirrored in the formulation of Art.27 of the I.C.A. 1997, which made it clear that 'the capital shall be allocated to carry out the business specified in the company's contract and to fulfil its obligations. It is impermissible to dispose of the capital in any other way'. This prohibition is of such stringency that a director, whether acting in the same company or having shares therein, is foreclosed entirely from receiving a loan from his company, even if it specialized in offering such a facility.<sup>147</sup>

However, this justification seems unconvincing, because it ignores the several advantages that could be obtained by providing financial assistance to the director. It is, first of all, a means to strengthen the relationship between the director and his company. Second, it is a means of preventing the negative consequences that result from the refusal to support him financially in a phase of financial distress. For example, a director may accept a benefit from a third party to solve his financial problem, at a time when it would have been possible for his company to support him financially. If there is any possibility of the misuse of these transactions, restrictions can be imposed on them, as will be seen in the following discussion. Thus, the strictness of Iraqi law in relation to this matter seems irrational and could have negative consequences.

By contrast, Art.31 of the P.B.A. 2004 allows the board of directors to give a credit to a director or to any connected person. The credit transaction is defined according to Art.1 of the P.B.A. 2004:-

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<sup>145</sup> As mentioned earlier, the C.A. 2006 has regulated certain transactions that to be concluded between a company with its director, such as: the director's long-term service contract (ss.188-189); transactions involving substantial property (ss.190-196), loans to the director (s.197); quasi-loans (ss.198-200); credit transactions (ss.201-202), etc.

<sup>146</sup> The Case No. 276/C 1/81/87 on 29/12/1987, mentioned in *Al-Qahda J Rev* 43(1, 2) 1988, 326. It is worth noting that *Al-Tameez Court* is the highest court in the Iraqi judicial regime.

<sup>147</sup> In this context see the Ministerial Order of Regulating the Business of the Companies Financing Small and Medium-Sized Projects No.3 2010, Art.5 (Second).

Any disbursement or commitment to make a disbursement of a sum of money in exchange for the right to repayment of the amount disbursed and outstanding and to payment of interest or other charges on such amount, whether secured or unsecured, any extension of the due date of a debt, any guarantee issued, and any purchase of a debt security or other right to payment of a sum of money that may provide for the payment of interest either directly or by a discounted purchase price.

This broad definition of these transactions includes several that were mentioned under the C.A. 2006, such as loans to the director (s.197), quasi-loans (ss.198-200), and credit transactions (ss.201-202). Art.31 of the P.B.A. 2004 requires certain conditions for conferring this approval, which are:-

1. The transaction must be approved by the board of directors. If the concerned director is acting for a branch of a foreign bank, the approval must be given by the manager of the designated branch. It should be noted that s.201(2) of the C.A. 2006 requires the shareholders' approval for this transaction, in contrast with the P.B.A. 2004. This is due to the fact that the bank is a specialist entity for conferring the credit.

2. The aggregate amount of the credit granted by the bank to that person (including any credit granted to him by one or more of the bank's subsidiaries) must not exceed 50 per cent of the annual remuneration of that person. This condition aims to provide a guarantee to the bank and enables it to recover the credit from the annual remuneration of the director. At all events, the credit must not exceed the aggregate amount of credits disbursed to all related persons, which is 10 per cent of the unimpaired capital and reserves of the bank, or any lower percentage as specified under regulations issued by the Iraqi Central Bank (hereinafter the C.B.I).

However, the aforementioned limitations do not apply in the case of credit secured by a mortgage that consists of local property, the appraised value of which, in the opinion of the C.B.I. (at the time in which the credit is granted) exceeds the principal amount of the credit by not less than one-third of that principal amount.<sup>148</sup> The availability of this proprietary security to the bank is adequate for avoiding any risk in case of a failure in recovering the credit.

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<sup>148</sup> Art.1(b) of this Act.



3. The credit must be granted on the same terms and conditions as are offered by the bank to the public in the ordinary course of business at the time of granting the credit; otherwise the credit transaction will be invalid. This condition is necessary for avoiding any courtesy to the director on account of the company, and he is treated just like any external customer. To provide a further safeguard, Art.31(2), of the P.B.A. 2004 states that ‘every credit provided by a bank to a related person shall be promptly reported to the audit committee of the bank...’ to enable them to ascertain whether the decision taken is compatible with the above conditions.

The I.B.A. 2004, concerning the above transactions, converge with the C.A. 2006 in the rigorous requirements for concluding these transactions.<sup>149</sup> The C.A. 2006 necessitates that the shareholders’ authorization of these transactions should be based on the director’s declaration of his interests, and that this must involve certain statements.<sup>150</sup> If the director or any person connected with him is acting for a holding company of the company concerned with the transaction to be concluded, then the shareholders’ approval of the holding company is also required.<sup>151</sup>

Thus, it has been seen above that the P.B.A. 2004 provides broad protection to a company’s interests and paves the way for suggesting similar regulation to be incorporated into the I.C.A. 1997. Inserting similar amendments into the I.C.A. 1997 will enable companies and their directors to take advantage of the offer of these financial facilities and allow the director to avoid accept financial facilities provided by a third party, which may end up to placing him in a position of conflict of interest. Any financial facilitation to a director must be decided by the general assembly, provided that the transaction value does not exceed the net profits appearing in the company’s budget after the completion of one year of the director's good service. This proposal has two purposes: first, to avoid prejudice to the creditors’ interests; second, to create an incentive for a director to maximize the firm’s value, not only for its benefit but also for his own personal interests. To sum up, the P.B.A. 2004 offers useful guide to how the I.C.A. 1997 could be amended, in order that it could accommodate more

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<sup>149</sup> See the C.A. 2006, ss. 198(2), 200(2), 201(2),203(1).

<sup>150</sup> See the C.A. 2006, ss.198(4),200(4,5),201(4), 203(4).

<sup>151</sup> See the C.A. 2006, ss.198(3),200(3),201(3).

modern practices vis-a-vis putting in place a legal framework for facilitating the grant of credit by an Iraqi company to its directors.

## Conclusion

Imposing on director a duty to declare his interest in a transaction involving the company represents one of the important amendments inserted by the C.P.A. into the I.C.A. 1997 (Art.119), and into the P.B.A. 2004 (Art.21), but it is not, in itself, a sufficient step. Scrutiny of Art. 119 of the I.C.A. 1997 reveals many shortcomings and defects that result in poor corporate governance. The failure to address key aspects of this duty, and the ambiguity in tackling other aspects, are the hallmark of poor formulation of this duty in Iraqi law.

The legislative imperfections can be demonstrated when considering the conditions that give rise to the director's duty to disclose his conflicting interests. For example, Art.119 of the I.C.A. 1997 has nominated two bodies for granting approval in the event of a conflict of interests in a deal: the shareholders' approval concerning a "deal", and the board of directors' approval with respect to other "matters", without identifying the clear meaning of these terms for determining the scope of jurisdiction of each body. This matter may lead to irrational results in terms of determining the jurisdiction of each body. For instance, there are legal actions taken by the company by its unilateral will, which are probably more serious than a transaction (such as waive a debt or a mortgage). But these actions are nevertheless, subsumed within the board's power to take a decision thereon, because they are simply do not fall within the meaning of "deal". One might ask therefor why then does the legislator not empower the directors to give their approval in all cases. It is worth noting that empowering the directors with granting the approval would lead to saving the time that it would take to summon the shareholders in order to take the decision. Moreover, the directors are a better equipped body to take the approval decision rather than the shareholders who have less expertise in taking commercial decisions.

Moreover, the I.C.A. 1997 lacks also the means of clarifying the definition of the "interested" and "disinterested" director, and the persons connected with them: these definitions are extremely significant in determining the extent of the director's liability under this duty. The shortcomings in the formulation of these provisions extend also to the procedures for carrying out the duty. For example, the I.C.A. 1997 did not

identify the time-period for declaring the interests in a deal. The law failed also to set out the methods for declaring the interest, which adds another elements of uncertainty to the law, which fails to regulate this matter, unlike the position of the C.A. 2006.<sup>152</sup>

The ambiguity extends also to the mechanism for granting authorization for a conflict of interests. For example, the I.C.A. 1997, (unlike the P.B.A. 2004), neither bars the interested director from participation in the meeting, (after he has declared his interests), nor from voting in the board's decision-taking. It is suggested that such prevention does not serve the company's interests, because it does not rule out the possibility of extending "courtesy"<sup>153</sup> to disinterested directors by their co-directors. The most bizarre rule under the I.C.A. 1997 is that the law empowers all of the interested directors to *participate in the board meeting* and in decision-taking, which raises a question: what protection is given to the company's interests? It is vital in this situation to avail of the efforts of reserve (alternative) directors, and of allowing them to participate at the meeting alongside the original directors, or in shifting this power to them entirely, which may result in diluting courtesy to the interested director.

The above discussion of duty has paved the way for posing the following question: does the duty set out in Art.119 of the I.C.A. 1997 involve a harsh duty, as in English law? It has been shown that the answer is negative. This conclusion stems from the reality that the I.C.A. of 1997 has adopted the civil liability standards (fault, damage and causation) to confront the violation of this duty, and its capability to restrain a director's abuse of his office is questionable.

On the other hand, Iraqi law involves the imposition of some strict rules with regard to the infringement of the duty, notwithstanding its unsuitability to managerial activity. Examples of these rules are: (i) the non-mention of exceptions to the duty, and (ii) the imposition of a criminal penalty (imprisonment) on the wrongdoer. It has been established that this strictness is short-sighted, because it leads to negative results that could affect the company's interests, such as: the loss of flexibility and equity in

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<sup>152</sup> This Act mentioned to several ways of declaration of the interests, such as: the oral declaration; written declaration; electronic declaration; general declaration.

<sup>153</sup> The courtesy in Arabic Language means any behaviour built on favourable treatment to another person with view to obtain a future benefit from him. Thus, it is equivalent to well-known phrase in the English literature "back-scratching".

applying this duty, as is the case in the first situation; or loss of the director's service entirely, as is the case in the second situation. These consequences are evidence of *an absence of understanding of the concept of fiduciary duty in Iraqi law*, a concept that involves imposing a strict duty in certain places which require the fiduciary to be deterred from abusing his office, but requires flexibility to avoid imposing irrational restrictions on his freedom in other places.

Strictness may be derived from the need to regulate some transactions under company law which encompass a higher probability of the occurrence of a conflict of interests and threat than other transactions. Iraqi law identifies just two such transactions: (i) The contract of sale and purchase of a company's property involving the director, and (ii) Giving the director a banking credit under the P.B.A. 2004. It has been shown that the scope of the legal regulation of the first transaction is broad in some aspects, to a degree that it may lead to delaying the conclusion of the transaction. On the other hand, such regulation is narrow because it does not include the other connected persons or other kinds of transactions (e.g., barter, lease etc.), despite the probability of conflict of interest therein being considerable. It is suggested that regulating the substantial property transactions in the I.C.A. 1997 is the way to remove all these *lacunae*.

The P.B.A. 2004 regulates those credit transactions involving the director with a degree of sophistication that suggests it could be replicated in the I.C.A. 1997 without fear of it being used as a means of withdrawing the company's assets.

The above analysis of defects of Iraqi law in dealing with this duty reflects a degree of misunderstanding of the duty tenor, its aspects and, or a *fortiori*, misunderstanding of fiduciary duty generally. A simple comparison between the current drafting of this duty in the I.C.A 1997 with the following proposal for Iraqi lawmakers, reflects several contradictions in the current formulation.

**Art.6:<sup>154</sup> Declaration of an Interest in a Transaction or Arrangement:**

1.(a) A director must avoid a conflict of interest<sup>155</sup> by disclosing his direct or indirect interests in a transaction, legal action or arrangement<sup>156</sup> to the other disinterested directors in a joint stock company, or to the general assembly in other companies<sup>157</sup> before the company enters into these actions.

(b) The declaration of interests to the Board of Directors is adequate if holding a meeting (according to circumstances) is impossible or onerous.

2. After disclosing his interest, the concerned director must withdraw himself from the meeting and his absence shall not be counted for the purpose of constituting a quorum.<sup>158</sup>

3. Paragraph (1) shall apply even if a director became interested after the company has entered into a deal, legal action or arrangement. In this situation a declaration must be made as reasonably soon as possible from the date of director's knowledge of his interest.<sup>159</sup>

4. The disclosure must include the material facts concerning the nature and scope of director's interests.

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<sup>154</sup> The provisions below are supplementary to the proposed Articles mentioned in the previous Chapters.

<sup>155</sup> The suggested provision is more precise than the formulation of Art.119 (First) of the I.C.A. 1997 by its emphasis on the core of this duty, that is: preventing the conflict of interests. The suggestion also includes arrangements and any other legal actions to be taken by the company, which are not mentioned in Art.119.

<sup>156</sup> Inclusion of "arrangements" within the ambit of what interest that must be declared by the director, reflects the adoption of potential conflict of interests, which is the absent element from the current formulation of Art.119 of I.C.A. 1997. The arrangements are any understanding lacks specific legal effects, such as the agreement of joint cooperation or exchange of information between two companies in the near future.

<sup>157</sup> Under the I.C.A. 1997, except in the Joint Stock Company, there is no existence to the board of directors in Iraqi companies. Instead, the managing director, in these types of companies, runs the company under the supervision of the general assembly, which comprises limited members. It seems logical to empower those members to authorise the director to have an interest in the deal concerned.

<sup>158</sup> Art.119 of the I.C.A. 1997 does not prohibit the interested director from attending and voting in favour of the deal after obtaining prior approval from his co-directors. It has been demonstrated in this Chapter that this rule does not furnish the company with an adequate safeguard from, at least, the collusion of the co-directors with the interested director against the company's interests. So, the proposal comes to address this problem.

<sup>159</sup> This proposal addresses the situation in which a director has an interest after the conclusion of transaction. In this situation the interested director should be given a chance to discharge his duty. This duty has not been dealt with by Art.119 of the I.C.A. 1997.

5. The decision of approving the director's interest must be taken by the disinterested directors. The reserve directors shall be invited to join the meeting if the interested directors exceeded a half of the number of the board's members in the quorum. If the majority of directors are interested (even after calling the reserve directors to take part in the meeting), the decision shall be taken by the shareholders.<sup>160</sup>

6. In case of a voting tie, the chairman shall have the casting vote. However if the chairman and/or his deputy is interested in the transaction, the oldest disinterested member will replace them.<sup>161</sup>

7 (a) The disclosure must be directed orally, hard copy, electronically to the chairman of the general assembly or to the board before the meeting and must be recorded in its agenda. If the disclosure is incorrect or incomplete, a further declaration must be directed.<sup>162</sup>

(b) It is permissible for a director to make a general declaration of his interests, provided that this declaration is updated as reasonably soon as possible.<sup>163</sup>

8. The details of the matter shall be recorded in the minutes of the meeting and made available to the general assembly, the company's external auditors, specialist State bodies, and the courts.

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<sup>160</sup> The suggested provision, which has been clarified earlier in this Chapter, aims to put end to the practise of "back-scratching" to the interested director and his co-directors. It has been suggested that the only solution for this problem lies in calling the reserve director to attend a meeting for the purpose of prohibiting any influence may be practised on the original directors. The proposal stems from the fact that the reserve directors will have had little contact with the interested director by virtue of the paucity of their attendance at the board meeting.

<sup>161</sup> This proposal deals with the likelihood of the tie between the voices of opponents and proponents of the granting of the approval for a conflict of interests inside the board, concurrently with the likelihood whereby the chairman and his deputy have an interest in the deal, which may prevent them from taking the decision in the light of the company's interests. Iraqi law has not addressed this matter.

<sup>162</sup> Iraqi law does not refer to the methods of disclosure the interests in a deal, which results, as has been mentioned in this Chapter, in creating ambiguity for the director, who cannot be expected to be familiar with provisions of the law.

<sup>163</sup> Iraqi law does not refer to the general declaration in the case of the existence of continuous interests in a third party. The results of this legislative shortcoming is that the director will be bound to declare his interests concerning any situation that attracts the application of this rule.

9. There will be no requirement to make a disclosure of an interest if:<sup>164</sup>

(a) The director was not aware, or ought not to be aware of the existence of conflict of interests; or;

(b) Where the director is also the owner of a Sole Owner Enterprise, or a Sole Owner Limited Liability Company, the director of such a company must record his interest in the company's records and make them available to the persons mentioned in paragraph (8) of this Article.

(c) Where the situation does not reasonably<sup>165</sup> give rise to a conflict of interests.

#### **Art. 7: A Company's Transactions with its Director<sup>166</sup>**

1- (a) Any transaction to be concluded with the director becomes suspended unless it is approved by disinterested directors and the general assembly of the company based on a full declaration of transaction circumstances and its conditions.

(b) The restrictions mentioned in the above sub-paragraph shall not apply in the following cases:

(i) Where the subject-matter of the transaction is the company's property, which will be sold by a liquidator and their equivalents or by other experts in dealing with this property.

(ii) Where the subject-matter of the transaction is the property that its value does not exceed 10000 Million Iraqi Dinar and does not exceed 10% of the company's assets.

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<sup>164</sup> Iraqi law has not developed exceptions to the duty of declaration of an interest in a transaction. This status creates a degree of ambiguity for the interested director, his co-directors and the court as to whether or not he must comply with this duty in certain situations.

<sup>165</sup> "Reasonableness" is an objective standard, which is suggested to be adopted when assessing whether the director concerned has complied with the duty. This standard is espoused also by the C.A. 2006 (S.177(6-a)).

<sup>166</sup> Generally speaking, apart from the transactions of selling and buying a company's property enunciated in Art.592 of the Civil Code 1951, Iraqi law does not deal with some transactions that may be concluded by a director with his company. This legislative loophole leads to miss the opportunity to impose harsh consequences on a director in the case of exploitation his position to pursue only his personal interests in these transaction. The above proposal offers a pragmatic solution for ensuring a real protection to the company.



2. Paragraph (2) of this Article shall be applied to any loans or financial facilitations offered to a director, whatever its value.

## Chapter Seven

### Liability for Breaches of Managerial Duty

Introduction: There is no specific Iraqi Companies legislation governing directorial liability for breaches of fiduciary duty.<sup>1</sup> For example, there is no reference in this legislation to define the parameters of the director's liability or those of others involved in the director's breach.<sup>2</sup> Also, there are no rules governing the ratification of a director's wrongdoing.<sup>3</sup> Moreover, Iraqi Company law does not legislate legal consequences for infringing a managerial duty, nor enshrine rules governing the embroilment of a third party in such a breach. Consequently, resort is frequently had to the general principles of the Civil Code 1951, which may not always be an appropriate means for the regulation of managerial duties.

The similarity of approach between the Iraqi Companies' Act (herein after the I.C.A.) 1997 and other Iraqi special Company Acts on one hand, and the U.K Company Act 2006 (herein after the C.A.) 2006 on the other, is that none of these Acts contains sufficiently explicit rules governing breach of duty.<sup>4</sup> S.178 of the C.A. 2006 indicates

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<sup>1</sup> Two types of litigation may be instigated against the wrongdoer in Iraqi law: First, the company's claim, which is undertaken by its competent bodies, And; Second, the shareholder's claim, which is exercised in the company's name. (See Aziz Al-Khafaji, *the Commercial Companies* (House of Culture 2007) 302). The latter is what Iraqi law commentators call "the individual claim" and is equivalent in its content and purpose to the derivative actions under the C.A. 2006 (See ss.260-264 of the C.A. 2006). It is worth to mention that the Ministerial Order for Facilitating the Enforcement of the Private Banks Act (hereinafter M.O.F.E.P.B.A. 2004) No.4 2010, Art.63(First-G) indicated to this litigation, but without enshrining its conditions. Likewise the law's commentators have also reinforced the existence of this litigation. For more details of this matter see: Fawzi Mohammad Sami, *the Commercial Companies: a Comparative Study* (The Culture House Publisher 2006) 476; Aziz Al-Khafaji, *the Commercial Companies* (House of Culture 2007) 301; Bassem Mohammed Saleh & Adnan Ahmed Walee Al-Azzawi, *The Commercial Companies* (first edn, Baghdad University 1986) 252; Lateef Jabr Commanee, *the Commercial Companies* (First edn, Mustansiriya University 2008) 248.

The derivative action aims to redress the problems stemming from the director's control over the decision to sue the wrongdoer (when he himself could be the wrongdoer), and problems that might arise from laxity on the part shareholders with regard to oversight. See Aziz Al- Khafaji, *the Commercial Companies* (House of Culture 2007) 301.

This Chapter will be confined to litigation undertaken by the company, because there is no statutory regulation of the derivative actions under Iraqi law that would enable a comparative study.

<sup>2</sup> See Section Three of this Chapter.

<sup>3</sup> This issue will be tackled in depth in Section one of this Chapter, para 7.1.1.

<sup>4</sup> Except s.195 of the C.A. 2006, which refers to the civil consequences of violating the provisions of substantial property transactions in which a director is the counterparty.

that the common law must be applied in this regard, and the rules of the Civil Code of 1951 apply in Iraq (as they represent a general law for the enforcement of rights).<sup>5</sup> The reason for non-codification of these matters under the I.C.A. 1997 could be a belief that the provisions of the Civil Code 1951 (namely tort rules) are adequate in providing appropriate remedies for aggrieved company. But resort to tort liability<sup>6</sup> could raise problems connected with the degree of its consistency with managerial activity, and the necessity of providing deterrence as a means to avoid directorial abuse. Safeguarding a company requires the imposition of a degree of strictness to ensure a director's *compliance with his duty*, and English common law has formulated special rules for promoting this goal, as this Chapter will show. Accordingly, it is arguable that resort to the Civil Code of 1951 is inappropriate for maintaining the above purpose, because the purpose of the law is *remedial*, that is, it exists to *redress damage rather than to inhibit wrongdoing*, and the *absence of effective means of prevention* may provide a safe harbour for a director to engage in activities that are harmful to a company, as will be demonstrated in the course of this Chapter.

These flaws in the law include not only an absence of sanctions against the director, but also against any third party who may be involved in the breach. The following discussion is an attempt to determine whether there is a need for regulation of the matter in the I.C.A. 1997 under special rules differing from those contained in the Civil Code of 1951.

To achieve the above purpose, this Chapter will be divided into three sections: the first section will be allocated to an examination of the rules governing the company's decision to institute litigation. The second section will be devoted to a discussion of the penalties that should be imposed on a director who violates his duty. The third section will be allocated to the rules that govern a third party involved in the breach.

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<sup>5</sup> For more details concerning this point, see Chapter 2, section Three.

<sup>6</sup> It has been previously mentioned that resort to tort rules is crucial to address problems associated with inadequacy of Iraqi law in addressing certain situations of the conflict of interests. For more details for this matter see Chapter 4, para 4.1. 2 of this thesis.

## Section I

### The Rules Governing the Decision to Ratify or Litigate Against the Wrongdoer

#### 7.1.1 Ratification of an Infringement of Duty

Ratification is a legal action taken by a competent body of the company involving the affirmation that a transaction was tainted by a breach of a fiduciary duty. A company, in considering such a decision, often takes into account various factors, and might conclude that ‘...costs, and the inevitable loss...of the services of a managing director [or of all directors], who would be the defendant, would outweigh the benefit to the company of successfully prosecuting an action and might properly decide not to pursue it...’.<sup>7</sup> Furthermore, ratification is conducive to maintain the director’s entrepreneurial activities,<sup>8</sup> and reduce the number of individual (derivative) litigations.<sup>9</sup>

The Iraqi Companies’ Acts, unlike the C.A. 2006,<sup>10</sup> does not explicitly empower a company to ratify the infringement of duty, which raises numerous questions, such as: (i) is the company entitled to ratify the director’s breach? (ii) If yes, which body in the company is competent to take this decision? (iii) What are the conditions for ratifying the breach? (iv) What are the effects of ratification? These questions will be answered in the following discussions.

##### 7.1.1.1 Can a Director’s Breach Be Ratified under the I.C.A. 1997?

It has been seen that the provisions of the Companies’ Acts are mandatory,<sup>11</sup> which could reinforce the suggestion that ratification is forbidden. But it is also true that the Iraqi Companies’ Acts do not contain provisions prohibiting a director’s release. In

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<sup>7</sup> *Taylor v National Union of Mineworkers (Derbyshire Area)* [1985] BCLC 237, 255 (CH) (Vinelott J) (illustration added). Concerning the criticism addressed to shareholders’ ratification, see: Pearlie Koh, ‘Directors’ Fiduciary Duties: Unthreading the Joints’ of Shareholder Ratification’ (2005) 5(2) *I Crop L Stud* 363, 378-397.

<sup>8</sup> Ji Lian Yap, ‘Reforming Ratification’ (2011) 40 *Comm L World Rev* 1, 2.

<sup>9</sup> See the C.A. 2006, s.263(2-c-ii). Ji Lian Yap, ‘Reforming Ratification’ (2011) 40 *Comm L World Rev* 1, 6.

<sup>10</sup> S.239(1) of this Act allows the ratification of a director’s breach ‘amounting to negligence, default, breach of duty or breach of trust in relation to the company’, by a decision taken by company’s members (s.239(2)), according to certain conditions mentioned in this section.

<sup>11</sup> For more clarifications about this characteristic of Iraqi Company law, see Chapter 2, para 2.2.3.2 of this thesis.

addition, Art. 420 of the Civil Code 1951 allows the exoneration of the debtor (the director) from a debt before, or after, an action is brought against him. Finally, there are several provisions under this Code allowing a company to ratify a transaction concluded in a contravention of directorial duty.<sup>12</sup> Consequently, it can be discerned that ratification is permissible.

#### **7.1.1.2 Which Body within a Company is Competent to Give Ratification?**

As mentioned, the failure of the law to tackle this matter gives rise to a difficulty in determining the body that is competent to take the decision of ratification. A scrutiny of the provisions of the I.C.A. 1997 suggests that the general assembly is the competent body for taking the ratification decision, as is the case under the C.A. 2006,<sup>13</sup> according to the following arguments:

1. The director's release under the Civil Code of 1951 has an extinctive effect on the company's debts under its unilateral will. The I.C.A. 1997 considers the general assembly as '...the highest authority in the company...' concerning '... all matters that serve its interest...'.<sup>14</sup> Thus, any waiver of its debts that has influence on its financial position and therefore on its shareholders involves a serious decision that needs to be taken by the latter.

2. Granting this authority to the shareholders may solve the problem of the bias of other directors towards their colleague (if they are empowered to ratify the wrongdoing),<sup>15</sup> or problems arising from the implication of others in the same fault. Thus, empowering shareholders with taking this decision consistent with the exigency of preventing any threat to the company's interests may stem from the misuse of this power by the directors with a view of shielding their co-director (the wrongdoer) from liability. Conferring this power on the shareholders nevertheless will not solve the

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<sup>12</sup> For example: Art.136 of the Civil Code 1951 concerning ratification of the suspended contract; Art. 592 concerning the ratification of the contract of sale or purchase the company's property in which the director has an undeclared interest.

<sup>13</sup> S.232 (2) of this Act.

<sup>14</sup> The I.C.A. 1997, Art.102.

<sup>15</sup> Pearlie Koh, 'Directors' Fiduciary Duties: Unthreading the Joints' of Shareholder Ratification' (2005) 5(2) I Crop L Stud 363, 368.

problem of their lack to information about the contravention's facts, which renders their decision less informed than that of the directors.<sup>16</sup> This matter will be discussed in the next section.

### 7.1.1.3 The Conditions for the Validity of Ratification

The I.C.A. 1997 does not regulate the procedures for ratification and the conditions for its validity. The law does not state whether a director is bound to disclose the *material facts* of the breach as a requirement for ensuring that an informed ratification is provided by the shareholders.<sup>17</sup> Obviously, this shortcoming contradicts the following principles: (1) one of the purposes of the I.C.A. 1997 is to 'promote the provision of full information to owners in connection with decisions affecting their investment and their company'.<sup>18</sup> This objective is not embodied in detailed rules imposing a clear duty on a director to ensure that the ratification will be conducted in an informed manner. (2) The rules of ratification under the Civil Code of 1951 necessitate knowledge of the facts of the violation<sup>19</sup> as a condition for exercising this right.

By contrast, although s.232 of the C.A. 2006 does not refer to the disclose of the contravention facts, the common law must be applied '...for valid ratification...'.<sup>20</sup> A director, under English common law, is bound to give 'a full and frank disclosure ... calling together the general body of the shareholders'.<sup>21</sup>

There is a vital need for this rule to be transplanted into the I.C.A. 1997 in order to make it consistent with the general principles of law, by which the legitimacy of any legal action requires an absence of fraud.<sup>22</sup>

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<sup>16</sup> For more details on this point, see *ibid*, 385.

<sup>17</sup> Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 507-508, para 16.16.

<sup>18</sup> The I.C.A. 1997, Art.1(4).

<sup>19</sup> See the Civil Code 1951, Art.134(1).

<sup>20</sup> The C.A. 2006, ss.239(7), 170(3). See also R. J. C. Partridge, 'Ratification and the Release of Directors from Personal Liability' (1987) 46(1) Cambridge L J 122, 143.

<sup>21</sup> *Bamford v Bamford* [1970] Ch 212, 238 (CA) (Harman L.J).

<sup>22</sup> See the Civil Code 1951, Art.184(2).

Under current Iraqi law, shareholders find themselves compelled either to rely upon the facts presented by: (1) the directors (who are not subject to the duty to disclose full and correct information about the circumstances of the breach) or; (2) the information provided by shareholders themselves.

On the other hand, pursuant to Art.4 (Third) of the I.C.A. 1997, the delinquent director, or any person associated with him, is disqualified from voting on such a decision.<sup>23</sup> This ruling is similar to s.239(3) of the C.A. 2006, which also prevents the errant director or any person connected with him from voting on the ratification decision.<sup>24</sup> Accordingly, the required majority<sup>25</sup> is the majority of disinterested shareholders.<sup>26</sup> Art.4 (Third) of the I.C.A. 1997, however contradicts Art.98 of the I.C.A. 1997, which states that the valid decision must be taken by ‘the majority of the votes of the paid-up shares at the time of calling the meeting’. But if the interested shareholders constitute the majority, the meeting cannot properly take the decision. This conflict within the law’s provisions needs to be resolved by excluding the director (as a shareholder) and any person who connected with him, from the requirement of the shareholders’ meeting quorum.

At any event, pursuant to Arts.4 (Third) of the I.C.A. 1997, the decision taken has to be in the company’s interests, otherwise the minority shareholders are entitled to challenge it on the basis of prejudice to their lawful rights.<sup>27</sup>

#### **7.1.1.4 What is the Scope of Ratification?**

What are the wrongdoings that can be included or excluded from the scope of ratification? It can be discerned from the generality of provisions of the Civil Code of

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<sup>23</sup> Art.4(Third) of the I.C.A. 1997 prevents a company’s members from using their voting right in order to ‘harm or disadvantage the company to benefit themselves or those associated with them at the expense of other owners of the company’.

<sup>24</sup> See also Pearlie Koh, ‘Directors’ Fiduciary Duties: Unthreading the Joints’ of Shareholder Ratification’ (2005) 5(2) I Crop L Stud 363, 364.

<sup>25</sup> The C.A. 2006, s.239(4). This provision derives from rule fixed in *Foss v Harbottle* (1843) 2 Hare 461, 494 (VCC) that established the prevailing principle in English law, under which the majority of shareholders that represent the company are entitled to take decisions connected with the company’s interests. This approach has been reinforced in *Bamford v Bamford* [1970] Ch 212, 233 (CA) (Harman L.J). See also Pearlie Koh, ‘Directors’ Fiduciary Duties: Unthreading the Joints of Shareholder Ratification’ (2005) 5(2) I Crop L Stud 363, 368. Under s.239 (6-a) of the C.A. 2006 the ‘... unanimous consent of the members of the company...’ is sufficient to legitimize any decision that would otherwise be voidable.

<sup>26</sup> The C.A. 2006, s.232 (4).

<sup>27</sup> *North- West Transportation Company v Beatty* (1887) 12 App Cas 589, 593-594.

1951 that it deals with the exoneration of debtors<sup>28</sup> and the ratification of transactions<sup>29</sup> and that it encompasses all cases of violation of duties. But ratification is impermissible if it involves the sacrifice of the interests of the company and its minority shareholders, or where the law explicitly prohibits ratification.

Concerning the first exception, attention should be directed to the fact that ratification under the Civil Code of 1951 is based on the company's unilateral will. This unilateral will must be premised on a legitimate cause.<sup>30</sup> In other words, the ratification must always be undertaken with a view to achieving the company's interests. This applies in particular where the wrongdoing is trivial, or where the company's interest lies in avoiding sabotaging its relation with its skilled director. Arts.1(3), and 4(Third-4) of the I.C.A. 1997 impose the above duty on the "majority shareholders" or the "controllers" over the company, which is consistent with some English authorities indicating that '...The 'fraud' lies in their [the majority shareholders] use of their voting power, not in the character of the act or transaction giving rise to the cause of action...'.<sup>31</sup>

In relation to ratification that is prohibited by law, it is suggested that the following situations are excluded from the ratification scope:-

(a) *The misappropriation of a company's capital* cannot be absolved, because a company's capital must be allocated to '...carry out the business specified in the company's contract and to fulfil its obligations...'<sup>32</sup> only. Thus, the ratification of this misbehaviour would involve a tacit transfer of the company's assets to the errant director. This interpretation agrees with the common law, which prohibits the release of a director for the misapplication of a company's funds, including its opportunities.<sup>33</sup>

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<sup>28</sup> See Art.220 of the Civil Code 1951 which states 'if the creditor has exonerated the debtor then the debt is deemed to have lapsed'.

<sup>29</sup> See Art.136 of the Civil Code 1951, which includes all transactions flawed by violence or fraud. In this context, Art.160 of the Civil Code 1951 states 'that which is general will operate according to its generality'. Accordingly, the provisions that deal with ratification and release of a wrongdoer include all cases.

<sup>30</sup> The Civil Code 1951, Arts.184 (2), 132.

<sup>31</sup> *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1980] 2 All ER 841, 862 (CH) (Vinelott J) (illustration added).

<sup>32</sup> The I.C.A. 1997, Art.27.

<sup>33</sup> *Cook v Deeks* [1916] 1 AC 554, 564 (PC) (Buckmaster). This case is distinguishable from *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL), where ratification would have been possible, from a consideration that the latter case did not involve a misappropriation of the company's property, and that the directors were *bona fide*, contrary to *Cook v Deeks*. See Paul Davies, Sarah Worthington Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn,



Such conduct ‘...cannot be ratified by any majority of the members, however large...’.

<sup>34</sup> But the unanimous consent of company members should be adequate to ratify such wrongdoing.<sup>35</sup> Logically, the unanimous consent of shareholders should be applicable under Iraqi law, because shareholders are entitled to cede their proprietary rights in the company’s capital as long as this does not prejudice the interests of the minority. This inference, however, may contradict Art.27<sup>36</sup> of the I.C.A. 1997 which involves a mandatory provision. This point thus contributes another uncertainty to Iraqi law.

(b) *Defrauding the company’s creditors*; for example,<sup>37</sup> if the company is on the verge of insolvency, and the director takes a decision involving ‘withdrawal of [company’s] capital or transfer of assets when insolvency is imminent or when prohibited by law.’<sup>38</sup> The ratification of the misapplication of a company’s funds in these circumstances involves a tacit transfer of its assets to the errant director. The ratification is therefore confined to situations in which the company is a going concern.

(c) *State shares in the Mixed Sector Companies* are deemed a part of public domain,<sup>39</sup> since the State has a share in the company’s assets equivalent to its contribution to the capital. The State’s right to the company’s assets cannot be ceded even after the consent of the State representatives in the general assembly, except after following specific procedures for ceding of the public domain.<sup>40</sup>

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Sweet and Maxwell 2008) 587, para 16-86; Peter Loose, Michael Griffiths and David Impey, *The Company Director: Powers, Duties and Liabilities* (11 edn, Jordan Publishing Ltd 2011) 306, para 6.89; Stuard Sime & Margot Taylor, *Company Law in Practice* (10 edn., OUP 2014) 96, para 7.5.1.1; Tan Lay Hong, ‘Family- Owned Firms in Singapore Legal Strategies for Constraining Self-dealing in Concentrated Ownership Structures’ (2011) 23 S a c L J 890, 908-909; Brian R. Cheffins and Bernard S Black, ‘Outside Director Liability Across Countries’ (2006) 84(6) Tex L Rev 1385, 1403; Sarah Worthington, ‘Corporate Governance: Remediating and Ratifying Directors’ Breaches’ (2000) 116(Oct) L Q R 638, 671; Ji Lian Yap, ‘Reforming Ratification’ (2011) 40 Comm L World Rev 1, 2; John Lowry and Rod Edmunds, ‘Reflection on the English and Scottish Law Commissions ‘Proposals for Directorial Disclosure’ (2000) 5(1) Deakin L Rev 1, 11 fn (44).

<sup>34</sup> *Taylor v National Union of Mineworkers (Derbyshire Area)* [1985] BCLC 237, 254 (CH) (Vinelott J).

<sup>35</sup> See the C.A. 2006, s.239(6-a). See also Andrew Hicks & S. H. Goo, *Cases & Materials on Company Law* (16th edn, OUP 2008) 416.

<sup>36</sup> This Article states that ‘the capital shall be allocated to carry out the business specified in the company’s contract and to fulfill its obligations. It is impermissible to dispose of the capital in any other way’.

<sup>37</sup> See the I.C.A. 1997, Art.1(2) which identified the Act’s objectives.

<sup>38</sup> The I.C.A. 1997, Art.4(Third-2).

<sup>39</sup> The Civil Code 1951, Art.71(2).

<sup>40</sup> Under s.4 (11) of the Financial Management and the Public Debt Act No.94 2004, the Minister of Finance is empowered to cede the right of the federal government.

With the exception of the above situations, ratification includes any wrongdoing, such as fraudulent actions that are practised on the company or its shareholders which, according to English legal literature, should be outside the ambit of ratification<sup>41</sup> in order to sustain general confidence in this area of law. The *inclusion of fraudulent actions within the scope of ratification* is one of the consequences of non-regulation of this matter in Iraqi company law and its reliance on the rules of the Civil Code of 1951 in this respect. Likewise, the release also includes any benefit stemming from the abuse of managerial powers, since Iraqi law does not consider the usurped benefit as part of the company's assets.<sup>42</sup>

#### **7.1.1.5 The Effects of Ratification**

Once a decision to ratify a director's misbehaviour has been taken, the company loses the right to pursue the director (or any person involved in breach) or cancel its former decision for the same breach, as long as the decision was taken in the the company's interests. In other words, ratification creates the impossibility of a delinquent being held accountable for the same wrongdoing and places him in the position he would have been in, as if he had not committed the breach.<sup>43</sup>

There is a question related to the effects of the ratification: does the affirmation of the impugned transaction (the validity effect) include the release of a director from the results of his fault<sup>44</sup> (the extinctive effect) and so enable him, for example, to retain the benefits accrued as a result of the breach? The rules for ratification and for a debtor's release are laid out separately from each other in the Civil Code of 1951. This position suggests that the release of the director from the consequences of his breach does not necessarily lead to ratification of the illicit transaction. However, uncertainty

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<sup>41</sup> See A. J. Boyle, 'Attorney-General v Reid: the Company Law Implications' (1995) 16(5) Comp Law 131, 132; John Lowry and Rod Edmunds, 'Reflections on the English and Scottish Law Commission' proposals for Directorial Disclosure' (2000) 5 Deakin L Rev 1, 11; Brian R. Cheffins and Bernard S. Black, 'Outside Director Liability Across Countries' (2006) 84(6) Tex L Rev 1385, 1402-1403; Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) 45 Irish Jurist 82, 104.

<sup>42</sup> For more details about this theme see Chapter 4, para 4.2.1.3.

<sup>43</sup> Ji Lian Yap, 'Reforming Ratification' (2011) 40 Comm L World Rev 1, 6; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 507, para 16.38.

<sup>44</sup> Jennifer Payne, 'A Re-Examination of Ratification' (1999) 58(3) CLJUK 604.

still exists concerning this matter, which could also suggest that the company's right to demand accountability from its director, (whether or not he was a party in the transaction in question) ceases after the ratification of the transaction, according to the following arguments: first, ratification seems to imply that the deal does not involve prejudice to the company's interests, and that it contains fair conditions for the parties to the transaction. Second, provisions of the law do not mention the possibility of a combination of two different effects, i.e., ratifying the transaction and imposing a civil penalty on the wrongdoer. The failure to embracing these different effects is traceable to that the rules of ratification in the Civil law have been built on the assumption that the wrongdoer is the counterparty in the impugned transaction, and thus the plaintiff is entitled to select one of the above options according to his own interests. Thus, it is hard to say that the company retains the right to recover damages from the errant director when the transaction that gave rise to the breach has been ratified.

While this result meets with English common law,<sup>45</sup> s.195(3) of the C.A. 2006 contains a contradictory rule: under this Section a company is entitled to hold its director to account, irrespective of the confirmation of the transaction,<sup>46</sup> unless the ratification decision involves the contrary. This harsh provision enables the company to hold its director to account, while at the same time the company is able to ratify the illicit transaction, if that is in its interest. Under this rule, two aims will be served, that of deterring the director and that of sustaining the company's interests. However, this flexibility in dealing with the effects of a breach a duty has no existence in Iraqi law.

The release of a director from liability could be whole or partial, or for specific wrongdoing. The *ex-ante* exoneration for the infringement of a duty before it has

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<sup>45</sup> *Re Cape Breton Company* (1885) 29 Ch D 795, 811 -812 (C.A) (FRY L.J); *Burland v Earle* [1902] AC 83 (PC); *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134,150 (HL) (Lord Russell). Cited with approval in *Bamford v Bamford* [1970] Ch 212, 235 (CA); *Prudential Assurance Co Ltd v Newman Industries Ltd* (No. 2) [1982] Ch 204, 220 (CA).

In the English literature see R. J. C. Partridge, 'Ratification and the Release of Directors from Personal Liability' (1987) 46(1) Cambridge L J 122, 123-124; Jennifer Payne, 'A Re-examination of Ratification' (1999) 58(3) CLJUK 604; Hans C. Hirt, 'Ratification of Breaches of Directors' Duties: the Implications of the Reform Proposal Regarding the Derivative Actions' (2004) 25(7) Comp Law 197, 198.

<sup>46</sup> This section states:-

Whether or not the arrangement or any such transaction has been avoided, each of the persons specified in subsection (4) is liable:

(a) to account to the company for any gain that he has made directly or indirectly by the arrangement or transaction, and:

(b) (jointly and severally with any other person so liable under this section) to indemnify the company for any loss or damage resulting from the arrangement or transaction.

occurred is invalid, since there must be specific debts.<sup>47</sup> Suspending the release upon the achievement of certain action (e.g., restitution of the usurped property) is also permissible under Iraqi law,<sup>48</sup> but its effects commence after implementing this condition.

To sum up, the lack of special provisions to deal with the above legislative gaps that encapsulate this theme in the Civil Code of 1951 is evidence of the inadequacy of civil liability in shielding a company in these areas. This status gives a director a safe harbour to exercise harmful activities and then to rely on the aforementioned legislative shortcomings relating to ratification in order to evade liability.

### **7.1.2 Litigation and the Delinquent: Who is Entitled to Litigate against the Wrongdoer?**

No explicit answer to the above question is to be found in the Iraqi Companies Acts. However, it can be discerned from a scrutiny of Art.117 of the I.C.A. 1997 that the board of directors is entitled to bring an action against the errant director as part of the broad powers prescribed in this Article. But in a situation where there is collective involvement of its members in the breach, it would be unlikely to do so, unless membership of the board was changed.<sup>49</sup> So, obliging the director to report to shareholders about this matter, in order to enable them to taking the appropriate decision seems a rational approach.

Likewise, the general assembly is entitled to nominate a representative to take the decision, by virtue of its supervisory role over directors' activities, and its power of taking decisions in '...all matters that serve its interest'.<sup>50</sup>

The liquidator is entitled also to bring an action against a delinquent director. This inference is derived tacitly from Art.158 (2) of the I.C.A. 1997, which deemed the

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<sup>47</sup> See Art.126 of the Civil Code 1951 concerning the conditions of the validity of the legal actions.

<sup>48</sup> The Civil Code 1951, Art.423.

<sup>49</sup> As was the case in *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL). See also Brian R. Cheffins and Bernard S. Black, 'Outside Director Liability Across Countries' (2006) 84(6) *Tex L Rev* 1385, 1404.

<sup>50</sup> The I.C.A. 1997, Art.102.

liquidator to be an agent for the company, and this capacity empowers the agent to safeguard the principal's interests, including that of bringing actions.<sup>51</sup> The other Acts, however, give the liquidator an explicit power in this context.<sup>52</sup>

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<sup>51</sup> See the Civil Code 1951, Art.931; The Civil Pleadings Act No.83 1969, Art.52.

<sup>52</sup> See the P.B.A. 2004, Art.93 (1-e); the I.B.R.A. 2005, Art.60 (Fourth). Under the common law see *Multinational Gas and Petrochemical Co. v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258, 280 (CA) (May L.J).

## Section II

### The Remedies Imposed on a Director for Infringing his Duty

Introduction: There are two types of civil liability, *individual and collective*. The Civil Code of 1951 deemed individual liability to be the original form of liability, as it can be inferred from extrapolation of provisions of that Code.<sup>53</sup> The personal infringement of a fiduciary duty can be envisaged in cases involving, for example, the presence of a personal interest in a transaction, or the personal exploitation of a corporate opportunity.<sup>54</sup>

But it is also well known that decisions taken by the boards of joint stock companies, either unanimously or by a majority of votes, may be detrimental to a company's interests, or so give rise to *collective liability*.<sup>55</sup>

However, the focus of this Section will be on a director's individual liability as it represents the reason that gives rise to collective liability, and with a view of making the scope of this thesis more limited.

In this regard, pursuant to Art.209 of the Civil Code of 1951, numerous remedies can be imposed on a director for violating his duty. This Article states that:-

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<sup>53</sup> See Chapter 3, Branch 1 (Arts. 186-216) of this Code, which refers firstly to individual liability, while collective liability is mentioned in Art.217 as to be one of its applications.

This matter has been supported by Iraqi jurisprudence. See Ahmed Ibrahim Al-Bassam, *the Commercial Companies in Iraqi Law* (Second edn, Al-Zammaan publisher 1967) 189; Fawzi Mohammad Sami, *the Commercial Companies, a Comparative Study* (the Culture House Publisher 2006) 473; Rolf Dotevall, 'Liability of Members of the Board of Directors and the Managing Director-A Scandinavian Perspective' (2003) 37(1) Int'l L 7, 14.

<sup>54</sup> The I.C.A. 1997, Art.114 (First). See also Darinam M. Ibrahim, 'Individual or Collective Liability of Corporate Directors?' (2008) 93 Iowa L Rev 932.

<sup>55</sup> The situations that give rise to the collective liability are exemplified as: (a) Where a number of wrongdoers contribute to the same breach, as with joint involvement in the misuse of a company's funds, (*Ramskill v Edwards* (1885) 31 Ch D 100 (CH)); or have had a common interest in a deal or opportunity that was diverted to their company or their partnership (*Cook v Deeks* [1916] 1 AC 554 (PC)); (b) Where authorization has been given by other directors for a deal involving a conflict of interest, though it is contrary to the company's interests. (See the C.A. 2006, s.195(4-d), concerning the violation of provisions governing substantial transactions. See also: Kenneth W. Nielsen, 'Directors' Duties under Anglo-American Corporation Law' (1966) 43 U Det L J 605, 644). (c) Where the directors take part in a decision that involves a prejudice to the company's interests. (*Bairstow v Queens Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531 [53] (Robert Walker LJ). In line with this approach, see in Iraqi literature: Aziz Al-Khafaji, *the Commercial Companies* (House of Culture 2007) 299) or in cases where they fail to take the appropriate decision to avoiding any prejudice to this interest.

1. The court shall determine the method of payment of damage according to the circumstances...
2. The compensation shall be estimated in cash; the court however, depending on the circumstances and upon application of the aggrieved party, that to order the restoration of the *status quo ante* or adjudge the performance of a certain matter or restitution of a similar thing of the fungible [symmetric] <sup>56</sup> as compensation.

This result is consistent with the common law, under which the remedies are also non-exhaustive,<sup>57</sup> and have been left to the court's discretion according to the facts of the case<sup>58</sup> and the equity involved.

The focus in this section will be on certain remedies, such as *suspension* of the transaction, the *proprietary remedy* and *monetary compensation*. The suitability of the above remedies to the nature of the director's breach and their ability to inhibit his abuse *ex ante* will be the focus of the following discussion.

### 7.2.1 Suspending the Transaction

The suspended contract under Iraqi law is a unique remedy derived from Islamic Sharia. This remedy addresses several situations,<sup>59</sup> including where the will of the contractor has been flawed by fraud practiced by a counter party in order to motivate the latter to enter into a transaction.<sup>60</sup> Applying this remedy to the director presupposes a breach of his duty, ie., that he has entered into a transaction with the company, or via

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<sup>56</sup> [Illustration added]. It is instructive to mention that Art.64 of the Civil Code 1951 defines the meaning of "fungible property" as follows:-

1. Fungibles are things which may be substituted one for the other when making a payment; they are normally (customarily) assessed in dealing among people by number, volume or weigh.
2. All other things are non-fungible.

<sup>57</sup> Deirdre Ahern, 'Legislating for the Duty on Directors to Avoid Conflicts of Interest and Secret Profits: the Devil in the Detail' (2010) Irish Jurist 82, 104.

<sup>58</sup> D. E. McLay, 'Multiple Directorates and Loss of Corporate Opportunity: Bases and Remedies' (1980)10 Victoria U Wellington L Rev 429, 446.

<sup>59</sup> Under the Civil Code 1951, the suspension, as a remedy, imposes whenever the will of the contractor in a transaction has been tainted by coercion, error, fraud or where the contract has been concluded by the minor.

<sup>60</sup> Professor Aziz Karim Jaber Al-Khafaji, 'Is Unfairness a Defect in the Consent or in the Contract Itself' (2009) 1 Al-Kufa J L P S 15, 38; Thanon Yunis Saleh Mohammadi & Younis Salah Al-Din Muhammad Ali, 'Misrepresentation (or Fraud) as One of the Will Defects in the English Law: A Comparative Study with the Islamic Jurisprudence and Iraqi Civil Law' (2010) 1(8) Tikrit University J L & Pol S 1, 6.

another person, or that he has an undeclared interest in the transaction. The causes and consequences of applying this remedy will next be examined.

### **7.2.1.1 Situations in which a Transaction may be Suspended**

Suspending a transaction is conceivable in two situations:-

First, in cases involving the sale or purchase of the company's property by the director. It has been mentioned previously<sup>61</sup> that Art.592(1) of the Civil Code of 1951 prevents a director from being a party to these transactions, under his own name or under a pseudonym, without prior authorization. Scrutiny of the second paragraph of this Article<sup>62</sup> reveals that ratifying a transaction is sufficient to render it valid. This means logically that the transaction should be deemed suspended, and not void.

Two observations can be made on this provision: (1) it is unnecessary to prove fraud or deception on the part of the director. The concealment of his interest is sufficient in itself to constitute fraud.

(2) Attention should be given to the capacity of the counterparty, as a director, at the time of the transaction. His assumption of the post of director after the conclusion of the transaction does not affect its legitimacy. But he will be subject to the obligations set out in the Civil Code of 1951, just as in the case of any other contractor. This result is consistent with the requirements of engagement in substantial transactions, as stipulated by the C.A. 2006 and the common law.<sup>63</sup>

Second, in transactions other than the sale or purchase of a company's property, the proof of a director's fraud is a condition for suspending the transaction. But the

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<sup>61</sup> See Chapter 6, para 6.3.2.1.

<sup>62</sup> Art.592(2) of the Civil Code 1951 states that:

But the purchase in the situations enumerated in the preceding paragraph will however be valid if they are ratified by a party for whose account the purchase was made. But if the sale is not ratified, and then the property is re-sold once more, the first buyer shall bear the expenses of the second sale and the depreciation which might have occurred in the value of the thing sold.

<sup>63</sup> See Part 10, Chapter 4 ss.188-222 of this Act. See also *Re Cape Breton Company* (1885) 29 Ch D 795 (CA) in which the defendant had bought a property prior to his appointment as a director, and then sold it to his company without declaring his interest. The court held (Bowen L.J dissented) that the company's right is limited to rescinding the transaction (which had lapsed in this case). But the director is not liable for the different between the price of the initial purchase and the price of the company's purchase, as he did not act as a fiduciary the first time. See in this line *Re Lady Forrest (Murchison) Gold Mine Ltd* [1901] 1 Ch 582 (CA); *Burland v Earle* [1902] AC 83 (PC). See also P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 225, para 523.



difficulty of proving the fraud, in the light of a director's ability to conceal the facts about his violation, makes the plaintiff's task extremely difficult in this respect, for which reason English law has excluded fraud from its account.<sup>64</sup> Fortunately, Art.12(2) of the Civil Code of 1951 deemed that the mere '...non-statement in the contracts of trust<sup>65</sup> in which suspicion should be avoided therein' is sufficient to constitute fraud. It is suggested that the existence of undeclared interest in any transaction is sufficient to render the director guilty of deception.

### 7.2.1.2 The Effects of Suspending the Transaction

The effect of such a rule is that the transaction is deemed valid, but it does not produce its effect unless the company has knowledge of the existence of fraud, in order to be able to take its informed decision either to cancel or to affirm the action.<sup>66</sup> Under English law, the transaction would be voidable, that is, it is valid and produce its effects, but is subject to rescission by a decision of the company.<sup>67</sup>

The company in this contract is entitled either to affirm or to rescind the contract<sup>68</sup> within a period of time not exceeding three months from the time of the discovery of the fraud.<sup>69</sup> Here, ratification renders the contract valid retrospectively.<sup>70</sup> The affirmation takes the shape of an explicit decision,<sup>71</sup> or by the tacit undertaking of the transaction concerned,<sup>72</sup> or receipt of a property price after the facts are known.<sup>73</sup>

Rescission will not be possible, that is, the contract will stand, in certain circumstances enunciated in Art.123 of the Civil Code of 1951, as follows:-

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<sup>64</sup> In this context See the well-known case *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL).

<sup>65</sup> The contracts of confidence are transactions that their validity depends on the utmost degree of confidence (*Uberrima fide*) in the information presented by the counterparty in the stage of the conclusion.

<sup>66</sup> Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil law: A Comparative Study* (First edn, Coyle publisher 2005) 58.

<sup>67</sup> See the C.A. 2006, s.195(2).

<sup>68</sup> *Ibid*, 69.

<sup>69</sup> The Civil Code 1951, Art.136(2).

<sup>70</sup> Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 68-71.

<sup>71</sup> The Civil Code 1951, Art.134(1). See the same approach in English authorities *Re Cape Breton Company* (1885) 29 Ch D 795, 802 (CA) (Cotton J).

<sup>72</sup> *Movitex Ltd v Bulfield* [1988] BCLC 104 (CH); *Liquidator of Marini Ltd v Dickenson* [2003] EWHC 334 (Ch), [2004] BCC 172, 196.

<sup>73</sup> Sarah Worthington, 'Corporate Governance: Remediating and Ratifying Directors' Breaches' (2000)116 (Oct) L Q R 638, 660.

(a) When the unfairness in the transaction's conditions is trivial. In other words, the grievous unfairness is a prerequisite to rescinding the contract.<sup>74</sup> In such a case, a director will incur the liability for damage incurred by the company only, while the transaction will be immune from the rescission.

(b) If the transaction subject-matter has been destroyed, consumed, or exposed to fundamental change or defect.<sup>75</sup> In short, if there is no possibility of *a restitutio in integrum*, as articulated under English law.<sup>76</sup>

(c) If the impugned transaction has been concluded with a third party who was unaware of a director's deception at the time of the conclusion of the transaction. In other words, if the interests of *a bona fide* third party have intervened.<sup>77</sup> Here the company's right is confined to seeking compensation from the director.<sup>78</sup> But this situation concerns fraud only, and does not include all cases of suspension of contract in which the matters of good or bad faith of the third party do not affect the company's right of restoration its property under any hand.<sup>79</sup>

(d) If a period of three months expires without a decision being taken either to rescind or affirm the transaction.<sup>80</sup> Any delay in doing so within this period is construed as evidence of a tacit will to affirm the contract.<sup>81</sup> Delay under English law is also

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<sup>74</sup> No determination in the Civil Code of 1951 has made of the meaning of grievous loss. According to Islamic jurisprudence, numerous criteria have been posited for this purpose, including: (i) the materiality test, whereby the loss is substantial when it exceeds a quarter of the ten for money, half of the ten for the other properties, ten for animals, five for real estate (ii) The flexible criterion, whereby the grievous loss is not subsumed within the experts assessment. Thus, there is no unfairness if the property was sold for 100, 000 Dinar, although the experts' assessment falls within this range. For more details of this theme, see Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 50-51.

<sup>75</sup> In the same context, see the dictum of Lord Blanckburn in *Emile Erlanger v The New Sombrero Phosphate Company* [1877-78] L R 3 App Cas 1218, 1278 (HL).

<sup>76</sup> *Emile Erlanger v The New Sombrero Phosphate Company* [1877-78] L R 3 App Cas. 1218, 1278 (HL) (Lord Blanckburn); *Newbigging v Adam* [1886] 34 Ch D 582, 592 (CA); *The Right Hon G A F Cavendish Bentinck, M P v Thomas Fenn* (1887) 12 App Cas 652 (HL); *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1113 (CH).

<sup>77</sup> See the Civil Code 1951, Art.1148. In English law see *Victors Ltd (in liquidation) v Lingard* [1927] 1 Ch 323 (CH); *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, 2012 WL 3062611 [101].

<sup>78</sup> See the Civil Code 1951, Art.122.

<sup>79</sup> The Civil Code 1951, Art.134(1).

<sup>80</sup> The Civil Code 1951, Art.136(2).

<sup>81</sup> See the Civil Code 1951, Art.81.

conducive to this result,<sup>82</sup> subject to the court's discretion, though English law does not impose a formal time limit. One of the advantages of the *suspension rule* that distinguishes it from the *voidability rule*, is that it enables the company's valuable property to be restored within a short and specific period. The regime of suspension avoids also the transference of the property to a *bona fide* third party,<sup>83</sup> who will be (for this reason) the winner in any dispute with the company, as the case under English law.<sup>84</sup>

### 7.2.2 Proprietary Right (or Restitution)

The imposition of a proprietary remedy by law<sup>85</sup> aims to restore the *status quo ante* to the aggrieved party.<sup>86</sup> Therefore, merely establishing the ownership of the property is adequate to establish a director's obligation of restitution.

As mentioned previously, a director is in the position of a trustee.<sup>87</sup> This position renders him bound to restore the property to the company on demand<sup>88</sup> and with its former status.<sup>89</sup> If the director refuses to restore the property, or if he transfers it to another,<sup>90</sup> he is in the position of a usurper.<sup>91</sup> The rejection gives a firm the right to recover the original property,<sup>92</sup> plus its increments. In short, a director becomes liable for damage to the company's property, even if that damage occurred by reason of *force majeure*.<sup>93</sup>

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It is worth noting that s.195(2) of the C.A. 2006 mentions the above situations of the rescission lapse.

<sup>82</sup> *Emile Erlanger v The New Sombrero Phosphate Company* [1877-78] LR 3 App Cas 1218, 1278 (HL) (Lord Blanford).

<sup>83</sup> See the Civil Code 1951, Art.134(1).

<sup>84</sup> See the C.A. 2006, s. 195(2-c).

<sup>85</sup> Sarah Worthington, 'Corporate Governance: Remediating and Ratifying Directors' Breaches' (2000) 116(Oct) L Q R 638, 669-670.

<sup>86</sup> Nawaf Hazim Khaled, 'The Role of Fault Gravity in Estimating the Compensation' 3(11, 12) 2010) Al-Hiqouq 150.

<sup>87</sup> Abdul Razzaq Ahmed Al-Sanhoori, *The Intermediary in Explaining the Civil Law: Part 7(1)* (Al-Maarif 2004) 362, para 350.

<sup>88</sup> The Civil Code 1951, Art.969(1).

<sup>89</sup> Abdul Razzaq Ahmed Al-Sanhoori, *The Intermediary in Explaining the Civil Law: part 7(1)* (Al-Maarif 2004) 680, para 363.

<sup>90</sup> *Ibid*, 680, para 363.

<sup>91</sup> The Civil Code 1951, Art.201.

<sup>92</sup> The Civil Code 1951, Arts. 192, 201, 969.

<sup>93</sup> The Civil Code 1951, Art.193.

Proprietary compensation is also recoverable in cases where the director bought a property, and then transfers it to a stranger. The company would then be entitled to trace its property and to have it restored to them.<sup>94</sup> In this case a director would incur the costs of the second sale and any depreciation in the value of the property<sup>95</sup> that occurred within this period.<sup>96</sup>

Proprietary compensation is the delivery of a symmetry (fungible) thing that is equivalent in value to the value of the usurped property, or its value, in cases where it is impossible to deliver a fungible thing equivalent to the lost property.<sup>97</sup> A company is entitled to restoration, in case of any alteration in the nature of the property or depreciation in its value. In addition, the company is entitled to pecuniary compensation for any another damage. Alternatively the property may be left with the usurper in return for compensation of its value.<sup>98</sup>

To summarize, it has seen that Civil Code of 1951 encompasses rules of proprietary remedy similar to those set out under English law.<sup>99</sup> The divergence between the two is in the area of the *monetary compensation*.

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<sup>94</sup> This rule is inherent in English law. See *Boscawen v Bajwa*; *Abbey National plc v Boscawen* [1995] 4 All ER 769, 776 (CA) (Millett LJ).

<sup>95</sup> The Civil Code 1951, Art.592(2).

<sup>96</sup> But the exercise of this right is conditional on the property being identifiable. If the property has become part of the estate of someone who is deceased, the claim must be directed to the inheritors of the estate. See the Civil Code 1951, Art.970(2).

This consequence meets with the requirements of English law, whereby the plaintiff will lose his right of tracing the property under the common law, rather than under the law of equity. See *Agip (Africa) Ltd v Jackson* [1990] Ch. 265, 282. See also Daniel J. Carr, 'Equity Rising? Commonwealth Oil & Gas Co Ltd v Baxter' (2010) 14(2) Edin L Rev 273 (case comment), 278.

<sup>97</sup> The Civil Code 1951, Art.960.

<sup>98</sup> The Civil Code 1951, Art.194.

<sup>99</sup> *Paragon Finance plc v D B Thakerar & Co (a firm)*; *Paragon Finance plc v Thimbleby & Co (a firm)* [1999] 1 All ER 400, 409 (CA) (Millett); *J J Harrison (Properties) Ltd v Harrison* [2001] EWCA Civ 1467, [2002] 1 BCLC 162 [25], [277] (Chadwick LJ). See also Neil Harvey & Ian Yeo, 'Duties and Liabilities of Directors of a Private Limited Company Under English Law' (1996) I B L J 749, 757; A. J. Boyle, 'Attorney-General v Reid: The Company Law Implications' (1995) 16(5) Comp Law 131; Sarah Worthington, 'Corporate Governance: Remedying and Ratifying Directors' Breaches' (2000) 116(Oct) L Q R 638, 659; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 484, paras 15.43-64.

### 7.2.3 Monetary Compensation

The extent of the divergence between the Iraqi Civil Code of 1951 and English law concerning the monetary remedy requires each of them to be dealt with in a separate section.

#### 7.2.3.1 The Position under the Iraqi Civil Code of 1951

It has been mentioned that monetary compensation is the primary remedy under the Civil Code of 1951,<sup>100</sup> and that it aims to restore the injured party to his former position, as if he had not suffered any loss.<sup>101</sup> This remedy is applicable if it is either impossible to reinstate the original property, or if the nature of a director's breach renders compensation the sole remedy. This remedy is applied in particular when the director has usurped a corporate opportunity or exploited its information.<sup>102</sup>

This personal claim is premised on establishing the tort elements,<sup>103</sup> including damage, which will be the focus of the following discussion. In other words, the claim takes the shape of a right in *personam* against the delinquent, while the aggrieved does not own a right in *rem* over the subject matter of his alleged right. The monetary compensation consists of two elements enunciated in 207(1) of the Civil Code of 1951, which states:

In all cases the court will estimate the damage in limits that are commensurate with the injury and the loss of gain sustained by the victim, provided that this was a natural result of the unlawful act.

Generally, the loss incurred by the plaintiff and the loss of gains are independent elements rather than being cumulative, and together constitute the total compensation. For example, destruction of a company's assets may give rise to the claim of liability

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<sup>100</sup> See Art.209 of this Code 1951, which has been mentioned above.

<sup>101</sup> Emile Van Der Does De Willebois & Jean-Pierre Brun, 'Using Civil Remedies in Corruption and Asset Recovery Cases' (2013) 45 Case W Res J Int'l L 615, 622-629.

<sup>102</sup> Nawaf Hazim Khaled, 'The Role of Fault Gravity in Estimating the Compensation' (2010) 3(11, 12) Al-Hiqouq, 150.

<sup>103</sup> Again, it should be taken in mind that there are several legislative defects in addressing several aspects of managerial duty, as a result of Iraqi Company law failure to develop special rules of enforcement of directorial duty in all relevant Iraqi legislation. So, resort to tort liability is indispensable to bridge these gaps. See for instance Chapter 4, para 4.1.2.

for damage, plus the loss of the benefits that would have accrued from its use. But in the area of exploiting the company's opportunity, the elements mentioned may be reduced to a single one: under Iraqi law, a corporate opportunity is merely a potential gain, but loss of the opportunity *per se* constitutes damage that must be redressed.<sup>104</sup> However, the company may be unable to recover the gain fully, because it will be subject to the court's assessment. The court's investigation will concentrate on whether there is an actual (real) opportunity to engender profits, and not just a hope,<sup>105</sup> and on the company's chances of successfully exploiting the opportunity.<sup>106</sup>

The probability ratio<sup>107</sup> will increase or decrease the compensation amount<sup>108</sup> according to rules of mathematical calculation.<sup>109</sup> For example, if the case of *Industrial Development Consultants v Cooley*<sup>110</sup> had been reviewed under Iraqi law, the court would have taken into account the probability of the company's success in securing the opportunity, which in this case did not exceed 10%, and would have assessed the compensation accordingly.

The company must also demonstrate that a director has caused it damage by using its information, e.g., by means of his unauthorized activity on behalf of a competitor firm. For this reason, some commentators of Iraqi law believe that the provisions that contain restrictions on a director's freedom in this respect are merely statutory

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<sup>104</sup> Saadoun Al-Ameri, *the Compensation for Damages in the Tortious Liability* (Legal Research Centre 1981) 25, Yousif Zakaria, 'The Rules of Compensation for Missing an Opportunity in the Law' <<https://www.facebook.com/dr.yousifzakaria/posts/468559623216768>> accessed 11 September 2013; Adnan Al-Sarhan, 'The Damage' <[www.lawjo.net/vb/attach\\_hme\\_nt.php?attachmentid](http://www.lawjo.net/vb/attach_hme_nt.php?attachmentid)> accessed 11 September 2013.

<sup>105</sup> Yousif Zakaria, 'Conditions for Compensating a Missing Opportunity in Islamic Jurisprudence and in the Law' <<https://ar-ar.facebook.com/dr.yousifzakaria/posts/472164536189610>> accessed 11 September 2013.

<sup>106</sup> Saadoun Al-Ameri, *the Compensation for Damages in the Tortious Liability* (Legal Research Centre 1981) 32.

<sup>107</sup> Ibrahim Dessouki Abu Al-Laeel, 'Compensation for Losing an Opportunity' (1986)10(1) R J 81, 110 para 20; Yousif Zakaria, 'Conditions for Compensating a Missing Opportunity in Islamic Jurisprudence and in the Law' <<https://ar-ar.facebook.com/dr.yousifzakaria/posts/472164536189610>> accessed on 11 September 2013.

<sup>108</sup> Ibrahim Dessouki Abu Al-Laeel, 'Compensation for Losing an Opportunity' (1986) (1986)10(1) R J 81, 109 para 19.

<sup>109</sup> Yousif Zakaria, 'Conditions for Compensating a Missing Opportunity in Islamic Jurisprudence and in the Law' <<https://ar-ar.facebook.com/dr.yousifzakaria/posts/472164536189610>> accessed on 11 September 2013.

<sup>110</sup> [1972] 2 All ER 162. For more details about the facts of the the above case, see Chaper 4 of this thesis, fn(42).

restrictions, (disability rules)<sup>111</sup> and that infringing them does not in itself give rise to the director's liability. In practice, the passing of company information to another company by a multi-director is extremely difficult to prove, because it is hard for one company to be aware of what happened in the boardroom of another company.

Concerning the breach of *the duty to declare an interest in a deal*: the company must establish that the approval for the transaction has been given by reason of the participation of the interested director at the meeting and giving his vote, without obtaining a prior approval from it (fault element). In addition, the company must demonstrate that the undeclared interests in a deal has caused it damage (the causation link), which takes the shape of the acceptance to enter into the deal which contained unfair conditions for the company (damage element). So, if a director has succeeded in establishing that the conditions of the transaction concerned was beneficial to the company, and that his failure to declare his interest did not harm the company, liability will not arise.<sup>112</sup> Thus, the director does not need to disclose his interests when he knows that the clauses of the transaction agreement do not conflict with the company's interests, and this makes his duty less rigid. Damage must be demonstrated even if the director has used his voting right or his influence over his co-directors to obtain their approval for a conflict of interests in a contravention of Act.119 of the I.C.A. 1997, which caused invalidity of the decision taken.

Likewise, if a transaction is tainted by a bribe or a secret commission that did not affect the fairness of the transaction, then liability will not arise. The unfairness condition is applied apart from whether there is a threat to the company stemming from the director's conduct. It is instructive to mention that the agreement between the briber and bribed, according to Islamic Al-Sharia<sup>113</sup> and the Civil Code 1951,<sup>114</sup> will be null

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<sup>111</sup> Ahmed Ibrahim Al-Bassam, the *Commercial Companies in Iraqi Law* (Second edn., Al-Zammaan publisher 1967) 181, para 140; Akram Yamuluki, *the Brief in Explaining Iraqi Commercial Law: Part 2 in the Commercial Companies* (Private Company Publisher 1969) 250.

<sup>112</sup> This test is regarded by the American Delaware courts. See: Kenneth W. Nielsen, 'Directors' Duties under Anglo-American Corporation Law' (1966)43 U Det L J 605, 637, Deborah A. Demott, 'The Figure in the Landscape: A Comparative Sketch of Directors' Self-Interests' (1999) 62 Law and Contemp Probs 243, 253; Norwood P. Beveridge, Jr, 'The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction' (1992) 41 DePaul L Rev 655,671.

<sup>113</sup> Ali Al-Rubaie, *Bribery Rules in Al- Sharia and the Law: a Comparative Study* (Egypt Murtaza Foundation for Iraqi Books 2009) 21.

<sup>114</sup> Art.130(1) of the Civil Code 1951 invalidates any agreement that is contrary to general order or general morality. See also Art.138 of this Code.

and void, and the company would be unable to account its director for a benefit gained. It is hard in this instance for the court to quantify the damage resulting from the increase of transaction financial conditions by reason of adding the amount paid as a bribe to the total amount of the transaction to ensure the restoration of the benefit paid.<sup>115</sup> The difficulty stems from the fact that damage might be more, or less, than the benefit given to the director.<sup>116</sup> Therefore, the confiscation of the benefit is conducive to eliminate this difficulty. This is a flaw through which the court will lose an important means of quantifying the size of the damages.

The difficulties include not only the conceptual framework of civil liability, but also the technical matter of the compensation assessment. According to the author's personal experiences as a former solicitor, determining the quantity of damage requires the court to assign experts for this purpose.<sup>117</sup> This procedure takes a long time and involves additional costs, and there is no guarantee that the experts will be correct (or predicable) in their assessment.<sup>118</sup>

The above rules reflect the compensatory nature of civil liability, which aims to avoid the recovery of compensation greater in value than the value of the damage suffered by the aggrieved party. In addition, the complexities associated with proving the elements of the case could lead to undesirable results, such as the following: first, in inhibiting the company from instituting an action against the director, and inclining them to favour his removal. Secondly, the company may seek to absolve a director from his liability by settling the matter and then presenting the settlement of final accounts under this formula.<sup>119</sup> The above measures would be conducive to poor corporate governance, and are contrary to the role of civil liability in the area of

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<sup>115</sup> *European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] A.C. 250, [37].

<sup>116</sup> *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643 (QB); *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119. See also P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 222, para 515.

<sup>117</sup> See the Iraqi Evidence Act 1979, Arts.132-146.

<sup>118</sup> There are currently few experts in Iraq qualified to determine whether a director has exploited the company's confidential information and the commercial value of that information. For more details see Miqdad A. Al-jalili, 'The Judicial Accountancy and their Applicability in Iraq' (2010) 43(107) *Al-Rafidain Rev J* 9, 11.

<sup>119</sup> See Rules 6(18), and 10(19) of the Iraqi Accounting Standards Board (R.I.B.A.S.) 2011, under which the company must explain how to settle the litigation that would otherwise be brought against a director.



company law as a means to ensure that a company will gain the greatest possible benefit from its director, as opposed to focussing on the size of the damage.<sup>120</sup> These considerations are taken into account by English law, as will be seen in the next section.

### 7.2.3.2 The Position under English Law

It is not intended in this section to discuss all the rules governing the enforcement of fiduciary duty under English law, which are complex, and have many ramifications. Instead, it will highlight the general principles underpinning the equitable remedy, which are built on the *deterrence policy*.<sup>121</sup> The rationale behind this policy is to prevent, or at least reduce, the risk of a director's abuse of his office by nullifying any incentive for him to do so.<sup>122</sup> The consequences of the aforementioned principle are as follows:

1. The accountability of a director for his profits: at first, a fiduciary must be fully discharged of the benefits gained as a result of his wrongdoing,<sup>123</sup> as if it represented an authorized benefit by the company.<sup>124</sup> The rule of the accountability is linked with the time-honoured rule in English law, that is: a director is not allowed to retain any benefits stemming from the abuse of his office.<sup>125</sup> Confiscated benefits are to include

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<sup>120</sup> Suleiman Barrak Dayeh, 'the Role of the Compensation in the Contractual Liability' (2009) 1(1) Journal of the College of law-Al-Nahrain University 69, 77.

<sup>121</sup> Peter Devonshire, 'Account of Profits for Breach of Fiduciary Duty' (2010) 32 Sydney L Rev 389, 394.

<sup>122</sup> Matthew Conaglen, 'The Extent of Fiduciary Accounting and the Importance of Authorization Mechanisms' (2011) 70(3) C L J 548, 556-557.

<sup>123</sup> *Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company* [1914] 2 Ch 488 (CA); *Cook v Deeks* [1916] 1 AC 554 (PC); *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 (CH) [99]; *Murad v Al-Saraj* [2005] EWCA Civ 959, [2005] All ER (D) 503 (Jul) [77]. See also Matthew Conaglen, 'The Extent of Fiduciary Accounting and the Importance of Authorization Mechanisms' (2011)70(3) C L J 548, 555; L. S. Sealy, 'Some Principles of Fiduciary Obligation' (1963) 21(1) C L J 119, 128.

<sup>124</sup> P. J. Millett, 'Equity's Place in the Law of Commerce' (1998) 114(Apr) L Q R 214, 222.

<sup>125</sup> *Cook v Deeks* [1916] 1 AC 554, 564 (PC); P. D. Finn, *Fiduciary Obligations* (Law Book Company Ltd 1977) 231, para 535; Andrew D. Hicks, 'The Remedial Principles of Keeck v Sndford Reconsidered' (2010) 69 (2) C LJ 287, 313.

both current<sup>126</sup> and future profits,<sup>127</sup> and their proceeds,<sup>128</sup> including any renewal of the contract.<sup>129</sup> Stripping a director of the whole of his profits kills two birds with one stone: it provides full compensation to the company; it inhibits a director from abusing his office by the imposition of a harsh penalty.

The confiscation of a benefit does not require proof of damage,<sup>130</sup> or causation,<sup>131</sup> and does not depend on whether or not the impugned transaction has been affirmed,<sup>132</sup> which are the requirements of a claim for equitable damage.<sup>133</sup>

2. In order to prevent the plaintiff being compensated twice for the same loss,<sup>134</sup> he may be given a choice between depriving a director of a benefit gained, or receiving compensation for the loss.<sup>135</sup> This option is given when it can be shown that there is a

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<sup>126</sup> *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 [96] (CH).

<sup>127</sup> *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162, 176 (Assizes). But in *Murad v Al-Saraj* [2005] EWCA Civ 959, [2005] All ER (D) 503 (Jul) [116], Lord Jonathan made it clear that the accounting for profits may not include ‘...profits which are not tainted in any way by the position of conflict in which the defendants placed themselves...’ and he determined the period of accountability of the delinquent as two years. This approach seems fair, because the causation between the gained profits and the breach had become tenuous. For more details see Peter Devonshire, ‘Account of Profits for Breach of Fiduciary Duty’ (2010) 32 Sydney 389, 400-401.

<sup>128</sup> *Cook v Deeks* [1916] 1 AC 554 (PC); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 [97] (CH) (Lawrence Collins J). See also R.C. Nolan, ‘Enacting Civil Remedies in Company Law’ (2001) 1 J Corp Lm Stud 245.

For example in *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162 (Assizes), any additional profits obtained after the court decision is being recoverable, because it belongs to the company. This rule includes the case of multi-directorship.

<sup>129</sup> *Lindsley v Woodfull* [2004] EWCA Civ 165, [2004] EWCA Civ 720.

<sup>130</sup> Paul Davies, Sarah Worthington & Eve Micheler, *Gowers and Davies, Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 580, para 16-81; Michele Havenga, ‘Company Directors-Fiduciary Duties, Corporate Opportunities and Confidential Information’ (1989) 1 S Afr Mercantile L J 122, 131; Andrew Keay, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 480, para 15.28.

<sup>131</sup> *Bray v Ford* [1896] AC 44, 51 (HL); *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162, 176 (Assizes) (Roskill J); *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144 (HL) (Lord Russell). For more details of this issue, see Peter Devonshire, ‘Account of Profits for Breach of Fiduciary Duty’ (2010) 32 Sydney 389, 394.

<sup>132</sup> *Gwembe Valley Development Company Ltd v Thomas Koshy* [2003] EWCA Civ 1048, [2003] WL 21729210 [137]. See also: Len Sealy, ‘Directors’ Duties Revisited’ (2001) 22(3) Comp Law 79, 81.

<sup>133</sup> For more details of the above element in common law see *Swindle v Harrison* [1997] 4 All ER 705, 733 (CA) (Mummery LJ). R.C. Nolan, ‘Enacting Civil Remedies in Company law’ (2001) 1(2) JCLS 245, 266; Tsun Hang Tey, ‘Fiduciaries, Third Parties and Remedies-Singapore’s Perspectives and Contribution’ (2010) 24(4) Tru L I 234, 246.

<sup>134</sup> *Tang Man Sit (decd) (personal representative) v Capacious Investments Ltd* [1996] 1 All ER 193, 202 (PC). See also Len Sealy, ‘Directors’ Duties Revisited’ (2001) 22(3) Comp Law 79, 81; Archana Sinha, ‘Directors’ Duties- Breach of Fiduciary Duties’ (2002) 13(7) I C C L R 266, 267.

<sup>135</sup> *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 (CH) [140]; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749 (CH) [79]-[80]; *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119 [54]. See also Mathew D. J. Conaglen, ‘Equitable Compensation for Breach of

*quantitative difference* between the damage incurred by the company and the resultant benefit resulting from the breach, due to the fiduciary's failure to exploit the opportunity better than his firm.<sup>136</sup>

3. Pursuant to s.195(3) of the C.A. 2006,<sup>137</sup> if damage has been demonstrated, the court is entitled both to hold the delinquent to account and to impose equitable compensation<sup>138</sup> for the damage.

4. Also, the company is entitled to equitable compensation for damage when a director has failed to generate a profit due to his abuse of his office.<sup>139</sup>

In order to enable a company to deprive the director of his benefit entirely,<sup>140</sup> English law renders the director, and any stranger implicated in the violation, to be a *constructive trustee* in favour of the firm, since it treats the benefits gained as if the gains were part of the company's property.<sup>141</sup> This equitable technique enables the beneficiary to trace a benefit (or its fruits), and to be given priority<sup>142</sup> over the unsecured creditors of a director. This remedy has legal significance in cases where

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Fiduciary Dealing Rules' (2003)119 L Q R 246; Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 482, para 15.34.

<sup>136</sup> Pauline Ridge, 'Justifying the Remedies for Dishonest Assistance' (2008) 124 L Q Rev 445, 454; Paul Davies, *Introduction to Company Law* (2th edn., OUP 2010) 182.

<sup>137</sup> Which relates to the consequences of a breach of the rules governing the substantial transaction of property.

<sup>138</sup> For more details about "equitable compensation", its features, see Andrew Keay, *Directors' Duties* (Second edn, Jordan Publishing Ltd 2014) 475-480, paras 15.11-26.

<sup>139</sup> *Target Holdings Ltd v Redferns (a firm)* [1995] 3 All ER 785, 796-798 (HL) (Brown- Wilkinson); *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244, [2005] I CR 450; *Breitenfeld UK Ltd v Harold John Harrison, John George Harrison, Gemma Lucy Harrison, Harrison Special Steels Ltd* [2015] EWHC 399 (Ch), 2015 WL 685420 (Norris j.) [76]. See also: Matthew Conaglen, 'Remedial Ramifications of Conflicts between a Fiduciary's Duties' (2010) 126 L Q R 72, 78-80.

<sup>140</sup> Andrew D. Hicks, 'The Remedial Principles of Keech v Sandford Reconsidered' (2010) 69(2) C LJ 287, 299.

<sup>141</sup> *Cook v Deeks* [1916] 1 AC 554, 564 (PC); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC (CH) [96] (Lawrence Collins).

According to Jules Sher Q.C. in *Coulthard v Disco Mix Club Ltd* [2000] 1 W L R 707, 731 (CH) 'a constructive trust ... I shall refer to as the remedial constructive trust, was not treated like a real trust, where there was no question of limitation at all. The statute was applied to the wrongdoing which gave rise to the defendant's liability as constructive trustee'. Cited in *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48, [2003] 2 AC 366 [142].

Some scholars have raised doubts as to whether the exploitation of a corporate opportunity can be deemed in fact to be a part of a company's assets to justify considering the director a constructive trustee, and giving the company a priority over the director's creditors. For more details of this issue see Sarah Worthington, 'Corporate Governance: Remedying and Ratifying Directors' Breaches' (2000) 116(Oct) L Q R 638, 671; R.C. Nolan, 'Enacting Civil Remedies in Company Law' (2001)1(2) JCLS 245, 257; Curk Shue Sing, 'Avoidance of loss, Regal Hastings and the No Conflict Rule' (2013) 34(3) Comp Law 73, fn (24).

<sup>142</sup> *Foskett v McKeown* [2000] 3 All ER 97,120 (HL) (Lord Millett); *Boscawen v Bajwa*; *Abbey National plc v Boscawen* [1995] 4 All ER 769, 776 (CA).

the director is bankrupt,<sup>143</sup> except when there is a *bona fide* purchaser without a notice.<sup>144</sup>

However, this equitable technique of English law cannot be applied under the Civil Code of 1951. The regime of precautionary seizure set out under Arts. 231-250 of the Iraqi Civil Pleadings Act No.83 1969, which empower the court to seize a debtor's assets, is not compatible with the action of constructive trust due to its limited effects, which can be summarized as follows: Firstly, the effects of precautionary seizure commence at the date of the enforcement of the seizure. While the effect of the constructive trust begins on the date at which *the original right* arises. Secondly, the precautionary seizure is confined to debts that must be known, specified, payable, and fixed under a written instrument.<sup>145</sup> The compensatory nature of the plaintiff's right under the Civil Code of 1951, however, requires that the right must be determined at the date of the judgment, and not before. So, it is impossible to use this procedure to secure the company's right of compensation. Third, this procedure does not give the company priority over unsecured creditors of the director<sup>146</sup> (in contrast to constructive trustee rules). Apparently, precautionary seizure is unlikely to achieve the same purpose as the constructive trust under English law, which provides the utmost degree of safeguards to rights in a commercial environment.

To sum up, the pecuniary compensation approach under the Civil Code 1951 involves numerous *lacunae*. These shortcomings provide further evidence that tort liability is inconsistent with the nature of directorial activities, and that it is incapable of playing a deterrent role in this respect. The solution to these problems would be to consider the director as a *fiduciary* for the company's interests, and for him to be a constructive

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<sup>143</sup> Emile Van Der Does De Willebois & Jean-Pierre Brun, 'Using Civil Remedies in Corruption and Asset Recovery Cases' (2013 ) 45 Case W Res J Int'l L 615, 619; George L. Gretton, 'Constructive Trusts: Part 1' (1997) 1(3) Edin L R 281, 282.

<sup>144</sup> *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, 2012 WL 3062611]; *Boscawen v Bajwa*; *Abbey National plc v Boscawen* [1995] 4 All ER 769, 77(CACA) (Millett LJ) *Foskett v McKeown* [2000] 3 All ER 97, 120 (HL) (Millett LJ). See also: P. J. Millett, 'Equity's Place in the Law of Commerce' (1998) 114(Apr) L Q R 214, 217. Concerning the criticism directed to the regime of constructive trust in the commercial environment, see: Andrew D Hicks, 'The Remedial Principles of Keech v Sandford Reconsidered' (2010) 69(2) C LJ 287, 316-317.

<sup>145</sup> See the Civil Pleadings Act 1969, Art.231.

<sup>146</sup> In this context, see Arts.160 (2) of the Civil Code 1951 which prevent giving any priority or preference, except under an explicit provision. See also 1361(2) of this Code.

trustee of the benefits obtained which belong to the company. It could be said that some of the notions fixed under English law are fictions and inconsistent with the civil law system. But Iraqi law also makes use of similar legal ploys, for example, the legal person, and the continuation of the legal personality of the deceased person until the distribution of his legacy. Therefore there is no reason why Iraqi law should not borrow other useful conceptions from other schools of law, as long as this is done in the interests of a vulnerable person, such as a company.

### Section III

#### Liability of a Third Party for a Director's

#### Breach of Duty

Introduction: It may seem incongruous that a third party should incur liability for a director's breach of duty.<sup>147</sup> But the imposition of such a liability is significant for two reasons: Firstly, it is a means of preventing a director from dishonestly obtaining assistance in violating a duty.<sup>148</sup> It enhances respect for the law, particularly in the commercial environment.<sup>149</sup> Incurring liability to a third party would also help to combat money-laundering.<sup>150</sup> Secondly, it is in a company's best interests for a solvent person (who is often a company)<sup>151</sup> to incur the liability, and the possibility of a director's insolvency or his absconding would also be diminished.<sup>152</sup>

Despite this, the Iraqi Companies' Acts do not provide special rules for this liability, except for a partial treatment of some of its aspects. This legislative loophole raises the need, first of all, for the investigation of the extent to which the general principles of law address the liability of a third party in achieving the above purposes; and, secondly to ensure the appropriateness of these provisions with the the exigencies of avoiding the imposition of an improper and onerous restriction on a stranger's freedom.<sup>153</sup>

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<sup>147</sup> Sarah Worthington, 'Corporate Governance: Remediating and Ratifying Directors' Breaches' (2000) 116(Oct) L Q R 638, fn(98).

<sup>148</sup> *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 387 (PC). Pauline Ridge, 'Justifying the Remedies for Dishonest Assistance' (2008) 124 L Q Rev 445, 446; Tom Hibbert, 'Dishonesty and knowledge of Accessories and Recipients' (2000) 15(6) J I B L 138.

<sup>149</sup> In this context see the Commerce Act No. 30 1984, Art.3.

<sup>150</sup> Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 81.

<sup>151</sup> Paul Davies, Sarah Worthington & Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 598, para 16-97.

<sup>152</sup> Pauline Ridge, 'Justifying the Remedies for Dishonest Assistance' (2008) 124 L Q Rev 445, 446; Nikunj Kiri, 'Recipient and Accessory Liability-Where do We Stand Know?' (2006) 21(11) JIBLR 611; Charles Mitchell, 'Dishonest Assistance, Knowing Receipt, and the Law of Limitation' (2008) 3 CONVPL 226.

<sup>153</sup> Tom Hibbert, 'Dishonesty and Knowledge of Accessories and Recipients' (2000) 15(6) J I B L 138.

Accordingly, this section will be divided into two parts: The first will be devoted to showing situations where this liability arises. The second section will be allocated to discussing the effects of the liability.

### **7.3.1 Situations Causing the Liability of a Third Party to Arise**

As mentioned, neither Iraqi law nor Iraqi legal commentators explicitly deal with the liability of a third party under the headings of *knowing receipt* and *knowing (or dishonest assisting)*, which are the basis of liability under English law. The above English methodology will be adopted in exploring the position of Iraqi law in this respect.

#### **7.3.1.1 The Knowing Recipient**

The liability under this heading presupposes that a company has an interest in a property that was transferred in a tainted transaction, e.g., where the property was usurped or purchased by a director and then transferred to a stranger.<sup>154</sup> The recipient's liability is based on his knowledge of a director's breach. If the third party is a company, the knowledge of its director is equated with the company's knowledge.<sup>155</sup>

But what is the degree of knowledge is required in order for the stranger's liability to be triggered? The answer to this question involves the identification of situations that fall under this reason, and of the level of knowledge required under Iraqi law.

Concerning the first issue, Peter Gibson J. in *Baden, in Delvaux and Lecuit v Société General pour Favoriser le Développement du Commerce et de l'Industrie en France*

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<sup>154</sup> Daniel J. Carr, 'Equity Rising? *Commonwealth Oil & Gas Co Ltd v Baxter*' (2010) 14(2) *Edin L Rev* 273, 276.

<sup>155</sup> *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685 (CH); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [79]. See also Stephen Girvin, Sandra Frisby & Alastair Hudson, *Charlesworth's Company Law* (18<sup>th</sup> edn, Reuters 2010) 379-380, para 17.076.

SA<sup>156</sup> (hereinafter the *Baden* case), accepted a proposal that there are five kinds of required knowledge, which can be classified within two main categories:-

(1) Actual knowledge,<sup>157</sup> which includes, according to the Civil Code 1951, subsequent knowledge under a notice.<sup>158</sup>

(2) Constructive knowledge,<sup>159</sup> which includes: (i) wilfully shutting one's eyes to the obvious (a desire not to know);<sup>160</sup> (ii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make (when he believes that knowing certain facts is not subsumed within what is his business to know);<sup>161</sup> (iii) knowledge of circumstances which would indicate the facts to an honest and reasonable man;(iv) knowledge of circumstances which would lead an honest and reasonable man to inquire, and otherwise make the recipient liable according to his knowledge.<sup>162</sup>

The above categories represent standards of knowledge that do not differ from one legal system to another. However, there is *blatant inconsistency* between Iraqi legislation concerning the level of required knowledge, which can be summarized as follows:-

1. In the case of a transaction concluded by a company with a third party in which a director has concealed his interests, Art.122 of the Civil Code 1951 states that:

Where the fraud has been practiced by a person other than the contracting parties [third party] the contract will not be suspended except where it has been established by the aggrieved party that the other contracting party *was aware* or it was *easy for him to be aware of this fraud at the time of the contract conclusion*.<sup>163</sup>

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<sup>156</sup> [1983] BCLC 325 (CH) [250].

<sup>157</sup> See *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, 454 (Nourse LJ); *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30 [113].

<sup>158</sup> Art.257 of this Code. In English common law see: *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 291 (Millett J). See also Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 69.

<sup>159</sup> *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 293 (Millett J); *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30 [113].

<sup>160</sup> Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 58.

<sup>161</sup> *Ibid*, 58.

<sup>162</sup> *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 295 (ch) (Millett J); *Commonwealth Oil and Gas Co Ltd v Baxter* [2009] CSIH 75, [2010] S C 156 [94] (Lord Nimmo Smith); *Eagle Trust Plc v S B C Securities Ltd* [1993] 1 WLR 484 493 (CH) (Vinelott J).

<sup>163</sup> [Illustration and emphasis added].



This Article contains an approach that goes beyond mere actual knowledge, by virtue of using the phrase ‘it was easy for him to be aware of this fraud ...’. Therefore, if it is difficult for the third party to be aware of the breach, then in that case the liability would not arise. This is an ambiguous requirement, because it raises the question of whether it includes the categories set out in (ii), (iii) and (v) of *Baden's* classification. While fault, under Civil Code 1951, must be assessed “objectively”,<sup>164</sup> the Article mentioned adopted a subjective test. Apparently, this provision necessitates analysing the personality of the wrongdoer, because persons vary in their level of intelligence, diligence and vigilance. Therefore, this standard is extremely difficult to be applied by the court. Moreover, Art.122 of the Civil Code 1951 refers to the knowledge of the breach at the time of the transaction conclusion. But this *ex-ante* knowledge does not shield a company from the stranger’s abuse in avoiding liability after learning of the reality, in cases where a property is transferred to another *bona fide* purchaser. But this actual knowledge is confined to the above situation only, while the relation between the stranger and the owner in other cases is governed by the following provisions.

2. More generally, within the context of rights *in rem*, a stranger could allege, in case of a dispute with the company, that he has a priority in possessing the property. Art.1148(1) of the Civil Code 1951 gives this priority to a *bona fide* possessor, as follows: ‘A person is deemed *bona fide* if he possesses the thing and is unaware that he encroached on the right of another, and the good faith is always assumed, unless the contrary is established’.<sup>165</sup>

The matter of good or bad faith is a question of fact, and is not subject to the oversight of the High Court<sup>166</sup>. If the director has acquired the company’s property and then transfers it to a third party, the latter is deemed to be the successor of the transferor. The possession of a third party is separate and distinguished from the predecessor’s possession in the matters related to good or bad faith.<sup>167</sup>

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<sup>164</sup> The Civil Code 1951, Art. 251(1).

<sup>165</sup> See also the Civil Code 1951, Art.1164 in respect of chattel.

<sup>166</sup> Mohamed Taha Al-Bashir and Ganny Hassoun Taha, *The Rights in Rem: Part I* (Ministry of Higher Education and Scientific Research, 1982) 236-237 para 248; Bassam Majed Solaiman, ‘The Legal Regulation of Possession’ (2011) 14(50) *Al-Rafidain L J* 1, 33-36.

<sup>167</sup> Bassam Majed Solaiman, ‘the Legal Regulation of Possession’ (2011) 14(50) *Al-Rafidain L J* 1, 33-36.

Seemingly, Article 1148 (1) of the Civil Code 1951 requires actual knowledge that the property belongs to the company, and that a director has misused the company's property. Mere doubt is less than certainty, and therefore does not constitute the level of knowledge<sup>168</sup> mentioned under the *Baden* classification. Giving a broad interpretation to the above provision would collide with the time-honoured rule that states: 'the doubt shall be interpreted in favour of the debtor.'<sup>169</sup>

Art.1148(1) of the Civil Code 1951 is characterized by its ease of application and its consistency with commercial activity, which depends on speed in the transferral of property, without burdening the recipient with the duty to inquire about its source.<sup>170</sup> But this level of knowledge is extremely narrow and appears to be incapable to assimilate the circumstances mentioned in the *Baden* case, which occur every day and are conducive to attenuate the liability of the third party. Moreover, the knowledge of the others' rights adds another difficulty for the plaintiff. For example, under the above Article, a stranger may not be responsible for the purchase of a textile machine from a person if this is coupled with the knowledge of his capacity as a director in a textile factory and his financial position does not enable him to be the machine owner. Notwithstanding, the provisions of the Civil Code 1951 do not impose a duty to inquire about the source of the property. Furthermore, while inquiry into the validity of a transaction is inherent in the principle of good faith *per se*,<sup>171</sup> Art.1148(1) of the Civil Code 1951 confines the meaning of this principle to the matter of knowledge, which *is inevitably an unsound approach*, and is inconsistent with the essence of the principle.

In this respect, under English law, by contrast, the plaintiff should prove that there was a disposal of the company's assets in breach of a fiduciary duty, and the defendant should realize that his behaviour will assist in that breach or in receiving the trust

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<sup>168</sup> Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 149.

<sup>169</sup> The Civil Code 1951, Art.166. Some commentators think that good faith includes avoiding gross negligence. Mohamed Taha Al-Bashir and Ganny Hassoun Taha, *The Rights in Rem: Part 1* (Ministry of Higher Education and Scientific Research, 1982) 236-237, para 248.

<sup>170</sup> See the dicta of Lindley L J in *Manchester Trust v Furness* [1895] 2 QB 539, 545 (CA); *Eagle Trust Plc v S B C Securities Ltd* [1993] 1 W L R 484 (CH) (Vinelott J).

<sup>171</sup> *Niru Battery Manufacturing Co v Milestone Trading Ltd* [2002] EWHC 1425 (Comm), [2002] 2 All ER (Comm) 705 [135]. Cited in *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 (Ch), [2012] 3 W L R 835, [106-108].

property, but further details of the matter are not required.<sup>172</sup> Mere doubt is sufficient to raise the stranger's duty of inquiry.<sup>173</sup>

3. The Anti-Money Laundering Act of 2004 imposes duties on a financial institution to undertake an inquiry into the sources of property, if it:-

...has reason to doubt the identity of the customer or the beneficial owner of the funds... in order to form a reasonable belief that it knows the true identity of its customer and/or any beneficial owner of the funds involved.<sup>174</sup>

Apparently, the duty of inquiry includes constructive knowledge (what ought to be known) as defined in the *Baden* case. But the scope of this Act is restricted to criminal and unlawful activities,<sup>175</sup> e.g., expropriating the company's property; obtaining a bribe or a secret commission in the Mixed Sector Companies. The power of inquiry nevertheless does not include the perpetration of civil wrongdoing not spelt out by the law. The latter activities may likewise not give rise to the stranger's liability either because the misbehaviour is not criminalized by law, or because certain aspects of a director's duties are not codified in the I.C.A. 1997, and so are not considered to be statutory duties.

Numerous comments can be made about the above provisions:

First, the above provisions adopted the fault-based approach, which is embodied in the form of knowledge by a stranger of the breach of a managerial duty that has caused damage to a company.<sup>176</sup> So, this liability is original and is independent of a director's fault. Whereas the stranger's liability under English law is accessory (secondary)<sup>177</sup> to

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<sup>172</sup> *Baden, Delvaux and Lecuit v Société General Pour Favoriser le Développement Du Commerce et De l'Industrie en France SA* [1983] BCLC 325 (CH) [248]; *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, 700 (CA) (Hoffmann LJ); *Commonwealth Oil and Gas Co Ltd v Baxter* [2009] CSIH 75, [2010] S C 156 [87] (Lord Nimmo Smith). In *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 (HL) [109], Lord Millett has emphasised on that the '... accessory to any breach of trust whether fraudulent or not...' is sufficient.

<sup>173</sup> *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 (Ch), [2012] 3 W L R 835 [132].

<sup>174</sup> Art.17(1) of this Act.

<sup>175</sup> Art.3 of this Act states that the Act's jurisdiction includes 'Whoever conducts or attempts to conduct a financial transaction that involves the proceeds of some form of unlawful activity..'.

<sup>176</sup> See the Civil Code 1951, Art.217 which has been mentioned earlier in this Chapter.

<sup>177</sup> See *Agip (Africa) Ltd v Jackson* [1990] Ch 26, 295 (CH); *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 [26], [107] (HL)[Lord Millett]; *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 385 (PC).

a director's liability, due to his interference '... with the due performance by the trustee of the fiduciary obligations undertaken by the trustee'.<sup>178</sup> Proving the existence of a fault or a causal link between a stranger's conduct and damage to a company is irrelevant for causing the accessory's liability to arise,<sup>179</sup> as those requirements are also irrelevant for raising the director's liability. The advantages of enshrining a stranger's independent liability seems to be that it enables a company to obtain damages from him in cases where there are reasons for excluding<sup>180</sup> or releasing the fiduciary from liability.<sup>181</sup> But the difficulties in relation to proving the stranger's fault could operate to mitigate the effective accountability of a third party in this regard. Moreover, the strict rules for dealing with the consequences of a director's breach of his duty do not extend to a third party.<sup>182</sup>

Second, the above provisions reflect the lack of a uniform policy in tackling this matter, and there are practical difficulties in applying them. The above contradictions in the statutory provisions may create an ambiguity in determining the adopted approach by Iraqi law in relation to this liability, which could be exploited by a third party to fend off his liability.

Third, Iraqi law, by espousing the "knowledge" basis, seems remote from recent developments under English common law, which shift from the knowledge-based approach<sup>183</sup> towards the "unconscionability test". This approach necessitates that

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See also Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 598, para 16-97; Pauline Ridge, 'Justifying the Remedies for Dishonest Assistance' (2008) 124 L Q Rev 445, 448; Tom Hibbert, 'Dishonesty and knowledge of Accessories and Recipients' (2000) 15(6) J I B L 138.

<sup>178</sup> *Royal Brunei Airlines Sdn Bhd Appellant and Philip Tan Kok Ming* 1995] 2 AC 378, 387 (PC).

<sup>179</sup> Charles Mitchell, 'Dishonest Assistance, Knowing Receipt, and the Law of Limitation' (2008) 3 CONVPL 226, 227.

<sup>180</sup> This situation is exemplified, where, the director, for example, informs his company about the bribe that has been offered to him, which result to exclude him from liability.

<sup>181</sup> *Agip (Africa) Ltd v Jackson* [1990] Ch 26, 295 (CH); *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 385 (PC); *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 [26] (HL) (Lord Hutton).

For more details of this issue, see Pauline Ridge, 'Justifying the Remedies for Dishonest Assistance' (2008) 124 L Q Rev 445, 448. See also Paul Davies, Sarah Worthington and Eva Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 598, para 16-97; Tom Hibbert, 'Dishonesty and knowledge of Accessories and Recipients' (2000) 15(6) J I B L 138.

<sup>182</sup> Charles Mitchell, 'Dishonest Assistance, Knowing Receipt, and the Law of Limitation' (2008) 3 CONVPL 226-228.

<sup>183</sup> For more details of this approach see Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 59.

‘...the recipient’s state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt’.<sup>184</sup> Such a new basis, which presupposes the knowledge of third party of a breach,<sup>185</sup> has been praised for its ability to ‘... enable the courts to give common sense decisions in the commercial context in which claims in knowing receipt are now frequently made’.<sup>186</sup> This approach aims to add flexibility in assigning liability to a stranger instead of subjecting him to the strictness of the knowledge requirement, as in the *Baden* case,<sup>187</sup> but may be inconsistent with commercial practice built on speedy transfers of property. In brief, the unconscionability test was formulated to enable the court in some circumstances to relieve a director from liability.<sup>188</sup>

However, it would be irrational to suggest “unconscionability” as a basis for liability in Iraqi law, because this concept was developed by the common law over many long years, and moreover it is not free of vagueness.<sup>189</sup> The adoption of constructive knowledge as an indispensable element for applying the “unconscionability” test<sup>190</sup> is better suited to the realities of Iraqi law at this stage, because it offers a clear guide to the court and to a third party in this regard. It may be said that this approach involves burdening a stranger with the duty of inquiring about circumstances that are not

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<sup>184</sup> *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, 455 (CA) (Nourse LJ). Cited with approval in *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, 2012 WL 3062611 [33]; *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 (Ch), [2012] 3 WLR 835 [130] (CH); *Paragon Finance plc v D B Thakerar & Co (a firm)* [1999] 1 All ER 400 (CA) (Millett LJ), 409; *Crown Dilmun, Dilmun Investments Ltd v Nicholas Sutton, Fulham River Projects Ltd* [2004] EWHC 52, [2004] WL 62020 (ch) [202] (Petersmith J); *Quarter Master UK Ltd (in liquidation) v Pyke* [2004] EWHC 1815 (Ch), [2005] 1 BCLC 245 [79].

<sup>185</sup> Stephen Girvin, Sandra Frisby & Alastair Hudson, *Charlesworth’s Company Law* (18<sup>th</sup> edn, Reuters 2010) 375, para 17-070.

<sup>186</sup> *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, 455 (CA) (Nourse LJ).

<sup>187</sup> Stephen Girvin, Sandra Frisby & Alastair Hudson, *Charlesworth’s Company Law* (18<sup>th</sup> edn, Reuters 2010) 380-381, para 17-077; Simon Gardner, ‘Knowing Assistance and Knowing Receipt: Taking Stock’ (1996) 112 L Q Rev 56, 82; Tom Hibbert, ‘Dishonesty and knowledge of Accessories and Recipients’ (2000) 15(6) J I B L 138, 139.

<sup>188</sup> Stephen Girvin, Sandra Frisby & Alastair Hudson, *Charlesworth’s Company Law* (18<sup>th</sup> edn, Reuters 2010) 379, para 17.075.

<sup>189</sup> See the criticism of Lord Nicholls of the use of this term in *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 392 (PC). See also Tsun Hang Tey Tsun Hang Tey, ‘Fiduciaries, Third Parties and Remedies—Singapore’s Perspectives and Contribution’ (2010) 24(4) Tru L I 234, 243; Nikunj Kiri, ‘Recipient and Accessory Liability—Where do We Stand Know?’ (2006) 21(11) JIBLR 611, 612; Richard Nolan, ‘How Knowing is Knowing Receipt’ (2000) 59(3) CLJUK 447; Andrew Keay, *Directors’ Duties* (Second edn, Jordan Publishing Ltd 2014) 500, para 915.91.

<sup>190</sup> Simon Gardner, ‘Knowing Assistance and Knowing Receipt: Taking Stock’ (1996) 112 L Q Rev 56, 67.

brought to his attention directly. But inserting a flexible provision is adequate to allay concerns in this respect. For example, it is logical to hold a third party liable for the actual knowledge, and for the facts of which he ought to have been reasonably aware in view of his position. Capacity of a third party should be taken into the account for the purpose of making a distinction between professional persons (like banks<sup>191</sup> and merchants), who should be better able to discover the facts than normal persons. This suggestion is an appropriate solution for Iraq in its current stage of development, as it is often described as one of the most corrupt countries in the world.

### **7.3.1.2 Knowing of (or Dishonestly) Assisting in the Infringement of a Duty**

This is another reason for a stranger's accessory liability under English law, which rules that a third party who does not "receive trust property"<sup>192</sup> may nonetheless be liable if he '...dishonestly procures or assists in a breach of trust or fiduciary obligation'.<sup>193</sup> This assistance can be envisaged by, e.g: by offering a corporate opportunity, bribe, commission or any financial assistance to the director.<sup>194</sup> Secondly, the stranger's liability for knowing assistance is fault based under Iraqi law, as will be shown shortly, but premised on accessory liability under English law.<sup>195</sup>

But what is the basis of a stranger's liability under Iraqi law? Is it premised on merely knowing of a fiduciary abuse, or must there be a degree of fraud or dishonesty?

The position of Iraqi law towards this matter is unclear. There is no reference to this situation in the Iraqi Companies' Acts. Art.3 of the Commerce Act 1984, however, in its enumeration of the Act's objectives, refers to honesty as a requirement of fair trade,

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<sup>191</sup> Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 83-84.

<sup>192</sup> *Baden, Delvaux and Lecuit v Société General pour Favoriser le Développement Du Commerce et De l'Industrie en France SA* [1983] BCLC 325 [240] (ch); *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 292 (CH).

<sup>193</sup> *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC, 392 (PC). See also Simon Gardner, 'Knowing Assistance and knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 71.

<sup>194</sup> *Baden, Delvaux and Lecuit v Société General pour Favoriser le Développement Du Commerce et De l'Industrie en France SA* [1983] BCLC 325 [246] (CH) (Peter Gibson J); *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 [107] (HL) (Lord Millett).

<sup>195</sup> *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 387 (PC).

by stating that ‘trade is an economic activity based on confidence, honesty and precise obedience of rules of law, and who does not comply with that will expose himself to civil and criminal liability’. But this provision is part of a conceptual framework describing the behaviour expected from a trader, and it omits to lay down a clear duty in this respect. For example, the Article does not define the meaning of “honest” or “dishonest” behaviour, nor does it give any other detailed provisions as to, e.g., how to ascertain whether the trader has infringed this requirement. Therefore commercial custom has to be invoked in order to explain the meaning of honesty and to determine acceptable standards commercial of behaviour.<sup>196</sup> But that task is made impenetrably difficult, because custom is inherently a less accessible source of law by practitioners, or even by the professional persons. Moreover, there is notable absence of legal analysis to this concept on the part of Iraqi courts and academic commentators, which in turn creates uncertainty in the area of identifying this concept.

Therefore, resort should be made to the Civil Code 1951 in order to find an appropriate provision for governing the above situation. In this context, resort to fraud doctrine set out in the Civil Code 1951 are unhelpful, because it deals with the wrongdoer’s endeavour to motivate the aggrieved person to enter into a transaction. While the purpose behind the dishonest assistance to a director in abusing his powers is to deprive a company of a potential benefit under an agreement whereby the aggrieved person is a stranger.<sup>197</sup> Therefore, the only way to challenge the abuse is to define the perpetrators of such conduct as contributors to an illicit action in accordance with Art.217 (1) of the Civil Code 1951, which states that:

1. The several persons responsible for an unlawful act will be jointly liable in their obligation to pay damage for the injury done without distinction between the perpetrator, the accomplice and the instigator.

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<sup>196</sup> See the Civil Code 1951, Art.163(2) which imposes on the contractors having regard to the custom, as part of the contract stipulations.

<sup>197</sup> Art.142(1) of the Civil Code 1951 ‘the contract effects shall apply to the contracting parties and to their general successors..’. The general successors mean the heir and the devisee with an unlimited share in the dead legacy. Professor Aziz Karim Jaber Al-Khafaji, ‘Is the Unfairness a Defect in the Consent itself or in the Contract itself’ (2009) 1 Al-Kufa J L P S. 15, 38; Thanon Yunis Saleh Mohammadi & Younis Salah Al-Din Muhammad Ali, ‘Misrepresentation (or Fraud) as One of the Will Defects in the English law: A Comparative Study with the Islamic Jurisprudence and Iraqi Civil Law’ (2010)1(8) Tikrit University J L & Pol S 1, 6.

2. Who has paid the entire compensation may claim from the others such part which is assessed by the court according to circumstances and the gravity of the encroachment committed by each one of them: if it was not possible to determine the extent of the responsibility of each one of them, this liability will be apportioned among them equally.

The equivalence of intentional and unintentional fault is a hallmark of Art.217 (1) of the Civil Code 1951, and is traceable to the legislative desire to give greater importance to ensuring the compensation of the aggrieved person than to investigating the wrongdoer's state of mind. Apparently, Art.217 of the Civil Code 1951 was not formulated to address the position whereby an agreement can influence the interests of a third party (company), and thus it seems unhelpful in identifying the basis of a stranger's liability in the hypothetical situation given above.

In the light of the legislative ambiguity in this respect, it is suggested that actual knowledge represents the minimum degree of certainty, because any doubt should be interpreted in favour of the debtor.<sup>198</sup> But it is correct that knowing assistance differs from assisting the wrongdoer with foreknowledge that the wrongdoer's conduct will entail some elements of "furtherance of fraud"<sup>199</sup> or '...something amounting to want of probity...'.<sup>200</sup> Thus, abstract knowledge is logically insufficient.

It would be helpful here to look at English law, which deals with this theme extensively under the heading of "knowing assistance"<sup>201</sup> (or "dishonest assistance"). The dishonesty (or the lack of probity) '...means simply not acting as an honest person would act in the circumstances....',<sup>202</sup> which assimilates logically the knowledge of a

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<sup>198</sup> The Civil Code 1951, Art.166; the Evidence Act No.107 1979, Art.6.

<sup>199</sup> *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 292-293 (CH) (Millett J); *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 [117] (HL) (Lord Millett).

<sup>200</sup> *Eagle Trust Plc v SBC Securities Ltd* [1993] 1 WLR 484, 496 (CH) (Vinelott J).

<sup>201</sup> This approach had crystallised by decisions such as: *Agip (Africa) Ltd v Jackson* [1990] Ch 265 (CH); *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1110 (Koox J) (CH); *Eagle Trust Plc v SBC Securities Ltd* [1993] 1 WLR 484 (CH).

For more details of this theme see Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 71.

<sup>202</sup> *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 389 (PC) (Lord Nicholls).



director's misbehaviour.<sup>203</sup> The detailed knowledge of violation of a duty is unnecessary for raising a stranger's liability. Instead, it is sufficient that he has realised that this action is dishonest.<sup>204</sup> The dishonesty should be measured according to a *subjective test*, because it describes a person's state of mind. But the court may apply an *objective standard*, that of the honest and reasonable person.<sup>205</sup> The '...normally acceptable standards of honest conduct...' <sup>206</sup> are used as objective presumptions for this purpose. So, it is hard to describe a person as innocent by simply claiming that he was acting honestly when he was practicing a dishonest form of behaviour. <sup>207</sup> The facts of the case need to be taken into account, which includes scrutiny of:-

[T]he nature and importance of the proposed transaction, the nature and importance of his role, the ordinary course of business, the degree of doubt, the practicability of the trustee or the third party proceeding otherwise and the seriousness of the adverse consequences to the beneficiaries. <sup>208</sup>

The court also should regard in its evaluation other circumstances, such as the '...personal attributes of the third party, such as his experience and intelligence, and the reason why he acted as he did' <sup>209</sup>

Recognizing that the personal attributes of the stranger's behaviour likewise cannot be ignored completely, in *Twinsectra Ltd v Yardley* the court adopted multi-standards (*objective-subjective*) by requiring that 'the defendant must himself appreciate that what he was doing was dishonest by the standards of honest and reasonable men.' <sup>210</sup> This approach has been vindicated by the desire to give the defendant a chance to negate his liability by proving that he did not act in a manner contrary to his personal morality.<sup>211</sup>

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<sup>203</sup> Simon Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 L Q Rev 56, 71.

<sup>204</sup> *Twinsectra Ltd v Yardley* [2002] 2 All ER 377, para [127] (Lord Millett).

<sup>205</sup> *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 390 (PC); the dissented view of Lord Millett in *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 [127] (HL); *Barlow Clowes International Ltd (in liquidation) v Eurotrust International* [2005] UKPC 37, [2006] 1 All ER 333 [10] (Lord Hoffmann); *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492, [2007] Bus LR 220.

<sup>206</sup> *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492, [2007] Bus LR 220 [16].

<sup>207</sup> *Royal Brunei Airlines Sdn Bhd and Philip Tan Kok Ming* [1995] 2 AC 378, 388-389 (PC).

<sup>208</sup> *Ibid*, 390-391.

<sup>209</sup> *Ibid*, 391.

<sup>210</sup> [2002] 2 All ER 377 [35-50] (HL) (Lord Hutton). *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492, [2007] Bus L R 220 [16].

<sup>211</sup> Stephen Grivin, Sandra Frisby and Alastair Hudson, *Chaplesworth's Company Law* (Sweet & Maxwell 18<sup>th</sup> edn, 2010) 373-374, para 17-069.

However, the above *multi-tests* are impractical and ineffective in some circumstances, for example, when it can be shown that there is a blatant conflict between the defendant's beliefs and what is to be expected from a reasonable person. Also the *subjective standard* may be used as a device to evade liability,<sup>212</sup> as when a director claims that he believed that his conduct met the standard of honest behaviour. Therefore the *objective standard* as the principal standard for avoiding such an inconsistency is crucial in order to eliminate this discrepancy. This multi-standard of dishonesty has in fact been rejected in *Barlow Clowes International Ltd (in liquidation) v Eurotrust International Ltd*, in which the court asserted its adherence to the objective standard, and interpreted the rule as follows:

What he knows would offend normally accepted standards of honest conduct meant only that his knowledge of the transaction had to be such as to render his participation contrary to normally acceptable standards of honest conduct. It did not require that he should have had reflections about what those normally acceptable standards were.<sup>213</sup>

Apparently, the reluctance of English authorities to adopt a constant definition of "dishonesty" is attributable to the fact that this concept swings between subjective and objective considerations. In the opinion of the present author, dishonesty can be defined as any conduct that contradicts the commercial standards of honesty and probity inherent in the reasonable person, and imposes on him an obligation not to engage in a transaction that could raise for him a doubt of its being tainted by a breach of a fiduciary duty. But a third party may nevertheless fail to prove that he genuinely believed that his conduct was consistent with the above standards. The key to drafting such legislation lies in distributing the onus of proof. Although the conduct may reasonably be said to raise liability according to a subjective standard, the stranger has an opportunity to avoid his liability if he can prove that the transaction had not caused him any doubt. The advantage of this test is that it is conducive to protecting the

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<sup>212</sup> Nikunj Kiri, 'Recipient and Accessory Liability-Where do We Stand Know?' (2006) 21(11) JIBLR 611, 617.

<sup>213</sup> [2005] UKPC 37, [2006] 1 W LR 1476 [15].

company's interests (objective standard) without ignoring the subjective nature of dishonest conduct. This is the concept that needs to be transplanted into Iraqi law.

In conclusion, the lack of a comprehensive policy in tackling the above cases of third party liability renders the current rules of Iraqi law incapable of preventing him in advance from assisting the director in committing the breach. Dealing with this liability under company law is vital if the problem of the director's divided loyalty is to be addressed.

### **7.3.2 Effects of the Involvement of a Third Party in the Breach**

Whenever a stranger's liability has been established according to the above reasons, the court shall determine the appropriate remedies. These remedies take the shape of the rescission of the transaction, restitution of property and compensation for damage. These remedies will be the subject of the following discussions.

#### **7.3.2.1 Rescinding the Transaction**

It has been shown previously that the company is entitled to rescind or affirm the suspended transaction. However, the company loses this right in other transactions concluded between the errant director and a third party, since the company would not be a party to that agreement,<sup>214</sup> even if the agreement involves a usurpation of its opportunity.

But rescission is applicable where the company enters into a transaction with a third party, which is tainted by a breach of managerial duty. The effect of the rescission (where it is granted) is *restitutio in integrum*. The Civil Code 1951, influenced by Islamic Al-sharia, has imposed harsher rules in this respect. Under these rules, the deceived company (whether the seller or the buyer) in a transaction tainted by the

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<sup>214</sup> The Civil Code 1951, Art.142. See also Susan Mclaughlin, *Unlocking Company Law* (first edn, Hodder education 2009) 357, para 13.4.2.

breach of a duty is not responsible for restoring the “consideration” of the transaction, (e.g., the price) if it has suffered loss without a fault being imputed to it.<sup>215</sup> Such a strict rule is justified by the desire to impose a penalty on a stranger who assists in the violation of confidence.<sup>216</sup>

### 7.3.2.2 Restitution of Property

This remedy has a distinctive significance in the case of a knowing recipient, which gives a company the right to restore its property under any hand by virtue of its right *in rem*,<sup>217</sup> as is the case under English law.<sup>218</sup>

It should be noted the firm is entitled to retrieve its property, irrespective of whether the third party acted *bona fide* or *mala fide* in the following cases: (i) The sale and purchase of a property from a company without prior consent from it.<sup>219</sup> (ii) The expropriation of its property.<sup>220</sup> (iii) The loss of a chattel property by reason of theft, usurpation or betrayal of trust.<sup>221</sup> The law thus favours the interests of the owner over the interests of a *bona fide* stranger.<sup>222</sup> In other words, Art.1148 (1)<sup>223</sup> of the Civil Code 1951 applies on a *bona fide* recipient in all cases except the above cases. This is in

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<sup>215</sup> The Civil Code 1951, Art.134(2).

<sup>216</sup> Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 79-80.

<sup>217</sup> In the same line with Iraqi law, see the English cases: *Twinsectra Ltd v Yardley* [2002] 2 All ER 377 [105] (HL) (Lord Millett); *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, 2012 WL 3062611 [34]. See also: R.C. Nolan, ‘Enacting Civil Remedies in Company law’ (2001)1(2) JCLS 245, 265.  
See also Daniel J. Carr, ‘Equity Rising? Commonwealth Oil & Gas Co Ltd v Baxter’ (2010) 14(2) Edin L Rev 273, 277.

<sup>218</sup> *Paragon Finance plc v D B Thakerar* [1999] 1 All ER 400, 409 (CA) (Lord Millett); *Commonwealth Oil and Gas Co Ltd v Baxter* [2009] CSIH 75, [2010] S C 156 [20] (Lord President (Hamilton)).  
See also Tsun Hang Tey, ‘Fiduciaries, Third Parties and Remedies-Singapore's Perspectives and Contribution’ (2010) 24(4) Tru L I 234.

<sup>219</sup> The Civil Code, 592(2).

<sup>220</sup> The Civil Code 1951, Art.200.

<sup>221</sup> The Civil Code 1951, Art.1164. But the company should exercise this right (concerning this case) within three years from the time of the loss. Such a strict rule is attributed to the fact that the loss, in these cases, was caused involuntarily

<sup>222</sup> Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 77-78.

<sup>223</sup> This Article states that ‘A person is deemed *bona fide* if he possesses the thing and is unaware that he encroached on the right of another, and the good faith is always assumed, unless the contrary is established’.

contrast to the English law, which gives priority to a *bona fide* purchaser over the owner in all cases.<sup>224</sup>

It should be noted that the Civil Code 1951 does not impose any duty on a stranger to retain the property under his hand, or not to deliver it to the delinquent director or to any other person in the case of the existence of a doubt about his involvement in the breach of duty. The reason for this is that the above rules governing rights *in rem* are concerned with determining the priority between the possessor and the owner, and not with imposing further obligations on the possessor. The possessor is entitled to continue in possession of the property as long as he has demonstrated that he acted in *good faith*.<sup>225</sup> Whereas English law imposes a general obligation on the recipient<sup>226</sup> not to receive the property in these circumstances, and to retain it under his hand until receiving convincing evidence that the payer has the right to the dispose of it.<sup>227</sup> The third party, in these circumstances, is acting as a constructive trustee of the company's property and would be prevented from delivering it to any person other than the person who has a right on it.

Fortunately, the above duties are to be found in the Iraqi Anti-Money Laundering Act 2004 and in other special Companies' Acts. According to the former, a third party must 'decline or cease to do business with a customer'<sup>228</sup> and '...freeze the relevant assets until the financial institution receives any necessary verification...'<sup>229</sup> by the competent State body. However, the narrow scope of the jurisdiction of the Anti-Money Laundering Act 2004 and the other Acts, which are confined to financial institutions only, renders those Iraqi Acts less effective in addressing the breach of confidence for a wider range of strangers.

To sum up, it is demonstrated from a review the statutory provisions of the Civil Code 1951 that they contain partial treatment of a company's capability to retrieve its property, in the case of transferring it to a third party in the breach of duty. The reason

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<sup>224</sup> *Boscawen v Bajwa, Abbey National plc v Boscawen* [1995] 4 All ER 769, 776 (CA) (Millett LJ); *Foskett v McKeown* [2000] 3 All ER 97, 120 (HL) (Millett LJ); *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, 2012 WL 3062611 [34].

<sup>225</sup> *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30 [34]; *Foskett v McKeown* [2000] 3 All ER 97 at 120.

<sup>226</sup> *Richardson Anthony Arthur v The Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, 2012 WL 3062611 [37].

<sup>227</sup> *Boscawen v Bajwa, Abbey National plc v Boscawen* [1995] 4 All ER 769, 777 (CA) (Millett LJ).

<sup>228</sup> The Anti-Money Laundering Act 2004, Art.17(1).

<sup>229</sup> The Anti-Money Laundering Act 2004, Art.18(4); the I.B.R.A. 2005, Art.35(Second).

behind that is the law's failure to deal with this issue within obvious and comprehensive provisions. While English law provides the company with the right of retrieve its property in all cases as long as the bases of liability of a third party can be demonstrated.

### 7.3.2.3 Compensation for Damage

This remedy governs the liability of a third party rendering dishonest assistance, as it engenders the obligation to compensate a company for damage.<sup>230</sup> Likewise, in the case of a knowing recipient, if a company's property has been lost or damaged, Art.1168 of the Civil Code 1951 discriminates between possessors according to their state of mind: the *mala fide* third party is liable for damage that occurred to the company's property, even if the loss has arisen accidentally, unlike the *bona fide* possessor, who will not be liable in this case. To avoid liability, the stranger must demonstrate that the property would have been destroyed or damaged even if it had been under the company's hand.

It was stated earlier that the court, under Art.217 of the Civil Code 1951, shall determine the share of all contributors in damage according to the degree of gravity of the fault. If it is difficult for the court to do so, the wrongdoers must incur the loss wholly, equally, jointly and severally.<sup>231</sup> The third party (if he has paid the compensation totally) is entitled to pursue the director for recouping his share in the compensation paid, and vice versa. But he may lose this right in the particular case of a director's insolvency.<sup>232</sup>

However, there are exceptions to the application of the contributors' joint liability: that is in the case of transfer of the expropriated property to a third party<sup>233</sup> and the situation of concluding a transaction of purchasing a company's property that was tainted by undeclared interests.<sup>234</sup> The firm in these cases has the option *between* demanding

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<sup>230</sup> Tsun Hang Tey, 'Fiduciaries, Third Parties and Remedies—Singapore's Perspectives and Contribution' (2010) 24(4) *Tru L I* 234, 248.

<sup>231</sup> The Civil Code 1951, Art 321.

<sup>232</sup> The Civil Code 1951, Art. 334.

<sup>233</sup> The Civil Code 1951, Art.198(1).

<sup>234</sup> The Civil Code 1951, Art. 592(1).

compensation for damage either from the usurper or from a *mala fide* purchaser. The reason is that the law assumed that the second usurper has not contributed in the same fault, as a prerequisite of the imposition of the joint liability. This option is motivated by the desire to give the claimant a chance to find a solvent person.<sup>235</sup>

Thus, the sole advantage that arises from enshrining contributory liability in this area of law lies in the fact that the wrongdoers will share in “one compensation” to avoid the possible insolvency of one of them, but it is far from playing a deterrent role to avoid abuse in advance. The above rule should be applied even in cases where the delinquent director has founded a company to be a vehicle (creature)<sup>236</sup> for the diversion of an opportunity to it. This is due to the fact that the company, whether fully owned by the delinquent or taking the form of a joint stock company, is a separate legal person, and should not be liable for damage in the above scenario. Piercing the company’s veil of secrecy by proving that it is merely a sham (façade) used for concealing the director’s interests, and then stripping the third party of the personal benefit stemming from the breach,<sup>237</sup> is unlikely to acquire significance under Iraqi law. The reason is due to the adoption of the principle of compensation and the liability for “one compensation”, (a specific quantity of compensation).

By contrast, English law applies the principle of *piercing the company’s veil*<sup>238</sup> in order to deprive it of its profits in cases where there is a connection between a stranger and a director,<sup>239</sup> and in order to be consistent with the principle that a fiduciary, unlike a

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<sup>235</sup> The Civil Code 1951, Arts.134(2), 200. For more details see: Mohammed Ahmed Al-kznay, *the Suspended Contract in the Iraqi Civil Law: A Comparative Study* (First edn, Coyle publisher 2005) 153.

<sup>236</sup> R.C. Nolan, ‘Enacting Civil Remedies in Company Law’ (2001)1(2) JCLS 245, 267.

<sup>237</sup> In this context see *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 [17] (CH) (Rimer J).

<sup>238</sup> Piercing a corporate veil is an equitable technique, under which the liability for breach of a fiduciary duty may be incurred by the company’s shareholders, in spite of their limited liability. The liability arises if the plaintiff demonstrates that the company has been utilized as a facade (a sham) for implementing a fraudulent action or hiding the facts, which results in prejudice to the other rights. For more details of this issue see: Paul Davies, Sarah Worthington and Eve Micheler, *Gowers and Davies Principles of Modern Company Law* (8th edn, Sweet and Maxwell 2008) 200-209, paras 8-5-14; Florence Gakungi, ‘the Interpretation of the Doctrine of Piercing the Corporate Veil by the UK Courts in More Successful than by the US Courts’ (2012) 3 (2) King’s Student L Rev 212.

However, this equitable rule can not be applied in Iraqi law, because it is contrary to the company's independence, as a legal person with its rights and obligations independent from its founders. The legal person has been recognized by Iraqi Civil Code 1951 (Arts 47, 48(1)). Therefore, espousing this rule in Iraqi law requires codifying this situation by an explicit provision.

<sup>239</sup> For example, where a third party has acted to facilitate the breach.

third party,<sup>240</sup> is only liable for accounting to his company<sup>241</sup> (whereas the stranger, under English law, is liable for damage<sup>242</sup> resulting from his dishonest assistance). Another authority favours the approach of stripping a third party of his profits even if they are independent of the director,<sup>243</sup> so as to maintain to the utmost degree of the “preventive” function of legal rules.

To reconcile the two approaches described above, it is suggested that the first approach, that of common law, offers an effective and adequate safeguard to a company, and is more consistent with the general principles of fiduciary duty. It also eliminates the complexity resulting from the weakness of the causal link between stripping the stranger of his personal benefit and the director’s breach of duty. This weakness is exemplified by the fact that the benefit gained by a director would have found its way to the company if he had complied with his duty. Otherwise, he will hold it on behalf of his company, unless a third party has been used as a vehicle for implementing the breach or to hide its effects. This approach is appropriate for incorporation into Iraqi law.

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<sup>240</sup> For more debate of this point see *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643 (QB).

<sup>241</sup> *Cook v Deeks* [1916] 1 AC 554 (PC), which was discussed in *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 (CH) [99-103].

<sup>242</sup> *Royal Brunei Airlines San, Bhd and Philip Tan Kok Ming* [1995] 2 AC 378 (PC); *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643 (QB). For more details of this theme see also: Pauline Ridge, ‘Justifying the Remedies for Dishonest Assistance’ (2008) 124 L Q Rev 445.

<sup>243</sup> *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643 (QB).



## Conclusion

Enforcement of a director's duty, and of that of any person involved in the breach of a duty, is an indispensable vehicle for providing protection to the vulnerable person, namely the company, in this unbalanced relation, and for inhibiting the betrayal of the company's interests.

The I.C.A. 1997, like the C.A. 2006, does not lay down special rules for enforcing the director's duty. In this respect, the rules of the Civil Code 1951 must be relied on instead. By contrast, English law has developed special rules as a means of promoting the same purpose. The question mooted at the outset of this Chapter was: to what extent has the Civil Code 1951 laid down rules can operate to inhibit the director from breaching his duty, and also for the prevention, or at least the reduction, of the involvement in the breach of a third party?

In order to help answer this question, an investigation was made of the rules governing the company's decision to institute litigation against an errant director. It was revealed that the I.C.A. 1997 does not provide a solution to overcome the various problems identified in this regard. For example, the I.C.A. 1997 did not refer to the *individual and collective liability* of a director, in order to enable the law to clarify the basis of a director's liability, and also to play its educational function in this regard.

The ambiguity extends to the matter of *ratification* of a director's misconduct. The I.C.A. 1997 does not lay down rules governing the release of a director from his liability. This legislative loophole brings numerous uncertainties, for example: which body in a company is competent to take the decision of ratifying directorial misconduct? What is the scope of the ratification, and the conditions of taking this decision? What are the effects of ratification? Does the ratification lead to the release of a director from liability? The general principles of the Civil Code 1951 allow answers to be given to the above questions. However, the ambiguity surrounding the extraction of the legal answers and the potential differences in the interpretation of the law, constitute a notable threat to the company and its minority shareholders. This obscurity will enable a director inevitably to avoid his liability. Furthermore, the I.C.A.

1997 does not designate the body that is entitled to take the decision of suing a director, a crucial matter.

On the other hand, the Civil Code 1951 encompasses various remedies that can be imposed on the errant director, according to the court's broad discretion in selecting an appropriate remedy. This includes rescinding the impugned transaction that was concluded with a director and reinstating the company's property. However, the Civil Code 1951 has not adopted the approach of English law of stripping a director of his benefit so as to nullify any incentive for him to abuse his powers. Instead, the Civil Code 1951 adopted a *compensatory approach* by requiring damage that must be proven for the imposition of compensation against the errant director. It has been demonstrated in this Chapter that the compensation-based approach could fail to confront a director's misbehaviour, particularly where damage is not a result of the prejudice to the company interests, or where it is extremely difficult to prove.

Determining the liability of a third party embroiled in the violation of the director's duty is of great significance in ensuring a stranger's compliance with the law. It is important for inspiring confidence and is an additional guarantee for the recovery of damages. The I.C.A. 1997 did not lay out clear rules to define the stranger's misbehaviour, (unlike the case under English law), particularly in situations involving a knowing recipient of a company's property and dishonest assistance in committing the breach. The ambiguity of Iraqi legislation in respect of these matters raises numerous uncertainties. For example, is the liability based on actual or constructive knowledge? What is the meaning of "dishonesty" as a basis for determining this liability in the second case? What are the acceptable rules of commercial conduct that must be followed by the stranger in order to avoid liability? No obvious answer to these queries can be found in the Civil Code 1951. The current legal treatment of these issues by the law takes the shape of partial treatments by means of provisions that seem, in some circumstances, to contradict each other.

The above discussions concerning the liability of a director and the stranger lead to the conclusion that the Civil Code 1951 is deficient in its provisions for ensuring the accountability of a director and any other party implicated in a breach of fiduciary duty. These lacunae may provide a safe environment for enabling a director to hold divided loyalties. That is contrary to the goals of providing the company with

“safeguards” against a director’s abuse of his powers. Hence, it is necessary to codify the rules of company law to govern the enforcement of a director’s duty, to ensure deterrence and to safeguard companies against directorial misconduct. In this context, it is suggested that the following Articles be incorporated into Iraqi company law.

### **The Proposed Articles**

#### **Art.8:**<sup>244</sup>

1. A fiduciary shall be liable for the abuse of his powers, severally, or jointly with others who have involved in the breach. The liability includes any third party who involved in the breach.<sup>245</sup>
  
2. (a) The board of directors, a liquidator and the receiver are entitled to take the decision to institute civil or criminal action against the current or former directors or any officers, and to take a decision not to sue him/them in the light of the company’s interests.<sup>246</sup>
  
- (b) If all fiduciaries, or the majority, were involved in the breach of the duty or has a connection with the wrongdoer, the matter must be disclosed to the general assembly so that it may take appropriate action.<sup>247</sup>
  
3. A company’s members are also entitled to take the decision mentioned in paragraph (2-a) of this Article, either directly, or in accordance with a recommendation by any fiduciary or a public body.

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<sup>244</sup> The forthcoming provisions are supplementary to the proposed Articles mentioned in the previous Chapters.

<sup>245</sup> The above proposal is distinguished from the current provisions of the Civil Law in that it involves the emphasis on the joint liability, which is not only confined to the fiduciary but includes also a third party involved in the breach.

<sup>246</sup> Iraqi law failed in determining the body competent in taking the decision of suing the delinquent fiduciary. This proposal contains a solution for this gap.

<sup>247</sup> Iraqi law also does not refer to the possibility of the occurrence of a conflict of interests with respect to instituting litigation against the director inside the boardroom. The proposal contains the duty to inform shareholders about this conflict and allows them to take the appropriate decision.

### **Art.9: Ratification of the Transaction or Conduct:** <sup>248</sup>

1. The company's members<sup>249</sup> are entitled to ratify and/or release the director and any person who is involved in the same breach of a duty in respect of any action taken by them in a contravention to his duty.<sup>250</sup>
2. The Ratification decision shall be taken by the majority of the company's members, who are disinterested in the decision, on the basis of a correct and full disclosure of the facts of the infringement by the wrongdoer.<sup>251</sup>
3. The ratification or release will be invalid in the following situations:<sup>252</sup>
  - (a) Where the conduct involved an expropriation of company's funds and has not been taken unanimously by the members who attended the meeting.<sup>253</sup>
  - (b) Where the conduct involves a fraud on the company or its members.
  - (c) Where a company is on the verge of insolvency and the ratification involves prejudice to its financial position, unless it has been approved by the creditors who represent more than two thirds of its debts.<sup>254</sup>

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<sup>248</sup> Iraqi law has no clear provision which enables the company to ratify the transaction as long as it in its interests. This proposal is aimed at adding a flexibility in this regard.

<sup>249</sup> It has been demonstrated in this Chapter that any decision taken to absolve the director from the results of his breach involve a prejudice to the company's members, rather than its directors, particularly where the majority of them have involved in the same breach. Damage takes the shape of losing the amount of compensation, which, otherwise, can be used to redress the results of the breach. So, the company's member should be entitled to take this decision, as the case under the C.A. 2006 (239(2)).

<sup>250</sup> The current provisions of the Civil Code 1951 are not clear enough to enshrine the rules of ratification, and whether or not ratification should include releasing of the director from the results of the breach of duty.

<sup>251</sup> A director, under the I.C.A. 1997, is not bound to disclose the facts of his breach of duty. The proposed provision is aimed to emphasize on that the decision to be taken by the shareholders must be devoid of fraud or misrepresentation.

<sup>252</sup> It has been indicated in this chapter to that there is ambiguity in Iraqi law in determining the scope of the ratification and what actions are excluded from its ambit.

<sup>253</sup> This strict quorum can be justified on the ground that the ratification in the above case involves implicitly waiver of company's assets, which will be owed ultimately to its members after its dissolution. So, it is fair to require this quorum. The C.A. 2006 has referred to this requirement in s.239(6-a) thereof. But the required majority is *the majority of shareholders who attend the meeting*, because it is hard to envisage the attendance of all of the company's members the meeting, particularly in the large companies.

<sup>254</sup> Both English law and Iraqi law have not determined the person competent to ratify the director's misbehaviour, when he is simultaneously the sole owner of company. The author is of a view that the company's stakeholders, who own fixed debts in it, should be conferred this power, since they would be the sole aggrieved by the ratification.

(d) Where ratification is prohibited by law or a company's articles.

3. Apart from ratifying the transaction, the company is entitled to enforce the penalties mentioned in Article 3 against its fiduciary.

#### **Art.10 Consequences of a Breach of a Fiduciary Duty**<sup>255</sup>

The company is entitled to:-

(1) The restoration of its property when it has been transferred as a result of an unauthorized transaction or undeclared interests therein.

(2) The confiscation of any benefit resulting from the abuse of the powers under the foregoing paragraph, without the need to prove the elements of civil liability.<sup>256</sup>

(3) To demand compensation for damages resulting from the infringement of a fiduciary duty.<sup>257</sup>

(4) The above remedies are enforced without prejudice to a company's right to rescind the impugned transaction or arrangement, or to repeal the decision which is the subject of the violation, pursuant to rules of suspending the transactions set out under the Civil Code. All this without prejudice to the rights of a *bona fide* third party.

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<sup>255</sup> The above suggested provision contains special consequences for breaching a fiduciary duty. Incorporating these consequences in Iraqi law is crucial to deter a director in advance from abusing his office. The proposal is aimed at excluding the damage from the realm of enforcement of managerial duty, as a prerequisite condition for imposing civil liability under the Civil Law. The reason behind this exclusion is attributed to the fact that proving this element will be difficult in some circumstances. It has been shown in this Chapter that the Civil Code 1951, which is premised on remedial purposes, must be applied to the enforcement of managerial duties. While these rules, however, are incapable of deterring a director from abusing his office.

<sup>256</sup> Iraqi law does not adopt the approach of English law concerning stripping the delinquent director of any profit resulting from the abuse of his powers for the purpose of deterring him from doing so. The proposal is aimed to incorporate this principle into Iraqi law.

<sup>257</sup> Stripping the director of any profit resulting of a breach of a fiduciary duty is aimed at the restoration of the *status quo ante* for the two parties. Therefore, if there is any additional damage that exceeds the confiscation of the profit, the director should be liable for this. Iraqi law does not refer to this situation, because the law simply does not adopt the approach of the confiscation of profits.

### **Art.11: Liability of Third Party** <sup>258</sup>

1-(a) A third party is liable for his contribution to the infringement of a duty in the following cases:-

(i) When he receives property, benefits or interests with the knowledge that these result from a breach of duty or in circumstance where a reasonable person in his position<sup>259</sup> ought to have known that they resulted from a breach of a duty.

(ii) When he knowingly assists a director in his violation in a manner that contradicts acceptable standards of commercial conduct, good faith, or probity,<sup>260</sup> subject to the third party being entitled to rebut his liability if he can demonstrate that he genuinely believed that his behaviour did not violate these considerations and did not involve assistance in violating a managerial duty, and that this belief was based on reasonable assumptions.

(b) The third party incurs the penalties mentioned in subsections (1,3,4) of the Article 10, whereas the remedy mentioned in subsection (2) shall be applied only if a third party was used as a vehicle to implement the breach or to hide its effects.<sup>261</sup>

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<sup>258</sup> The most mysterious theme in the realm of the enforcement of managerial duty in Iraqi law is the liability of a third party for his involvement in a breach a duty. The provisions of the Civil Code 1951 do not enshrine comprehensible and comprehensive rules which constitute the bases of this liability, particularly the liability for the receipt of company property and the liability for assisting the director in the breach of his duty. The above suggestion represents an attempt to incorporate the solutions adopted by English law into Iraqi law.

<sup>259</sup> Individuals are different in their expertise, and their knowledge of circumstances of the breach of duty. Therefore, their liability should be affected correspondingly.

<sup>260</sup> These considerations are vital in aiding the court to determine whether the impugned behaviour is honest or dishonest.

<sup>261</sup> Generally speaking, a third party is not liable for accounting the company, because he does not act as a fiduciary for it, unless if the company has succeeded in establishing the circumstances mentioned in the above paragraph. Of course, there is no mention of this matter in Iraqi law.

## Chapter Eight

### Conclusion

This thesis has sought throughout the previous seven chapters to answer one main question: the extent to which Iraqi law provides a company with adequate and effective safeguards for protecting it from a director's abuse of his powers. The reason for choosing this topic is its significance, first, as a means of safeguarding the company's existence and, second, in addressing the paucity of Iraqi literature in its treatment of this issue.

An examination of this question was undertaken in the context of the duties concerning the director's loyalty: the duty to act in the company's interests; the duty to avoid conflicts of interest; the duty to declare an interest in a deal; and finally the enforcement of these duties. English law was used in this comparative research as a guide to exploring the shortcomings of Iraqi law in this area.

The purpose of this Chapter is to exhibit the research findings. To attain this purpose, the general findings will be presented in the first section and the second section will single out the particular results, chapter by chapter. The third section will contain the author's suggestions for future research. A final summary of the findings will be given in the fourth section.

#### 8.1 A Summary of the Main Findings of the Research

The problems pertaining to a director's "self-interest" and potential for divided loyalty have occupied the attention of lawmakers for a long period of time. English company law has found that the imposition of certain obligations on a director is the best means of countering this selfish instinct. These legal safeguards (duties) are crucial for maintaining the company and securing the effective contribution of investors.

This approach has been followed by Iraqi law, but in a defective manner. It has been demonstrated in this thesis that Iraqi law has incorporated *some aspects* of managerial duties, and that some of its facets are similar to those termed "fiduciary duties" under English law. Iraqi lawmakers, however, have failed to enshrine a complete set of legal

principles sufficient to deter a director's opportunism in this area. Thus Iraqi law remains inadequate compared to English law.

The reason for these defects can be ascribed to *the absence of a conceptual framework* as the basis for comprehensively articulating directorial duties in Iraqi law. Every legal system should be based on a conceptual framework in order to justify its existence and to explain its content and goals, as is the case with English law. Under English law, managerial duties are premised on the *fiduciary doctrine*, under which a fiduciary must act in the interests of the beneficiary and avoid any situation in which his interest may conflict with his duty. To attain this goal, any breach of that principal obligation will result in the fiduciary confronting serious personal consequences. This liability is "freestanding": it is not premised on a remedial principle (restitution). Rather, the establishment of liability on this basis is aimed at confronting any threat to the company's interests from its directors, including conflicts that are merely potential.

It has been demonstrated in the present thesis that such a conceptual framework is absent from Iraqi law. If the general notion had existed, it would have been resorted to in order to fill any gaps arising from the defects of Iraqi domestic statutory provisions. The current regulation of the directorial obligation reflects a mere aspiration on the part of Iraqi lawmakers to provide a company's members *with a certain level of protection*, and is not based on a specific legislative policy or a specific conceptual basis. It is difficult, given this situation, to draw a nexus between the obligations scattered across several areas of Iraqi law<sup>1</sup> and to extract from these a specific conceptual notion to underpin the basis of managerial duty under Iraqi law. Extracting such a general concept depends on the completeness of the landscape of managerial duty in Iraqi law. It has been seen that the legal composition of managerial obligation remains in need of further improvement in the near future, in order to be able to confront the issue of directorial self-interests.

It seems that the reform by the C.P.A. of the I.C.A. 1997 by way of Order No.64 2004 did not take the foregoing consideration into account. Ultimately, the overhaul of Iraqi law has resulted in *a partial treatment of some problems* and has failed to deal with the root of the problem, that is to say, it has not embraced the notion of fiduciary duty.

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<sup>1</sup> This legislation is represented by the P.B.A. 2004 and the I.B.R.A. 2005.



Unfortunately, other legislation enacted since 2003<sup>2</sup> has perpetuated the defective approach of the I.C.A. 1997.

## **8.2 A Summary of the Research Findings Chapter by Chapter**

The research is composed of seven chapters. The introductory chapter contains the thesis statement, the main questions and an outline of the overall structure of the work. It demonstrates, by means of a review of the relevant literature that, compared to English publications, there is a notable lack of Iraqi studies dealing with this topic. The reason for the paucity of Iraqi literature and case law is attributable to the nature of the Ba'ath Socialist regime that dominated Iraq over a long period of time, with the result that the scope of competition between companies was narrowed to a considerable degree. By contrast, the occurrence of judicial disputes is one of the results of competition in capitalist economies such as that of the U.K. These cases direct the attention of courts, scholarly commentators and lawmakers towards finding solutions for new problems. The outcome of these efforts is the generation of useful material for codification by the lawmakers. Therefore, the author's analysis of the provisions of Iraqi law was undertaken in the light of the available works in English law, the available Iraqi research and his understanding of Iraqi law.

In Chapter Two, which seeks to find features of the fiduciary doctrine of English law in Iraqi law, the thesis argues that managerial duties under Iraqi law lack the necessary conceptual basis to combine its different aspects within a general framework. This conclusion was reached by analysing the various provisions of Iraqi Company legislation. Statutory obligations are frequently found to be incomplete,<sup>3</sup> and certain duties are not mentioned in the laws.<sup>4</sup> These statutory duties are often scattered within different pieces of legislation<sup>5</sup> and contain rules that may well be in conflict with each

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<sup>2</sup> For example the P.B.A. 2004 (Arts.17, 21) and the I.B.R.A. 2005 (Art.42 (Second)).

<sup>3</sup> For example, the conflict of duties under Art.110 of the I.C.A. 1997 is narrow in scope, and applies only to directors of companies that exercise similar activities. The same approach is to be found in the P.B.A. 2004, 17(5-A) and the I.B.R.A. 2005, Art.42 (Third).

<sup>4</sup> For example, the I.C.A. 1997 does not stipulate the duty to avoid conflict of interests as a general rule. Also the duty not to accept a benefit from a third party has been ignored in all Iraqi companies' Acts.

<sup>5</sup> The I.C.A. 1997 prohibits multiple directorships, and lays down the duty to serve the company's interests (Arts.1, 110, 120). The P.B.A. 2004 includes the duty to act in the company's interests, the avoidance of multiple directorships and the duty to declare an interest in a transaction (Arts. 17, 21). Finally, the I.B.R.A. 2005, in its Article 42, regulates the duty to avoid conflicts of interest.

other. The contradiction between the provisions of the different Acts is of a degree whereby fiduciary and non-fiduciary duties, which should be distinct and independent, are often articulated and conflated within the same Article.<sup>6</sup> All this is evidence that the legislative treatment of managerial duty under Iraqi law is not based on fiduciary doctrine or any other comparable legal notion.

Likewise, scrutiny of the relevant principles of Iraqi Civil Code (which seem at first glance similar to the notion of fiduciary doctrine) reveals that the Code represents a main resource of Iraqi Company Law, and that frequent resort to its rules must be made in order to fill any gap in the provisions of Company Law.<sup>7</sup> This chapter demonstrates the existence of an evident asymmetry between the rules of the civil law and fiduciary duty. The reason can be attributed to the fact that the principles mentioned under the Civil Code 1951 had a *remedial basis (restitutionary)*, and omitted to confront *potential risks* to the interests of the company. Civil law, therefore, is an inappropriate instrument for addressing the problems of a director's divided loyalty. This interpretation implies that the concept of fiduciary duty is unique and distinctive, and has no counterpart in Civil Law jurisdiction. It appears that the only way to safeguard a company from a threat to its interests is by reliance on the available statutory provisions of current Iraqi legislation. The latter's capacity to deter the abuse of managerial powers is very questionable.

It was shown in this Chapter that caution should be employed in dealing with the view of some sceptical scholars concerning the possibility of a successful transplantation of the concept of fiduciary duty into Iraqi civil law. The argument of the sceptics could be ascribed to the nature of the court's role in Iraqi law, which is limited to applying the law's provisions rather than to innovating rules of law. The author is of the opinion that it is possible to envisage a creative role for the Iraqi courts, even if they are restrained by the provisions of law. This role is vital for filling the innate legislative gap resulting from the incompleteness of statutory provisions covering all contingencies. Laying down the conceptual framework of the fiduciary doctrine, while at the same time furnishing the court with broad discretion in acting within that framework, would be

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<sup>6</sup> For example, the combination of the duty to act in the company's interests and the duty of care, found in Art.120 of the I.C.A. 1997 and in Art.17(5) of the P.B.A. 2004.

<sup>7</sup> The Civil Code 1951, 1.

an adequate formula for ensuring the successful transplantation of this doctrine. This conceptual framework does not exist within current Iraq law.

In Chapter Three, the focus was on the duty to act in the company's interests. This duty has often been described in English law and its literature as being at the core of fiduciary obligation. The broad concept of this duty conflates it with the notion of loyalty, another doctrine of fiduciary duty in the Anglo-Saxon school of law. It was found that it was useful to examine this concept in order to ascertain whether it has a root in Iraqi law. The notion of loyalty has particular significance, because it is a parameter that can guide the director to adhere to his company's interest when he is discharging his powers. The Chapter contained a discussion of the principle of undivided loyalty and some of its applications. This English rule means that a director must hold loyalty to his company as his sole interest. The principle must be respected even in the case of the director serving on the board of more than one company. This concept is not a feature of Iraqi law, yet its root is inherent in the agency contract. But this inference is less accessible by the director or even by professional persons in Iraq. It is vital to show that this concept *floats on the legal surface of Iraqi law*, by the enactment of a clear provision that embodies this concept.

It was argued in this Chapter that Iraqi law had missed the opportunity to provide the director with a clear guide on how to respect the duty to act in accordance with the company's interests, and in addition, to provide an accountability element. This argument is premised on the reality that in Iraqi law the duty had been formulated in an ambiguous manner. It involves a combination of two independent and distinct duties *in one formulation*: the duty to act in the company's interests, and the duty of care. The crux of the distinction between these duties is the principle of good faith. The latter is assumed to be an element of the duty to act in the interests of the company, a duty often violated in a dishonest and deliberate manner. The duty of care, however, (managerial behaviour) should not depend on the good faith of the delinquent. Consequently, English law has classified managerial duties into two classes, fiduciary and non-fiduciary, and imposes legal sanctions for the violation of these duties. A breach of the duty to act in the company's interests, by acting in pursuit of a personal interest, results in depriving the perpetrator of all benefits gained as a result of the breach. Furthermore, bad faith may be considered an indicator of disloyalty. The confiscation of profits aims to restrain the director's ambition from perpetrating the

breach. However, proving the elements of liability (fault, damage, causation link), is a condition of redressing the breach in the duty of care under English law.

By contrast, the aforementioned formulation of Iraqi law results in a loss of the opportunity to impose harsh consequences on the *mala fide* delinquent. The conflation of the aforementioned duties in one formulation makes it difficult to apply the principle of good faith. First, the subjective standard for a review of directorial conduct, as enunciated in Act.120 of the I.C.A. 1997, gives a director a chance to avoid his liability. The subjective standard was coined merely out of a desire to furnish a director with broad discretion, at the expense of providing an effective standard for reviewing his conduct. The objective standard mentioned in Art.17(6) of the P.B.A. 2004, however, contradicts the principle of good faith, presenting it as a matter of a state of mind, so long as the director's behaviour will eventually be assessed objectively.

On the other hand, identifying the company's interests is another issue, and creates a further cause of conflict between a director's interests and his duty. Generally speaking, Iraqi law has adopted the English traditional approach that considers a company as a vehicle for maximising its members' interests only. Iraqi law failed to adopt the principle of separation between ownership and management, by obliging a director to be a member of the company as a condition of being a member of the board of directors. However, Iraqi law has failed to internalise rules, such as those reinforcing an obligation to have regard for the shareholders' interests as a whole; to act fairly between them; to act in accordance with a long term strategy that fosters the interests of future shareholders; and to maintain the company as a going concern. The non-existence of the above rules in Iraqi law may motivate a director to take decisions favouring the interests of a group of shareholders, because they are commensurate with his personal interests, without regard for the company's stability or its members as a whole. The same situation can emerge vis-a-vis stakeholders. Under Iraqi law, a director is not bound to consider the interests of those participants in a company. He is thus granted an opportunity to take decisions leading to the generation of faster profits for the company's members (he being one of them) at the expense of the stakeholders. At the end of Chapter Three, the author presents a proposal for a reformulation of the duty to act in the company's interests in Iraqi law as an independent duty, containing the aforementioned rules for solving the clash between

the director and the company's members, and also embracing the interests of stakeholders.

In Chapter Four, (the duty to avoid a conflict of interests), it is shown that Iraqi law has failed to formulate a general duty to restrain this threat, in contrast to English law (s.175 of the C.A. 2006). This legislative defect represents a serious gap which can be exploited by a dishonest director to engage in harmful activities contrary to his company's interests. There is only a brief reference to this rule in the clauses of the I.C.A. 1997, and the broad and ill-formulated drafting of this duty in the I.B.R.A. 2005 renders the provisions less effective in restraining the ambition of a dishonest director. There is therefore a notable lacuna in this respect.

To fill this legislative gap and to prevent directorial abuse, resort is made to tortious liability. However, the difficulties regarding the conditions of establishing this liability (fault, damage and a causal link), alongside the reality of a director's control over a company's affairs and its documents, makes the effectiveness of tortious liability doubtful. Furthermore, liability in this relationship should be based on the potential threat to the company rather than on actual prejudice to its interests. This reality has been considered under English law, which clearly stipulates that a director's liability does *not* depend on establishing these elements. To provide effective protection to the Iraqi company, a special legal regime of the no-conflict rule should be formulated so as to address the director's abuse of his powers, including even potential abuse. This goal can be achieved only by discarding tort liability as set out in Civil law and establishing the director's liability simply based on his failure to disclose the situation that constitutes a conflict of interests.

The shortcomings in regulating this duty in Iraqi law add another difficulty in identifying a corporate opportunity. In this ambiguous legal environment, a corporate opportunity under Iraqi law is any business prospect that falls within the line of the company's business. This test represents the legal threshold of the company's capability (ability) in exercising its activities as a legal person. But this single test is insufficient for addressing the manoeuvres of a director who is empowered, for example, to change the company's line of business so that the business prospect falls outside its capacity. There is also the difficulty of identifying a company's interest in the first place. English law, by contrast, uses numerous tests for confronting this

probability: the director's capacity; whether the opportunity falls within the company's line of business; and whether the opportunity is a maturing opportunity. The law confers discretion on the court in applying the test for safeguarding a company.

Iraqi law, on the other hand, fails to draw clear and uniform guidelines with regard to restricting the director's entrepreneurial ambitions, both within the period of his engagement, and following his resignation. Overall, a director, under the I.C.A. 1997, is free to exercise his commercial activities or to engage in serving another rival company (after obtaining the approval of his company). However, the conflict of duties has a narrow scope under Iraqi law. It is limited to prohibiting service in rival companies, rather than including all cases of "*conflict of duty*",<sup>8</sup> as is the situation under the C.A. 2006. Apparently, this *lacuna* gives the director a legal licence to hold *divided loyalty* by "serving two masters" who have conflicting interests. As long as he does not serve *as a director* in two rival companies, he is free, for example, to be an employee or auditor in a rival company or be *a trustee of shares in a company in which he serves as a director*.

The conflict within Iraqi legislation in this area of the law is evident: under the I.C.A. 1997, service in a competitor company depends on obtaining approval, however, other Iraqi legislation absolutely prohibits a director from holding a similar post in a competitor company,<sup>9</sup> or even from exercising legal competition with his company by operation of law.<sup>10</sup> This is an anomalous situation, because a company should be given the opportunity to ascertain whether these activities involve a real threat to its interests, and avoid the irrational stifling of entrepreneurial business.

This contradiction also reflects the absence of a uniform legislative policy in dealing with this issue under Iraqi law. At the end of Chapter Four the author presents a proposal for reforming Iraqi law regarding this duty, based on a comprehensive and comprehensible drafting of the rules in accordance with the realities of Iraqi law. The

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<sup>8</sup> The conflict of duties can be envisaged, e.g., where the person in question, who acting as a guardian for a minor, to employ the latter's money in a company in which he serves as a director.

<sup>9</sup> See the I.C.A. 1997, Art.110 (Second). Compare this provision with the P.B.A. 2004, Art.17(5-A) and the I.B.R.A. 2005, Art.42 (Third).

<sup>10</sup> The I.B.R.A. 2005, Art.42 (Second-b).

proposal is premised on drafting a general rule of avoiding a conflict between *duty and an interest* and a *conflict of duties*, and sets out procedures that should be followed in order to obtain the company's approval for a conflict of interests with regard to these situations.

In Chapter Five, special applications of the no-conflict rule are considered, such as the situation of the nominee director (conflict of duties), and the duty not to accept a benefit from a third party (conflict of interests). The aim of this chapter is to demonstrate whether the no-conflict rule has been respected in these special situations.

Concerning the first application, it was shown that Iraqi company law contains provisions that allow a group of shareholders to nominate their representatives to the board of directors. It was demonstrated that these provisions can enable the nominee director to promote the private interests of his nominator, rather than the interests of the company as a whole. It seems that Iraqi law grants legitimacy to a director who puts the special interest of his nominator ahead of the company's interest. This licence unquestionably constitutes a real threat to Iraqi companies and implies the potential for a breach to the no-conflict rule.

The second application of the above principle is the duty not to accept a benefit from a third party. The director indulging in this form of misconduct owes two loyalties: a legal (ostensible) loyalty to his company and an actual loyalty to the donor of the bribe (or any secret benefit) by virtue of falling under the donor's influence. Despite the seriousness of this behaviour, Iraqi legislation has not addressed such conduct with explicit provisions. This is in sharp contrast to s.176 of the C.A. 2006. Scrutiny of the general principles of Iraqi legislation reveals that reliance on tort, or on criminal law, may not be enough to deter the director from committing such misconduct. This legal shortcoming can be attributed to the burdensome conditions that must be proven by the company in order to attribute the liability (the elements of tort as mentioned above when Chapter four was discussed). Hence, espousing the innovative liability of English approach, which has been codified in s.176 of the C.A. 2006, under which liability arises merely by virtue of the failure to disclose a secret profit, seems to be the more rational approach. The author concludes, by reviewing the above cases, that

there is a need to codify these situations under special provisions in order to be commensurate with the no conflict rule.<sup>11</sup>

Chapter Six focuses on the duty to declare an interest in a deal to be concluded with a company. In this chapter, the author demonstrates that several pitfalls and *lacunae* in the drafting of Iraqi provisions dealing with this duty could affect the required level of protection for the company. For example, the law has entrusted to the general assembly the granting of approval for any conflict of interests associated with a deal. The reason for this power being given to shareholders is to provide a high level of safeguards in granting the necessary approval. However, there are various legal actions that might involve a higher level of threat to the company, and to which the board of directors is nevertheless empowered to give its approval, (for example, the ceding of a debt or a mortgage). Moreover, assigning to shareholders the power to grant approval is inconsistent with commercial reality, which necessitates speed in concluding commercial transactions, and expertise in assessing the merits of transactions. To eliminate all of these contradictions, the author suggests in this chapter that the board of directors should be empowered to grant approval for the conflict of interests in a deal.

Another problem that is identified is the failure of the I.C.A. 1997 to define the meaning of some terms, such as: the “deal”, the “interested director”, “connected persons” and “direct” and “indirect interests”, which adds to the uncertainties surrounding these matters. Iraqi law, moreover, does not provide the solution to other problems. It does not define, for example, the methods or time schedules in relation to a declaration of interests. It also fails to stipulate who is empowered to give impartial and informed approval inside the boardroom where all directors are interested in a deal. The ambiguities that shroud the above points will inevitably give a director the opportunity to shun compliance with his duty, leaving the way open for an abuse of office.

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<sup>11</sup> The proposal was premised on statutory regulation of the position of a nominee director and the insertion of innovative rules, such as the imposition on the nominee of the duty to disclose any matter that could bring about a conflict of interests between his nominator and the company in which he serves. Subsequently the nominator incurs the liability for any detriment to the company’s interests resulting from the nominee’s compliance with his instructions. The proposal also includes the duty not to accept a benefit from a third party, along the lines of s.176 of the C.A. 2006.



Finally, Iraqi law repeats an omission of the kind mentioned under the no-conflict rule by subjecting this duty to tortious liability. The danger here is that the desired strictness of application of this rule may be vitiated, since a director can establish that his undeclared interests in a transaction did not cause damage to the company. Likewise, the law has failed to regulate some transactions that involve a high level of conflict of interests, such as of lease, hiring transactions, etc. The law also forbids a company to grant a credit or a loan to its director. Undoubtedly the above defects in Iraqi law reflect the absence of a uniform legislative policy dealing with this matter, and provides a director with the opportunity to take advantage of these defects by practicing dishonest activities. For this reason, a proposal to overhaul this duty is presented in the Chapter, which aims to lay out a comprehensive duty in order to address several aspects of the corresponding conflict of interests.<sup>12</sup>

In Chapter Seven (the enforcement of managerial duty), it is demonstrated that Iraqi law has failed to develop special provisions to govern this theme, therefore necessitating a resort to Civil Law in order to fill the gap. The remedial (compensatory) nature of civil law is, however, inconsistent with the nature of the managerial duty, which should be premised on the *prevention of director's threat to a company*. For this very reason, English law has developed special rules that operate to achieve that goal.

Iraqi Company Law, for instance, does not contain provisions that set out rules governing the decision to sue the delinquent director. The law, for instance, has not explicitly designated the body that is qualified to give its approval to institute litigation against the delinquent. This matter is often the source of conflicts of interest between the director (and shareholders who are connected with him) and the company. Likewise, Iraqi Company Law does not address the problem associated with the ratification of wrongdoing. The broad concept of the ratification and release of a debtor enunciated under the Civil Code 1951 includes many cases of misbehaviour, which

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<sup>12</sup> The proposal includes several rules that are not currently set forth in Art.119 of the I.C.A. 1997, for example: assigning the board of directors to grant its approval for conflict of interests; the mention of transactions and arrangements that give rise to the duty of declaration; regulating the general declaration of the permanent interests of a third party; the mention of the ways of declaration and exceptions to this duty. The proposal includes also laying out the rules governing the transactions that may be concluded by the director with his company.

correspondingly may be excluded from ratification Under English law.<sup>13</sup> This is because they involve a threat to the interests of the company and its minority shareholders. The failure to properly regulate certain aspects of the law in this respect will assist the errant director in avoiding his liability, because the interpretation of the vague aspects of the law must be made in his favour.<sup>14</sup>

A scrutiny of the rules governing the remedies that can be imposed on a director to redress the breach of duty reinforces the above argument about the inconsistency of the civil law with regard to the safeguarding of the company *ex ante*. The divergence point with English law lies in the requirement in Iraqi law *to establish damage* to the company as an element of the tort liability. It is difficult, for example, to establish the misuse of a company's information in the case of a director's service in another company, or in the case of his competition with the company. This requirement is applicable even if the director has obtained the approval of the first company to serve in the second company. Likewise, in order to establish a director's liability for an unauthorised exploitation of a corporate opportunity, the company must demonstrate that the director's behaviour has caused it to lose a *certain* (actual) opportunity, and not just a *possible* opportunity. The amount of damage that a company is entitled to recover from the errant director depends on the ratio of profit that he has gained from the opportunity.

The same result can be shown in the case of a breach of the duty to declare interest in a deal or the acceptance of a benefit: the company in these cases must also demonstrate that the non-declaration of the interests has caused damage to the company, for example, by increasing the financial conditions of the transaction with a view to offsetting the amount paid as a bribe, with determination of the quantity of damage. By contrast, it is settled under English law that the *mere breach* of a fiduciary duty is adequate justification for stripping a director of all of the benefits gained, without the need to prove damage. There is, therefore, a need in Iraqi law for a special regulation concerning a director's liability in this matter, in order to ensure that he is inhibited from abusing his office.

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<sup>13</sup> E.g., the release of a debtor for conduct that amounts to a misappropriation of the company's property and fraudulent actions.

<sup>14</sup> See the Civil Code 1951, Art.166.

The lack of obvious rules tackling the problems of a director's abuse under the Civil Code 1951 extends also to the basis of the liability of a third party embroiled in breach of the duty. By contrast, English law identifies the basis of this liability under two headings, knowing receipt and dishonest assistance, and explains the conditions for imposing liability on a stranger under the above headings. By contrast, Iraqi law's approach towards this issue is that statutory provisions of legislation require different levels of knowledge. It is stated, for example, that "it is easy for a person to be aware of a breach",<sup>15</sup> and "actual knowledge"<sup>16</sup> is distinguished from "constructive knowledge".<sup>17</sup> These contradictory provisions reflect *the lack of a uniform policy* to address the involvement of a third party (recipient) in a breach of managerial duty, and the result is greater obscurity in the position of Iraqi law with regard to this issue. Likewise, the law has failed to regulate the stranger's liability under the second heading of liability (dishonest assistance).

All of the above shortcomings of Iraqi law identified by the author support the argument that tortious liability is an inadequate means of redressing a breach of managerial duty. There is therefore a need for special rules to regulate the enforcement of managerial duty in Iraqi Company Law. A proposal for developing Iraqi law in this respect is offered at the end of Chapter Seven. The proposal focuses on setting out the rules for governing, first, the individual and collective liability of the director; secondly, to identify the competent body for taking the decision to begin litigation against the errant director; third, to set out rules governing the ratification of the wrongdoing; fourth, to determine the civil consequences of violating the duty, revolving around the principle of deterring the director from committing the breach; and finally, to stipulate the bases and consequences of the involvement of a third party in the breach of managerial duty.

It was shown from an examination of the position of Iraqi law towards fiduciary duties that there is a defective legislative approach. This reinforces the conclusion of the present research that Iraqi law has failed to provide sufficient protection for the

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<sup>15</sup> The Civil Code 1951, Art. 122

<sup>16</sup> The Civil Code 1951, Art. 1148(1)

<sup>17</sup> Anti-Money Laundering Act 2004, Art.17(1).

company against various aspects of directorial misbehaviour. The fiduciary doctrine is, in fact, substantially absent from Iraqi law. The main legislative defects can be summarized as follows:-

1. A failure to enshrine some of the most important duties for ensuring a director's compliance with his duty, instead of pursuit of his personal interests. The law, as mentioned earlier, does not mention the principal duties, such as the duty to avoid a conflict of interests (as a general duty), or the duty to avoid accepting a benefit from a third party; and the narrow conception of the conflict of duties. In other words, the I.C.A. 1997, *is not a complete freestanding Code*, and offers only a partial regulation of certain managerial duties. Recourse has therefore been made in this thesis either to the Civil Code (and other Acts, such as the labour law, etc.), or to the other sources of law (for instance, Islamic Al-Sharia, custom) in an attempt to overcome the shortcomings of Iraqi law).

2. An espousal of rules contrary to the principle of undivided loyalty (a solid doctrine in English law) represents a major failure in Iraqi law. These rules include, for example, the provisions for nominating a director by a group of shareholders. They are aimed at fostering the private interests of the nominator rather than the company's interests as a whole.<sup>18</sup> Moreover, as mentioned earlier, the conflict of duties is confined to a director's service in a competing company,<sup>19</sup> which gives implicit licence to him to hold a divided loyalty in all cases outside the above ambit.

3. The Iraqi special companies' legislation contains rules contradicting those set out in the I.C.A. 1997, for example the rules governing multiple director<sup>20</sup> and the director's freedom to exercise competitive activities.<sup>21</sup> It is worth noting that the re-codification of the same duty is another failure in Iraqi law, because it involves unhelpful repetition of the same principle already enunciated in the general legislation of companies.

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<sup>18</sup> See the I.C.A. 1997, Art.103(1); the P.B.A. 2004, Art.17(5-a); the I.B.R.A. 2005, Art.49 (Third).

<sup>19</sup> See the I.C.A. 1997, Art.110(2); the P.B.A. 2004, Art.17(5-a); the I.B.R.A. 2005, Art.42 (Second-a).

<sup>20</sup> See the I.C.A. 1997, Art.110 (Second) which leaves to the company's members the decision regarding engagement to serve in another rival company, whereas the P.B.A. 2004, Art.17 (5-a) and the I.B.R.A. 2005, Art. 42(Third) entirely prohibit the director from entering into such engagements.

<sup>21</sup> This matter is discussed extensively in Chapter 4. To recapitulate, while the I.C.A. 1997 allows a director to engage in legitimate competition with his company, Art. 42(Second-b) of the I.B.R.A. 2005 prohibits him from doing so in all cases.

Moreover, these contradictions reflect a “legislative messiness” in this area of law, and hinder the establishment of a uniform legislative policy in this arena. Evidently, the above conflict of legal provisions has a negative influence on the unity and coherence of the legal rules that govern this area. It also gives support to the argument that a fiduciary duty is a non-existent notion in Iraqi law.

### **8.3 Conclusion**

It has been demonstrated by a review of the findings of this thesis that the current legal regulation of managerial duties in Iraqi law is incapable of attaining the goal of protecting companies and their members from a director’s abuse of his powers. This argument is built on Iraqi legal realities and can be summarized as follows: the current regulation is an incomplete system, as it lacks a conceptual basis; and furthermore there are several contradictions among the statutory provisions of the legislation that support this conclusion. Consequently, the current regulation of director’s duties under Iraqi law provides safe havens where a director is able to engage in activities harmful to the company, instead of providing the company with safeguards.

Some may say that it is not legitimate to judge a legal system by comparing it with a more developed legal regime (English law in this thesis), and to conclude that the non-existence of certain elements within it is evidence of its incompleteness. It could even be said that the incompleteness of any legal system should be judged according to its own legal (domestic) setting. This argument, however, is not entirely valid, because the misconduct that constitutes a breach of managerial duty does not vary from one country to another. The focus in all cases should be on the adequacy of a legal regime and its effectiveness in addressing the abuse of managerial power. It has been shown in this thesis that the rules governing fiduciary duty under English law are premised on logical and pragmatic solutions, and are even eligible to be considered as a universal system. The great benefit to be gleaned from making a comparison with a more developed legal system is its use in identifying legislative defects and developing solutions, as has been shown in this thesis is the case under English law.

Iraqi law has recently adopted a capitalist economic regime. This regime is in need of a special legal system in order to support the principles of liberty of trade and competition which calls for a corresponding respect for the legitimate interests of others (the company). Current Iraqi legislation may be the foundation of the legal system of the near future which, it is hoped, will be more robust and more stable. But at this stage, a major overhaul should be undertaken of current Iraqi company law as a step towards attaining the above goal. It is hoped furthermore that this thesis has offered some helpful indicators of defects in Iraqi law. Every Chapter contains several suggestions for improving the legal reality of Iraqi law, and it is not intended to repeat these suggestions again. Rather, it is adequate in this respect to present an overview of the general features of the overhaul plan, as follows:

1. To transplant the concept of the fiduciary doctrine into the general Iraqi legislation of company law (the I.C.A. 1997). Such a reform is vital in order to identify the conceptual basis around which other managerial duties revolve. Transplanting this concept will assist the courts and legal practitioners to interpret these duties, to understand their content and also to justify their enactment. It will also serve to bridge the gap resulting from the innate incompleteness of the law. If this point had been taken into account when the overhaul of the I.C.A. 1997 was undertaken, the 2004 reform would have achieved its objectives.

2. To insert a *special chapter* in the I.C.A. 1997, incorporating the aforementioned duties into an integrated framework, so that it becomes the “Code” that contains all rules governing this area of the law. It will consist of, a comprehensive formulation, comprehensible to the director and to all those who deal with the company, as is the case with the English Companies Act of 2006.

3. To enshrine special rules for the enforcement of managerial duties in order to be consistent with the special nature of these obligations. The confiscation of the benefit resulting from breaches of a fiduciary duty should be considered essential for inhibiting a director from committing wrongdoing.

4. To remove all provisions in all other special Acts which enshrine the managerial duties of the director. This is vital in order to avoid any complexity in interpreting these provisions in conjunction with *the general Legislation of Companies* (the I.C.A. 1997).

#### **8.4 Suggestions for Future Studies in this Area of Law: How to Melt the Iceberg that Divides Common Law and Civil law Jurisdictions in this Area of Law?**

It is hoped that this thesis represents a step, if only a small step, towards deploying the culture of English law in Iraq. A further hope is that Iraqi studies will in the near future turn their attention to issues such as corporate governance within the context of directors' duties, and the protection of stakeholders' interests, particularly those of creditors, and the director's liability in the case of the firm's insolvency. The author is of the view that the legal shortcomings that have been highlighted in this study would not have occurred if comparisons had been made with a similar legal system.

It is hoped that future literature dealing with this area of company law will be able to benefit from English law by undertaking a comparison between that law and its own domestic laws. Such a comparison is crucial in dealing with the fact that the concept of fiduciary duty in the common law countries offers pragmatic solutions to agency problems. Melting the great iceberg of misunderstanding of the concept of fiduciary duty as established in the common law jurisdictions will help to put an end to the long-standing dominance of the French school of law over the legal development of Iraqi law. This dominance is premised on a solid belief that the French paradigm of law has always offered the best solutions to problems that relate to company law. Yet this thesis has revealed that the I.C.A. 1997, which derives most of its rules from the French school of law and from other Arab jurisdictions, has adopted rules that could provide fertile soil for the emergence of conflicts of interest.

Furthermore, a critical scrutiny of the school of common law will bring several economic benefits. It will, for example, assist in overcoming the hesitancy of foreign investors from common law countries. These investors will be far more willing to

invest in a civil law country, such as Iraq, if the domestic laws comprehensive acceptable elements of fiduciary obligation.<sup>22</sup>

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<sup>22</sup> This information is extracted of the personal observation of the author as a former officer in the Department of Contract in one of the Iraqi Ministries.



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