Briefing Note: The Duty of Loyalty - What Can a Business Expect from its Directors, Partners and Senior Employees?

Introduction

This Briefing Note explores the duties of loyalty to a business that are owed by company directors, partners, certain senior employees and other fiduciaries, both under the common law and under the Companies Act 2006, as well as outlining remedies available in the event of breach and possible defences that may be available.

This Briefing Note should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

Briefing Note
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1. What is a fiduciary duty?

A common law fiduciary relationship arises where it is agreed that one person (A) will act on behalf of or for the benefit of another (B) in circumstances which give rise to a relationship of trust and confidence. Typically, A will have a degree of discretion or power over B's best interests and, in turn, B relies on A to act in B's best interests. A fiduciary is expected to act in the interests of the other – to act selflessly and with undivided loyalty[1]. It is this obligation to act selflessly which distinguishes a fiduciary from an individual who merely owes contractual obligations, ie the difference between a company director and a mere employee.

Fiduciary relationships have been held to arise in the following situations:-

- Partners to their fellow partners
- Solicitors and other professional advisers to their clients
- Trustees to their beneficiaries
- Agents (including commercial agents) to their principals
- Directors to their companies (not the shareholders)

Fiduciary duties should not be confused with contractual obligations, although a fiduciary relationship may (but does not necessarily) arise out of a contractual one.

2. What fiduciary duties does a director owe?

There are several types of company director. An executive director is usually an employee of the company and is involved in the day-to-day management of it, whereas a non-executive director will often retain a degree of independence and become involved in the affairs of the company on a limited basis, often just attending and preparing for Board meetings. However, there is no distinction in principle between the duties owed by executive and non-executive directors[2].

Usually, executive and non-executive directors will have their details registered with Companies House. Frequently, employees are given the title of director and held out by the company as being such, even

[1] Finn, *Fiduciaries Obligations (1998) P4*
[2] *Dorchester Finance Co v Stebbing [1989] BCLC 498*

though they have not been validly appointed. These are known as de facto or quasi directors, and they also owe fiduciary duties to the company in respect of the functions that they perform[3].

The corollary to a quasi director is a person in accordance with whose directions or instructions the Board are accustomed to act. Typically, this will be a majority shareholder. This individual will be a "shadow director"[4]. It is not sufficient for the shadow director merely to give instructions, the Board or at least the majority of the Board must be in the habit of following those instructions. A shadow director may also owe a range of fiduciary duties but this will often be dependent upon his position and functions[5].

A director owes his fiduciary duties to the company and only the company can enforce them. Generally speaking, the only way in which a shareholder can enforce a fiduciary duty against a director is through the company itself, often by means of a derivative action on the company's behalf. There are some exceptions to this general rule which are beyond the scope of this Briefing Note.

Normally, a director will only owe fiduciary duties to his company for the duration of his directorship and they will come to an end upon his resignation or removal. However, some of the duties that arise during the directorship have a continuing effect after the directorship has come to an end, eg the duty not to exploit confidential information and maturing business opportunities.

Common Law Duties

As will be seen, many of the common law duties that a director owed towards his company were codified in statute with the introduction of the Companies Act 2006 ("CA 2006"). However, not all of them were incorporated within the CA 2006. Furthermore, the CA 2006 makes it clear that the existing case law and principles will continue to be relevant in interpreting and applying the general duties under the CA 2006. We must therefore look first at what common law fiduciary duties a director owes to his company.

Duty to act in good faith and in the best interests of the company

A director has to act at all times in good faith in what he considers to be the best interests of his company. This is a subjective test and provided a director can demonstrate that he has exercised his powers diligently and in good faith, a court will not interfere even if the court may have exercised these powers differently.

What is in the best interests of the company is usually assessed by reference to the short-term and long-term interests of its current and future shareholders. Where there are different groups of shareholders with differing interests, the directors have to act fairly between the different groups[6]. However, where the interests of the company and the shareholders are divergent, the interests of the company will prevail[7].

Where the company is insolvent, the directors, when carrying out their duties to the company, also have to consider the interests of the creditors, which become paramount[8].

A duty to act within powers conferred by the company's constitution and to exercise his powers for a proper purpose

[3] *Re Canadian Land Reclaiming and Colonising Co (1880) 14 Ch.D 660)*
[4] *Section 251 (1) Companies Act 2006*
[5] *Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Ch)*
[6] *Mutual Life and Insurance Co of New York v Rank Organisation Ltd [1985] BCLC 11*
[7] *Dawson International Plc v Coats Paton Plc [1989] BCLC*
[8] *Liquidator of West Mercia Safetywear Ltd v Dodd (1988) 4 BCC 30*

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A director must not cause a company to undertake activities that fall outside of its memorandum and articles or to exercise his powers for any improper purpose, even if he believes that his conduct may be in the best interests of the company[9].

A duty not to fetter his own discretion

In other words, a director has to exercise independent judgment on the company's behalf and cannot agree with a third person to vote at board meetings in any particular way, unless permitted to do so under the company's articles.

A duty to avoid conflicts of interest

A director must avoid placing himself in a position where there is a conflict or even a potential conflict between the duties he owes to the company and either his own personal interests or duties he owes to a third party. This duty extends to:-

- Entering into contracts with the company without the approval of the shareholders following full disclosure (unless authorised under the company's articles)
- The use of information or opportunities
- Competing with the company

The law dealing with the extent to which the fiduciary can benefit from business opportunities that he becomes aware about during the currency of the fiduciary relationship is complex and convoluted. It is influenced both by the duty to avoid conflicts of interest, the duty not to make unauthorised profits (see below) and the contractual duty of fidelity.

The law has been settled where unlawful profits are made whilst the fiduciary relationship subsists since the late 1960s. Where a cinema operator formed a subsidiary company to acquire two further local cinemas with the intention of selling all three as a package but subsequently discovered that it could not fund the entirety of the transaction, some of its directors chose to fund the shortfall by personally subscribing for shares in the subsidiary. The shareholdings were later sold at a substantial profit and the company subsequently brought an action to recover that profit on the basis that the directors, as fiduciaries, were not entitled to profit personally from business opportunities that had come their way during, and as a result of, their fiduciary relationship. The House of Lords unanimously found against the directors, concluding that it was immaterial that the company could not have subscribed for the shares itself, or indeed whether the company had been damaged or even benefited by the directors' actions. "The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account"[10].

The question then arose as to what the position was in relation to a company director who resigned from the company in order to free himself from his employment contract so that he could take advantage of a valuable contract for his own benefit. In *Industrial Development Consultants v Cooley*, a managing director had been negotiating to design and build depots for a third party. The negotiations were unsuccessful. The managing director resigned on a false premise and subsequently, but only after his directorship had ended, secured the contract for himself, although the proposal (which he had not passed on to his employers) had been elicited during the course of his employment. Unsurprisingly, the court applying the above principles, concluded that the director had put himself in a position where "his own private interests conflicted grievously" with those of

[9] *Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821*
[10] *Regal (Hastings) v Gulliver [1967] 1 AC 134*

his employer and ordered him to account to his former employer for profits which he "has made and will make as a result of having allowed his interest and his duty to conflict"[11].

By contrast, a director was permitted to keep profits derived from contracts for the supply of postal boxes to the Cameroon postal authorities, which he obtained after he had resigned as managing director of the company, which had previously supplied the post boxes[12]. *Hutchison J* concluded that there had been no breach of fiduciary duty because the company had not been actively seeking repeat orders from the client at the time of the director's resignation. Consequently, there was no "maturing business opportunity" to exploit, nor could the director's resignation have been prompted or influenced by a wish to acquire for himself such an opportunity as it was not his position with the company that gave rise to the opportunity but rather it came from his own fresh initiative. In other words, there was an absence of any causative link between his resignation and the acquisition of the business opportunity.

In a further development of the law in this area, the High Court considered the case of a director who resigned after falling out with his business partner, having already taken steps to prepare to compete by incorporating a new company. Having set up his new business, the director then employed all of the staff of his former company and acquired many of its current and prospective clients and the benefit of the contracts that they had with the previous company[13]. *Lawrence Collins J* adopted a proprietary approach to the business "opportunity" and concluded that by seeking to exploit the opportunity after resignation the director was "appropriating for himself" the company's property. In his judgment he conflated a "maturing business opportunity" with one that already existed or had already been exploited.

The application of these duties to "actual contracts" as well as "maturing business opportunities" was a significant extension of the law and, as a result, directors may now legitimately be precluded from exploiting even the existing contracts of their former employers. It would be surprising if this judgment was intended to have the effect that a director is prohibited from soliciting the custom of his former company in the absence of any post-termination restrictive covenants on the grounds that that custom was in some way a proprietary interest of the company as this would potentially be contrary to public policy and in restraint of trade. Nevertheless, this appears to be the effect of this decision and although there have been subsequent deliberations by both the High Court[14] and the Court of Appeal[15], neither has expressly resiled from what must surely be regarded as "a high watermark" in the state of the law in this area.

A duty not to make unauthorised profits

A director must account for any profit that he makes personally as a result of his directorship unless such profit was authorised by the shareholders or was in accordance with the company's articles. This is a strict duty and is not dependent on establishing fraud; bad faith or even the company suffering any loss[16].

Statutory duties

To a large, but not absolute extent, the statutory duties that a director owes to his company under the CA 2006 supplant the pre-existing common law rules and equitable principles. However, the statutory duties are to be interpreted and implied in the same way as the corresponding common law rules and equitable principles[17]. The remedies available under the CA 2006 also mirror the remedies that were available before

[11] *[1972] 1 WLR 443*
[12] *Island Export Finance Ltd v Umunna [1986] BCLC 460*
[13] *CMS Dolphin Ltd v Simonet [2001] BCLC 315*
[14] *Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Ch)*
[15] *Foster Bryant Surveying Ltd v Bryant [2007] IRLR 425 CA*
[16] *Murad v Al-Saraj [2005] All ER (D) 503*
[17] *Section 170 (4) CA 2006*

that Act came into force. Furthermore, some common law or equitable duties have not been codified under the CA 2006 and remain relevant, such as the duty to consider and act in the interests of creditors and the duty of confidentiality.

These statutory duties are owed to the company and it is the company that has the right to enforce them, although in some circumstances, shareholders may be able to bring a derivative action.

Duty to act within his powers (section 171)

A director must act in accordance with the company's constitution and only exercise powers for the purpose for which they are conferred. A company's constitution includes its articles and any decisions taken in accordance with its constitution or by its shareholders to the extent that they can be regarded as a decision of the company. This section appears to do little more than replicate the previous case law.

Duty to promote the success of the company (section 172)

This replaces the duty to act in good faith in the best interests of the company and provides that a director 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. In doing so, the director must have regard (amongst other matters) to:-

- The likely consequences of any decision in the long-term.
- The interests of the company's employees.
- The need to foster the company's business relationships with suppliers, customers and others.
- The impact of the company's operations on the community and the environment.
- The desirability of the company maintaining a reputation for high standards of business conduct.
- The need to act fairly as between shareholders.

This duty is subject to any other enactment or rule of law requiring directors in certain circumstances to consider or act in the interests of the company's creditors.

The structure of the section means that the matters that the director must have regard to, as are listed above, are ultimately subordinate to the overarching duty to promote the success of the company for the benefit of its members as a whole, although the director cannot disregard the factors listed, which are not exhaustive.

It has been held that the duty imposed upon the director is subjective and ultimately depends upon the director's bona fides[18].

This duty applies to all decisions made by directors, not just formal board decisions. Consequently, it is considered good practice for board minutes to state that directors have taken the factors outlined in section 172 into account when reaching their decision.

[18] *Re Southern Counties Fresh Foods Ltd [2008] EWHC 2810*

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Duty to exercise independent judgment (section 173)

A director must exercise independent judgement but this duty will not be infringed by a director who acts in accordance with an agreement entered into by the company that restricts the future exercise of his discretion or in a way which is authorised by the company's constitution. This statutory duty replicates the previous common law duty that a director may not fetter his own discretion.

Duty to exercise reasonable care, skill and diligence (section 174)

A director must exercise the reasonable care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out those functions and that the director actually has. Consequently, there is both an objective and subjective test to be satisfied. It follows that where a director has specialist knowledge, for example a finance director who is also a chartered accountant, the higher subjective standard must be met.

Duty to avoid conflicts of interest (section 175)

A director must avoid a situation in which he has, or could have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This applies, in particular to the exploitation of any property, information or opportunity regardless of whether or not the company could take advantage of the same. However, this duty will not arise in respect of transactions or arrangements covered by *section 177 and 182* of the *CA 2006* – see below.

The duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or if authorisation is given by the other directors, who do not have such an interest and where such authorisation is permitted by the company's constitution. The director concerned cannot vote, nor form part of the quorum at which board authorisation is granted.

Unlike most of the other statutory duties, this duty continues to apply after the person ceases to be a director in respect of the exploitation of any property, information or opportunity of which he became aware whilst he was as director.

Duty not to accept benefits from third parties (section 176)

A director must not accept a benefit from a third party conferred by reason of him being a director or by anything he does, or does not do, as a director. However, the duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

This does not preclude the director accepting benefits from the company, any associated company or, for example, through any other company through whom he provides his services. As with *section 175* this duty continues to apply after he ceases to be a director in relation to things done or omitted to be done before he ceased to be a director.

Duty to declare an interest in a proposed transaction or arrangement (section 177)

If a director 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 before the company enters into the transaction or arrangement.

Where the duty to avoid conflicts of interest (*section 175*), or the duty to declare an interest in a proposed transaction or arrangement (*section 177*), is complied with by means of authorisation by or disclosure to the other directors, then the said transaction or arrangement will not be set aside by reason of any other rule or principle requiring the consent or approval of the shareholders. Essentially, therefore, the other directors, not the shareholders, have the power to authorise the conflict[19].

Duty to Disclose Wrongdoing

In recent years the courts have developed a new category (or more strictly a new sub-set) of fiduciary duty, namely the duty to disclose one's own wrongdoing or that of any other person insofar as it affects the company. Traditionally, it had been understood that neither an employee nor a director had any duty to disclose his own wrongdoing, whether arising as a fiduciary or a contractual duty[20]. That proposition has steadily been eroded by subsequent judgments in recent years.

For instance, it has been decided that a senior employee, who held the position of European Zone Controller, but was not a director and, who, together with other employees, arranged to set up and carry on a competing business, owed a duty to disclose the misconduct of the other employees, even if he was under no duty to disclose his own misconduct, notwithstanding that by disclosing the actions and intentions of his colleagues he would inevitably be disclosing his own misconduct[21].

Since then, the courts have definitively established the existence of a fiduciary duty to disclose one's own wrongdoing. Such issues commonly arise where the company or employer seeks to avoid or recover payments made on termination of employment, whether by means of a severance payment, a bonus payment or by share options. As opposed to a freestanding category of fiduciary duty, it was held that a director's duty to act to promote the best interests of his company prima facie includes a duty to inform the company of any activity, actual or threatened, which damages those interests. The fact that the activity involves both himself and others does not excuse him from such disclosure[22].

In *Tesco Stores Ltd v Pook*[23] the Defendant was a senior manager who reported into the Board, and was responsible for approving invoices. He falsely approved invoices from a company he owned and controlled and shortly before his dismissal sought to exercise share options which had become exercisable. The High Court found that directors and senior employees have a positive duty to disclose breaches of their fiduciary duty which, in this case, included the receipt of a bribe, the existence of a conflict of interest and making a secret profit. The court found that there was an implied term that the share option was not exercisable so long as the employee was in breach of a serious duty, including the duty of disclosure.

The issue was largely put to rest by the Court of Appeal in *Item Software (UK) Ltd v Fassihi*[24] in which a director had conduct of negotiations for the renewal of a distribution agreement, during which he encouraged the company to adopt an aggressive stance in the negotiations, whilst simultaneously suggesting to the other party that he could set up his own company to take over the agreement. The Court of Appeal concluded that the director did owe a fiduciary duty to disclose his own wrongdoing but, as, in *British Midland Tool*, the duty

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[19] *Section 180 CA 2006*
[20] *Bell v Lever Bros Ltd [1932] AC 161, HL*
[21] *Sybron Corp v Rochem Ltd [1984] CH 112*
[22] *British Midland Tool Ltd v Midland International Tooling Ltd [2003] 2 BCLC 523*
[23] *[2004] IRLR 618*
[24] *[2004] EWCA Civ 1244*

was nothing more than a manifestation of the general duty to act in good faith in the best interests of the company, now enshrined within *section 172 CA 2006*.

This case drew a distinction between the duty of disclosure owed by directors and other fiduciaries and the duty owed by ordinary employees. Where the individual is a mere employee, it is far less likely that, absent an express contractual obligation, he will be found to be subject to a duty to confess his own wrongdoing[25]. Such employees may be under an implied contractual duty to report on other employees but only when the circumstances are such (due to the seniority of the employee and the nature of the employment) that such a duty could be inferred[26].

Duty to Disclose other matters of interest

In light of the broad nature of the duty to act in good faith and in the best interests of the company/to promote the success of the company, it is likely that the duty of disclosure extends beyond a duty to report wrongdoing into a duty to disclose matters which may amount to a potential commercial threat, either now or in the future, to the company/employer. Where a fiduciary gains knowledge of another employee proposing to leave to set up as, or to join a competitor, it has been held that the fiduciary is not just obliged to disclose his knowledge, but must also use his best endeavours to persuade each member of the team proposing to leave to remain with the current employer[27]. If a fiduciary wishes to be part of the team move, he is obliged to resign his office "as soon as his intention has been irrevocably formed and he has launched himself in the actual taking of preparatory steps"[28].

A director may resign at any point regardless of how inconvenient or damaging this may be to the company[29]. The extent of the fiduciary duty may also reduce during a period of notice before the resignation has formally taken effect, doubtless due in large part to the fact that at that stage the director has already disclosed his future intentions and the company could act accordingly[30]. Nevertheless, there is little doubt that where a director receives an approach to recruit him during his employment and discusses that approach with the competitor, he is likely to be under a duty to disclose this fact to his current employer[31].

Absent a direct approach from a competitor is a director nevertheless obliged to disclose a personal intention to compete against his company at some point in the future? Initially it was thought that having regard to public policy and restraint of trade principles, no such duty would arise[32]. This approach, however, was subsequently held to be limited to situations where a director was intending to compete on his own without any involvement of other employees or directors of the employer[33].

This view was also preferred by *Etherton J* who concluded that "a director would be under a duty to alert his fellow board members to a nascent commercial threat to the future prospects of the company, and that duty would be all the greater (and certainly no less) when he, himself, was planning to be part of the threat"[34]. It

[25] *Helmet Integrated Systems Ltd v Tunnard [2007] IRLR 126*
[26] Per Lord Atkin in *Bell v Lever Bros* (see above)
[27] *British Midland Tool v Midland International Tooling Ltd* (see above)
[28] *Ibid*
[29] *CMS Dolphin v Simonet [2001] 2 BCLC 704*
[30] *Foster Bryant Surveying Ltd v Bryant [2007] IRLR 45, CA*
[31] *Kynixa Ltd v Hynes [2008] EWHC 1495 (QB)*
[32] *Balston v Headline Filters [1990] FSR 385*
[33] *British Midland Tool Ltd v Midland International Tooling Ltd* (see above)
[34] *Shepherds Investments Ltd v Walters [2007] IRLR 110*

seems tolerably clear from the case law then that the point at which the fiduciary duty, in the absence of an immediate resignation, is breached, is the formation of a irrevocable intent to compete – also described as a "settled intention"[35].

3. Who Can Enforce Directors' Duties?

The statutory and common law duties referred to above are owed by the director to the company alone, although if the director is also a shareholder, there may be a breach of a shareholders agreement, for instance. It follows that only the company can enforce directors' duties, although in certain circumstances, shareholders may be able to bring a derivative action which is brought in the name of and on behalf of the company, not on behalf of the shareholder.

A derivative action can be brought under *section 260 CA 2006* in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director. The cause of action may arise before the person seeking to bring a derivative claim became a shareholder of the company[36].

Nevertheless a shareholder will have to overcome a number of procedural hurdles in bringing such an action. The court must refuse permission for a derivative claim to be brought where it is satisfied that either a person acting in accordance with a general duty to promote the success of the company under *section 172* would not seek to continue with the claim or where the act or omission giving rise to the cause of action has been authorised (see above) or ratified (see below) by the company[37].

The court must have regard to the following matters when considering whether to grant permission for a derivative claim to be brought:-

- Whether the member is acting in good faith in seeking to continue the claim.
- The importance that a person acting in accordance with a duty to promote the success of the company would attach to continuing the claim.
- The extent to which the act or omission could be, or was likely to be, authorised or ratified by the company.
- Whether the company has decided not to pursue the claim.
- Whether the act or omission could be pursued by the member in his own right rather than on behalf of the company.
- Any evidence as to the views of other shareholders who have a personal interest, either directly or indirectly in the matter.

4. What are the Available Remedies?

[35] *Cook v MSHK Ltd [2009] IRLR 838*
[36] *Section 260(4) CA 2006*
[37] *Section 263(2) CA 2006*

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The consequences of breach of a director's statutory duties are the same as would apply under the corresponding common law rule or equitable principle[38]. With the exception of the duty to exercise reasonable care, skill and diligence under section 174, where the remedy is usually one of damages only, the full panoply of common law and equitable remedies are available to the company where the director has breached his statutory or common law fiduciary duties. These include:-

An injunction or similar order

An injunction is a discretionary remedy that is generally only granted where the breach is ongoing or still threatened. Similar discretionary remedies may include a declaration, an order for delivery up of company property or confidential information or an order for specific performance. In appropriate cases, a breach of fiduciary duty may justify the bringing of a claim for springboard relief[39]. For further information about injunctions, including springboard injunctions, see our Briefing Note.

Setting aside of the transaction/rescission

If the director enters into an unlawful transaction with the company, then the contract is voidable and can be rescinded at the election of the company. In certain circumstances, the director may still be able to claim reasonable remuneration by way of an equitable allowance for work carried out if his efforts have resulted in a gain to the company as well as personal gain but the circumstances in which this will be permitted are extremely limited[40]. A transaction may also be set aside in circumstances where the company is, or becomes, insolvent but this is beyond the scope of this Briefing Note.

Account of Profits

This is a restitutionary remedy, usually available where the director has been unjustly enriched at the expense of the company. This may be particularly useful where the company will struggle to establish any loss but can demonstrate that as a result of his breach of fiduciary duties, the director has personally benefited. See our Briefing Note on account of profits and other restitutionary remedies for further details.

Damages

If the company suffers loss as a result of the director's breach of fiduciary duties, common law damages for breach of contract or equitable damages for breach of fiduciary duty may be available. Please refer to our Briefing Note on damages for further details.

5. Are there any Defences or Reliefs Available?

Ratification

Traditionally, under the common law, the shareholders of a company could ratify a director's breach of fiduciary duty, effectively affirming the transaction. This had the effect of releasing the director from any personal liability. The potential for abuse of the minority shareholder's interest was such that limits were placed on the power of the majority to ratify the transaction in certain circumstances, including where the company could not have lawfully performed the act in the first place; where it amounted to a fraud or oppression of the minority shareholders or in circumstances of dishonesty.

[38] *Section 178 CA 2006*
[39] *Midas IT Services v Opus Portfolio Ltd (unreported) 21 December 1999)*
[40] *Guinness Plc v Saunders [1990] 2 AC 663; O'Sullivan v Management Agency and Music Ltd (1985) QB 428*

Further changes to the common law position were introduced by section 239 CA 2006 so that any ratification decision had to be taken by the shareholders without reliance on the votes of the director concerned or any connected person, ie family members. However, these restrictions will not apply where there is unanimous consent in favour of a ratification resolution.

The pre-existing common law restrictions on ratification have been held to survive the CA 2006 so a company may not ratify unlawful acts, nor may it ratify breaches of duty where affirmation was brought about by unfair or improper means, was illegal, fraudulent or oppressive towards the minority of shareholders[41].

Relief from the Court

By reason of *section 1157 CA 2006*, where proceedings are brought against a director for breach of duty, the court may relieve him from liability if he considers that he has acted honestly and reasonably and considering all the circumstances of the case he ought fairly to be excused. The director can also apply to the court where he has reason to anticipate that a claim may be made against him in the future.

Indemnity and Insurance

By reason of *section 232 CA 2006* any provision that exempted a director from liability for negligence, default, breach of duty or breach of trust, in relation to the company, is void. The company are, however, entitled to indemnify the director in respect of defence costs or costs incurred in relation to an application for relief under *section 1157*, provided that those costs are repayable if the director is unsuccessful.

By reason of *section 233 CA 2006*, a company may purchase insurance for its directors against any liability attaching to them in connection with any negligence, default, breach of duty or breach of trust in relation to the company.

6. Fiduciary Duties Owed by "Mere" Employees

It is important to recognise the distinction between fiduciary duties and the duty of fidelity which is an implied term of every employment contract. The duty of fidelity requires that during the continuance of employment, an employee will act in his employer's interests and not use the time for which he is paid by the employer to further his own interests[42]. This duty, therefore, requires an employee to have regard to his employer's interests but does not place an employee in a position where he is obliged to pursue his employer's interests at the expense of his own[43].

The starting point for analysing whether an employee is in a fiduciary position is the contract of employment itself which "regulates the basic rights and liabilities of the parties"[44]. The fiduciary relationship itself must, at the very least, be consistent with the terms and operation of the contract according to its proper construction. That is not to say that fiduciary duties cannot arise out of the employment relationship but they arise not as a result of the mere fact of the relationship itself, but where there are specific obligations which have placed the employee in a position where he is obliged to meet the rigorous duties imposed by equity in addition to his contractual obligations[45].

The importance of the terms of the contract have been reiterated more than once by the Court of Appeal which has confirmed that it is essential to focus on the substance of the contractual duties the employee

[41] *Franbar Holdings Ltd v Patel [2009] EWHC 1534 (Ch)*
[42] *Wessex Dairies Ltd v Smith [1935] 2 KB 80*
[43] *University of Nottingham v Fishel [2002] ICR 1462*
[44] *Hospital Products Ltd v United State Surgical Corporation (1984) 156 CLR 41 cited by Privy Council in Kelly v Cooper [1993] AC 205*
[45] *See Fishel above*

owes and to determine, having regard to issues such as seniority, degree of independence and the level of trust conferred, whether a fiduciary obligation is warranted[46]. In this case, a salesman working for the manufacturer of protective equipment identified a new design for a fire helmet and then took steps, in his own time, without disclosing the same to his employer, to develop the business idea. He was found not to owe fiduciary duties because it was never in the contemplation of either party that as a salesman he would develop products, only sell them. The approach adopted by the Court is, therefore, highly fact specific.

This approach is also evident in the most recent case on this subject to come before the Court of Appeal[47]. Mr Ranson was divisional manager of a IT consultancy and his contract of employment had no post-termination restrictive covenants although it did contain a confidential information clause. During his employment, he incorporated another company, opened bank accounts and drafted business plans prior to his resignation. During his notice period, he had discussions with business contacts of his employer. The main issue was whether or not Mr Ranson was under a duty to report his own "wrong doing" to his employer which would have been the case had he owed a fiduciary duty (see above) but not if he was a mere employee. The Court of Appeal concluded that Mr Ranson was not under a contractual duty to report his own wrong doing or any competitive threat as did not owe any fiduciary duties to his employer.

Any employer wishing to impose fiduciary-like obligations upon a mere employee, as opposed to a director, such as the duty to report any wrong going or nascent commercial threat; a duty to avoid any conflict of interest; a duty not to exploit any maturing business opportunity, etc, is best advised to include express terms to this effect within the employment contract itself.

If you would like to know more about this topic or our other legal services, please contact Paul Maynard pcm@gabyhardwicke.co.uk

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[46] *Helmet Integrated Systems Ltd v Tunnard [2007] IRLR 126*
[47] *Ranson v Customer Systems Plc [2012] EWCA Civ 841*