DUTIES OF EMPLOYEES AND DIRECTORS

TO DISCLOSE MISCONDUCT

by

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1. In this paper, I examine the question whether an employee or director owes a duty to disclose his own misconduct to his employer or the company. This requires a consideration of five principal authorities: *Bell v Lever Bros*, *Sybron v Rochem*, *Horcal v Gatland*, *Tesco v Pook*, and *Item Software v Fassihi*. I consider what conclusions may be drawn from the current state of the authorities in the light of the important recent decision of the Court of Appeal in *Item Software*.

Bell v Lever Brothers

2. The starting point for the analysis of whether an employee has a duty to disclose his own wrongdoing has for many years been, and remains to this day, the decision of the House of Lords in *Bell v Lever Brothers Ltd* [1932] AC 161.

3. It is not an altogether easy decision to follow, or to interpret. This is for several reasons. First, there are a number of different grounds for the decision reflecting the various claims advanced some by way of late amendment to the pleaded case and some not even apparently reflected in the pleadings. Secondly, the action was tried by a judge and jury, with the result that some of the key facts are to be found in the answers to questions put to the jury. Thirdly, not only did the House of Lords split 3 to 2, but the majority differed in the result from both the trial judge and a unanimous Court of Appeal. Moreover, consideration by their lordships of the issue of an employee's duty to disclose his own wrongdoing is secondary to their main focus which is on the doctrine of mistake.

4. Despite these qualifications it is necessary, in order to understand the law in this area and its development over the 70 years since *Bell*, to take some time to examine the speeches of their lordships on this issue. This requires an appreciation, albeit in summary form, of the facts of the case.

The facts

5. The facts in *Bell* concerned essentially two companies, two individuals and some cocoa. The first company is Lever Brothers Ltd itself. Lever Brothers owned 99% of the share capital of the Niger company. The Niger Company dealt in West African

produce, including cocoa, but was making heavy losses. To address this problem, Lever Brothers made two appointments to the Niger company in 1923. Mr Bell (then a "joint manager of one of the great London banks") was appointed as Executive Chairman, and Mr Snelling ("an accountant of exceptional ability") as Executive Vice-Chairman. Each was appointed on a five-year contract, which in 1926 was replaced by a fresh five-year contract. Each became a director of the Niger company.

6. The appointments were a resounding success. Messrs Bell and Snelling converted great losses into great prosperity. Whilst doing so, in a 6-week period in 1927, Messrs Bell and Snelling entered into 4 cocoa transactions on their own account, making for themselves a profit of £1,360. The fact of the transactions remained unknown to either Lever Brothers or Niger until the later events which gave rise to the litigation.

7. By 1929, the position of Niger had so greatly improved that it merged with a competitor on favourable terms. The result of the merger, however, was that there were no positions available for the two individuals who had been so instrumental in turning around the company's fortunes. As a consequence, agreements were entered into between Lever Brothers and the two employees, terminating the employment of the latter in return for payments of £30,000 to Mr Bell, and £20,000 to Mr Snelling, no doubt sizeable sums at the time.

8. Some two months after the termination of their employment, and the payment of the agreed compensation, the four cocoa transactions came back to haunt the employees. In the course of arbitration proceedings, inquiries were made as a result of which the four transactions were brought back to the minds of the employees who then described the transactions to Lever Brothers.

9. The company was none too impressed to learn of the previously undisclosed profits made by their employees, and shortly afterwards commenced proceedings against them. As Lord Atkin put it (212) "Levers discovered facts which indicated that their expenditure of £50,000 and their expressions of regard had been misplaced."

10. The company sought recovery of the profits made by the employees on the transactions, damages for fraudulent misrepresentation and concealment, rescission

of the termination agreements, and repayment of the monies paid under a mistake of fact.

Wright J

11. The company's case was advanced before Wright J on the basis of fraud and mistake. No case was put of duty to disclose.

12. In response to specific questions put, the jury decided importantly that there was no fraudulent misrepresentation or concealment by the employees concerning the cocoa transactions, that they had entered into the four transactions for their own benefit, that the company were entitled to terminate their employment because of the transactions and would have done so had they known about them at the time, but that the employees did not have the transactions in mind when entering into the termination agreements.

13. On the basis of these answers, the judge decided that the termination agreements should be set aside on grounds of mutual mistake. He held that all parties entered into those agreements under the common mistake that the contracts of service were binding, in the sense that they could not at that moment have been got rid of without the employees' consent.

The Court of Appeal

14. The Court of Appeal (Scrutton, Lawrence and Greer LJJ) took the same view as the trial judge on mistake. They also held that, although it was not pleaded, that his judgment could be supported on the ground that the employees during the termination negotiation were under a duty to disclose the offending transactions of 15 months before; and that they were not excused from disclosure by reason of the fact that, as the jury had found, the transactions had passed from their minds.

The House of Lords

15. As I have said, the House of Lords allowed the appeal by a 3 to 2 majority. However, there is only one dissenting speech, that of Lord Warrington with whose speech

Viscount Hailsham agreed. In addition, as Lord Warrington explained, he purposely avoided dealing with the question whether the employees were under an obligation as servants to disclose to Lever Brothers their breaches of the service agreements. The three law lords in the majority – Lords Blanesburgh, Atkin and Thankerton – each gave speeches, each of which requires some examination, although in the event only two are helpful for present purposes.

16. Lord Blanesburgh allowed the appeal on the ground that no case other than their pleaded case was open to the company, and mutual mistake had not been pleaded. As to the alleged duty of disclosure, he added that he agreed with the answer given on this by the other two lordships who were in the majority.

17. Lord Atkin decided that, even if it was open to them, an argument based on mutual mistake could not succeed. He concluded (223) that it would be wrong to decide that an agreement to terminate a contract is void if it turns out that the contract had already been broken and could have been terminated otherwise. The contract released is the identical contract in both cases, and the party paying for release gets exactly what he bargains for. There is no relevant mistake of fact.

18. Turning to the disclosure argument (227), Lord Atkin began by noting that the jury had negatived fraudulent concealment. This claim, however, was based upon the contention that Bell owed a duty to Levers to disclose his misconduct, and that in default of disclosure the contract was voidable. Lord Atkin pointed out that ordinarily the failure to disclose a material fact which might influence the mind of a prudent contractor does not give the right to avoid the contract. The exceptions include contracts of utmost good faith (*uberrimae fidei*), of which contracts of insurance are an example but contracts of employment are not.

19. In a passage oft-quoted in later cases, Lord Atkin said (228):

> "It is said that there is a contractual duty of the servant to disclose his past faults. I agree that the duty in the servant to protect his master's property may involve the duty to report a fellow servant whom he knows to be wrongfully dealing with that property. The servant owes a duty not to steal, but, having stolen, is there superadded a duty to confess that he has stolen? I am satisfied that to imply such a

duty would be a departure from the well established usage of mankind and would be to create obligations entirely outside the normal contemplation of the parties concerned."

20. Lord Atkin bolstered his view by considering the homely examples of a master who, having raised his butler's wages, later seeks recovery of the increase upon his subsequent discovery that the butler had previously received a secret commission from the wine merchant; and the master who, having given his cook a month's wages in lieu of notice, seeks their return on subsequently discovering the cook had been pilfering the tea. In neither case could the master succeed. As Lord Atkin concluded:

"He takes the risk; if he wishes to protect himself he can question his servant, and will then be protected by the truth or otherwise of the answers."

21. Finally, Lord Thankerton held (231) that in the absence of fraud, neither a servant nor a director of a company is legally bound forthwith to disclose any breach of the obligations arising out of the relationship so as to give the master or the company the opportunity of dismissal. There may well be cases, he added, in which the concealment of the misconduct amounts to a fraud on the master or company, but the jury had excluded that view in the present case. Accordingly, the employees here had no legal duty to disclose their cocoa transactions either at the time of their commission or in negotiating the termination agreements (232).

Conclusions from Bell v Lever Bros

22. In the light of this analysis, the following conclusions may be derived form the decision in *Bell* which are relevant for the purpose of our present inquiry:

22.1. It was apparently material to the decision in the case that there was no fraud on the part of the employees. The offending transactions were not in their minds when entering into the termination agreements.

22.2. Only two of their five lordships expressed any reasoned view on an employee's or director's duty of disclosure of their own misconduct (although a third agreed with these two). In so doing, Lords Atkin and Thankerton held that

there was no general duty on the part of an employee to disclose either own past misconduct to their employer or company. Lord Thankerton extended this principle, *obiter*, to a director.

22.3. Such duties of disclosure generally arise in specific classes of contracts of utmost good faith, of which the employment contract is not one. To impose such a duty on an employee, however, would be to create obligations outside the normal contemplation of the parties.

22.4. Lord Atkin stated that an employee may be under a duty to disclose to the employer the misconduct of a fellow employee.

Sybron Corporation v Rochem Ltd

23. Matters were taken a step further by the Court of Appeal in *Sybron Corporation v Rochem Ltd* [1984] Ch 112. The case is important not only for the development in the law which it represents, but also because the three members of the Court carefully consider the effect of the decision in *Bell v Lever Brothers*.

The facts

24. On any view, the position of the employee in *Sybron*, a Mr Roques, was particularly unmeritorious. As Stephenson LJ said of the case advanced for the employee by his counsel Mr (now Justice) Munby "If this is the law, in my judgment there is something very seriously wrong with the law." By the end of his judgment, he was able to express himself "happy to find that the law is not so outrageous as to enable Mr Roques to keep" his money. It was undoubtedly a hard case; whether it made bad law is another matter.

25. Sybron was an American financial conglomerate. One of its group companies was Gamlen Chemical Co Ltd which specialised in chemicals and equipment for cleaning ships and industrial sludge. Mr Roques was employed by Gamlen as its European zone controller, in effect the No.1 for Europe. He had the power of hiring and firing over the whole of the European zone. His right-hand man was a Mr Bove.

26. During the last 2 of his 21 years of employment by Gamlen, Mr Roques conspired with other employees, including but not limited to Mr Bove, to set up and carry on a new business, Rochem, in competition with and so as to injure the business of Sybron, and to conceal their involvement from Sybron. In effect, the judge found that what he called the top management, headed by Mr Roques and Mr Bove, defected, unknown to Sybron whilst still employees, to the Rochem companies and worked actively against their employers.

27. One of the terms of Mr Roques' employment entitled him to the benefit of a life assurance policy into which he and his employer made contributions. Following his early retirement, Mr Roques was paid a lump sum and received annual payments pursuant to the terms of this policy. Under rule 8(b) of the scheme, he would not have been entitled to this benefit in full if he had been dismissed for fraud or serious misconduct.

28. When Sybron subsequently discovered Mr Roques' involvement in the conspiracy it brought a large claim for millions of dollars as damages for conspiracy, one small part of which concerned an attempt to recover monies paid pursuant to the life assurance policy.

The Court of Appeal

29. The judge decided that Sybron could rely on rule 8(b) of the scheme and granted the orders sought by Sybron. The Court of Appeal dismissed Mr Roques' appeal.

30. It might be thought that since the employees in *Bell v Lever Brothers* were acquitted, yet Mr Roques' was found guilty, of fraud, that the case of *Bell v Lever Brothers* was distinguishable from the dispute between Sybron and Mr Roques. But the case was not clearly decided on that straightforward basis.

31. This may be due to a submission on behalf of Mr Roques which the trial judge accepted and which was cited without apparent disapproval by Stephenson LJ. That submission was that the House of Lords in *Bell* made it clear that in general terms if the employee has committed a <u>fraudulent</u> breach of the terms of his employment,

there is no superadded duty upon him to report his own dishonesty (121). It seems to me to be far from clear that the House of Lords went that far. But Stephenson LJ found it unnecessary to resolve that issue by finding an alternative route to reach what he clearly considered the just result in the case before him.

32. In his judgment, what entitled Sybron to recover the payments made to Mr Roques was the latter's serious misconduct in breach of contract in failing to report to Sybron the fraudulent misconduct of Bove, his No.2, and the other subordinates. He does note, though, that it is puzzling that it never seems to have occurred to counsel or to any of the many judges who dealt with *Bell* that they might have to consider the duty of Bell to report Snelling's misconduct, or Snelling's duty to report Bell's.

33. Stephenson LJ found support for this approach in an earlier decision of the Court of Appeal in the case of *Swain v West (Butchers) Ltd* [1936] 3 All ER 261. This led Stephenson LJ to express the following general principle, which he considered followed from *Swain* and was consistent with *Bell v lever Brothers,* namely (126):

> "that there is no general duty to report a fellow-servant's misconduct or breach of contract; whether there is such a duty depends on the contract and on the terms of employment of the particular servant. He may be so placed in the hierarchy as to have a duty to report either the misconduct of his superior, as in *Swain*, or the misconduct of his inferiors, as in this case.

34. Fox LJ agreed, expressing himself in similar terms (129):

> "I am not at all saying that an employee has in every case a duty to disclose to his employers any information that he has about breaches of duty by his fellow employees. I can see that ordinary usage is in many respects against such a rule. The matter must depend, I think, upon all the circumstances of the case. The important circumstances in the present case are that Mr Roques was in a senior executive position in the group and there was existing a continuing fraud by the employees against the company, of which he was well aware."

35. Kerr LJ held that Mr Roques was throughout in fraudulent breach of a clear duty owed to his employers to put an end to the activities of Mr Bove and the other conspirators, who were engaged in seeking to destroy the employers' business for their own purposes, and this continuing breach of his duty induced the mistake on Sybron's part.

36. But it is in its analysis of *Bell v Lever Brothers* that Kerr LJ's judgment is perhaps most illuminating. He considered that all that *Bell v Lever Brothers* decides, at most, is that Mr Roques was under no duty to disclose his own misconduct. He said "at most" because he was far from convinced that *Bell v Lever Brothers* applies, even to this extent, to cases where the concealment is fraudulent, as in *Sybron*, since the absence of fraud was stressed throughout the appellate proceedings in *Bell v Lever Brothers* itself.

37. All members of the Court of Appeal were clear that the fact that compliance by Mr Roques with his duties in this regard would inevitably have revealed his own fraudulent complicity was irrelevant.

Horcal Ltd v Gatland

38. The next case in this line of cases is another decision of the Court of Appeal in *Horcal Ltd v Gatland* [1983] IRLR 459 (Glidewell J), [1984] IRLR 288 (CA).

The facts

39. Mr Gatland was managing director of Horcal, who were building contractors. The chronology of events is of some importance to the outcome of the case and needs to be set out in some detail.

40. In early 1978, disagreements arose between Mr Gatland and a Mr Watson, the controlling shareholder of Horcal, and they decided to separate. On 3 June 1978, Mr Watson made proposals to Mr Gatland in effect for the purchase by Mr Gatland of Mr Watson's interest in Horcal including a proposal as to the price.

41. Whilst negotiations on this proposal were underway, on 12 June 1978, Mr Gatland on behalf of Horcal provided an estimate for building works to a client, Mrs Kingsbury, who accepted the estimate the same day. Shortly thereafter, and before 24 July, Mr Gatland decided to receive the payment personally from Mrs Kingsbury for this work and to pay the expenses himself on the basis that this would not

deprive the shareholders of any profit since he was to become the sole shareholder if the proposal then on the table was implemented.

42. However, Mr Gatland and Mr Watson were unable to agree on this proposal and on 24 July they agreed a different means of parting company. That is, Mr Gatland would leave Horcal in return for a payment of £5,000.

43. At the date of entering into that agreement, the building contract with Mrs Kingsbury was not in his mind although he had by that date decided to pocket the proceeds himself. Subsequently, Mr Gatland was paid for that building contract by the end of August 1978. His resignation took effect on 31 October 1978, and he was then paid the £5,000 termination payment. He managed to keep secret from Horcal the building contract with Mrs Kingsbury.

44. Unfortunately for Mr Gatland, during the following year Mrs Kingsbury complained about some aspect of the job that had been done which brought the whole matter to the company's attention, including the payments she had made direct to Mr Gatland.

The Court of Appeal

45. Horcal, the company, commenced an action against Mr Gatland to recover the sum of £5,000 paid to him pursuant to the termination agreement. It was claimed that the sum of money had been paid under a mistake of fact, and that the agreement under which it had been paid was void, the basis of that allegation being that Mr Gatland had committed a breach of his duty as director and that he had failed to disclose that breach of duty to Horcal at the date the termination agreement was made, thereby inducing a unilateral mistake on the part of the company.

46. Glidewell J dismissed the company's claim and the Court of Appeal dismissed the appeal.

47. The leading judgment was given by Robert Goff LJ, although it will be seen that the decision turned essentially on the facts of the case. In the course of his judgment, Robert Goff LJ said (para 16) that the company's argument, that a director is under a

duty to disclose any breach of duty on his part before an agreement of the kind in the present case was entered into, could lead to the extravagant consequence that a director might have to make a "confession" as a prerequisite of such an agreement.

48. However, it was not necessary to decide whether the company's argument was correct or not. This is because, on the judge's findings, Mr Gatland had committed no breach of duty by the date of the termination agreement on 24 July which he would have had to disclose if any duty of disclosure rested on him. All that had happened was that, by that date, Mr Gatland had formed the intention to pocket the proceeds but had done nothing to implement that intention. As Lawton LJ stated in his judgment, the law is concerned with deeds, not thoughts (para 24). It does not appear from the report that *Sybron v Rochem* was cited to the Court, although it is to be noted that the third member of the Court was Fox LJ who had been a member of the Court in *Sybron*. Fox LJ simply stated that he agreed with Robert Goff LJ.

Tesco Stores Ltd v Pook

49. I turn now to *Tesco Stores Ltd v Pook* [2004] IRLR 618.

The facts

50. Mr Pook was employed by Tesco as the new grocery development manager in its e-commerce department. Part of his duties involved the approval of invoices. He concocted false invoices, approved them for payment and also received a bribe in excess of £300,000 from a customer. Subsequent to the commencement of the civil proceedings brought by Tesco against Mr Pook, he was convicted of theft and sentenced to 3 years 11 months' imprisonment, which he was still serving when the trial was heard by Mr Justice Peter Smith.

51. The day before Mr Pook attended a disciplinary hearing and was dismissed, he applied to exercise share options which – unsurprisingly – the employers refused.

52. Undeterred, in the course of proceedings commenced by his employers, Mr Pook counterclaimed in relation to the denial of the exercise of his share options. It is in this context that the duty to disclose arose.

53. However, what the Judge had to say on this subject is obiter. This is because he held that there was an implied term in the share option scheme that the option was not exercisable as long as the employee was in repudiatory breach of the contract of employment.

54. As the Judge stated, that finding made it unnecessary to consider the alternative argument based on the positive obligation to disclose (paragraph 53). Nevertheless, consider it he did.

55. The argument for Tesco was that Mr Pook was under a positive obligation to disclose his breaches of fiduciary duty. He failed to do so. Had he done so the contract of employment would have been *immediately terminated* by Tesco.

56. Having considered the authorities, the Judge stated his opinion that directors have a positive duty to disclose breaches of their fiduciary duty. He was of the opinion that senior employees (of the kind identified in *Sybron*) have a similar duty. He did not believe that the finding of such duties is in conflict with the authorities starting with *Bell* and following (paragraph 65).

57. He reasoned that it would be an odd thing if Mr Pook was under an obligation to disclose breaches of duty of fellow employees (as in *Sybron*) but not under an obligation to disclose his own breaches.

58. Is this decision consistent with the authorities as the Judge suggested? First, the Judge considered *Bell v Lever Brothers*. It seemed to him that if Messrs Bell or Snelling owed a fiduciary obligation, then Lord Atkins' decision may not have been the same. This ground for distinguishing *Bell v Lever Brothers* is difficult to reconcile with Lord Thankerton's clear dicta (albeit *obiter*) that, in the absence of fraud, neither a servant

nor a director of a company is legally bound forthwith to disclose any breach of the obligations arising out of the relationship (p231).

59. Next, Peter Smith J turned to *Horcal v Gatland*. He cited the passage from Robert Goff LJ's judgment, to which I have already referred, in which he recognises the force in the argument against a duty to disclose on the ground that it could lead to the extravagant consequence that the director might have to make a "confession" as a prerequisite to a termination agreement. Peter Smith J concluded from this passage that had it been necessary for Robert Goff LJ to decide this point then he would have accepted that a director had a positive duty to disclose breaches of fiduciary duty (meaning his own). But it is difficult to see how that conclusion can be drawn from the passage of Robert Goff LJ's judgment which he cites.

60. There must, therefore, be some doubt as to how much assistance, if any, can be derived from *Tesco v Pook* where the dicta on the duty to disclose are admittedly obiter and where the earlier authorities are not wholly persuasively distinguished.

Item Software (UK) Ltd v Fassihi at first instance

61. This brings me to Item Software itself. The matter came on for trial before Nicholas Strauss QC sitting as a deputy judge of the Chancery Division. He gave judgment on 5 December 2002: [2003] IRLR 769. The appeal against his findings on disclosure was dismissed by the Court of Appeal on 30 September 2004: [2004] IRLR 928; [2005] ICR 450. Between the two hearings, the first instance judgment in *Item Software* was the subject of consideration by Hart J in the case of *British Midland Tool Ltd v Midland International Tooling Ltd*. It will be convenient to consider these three decisions in chronological order.

The facts

62. First, the facts in *Item Software*. Item supplies reliability software. The major part of its business was the distribution of software products produced by another company, Isograph. Item paid Isograph royalties on sales. Mr Fassihi was at the relevant time the sales and marketing director of Item.

63. There came a point when Item decided to try to negotiate more favourable terms with Isograph. Item sought a reduction of royalties on sales; Isograph refused. This caused something of a deterioration in the relation ship between the parties leading Item to serve conditional notice of termination of the distribution agreement.

64. During the notice period of the distribution agreement, and whilst Mr Fassihi encouraged Item to take up a tough stance in the ongoing negotiations with Isograph, he also wrote to Isograph suggesting that he would set up his own company to take over the distribution agreement with Isograph. This was, on any view, a gross breach of duty on the part of Mr Fassihi who had also put himself in a position in which his personal interest conflicted with his duty to Item.

65. The distribution agreement between Item and Isograph was brought to an end. Isograph then entered into a new agreement with a company which was ostensibly operated by a close friend of Mr Fassihi, who persuaded a number of Item's employees to leave Item and join the new company. When Item discovered what was going on, they summarily dismissed Mr Fassihi.

66. Item commenced proceedings against Mr Fassihi and others. It claimed that Mr Fassihi breached his duty as a director and as an employee to act in good faith in Item's best interests in three respects and that this resulted in the termination of the Isograph agreement, with the consequence that Mr Fassihi was liable for Item's loss of profit.

67. The first two alleged breaches of duty are not relevant for our purpose save by way of background. They were, first, that Mr Fassihi sought to divert Item's contract to his new company and, secondly, that having done so he continued to press Item to take a hard line in negotiations with Isograph in order to improve his own prospects of securing the business for his own company.

68. As to these breaches, the Judge found that the possibility that Mr Fassihi's attempt to secure the contract for himself made a difference to Isograph's position in the negotiations was negligible. Neither was the Judge satisfied that Item would have negotiated any more cautiously even if Mr Fassihi had not been egging it on.

69. It is, however, the third alleged breach which is of interest for present purposes. Item contended that Mr Fassihi was in breach of his duty to act in the interests of Item by failing to disclose what he had done.

70. The Judge, Nicholas Strauss QC, found it was highly probable that had Mr Fassihi disclosed what he had done, it would have led Item to accept Isograph's proposal instead of indulging in the further brinkmanship which caused Isograph to lose patience and serve notice of termination.

71. Given the Judge's conclusions on what caused the termination of the agreement, the crucial issue of law arising, as the Judge identified it was whether, in addition to Mr Fassihi's breach of duty in seeking to divert Item's main contract to his new company, the failure to disclose that misconduct to Item was a further breach of duty. What had to be considered, the Judge said, was "whether an employee or director of a company is ever, and if so in what circumstances, obliged to disclose his own misconduct to the company which is a victim of it" (para 38).

72. The Judge reviewed the relevant authorities, including *Bell v Lever Brothers*, *Horcal v Gatland*, *Sybron v Rochem*, *BCCI v Ali*, *Nottingham University v Fishel*, and *Neary v Dean of Westminster*.

73. Having done so, the Judge summarised the position on the authorities in the following propositions (para 51).

    73.1. *Bell v Lever Bros* is authority for two quite different propositions in relation to the disclosure of misconduct.

    73.2. The first proposition is that an employee's duty to act in good faith and in the interests of his employer does not require him to disclose his own misconduct at or after the time it is committed, even where it may be in the employer's interests to know of it.

73.3. The second proposition is that the employee will still owe no duty to disclose his own misconduct, if he later enters into a contract with the employer to vary or terminate his contract of employment, even if the misconduct would be a material matter to be taken into account by the employer.

73.4. As to the first proposition, it is not an absolute rule. There are cases in which particular aspects of the employee's functions in the business require disclosure of the relevant facts, even if this involves owning up to misconduct.

73.5. It is possible that the general rule will also be inapplicable if, in the circumstances, the concealment of misconduct is fraudulent.

73.6. It is not clear on the authorities whether the position of a director is the same as that of an employee.

74. The Judge held that in that case Mr Fassihi's misconduct did give rise to the super-added duty of disclosure. This was principally because, given his involvement in the negotiations on behalf of Item, his duties of fidelity and care required him to disclose information relevant to those negotiations, including his own attempt to sabotage those negotiations. He further held that this was a case of fraudulent concealment. For these reasons, the Judge considered that *Bell v Lever Bros* was distinguishable, and the non-disclosure of his misconduct was a breach of duty by Mr Fassihi.

75. That being so, it was unnecessary for the Judge to decide whether *Bell v Lever Bros* was distinguishable for the additional reason that Mr Fassihi was a director of Item as well as an employee. However, he expressed his opinion that Mr Fassihi did owe a duty of disclosure by virtue of his position as a director.

RGB Resources Plc v Rastogi

76. Very shortly after judgment was given at first instance in *Item Software*, Laddie J made some interesting observations on this area in *RGB Resources Plc v Rastogi & Ors* [2002] EWHC 2782 (Ch)[1].

77. Mr Patel, the fourth defendant, applied to strike out the claim brought against him following the collapse of RBG Resources, of which he was a senior executive. RBG alleged that Mr Patel owed duties *inter alia* to make enquiries concerning the other defendant employees in so far as their conduct gave rise to a suspicion of dishonesty and/or to take steps to stop or prevent the dishonest activities of others affecting RBG and to disclose such activities to RBG and, where necessary, to third parties including the authorities and RBG's auditors.

78. In this context, Laddie J considered whether there was "a general obligation to whistleblow" (paras 37-46) and "a duty to investigate" (paras 47-49).

79. As to the former, the Judge considered *Sybron v Rochem* and continued (para 40):

> "There is no general rule…that before this duty [to whistleblow] can be imposed, the employee must be given a supervisory function over the other employees. Whether or not Mr Patel was under a duty to report wrongdoing by his co-defendants is a matter of fact which is dependent upon a multitude of factors, including the terms of his contract of employment, his duties and his seniority in the company. One of the relevant factors will be the nature of the wrongdoi8ng and its potential adverse effect on the company. Where, as here, the alleged wrongdoing went to the very survival of the company, it is more likely that the court would imply a duty to report. As the extract from the judgment of Stephenson LJ set out above indicates [in *Sybron*], such a duty may include a duty to report the wrongdoing of his superiors."

80. Laddie J recognised that it could not be assumed that there was a universal obligation to investigate whether there had been wrongdoing in the company. Such an obligation is likely to arise in fewer cases than those in which there is an obligation to report wrongdoing already known to the employee. A major factor in deciding whether such an obligation exists must be the terms of the employee's contract of employment and the duties he has been assigned within the company

[1] See the casenote by Lewis (2004) 33 ILJ 278 and the casenote by Wynn-Evans on *Tesco v Pook* and *Item Software* at (2005) 34 ILJ 178.

(para 47). The Judge held that there was a sufficiently arguable case that Mr Patel was under an obligation to investigate in the circumstances that had arisen.

British Midland Tool

81. Before turning to the appeal in the *Item Software* case, it is worth noting another decision which was given between *Item Software at first instance and in the Court of Appeal*. It is the case of *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523.

82. It arose in the slightly different context of a group of senior employees and directors acting in concert to leave one business and set up in competition. In the course of his judgment, Hart J endorsed the approach of Nicholas Strauss QC in *Item Software*. In some important words of general application, Hart J said (para 89):

> "A director's duty to act so as 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 is contemplated by himself is, on the authority of *Balston's* case, a circumstance which m ay excuse him from the latter aspect of the duty. But where the activity involves both himself and others, there is nothing in the authorities which excuses him from it."

Item Software in the Court of Appeal

83. Back to *Item Software*. Mr Fassihi appealed the Judge's decision on the disclosure issue. The appeal was dismissed by the Court of Appeal.

84. In the course of an illuminating judgment, Arden LJ subjected the leading authorities, in particular *Bell v Lever Bros* to careful analysis, and also reviewed the policy reasons behind those decisions. Mummery LJ and Holman J agreed with Arden LJ on the disclosure issue.

85. What are the key points to emerge from the Court of Appeal on the disclosure issue?

86. First, it should be noted that, whilst the Judge had addressed this issue principally in terms of an employee's duty, Arden LJ did so by focussing on the duties of a

director. This was the logical starting point, she thought, since the duties of a director are in general higher than those imposed by law on an employee (para 34).

87. Secondly, Arden LJ preferred to base her conclusion 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. The duty is expressed in general terms, which is one of its strengths. It is dynamic and capable of application in cases where it has not previously been applied but the principle or rationale of the rule applies. On the facts of this case, there was no basis, concluded Arden LJ, on which Mr Fassihi could reasonably have come to the conclusion that it was not in the interests of Item to know of his breach of duty.

88. Thirdly, Arden LJ turned to *Bell v Lever* and subsequent cases. She noted the differences in approach between Lords Atkin and Thankerton who gave the leading speeches on disclosure and then asked what was the *ratio* in *Bell v Lever* on the disclosure point. She answered this question in part by identifying what was not the *ratio*. She held that the majority in *Bell v Lever* did not decide that there could never be a duty to disclose his own misconduct on the part of the employee. She also held that the majority did not decide that a fiduciary would not owe any such duty. Her conclusion that Mr Fassihi was bound to disclose his misconduct was consistent with policy and also economically efficient.

89. Fourthly, it was unnecessary in Arden LJ's view to consider to what extent an employee has a duty to disclose his own misconduct. She noted that, following the *Sybron* case, one route by which it might be concluded that Mr Fassihi had a duty to disclose his own wrongdoing is that no logical distinction can be drawn between a rule that an employee should disclose his own wrongdoing and a rule that he should disclose the wrongdoing of his fellow employees even if that involves discloses his own wrongdoing too. She added that the Court had not been taken to any of the developing jurisprudence on the mutual duty of trust and confidence (para 60).

Conclusion

90. The following conclusions may be drawn from the present state of the authorities in the light, in particular, of the decision of the Court of Appeal in *Item Software*.

90.1. There is no general rule that an employee or director may never owe a duty to disclose his own misconduct. *Bell v Lever Bros* is not authority for any such general rule.

90.2. An employee or director may owe a duty to disclose the misconduct of other employees, even where that necessarily involves discloses his own misconduct. Whether he owes such a duty depends on all the circumstances, including his position within the business and his express contractual obligations: *Sybron v Rochem*.

90.3. The director's duty to act in what he in good faith considers to be the best interests of the company may require the director to disclose his own misconduct. This general formulation is preferable to seeking to identify particular duties of disclosure, in part, because it has the merit of flexibility in novel circumstances: *Item Software*.

90.4. The issue whether an employee owes a duty to disclose his own misconduct is undecided. Earlier authorities such as *Sybron* are likely to be relevant to the determination of that issue, as is the evolving jurisprudence on the mutual duty of trust and confidence: *Item Software*.

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