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DUTIES AND DIRECTORS AND EMPLOYEES

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The Sources of Duties

1. Employees and directors may owe duties which are derived from disparate sources:
 - 1.1. the duties owed pursuant to the contract. These will include both the express and implied terms and the characteristic terms of an employment relationship;
 - 1.2. fiduciary duties, typically owed only by senior employees and directors;
 - 1.3. statutory duties under the Companies Act and other legislation. These tend to be owed only by directors and officers. These duties rarely form the basis of private law claims against directors and are therefore beyond the scope of this paper. It should be noted that the Company Law Reform Act 2006, assuming it is passed, will make radical changes to the duties of directors under the guise of codification of all of a director's duties.

Contractual Duties

2. Contracts of employment contain characteristic implied terms:
 - 2.1. the duty of trust and confidence – dealt with by Bob Hepple earlier this morning;
 - 2.2. the duty (or duties) of good faith and fidelity.
3. These terms can be considered as characteristic rather than implied in fact because they are essential parts of the contract of employment. Treitel in *The Law of Contract*, regards these as terms implied in law as distinct from terms implied in fact (e.g. by means of the officious bystander test).
4. As such, generally it is not possible to exclude such terms even by use of express terms in the contract.
5. The duty of good faith and fidelity is of long standing, dating back at least to *Robb v Green* [1895] 2 QB 1 and [1895] 2 QB 315, CA. In that case, the term was treated as a

necessary implication in the category of employment contract where the employee was entrusted with confidential information. The judges in the Court of Appeal seem to have viewed the term as applying both in contract and in equity (as to which see below).

6. It is important to note that the implied duty of good faith enunciated in *Robb v Green* was at least partly the basis for the decision in *Faccenda Chicken v Fowler* [1987] Ch. 117 which suggested, as in *Robb v Green*, that the implied obligation of confidence in employment contracts was an incident of the obligation of good faith rather than some free standing implied obligation.
7. The difficulty comes when one tries to pin down the scope of the implied contractual obligation of good faith and fidelity. As Lord Greene MR said in *Hivac v Park Royal* [1946] Ch 174:

“It has been said on many occasions that an employee owes a duty of fidelity to his employer. As a general proposition that is indisputable. The practical difficulty in any given case is to find exactly how far that rather vague duty of fidelity extends. Prima facie it seems to me on considering the authorities and the arguments that it must be a question on the facts of each particular case.”
8. This is echoed by Lord Denning in *Vokes v Heather* [1945] 62 RPC 135, 141:

“...whether a particular act on the part of the servant is in breach of the contractual obligation [of good faith] the court has to determine, and the extent of the obligation, put in general terms, to show the good faith may vary very much indeed according to the particular nature of the contract.”
9. As pointed out by Lord Atkin in *Bell v Lever Bros* [1932] AC 161, a contract of employment is not a contract of the utmost good faith (*uberrimae fides*). The obligation of the employee is not to subsume himself to the interests of the employer but to serve his employer in accordance with the terms of the contract. As such, the principal basis for holding that an employee owed no duty to confess his past contractual breaches was that the imposition of 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.”

10. A similar point was made in a slightly different context by Hart J in *British Midland Tool v Midland International* [2003] 2 BCLC 523 by Hart J where he said in an *obiter* passage (at paragraph 94):

“The employee’s duty of fidelity to his employer, although in some respects similar in content to the director’s fiduciary duty to the company... is by no means identical. Importantly it does not include, in the usual case, any prohibition as such on being in a position where his duty as employee and his self-interest may conflict.”

11. The obligation of trust and confidence is of little relevance in this context. As was stated by Lord Steyn in *Mahmud v BCCI* [1997] ICR 621H -

“There was some debate at the hearing about the possible interaction of the implied obligation of confidence and trust with other more specific terms implied by law. It is true that the implied term adds little to the employee's implied obligations to serve his employer loyally and not to act contrary to his employer's interests.”

12. The practical limits of the duty of good faith are thus inherently hard to define. However, some matters fall clearly within and outside its scope:

- 12.1. competing during employment is generally in breach of the duty - see e.g. *Marshall v Industrial Systems* [1992] IRLR 294;

- 12.2. moonlighting probably is not a breach - *Hivac Ltd v Park Royal Scientific Instruments Ltd* [1946] Ch 169 and *Nova Plastics Ltd v Froggatt* [1982] IRLR 146. However, this will only be so if it does not create a significant conflict of interest or otherwise cause harm to the employer - see e.g. *Lancashire Fires v Lyons* [1997] IRLR 113;

- 12.3. This reflects the now rather anomalous position in relation to the fiduciary duty of good faith - *London & Mashonaland Exploration Co Ltd v New*

Mashonaland Exploration Co Ltd [1891] WN 165; *In Plus Group Ltd v. Pyke* [2002] 2 BCLC 201; c.f. *Bristol and West BS v. Mothew* [1998] Ch. 1, 18;

- 12.4. on the other hand, preparing for competitive activity that will only occur after the termination of employment is generally not in breach – see e.g. *Balston v Headline Filters* [1993] FSR 385;
- 12.5. the fineness of this line is identified in cases such as *Ward Evans Financial Services v Fox* [1999] IRLR 288 which shows that it is possible to cross the line even before trading in fact commences;
- 12.6. undertaking work for oneself when supposed to be working for one's employer is also a breach – *Thomas Marshall v Guinle* [1979] Ch 227. That case was about preparations to compete being undertaken in working time but the same must apply to any act that is not done on behalf of the employer;
- 12.7. recruiting, encouraging or inciting employees to leave will always be a breach of the duty of good faith;
- 12.8. however, in some circumstances, considering one's future with a fellow employee and leaving in concert may not be a breach – *Searle v Celltech* [1982] FSR 92; *Tithebarn v Hubbard*, 7th November 1991, EAT;
- 12.9. taking steps whilst in employment to divert business opportunities to oneself to be undertaken after termination will invariably be a breach – *Sanders v Parry* [1967] 1 WLR 753.

Equitable Obligations

13. The traditional view was that it is not the common law but equity that demands and protects good faith and fidelity at the same time imposing other obligations also binding the conscience of the trustee. True fiduciary obligations to act in good faith and with fidelity to others are therefore only imposed in narrow circumstances: where fiduciary obligations are imposed.

14. The classic statement is that a fiduciary is expected “to act in the interests of the other – to act selflessly and with undivided loyalty” (Finn, *Fiduciaries Obligations* (1998) p.4.). The obligation to act selflessly is what distinguishes a fiduciary from a person who merely owes contractual obligations. Contractual obligations are not imposed to ensure that people act to the benefit of others. Contractual obligations provide security for the pursuit of self-interest because they are imposed as a result of the objectively viewed intention of the parties rather than those appropriate to someone caring for the property of another.
15. This is reflected in the remedies traditionally awarded. Whereas equity will protect the best interests of the beneficiary of a fiduciary obligation, the common law will only award the victim of a breach of contract what he or she expected to gain from the arrangement.
16. The other principal fiduciary duty in this context is not to allow one’s own interest and the interest of the company to conflict (“the no conflict rule”).
17. Lastly, a director must account to his company for the entirety of its property and the profits made from his position as a fiduciary (“the no profits rule”).
18. The line between contract and fiduciary duty in employment law is easily blurred and has become significantly more blurred over the last few decades, particularly because employees owe duties of good faith and fidelity and trust and confidence. Indeed, *Harvey* states: “insofar as a servant acts as agent of his employer, the relationship of master and servant is akin to the fiduciary relationship of principal and agent” (A [597]).
19. This is unsurprising: the obligation of good faith seems generally to be defined in the same way for both director and employee. The test is a subjective one – it is whether the director or employee considered himself to be acting in the best interests of the company. The classic enunciation for a director is that of Lord Greene MR in *In re Smith & Fawcett Limited* [1942] Ch 306:

“The principles to be applied in cases where the articles of a company confer a discretion on directors with regard to the acceptance of

transfers of shares are, for the present purposes, free from doubt. They must exercise their discretion bona fide in what they consider - not what a court may consider - is in the interests of the company, and not for any collateral purpose.”

20. It is put in different terms by Lord Denning in *Scottish Co-operative Wholesale Limited v Meyer* [1959] AC 324,366: it is the duty of a director of a limited company to “do his best to promote its business and to act with complete good faith towards it”. This is a true distinction between the duties owed by employees and true fiduciaries but the practical distinction between partial and complete good faith is harder to grasp.
21. As Lord Denning said in the earlier case of *Vokes v Heather* [1945] 62 RPC 135, 142:

“The introduction of equitable principles, apart from contract, into relationships of [master and servant] is a thing which I think should be, in general, repudiated.”
22. As such, the courts have sought to maintain the distinction between contract and fiduciaries in the employment context: *Nottingham University v. Fishel* [2000] IRLR 471 provides an excellent case study (see below).

Who Is A Fiduciary In The Employment Context?

Nottingham University v. Fishel [2000] IRLR 471

23. Dr Fishel was a clinical embryologist and director of a self-funded infertility unit (called Nurture) at Nottingham University. Under the terms of his employment with Nottingham University he was required to receive consent before undertaking paid outside work. In the event Dr Fishel did a considerable amount of work abroad, using staff from Nurture, and arranging remuneration direct (for himself) with foreign clinics. Consent was not sought, but the University was aware of his activities.
24. The clinic at Nottingham University was a success and Dr Fishel received considerable bonus payments. This success was due in no small part to the initiatives of Dr Fishel and its international reputation. After becoming the University’s highest paid employee his salary was negotiated downwards and he eventually resigned. The University brought a claim for an account of profits for the work done abroad and for

profiting from the work of those under his control at the clinic. This, it was alleged was inconsistent with the undivided loyalty rule and misuse of his position to exploit opportunities to profit.

25. Elias J:

25.1. In performing outside work without consent Dr F had breached his employment contract. He was liable for damages. However, the university had suffered no loss as it actually gained from his actions (at [73]). I.e. its expectations had been met and it did not matter that Dr F had made money off the back of them;

25.2. Employee's duty of loyalty and good faith did not entitle employer to be told of work undertaken by employee for profit even if in breach of contract. "Absent the fiduciary obligation, the employee is not obliged to disclose the fact that he has earned sums from third parties" (at [74]).

26. Restitutionary damages could not be awarded, following CA in *A-G v. Blake*, Dr F had not done the very thing he had contracted not to do and so the test was not met.

27. As a matter of principle fiduciary and contractual obligations are distinct in the employment context:

"...the essence of the employment relationship is not typically fiduciary at all. Its purpose is not to place the employee in a position where he is obliged to pursue his employer's interests at the expense of his own. The relationship is a contractual one and the powers imposed on the employee are conferred by the employer himself. The employee's freedom of action is regulated by the contract, the scope of his powers is determined by the terms (express or implied) of the contract, and as a consequence the employer can exercise (or at least he can place himself in a position where he has the opportunity to exercise) considerable control over the employee's decision-making powers." (at 90)

28. However, fiduciary relationships can arise within a particular contractual relationship where there are specific contractual obligations which the employee has undertaken and which place him in a position where equity imposes rigorous equitable duties in addition to his contractual obligations: "Where this occurs, the scope of the fiduciary

obligations both arises out of, and is circumscribed by, the contractual terms; it is circumscribed because equity cannot alter the terms of the contract validly undertaken” (at [91])

29. “Potentially ambiguous terminology” in employment cases “may trap the unwary” (at [91]) The “implied duty of good faith is being used in circumstances where no fiduciary obligation arises at all ... the duty is one where each party must have regard to the interests of the other, but not that either must subjugate his interests to those of the other” (at [95]). Care must be taken not to equate duties of trust and confidence or loyalty with fiduciary duties (at [96]).

“[I]t is necessary to identify with care the particular duties undertaken by the employee, and to ask whether in all the circumstances he has placed himself in a position where he must act solely in the interests of his employer” (at [97]).

30. As to breach:

- 30.1. If Dr F had treated patients at another clinic in breach of the contractual duty not to compete this may well have “been sufficient to trigger” a fiduciary duty (at [107]),
- 30.2. But he was under no duty to secure work abroad and if he had done it in his spare time could not be alleged to breach any fiduciary obligation (at [108]),
- 30.3. The money that Dr F earned abroad was paid to him despite his university links not because of it and the money he received was not held on trust (at [112])
- 30.4. However, in relation to profits made from work done by other employees of Nurture there was a potential conflict between his “specific duty” to the University to direct them to work for the university and to direct them to work for his own benefit (at [115]). Moreover, he did actually abuse his position in this respect (at [116]). Therefore he was liable for profit made for treatment abroad by embryologists working under his supervision.

31. Despite Elias J's attempt to distinguish fiduciary from contractual obligations his conclusion was that Dr F owed fiduciary obligations

31.1. where he directed employees to work for his benefit,

31.2. if he worked for a competitor, or

31.3. if he made profits by exploiting his position or was paid money in his university capacity.

Each of these examples could conventionally be understood as examples of breach of a fiduciary position. In particular both (.2) and (.3), and probably also (.1), do not appear to have any necessary relation to Dr F's senior position and could apply to any employee (in relation to (.1) any manager). It therefore seems that even where an employee is not in a "fiduciary relationship" equity may impose certain specific obligations of good faith and fidelity.

32. Note that in a leading statement of principle Mason J in the High Court of Australia slipped "employee and employer" amidst the five standard categories:

"The accepted fiduciary relationships are sometimes referred to as relationships of trust and confidence or confidential relations (cf. *Phipps v. Boardman* [1967] 2 AC 46, at p 127), viz., trustee and beneficiary, agent and principal, solicitor and client, employee and employer, director and company, and partners. The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position. The expressions "for", "on behalf of" and "in the interests of" signify that the fiduciary acts in a "representative" character in the exercise of his responsibility" (*Hospital Products Ltd v. US Surgical Corp* (1984) 156 CLR 41, 96-7)

33. Likewise in *Attorney-General v. Blake* ([1998] Ch. 439, at p. 453) the Court of Appeal accepted without question that the relationship of employer-employee is fiduciary.

34. In *Neary v. Dean of Westminster* [1999] IRLR 288, 290: the mutual duty of trust and confidence was described as a “fiduciary relationship” (though note Elias J’s criticism of this case (in which he appeared as unsuccessful counsel)) at every opportunity during his judicial career including in *Fishel*.
35. Of perhaps greater note is the formulation of Millett LJ in *Bristol & West v Mothew* [1998] Ch 1, 18A which is in some ways rather more consistent with that in *Neary* than *Fishel*:

“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 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 the 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. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary. As Dr Finn pointed out in his classic work *Fiduciary Obligations* (1977), p. 2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary.”

36. Two further comments are also instructive:
- 36.1. In *Henderson v Merrett* [1995] 2 AC 145, 206 Lord Browne-Wilkinson said “The phrase ‘fiduciary duties’ is a dangerous one, giving rise to a mistaken assumption that all fiduciaries owe the same duties in all circumstances. This is not the case.”
- 36.2. In *Norberg v Wynrib* (1992) 92 DLR (4th) 449, 481, Sopinka J stated “Fiduciary duties should not be superimposed on those common law duties simply to improve the nature or extent of the remedy”.
37. In practical terms, the most useful (and overlapping) indicators of the existence of fiduciary duties seem to be the following:
- 37.1. was the employee a quasi-director or a mere employee?

37.2. was the employee entrusted with authority over and principal responsibility for a particular area of the business?

37.3. had the employee agreed to have no personal interest in the particular types of work which have been or are to be the subject of competition?

The Duty of Disclosure of Wrongdoing

38. The Courts have recently been creating a whole new suite of claims for wronged or vindictive former employers. The duty to disclose one's own wrongdoing is the principal weapon in such an employer's armoury.

39. *Bell v Lever Bros* [1932] AC 161 has long been thought to have held that neither an employee nor a director was under no duty to disclose his own wrongdoing:

"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. If a man agrees to raise his butler's wages, must the butler disclose that two years ago he received a secret commission from the wine merchant; and if the master discovers it, can he, without dismissal or after the servant has left, avoid the agreement for the increase in salary and recover back the extra wages paid? If he gives the cook a month's wages in lieu of notice can he, on discovering that the cook has been pilfering the tea and sugar, claim the return of the month's wages? I think not. 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."

40. *Bell v Lever Bros* is a difficult case in many different ways, with a 3-2 split in the House of Lords, differing reasons amongst the majority, complicated facts and arguments about pleading points. Bell and his colleague were employees of Lever Bros but directors of the not quite wholly-owned subsidiary of Lever Bros for which they worked. They had made secret profits in dealings in the cocoa market and concealed those dealings. Thereafter, they had entered into an agreement pursuant to which their employment was terminated and directorships vacated on payment of several years' salary.

41. The subsidiary claimed an account of the secret profits by reason of breach of fiduciary duty and Lever Bros claimed repayment of the sums under the agreement for the termination of employment because it was entered into either by reason of fraud or under a unilateral mistake of fact by Lever Bros, namely that it was not entitled to terminate the employment without payment. Bell and his colleague admitted liability to account for the secret profits to the subsidiary but denied liability to Lever Bros in relation to the termination sums.
42. It seems that Lever Bros made some serious and unjustified allegations of fraud. Perhaps as a result, and much to the surprise of the Court of Appeal, the jury found that there was no fraudulent misrepresentation at the time of entering the termination agreement. As such, Lever Bros were thrown back onto the claim of mistake.
43. In the Court of Appeal there was plainly significant argument about duties of disclosure both to the subsidiary as an aspect of the fiduciary duty and to Lever Bros under contract. It seems that it was all but conceded by counsel in argument that such a duty arose to the subsidiary as an incident of the fiduciary duty to account but it was contended that no such duty arose in contract. Argument seems to have proceeded in the House of Lords solely on the issue of disclosure under contractual duties (see page 165b-c).
44. The minority in the House of Lords chose not to deal with the issue of disclosure of wrongdoing. Of the majority, Lord Blanesburgh seems to have been of the view that there was not even a breach of fiduciary duty by the Appellants but agreed with Lords Atkin and Thankerton as to the absence of a duty of disclosure in contract. It seems to me to be impossible to identify any attempt or desire by Blanseburgh to agree with anything said in relation to a duty of disclosure arising out of fiduciary duty. Lord Atkin made no express comment on any duty of disclosure arising out of breach of fiduciary duty albeit that he did indicate that different pre-contract duties of disclosure arose where there was a fiduciary relationship.
45. Thus only Lord Thankerton considered the issue in relation to directors, doing so in compendious fashion with employees. The only case relied upon by him in relation to directors was *Healey v Rubastic* [1917] 1 KB 946 which on its face was limited to duties

in contract. As such, little assistance can be derived from his judgment by way of binding precedent.

46. Despite this, the judgment in *Bell v Lever Bros* was long thought to apply equally to both directors and employees. Recent cases make plain that this view was incorrect in relation to directors and have created some doubt in relation to even employees.
47. *Sybron Corp. v. Rochem* [1984] Ch. 112, CA. Held: Although the employment contract did not always require disclosure of the misconduct of fellow employees, the terms and nature of the employment might well be such that there was a contractual duty to disclose the misconduct of other employees even if that thereby disclosed the employee's own misconduct. This case was one of contract not fiduciary duty, albeit that Mr Rochem was in a senior position which made the position yet clearer. It was noted by Kerr LJ that there might be an obligation of confession by employees in cases of fraud, that not having been decided by *Bell v Lever Bros*.
48. *Van Gestel v. Cann* [1987] CL 454, CA. Held, obiter: Directors have a positive duty to disclose their wrongdoing.
49. *Tesco Stores Ltd v. Pook* [2004] IRLR 618. D was a senior manager, just below board level, at Tesco. He was responsible for approving invoices. He falsely approved invoices from a company owned and controlled by himself for £512,236. Furthermore, he accepted £323,750 from a company that did business with Tesco. The day before he was dismissed he sought to exercise share options, but he was prevented from doing so. Tesco sued for both amounts. D counterclaimed against the refusal to let him exercise his share options.
50. The court held that the money received from other company was a bribe. It gave rise to a conflict of interest and secret profit and it was held on trust for Tesco (at [44]-45]).
51. More controversially, it held that there was an implied term that the share option was not exercisable so long as the employee was in serious breach of contract. As such, there was no need to consider the issue in relation to duty of disclosure and the conclusion on that is *obiter*.

52. In a somewhat confused judgment, Peter Smith J held that the bribe was held on trust (relying on *AG of Hong Kong v Reid*). As such, there was a fiduciary duty to account. Mr Pook had breached that duty. The judgment then considers, without distinction, the obligation on directors to reveal their own breaches of fiduciary duty. He then alights on the (contractual) obligation of senior employees to reveal the misconduct of others (as in *Sybron*) and then elides the two without any sensible attempt to distinguish the binding authority of *Bell v Lever Bros*.
53. The initial stages of reasoning are useful. The latter stages seem to be simply wrong. If one takes the earlier stages, Mr Pook owed a duty to account for the bribes he had taken and was in breach of it. If he had complied with his duty he would have been summarily dismissed and therefore would never have been allowed to exercise his share options. If viewed in this light, the case seems straightforward. However, it is not entirely clear that the solution is correct.
54. Any recipient of a bribe, whether a fiduciary or not, probably holds that bribe on constructive trust in favour of his principal (see the erudite discussion by Lawrence Collins J in *Daraydan Holdings v Solland International* [2005] Ch 119, of the conflict between *Lister v Stubbs* and *AG Hong Kong v Reid*). Equity looks on as done that which ought to be done. As such, the obligation to account is an obligation to account immediately. On this analysis, the obligation to account is identical to an obligation to reveal the fraud.
55. The difficulty lies in reconciling this analysis with Lord Atkin's analysis of the obligations of his butler who takes a bribe from the wine merchant. If *Daraydan* (and this aspect of *Pook*) is correct, the secret commission is held on constructive trust with an immediate obligation to account for it. As such, there is deemed to be immediate disclosure of wrongdoing. In turn, the loss flowing from such a failure to disclose includes any later increases in salary or *ex gratia* sums paid on later termination of the contract. This would be precisely contrary to the conclusion in *Bell v Lever Bros* in relation to the butler (though oddly not in relation to the case because the obligation to account and the fiduciary duties were owed to the subsidiary and not to Lever Bros).

56. *Item Software (UK) Ltd v. Fassihi and others* [2004] EWCA Civ 1244 seeks to sidestep some of these issues, dealing only with the position in relation to fiduciaries. Arden LJ stated:

“For my part, I do not consider that it is correct to infer from the cases to which I have referred that a fiduciary owes a separate and independent duty to disclose his own misconduct to his principal or more generally information of relevance and concern to it. So to hold would lead to a proliferation of duties and arguments about their breadth. 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: per Goulding J in *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11, 21. The duty is expressed in these very general terms, but that is one of its strengths: it focuses on principle not on the particular words which judges or the legislature have used in any particular case or context. 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.”

57. The Court went on to hold that a fiduciary in general owed a duty to disclose his own wrongdoing. The court drew a distinction between fiduciaries and ordinary employees, constrained as it was by the decision of the House of Lords in *Bell*.

58. The most difficult question raised by Arden LJ's judgment is that the duty of disclosure is not a freestanding duty but merely an aspect of the duty of fidelity. However, the duty of fidelity is, for the reasons set out above a duty that is both fiduciary and contractual in nature. Given that *Bell* was binding authority on Arden LJ to the effect that the employee's contractual duty of fidelity imposes no such duty of disclosure, her conclusion is consistent only with a radically different content for the contractual and fiduciary duty of fidelity.

59. Returning yet again to Lord Atkins' butler, he cannot have thought that it was in the best interest of his master for him to remain ignorant of the secret commissions from the wine merchant? Why is it contrary to the common usage of mankind for a junior person to confess to wrongdoing but not for a senior employee? Indeed, there is an entire doctrine at law based upon the premise that fraudulent directors cannot be expected to confess their own fraud (the *Hampshire Land* exception from the attribution of the knowledge of a director to the company).

60. It may be that the decisions in both *Bell v Lever Bros* and *Lister v Stubbs* are premised on a rigid class division that is no longer a common analysis:
- 60.1. gentlemen owe fiduciary duties because they can be trusted;
- 60.2. the lumpen proletariat cannot be expected to live up to such high ideals.
61. At present, the most that can be said is that those who can be classified as fiduciaries will be held to owe fiduciary duties that encompass disclosure of wrongdoing. Mere employees, particularly if lowly, must still be subject to the general position set out in *Bell*.
62. The principal issue relates to those who are not statutory directors but hold positions of great responsibility. They may be fiduciaries if they meet the tests identified in *Fishel*. They may be mere senior employees owing *Sybron* duties to disclose the misconduct of others. They may be lowly employees owing duties of very uncertain ambit if they have been guilty of fraud or are the recipient of bribes.
63. It should be noted that the very broad terms of the judgment in *Fassih* give rise to a number of, as yet untested, possibilities. In relation to team moves, it is well established that it will be a breach of both the fiduciary and contractual duty of loyalty for a director to fail to inform the company of the fact that a major competitor is recruiting staff – *British Midland Tool v Midland International* [2003] 2 BCLC 523.
64. As such, there is no reason in principle why an injunction will not lie to compel a participant in a team move to inform the company of everything he knows about the recruiting of other employees. The damages that may be suffered in such circumstances could encompass all losses sustained by reason of the team move if it can be proved either that the employee is a fiduciary who has made a profit out of the move or that the employer has lost the chance to seek to retain the departing staff.

IDC v Cooley liability

65. As set out above, two of the classic fiduciary duties are the duty not to allow one's self interest and the interest of the company to conflict and the duty not to make unauthorised personal gain from one's position as a fiduciary.
66. The principal example of this prohibition on personal gain being applied against directors is *Regal (Hastings) v Gulliver* [1967] 2 A.C. 134. In that case, the plaintiff company owned a cinema in Hastings and wished to purchase 2 further local cinemas in the area with the intention of selling the whole enterprise as a package. In order to do this, a subsidiary with a capital of 5000 £1 shares was formed to take a lease of the 2 cinemas. However, the Company on its own could not raise enough cash in order to obtain the required leases.
67. As the company could not afford to put more than £2,000 into the subsidiary, four of the directors and the company solicitor each subscribed for 500 shares, and the fifth director found some outsiders to take up the remaining 500. The combined concern was then sold (by way of a takeover) and each of the purchasers made a significant profit.
68. The purchasers then brought an (unmeritorious) action against all five of the directors and the company solicitor, claiming that the profits received by each of these individuals had been obtained through a breach of their respective fiduciary duties, and therefore had to be accounted for to the company.
69. The claim against the director who had not subscribed for any shares failed (as he had made no profit personally). So too did the action against the company solicitor (as he had subscribed for his shares with the consent of the board of directors as then constituted). However, in the House of Lords the actions against the other four directors succeeded. Lord Russell of Killowen - giving the leading judgment - stated that the directors had "unquestionably acquired their shares by virtue of their fiduciary position".

70. It is essential to note that their Lordships found it immaterial that the company could not itself have subscribed for the shares (and that therefore the company had suffered no loss). The judgment was a straight application of the rule prohibiting fiduciaries profiting from their position(s): whether or not the purchasers had suffered a loss, it was clear that fiduciaries had profited. As stated by Lord Upjohn:

“The relevant rule for the decision of this case is the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust, which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict”.

71. It is perhaps relevant to note that with informed consent of the shareholders in general meeting, the directors could have invested and made profits themselves. However, the mere fact that such consent would have been forthcoming if sought in advance was not sufficient to save them from liability.

72. A different application of the same principles arose in the case *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162. Here the court was faced with the situation where a company director resigned from the company in order to free himself from his contract of employment, so that he could acquire a valuable contract from a third party business for his own benefit.

73. The facts of the case were that during his time as a director of the Claimant company, the Defendant had been involved in unsuccessful negotiations with the Eastern Gas Board for a contract to design and build certain depots. These negotiations had been unsuccessful primarily for the reason that the Eastern Gas Board objected to the use of consultant organisations (such as the Claimant). However the Eastern Gas Board *was* interested in acquiring the expertise of the Defendant himself and therefore tentatively approached him in his personal capacity.

74. A meeting was arranged for Friday 13th June 1969, where the Defendant was informed of the proposal. He then spent the weekend preparing certain documents in preparation of taking on the contract, and finally, on Monday 16th June, the Defendant informed his current employer that he was on the verge of mental break-down. (He

did this in order to obtain an immediate release from his contract of employment). Upon being released, the Eastern Gas Board immediately awarded the contract for the construction of the depots to the Defendant, and the Claimant sued for breach of fiduciary duty.

75. In a straight application of *Regal (Hastings)*, Roskill J found that as a director, the Defendant owed a fiduciary duty to the Claimant:

“Therefore, I feel impelled to the conclusion that when the Defendant embarked on this course of conduct of getting information on 13th June, using that information and preparing those documents over the weekend of 14th/15th June and sending them off on 17th June, he was guilty of putting himself into the position in which his duty to his employers, the plaintiffs, and his own private interests conflicted and conflicted grievously. There being a fiduciary relationship...it seems to me plain that it was his duty once he got this information to pass it to his employers and not to guard it for his own personal purposes and profit. He put himself into the position when his duty and his interests conflicted”.

76. As made clear from the above quotation, Roskill’s judgment was fundamentally based on the finding that the Defendant had breached the fiduciary duty he owed *whilst still employed by the Claimant*. It was the Defendant’s conduct over the period between 13th June and the date of his resignation that amounted to a breach of fiduciary duty. It was during this period that the Defendant allowed himself to be placed in a position in which his fiduciary duty and his personal interests conflicted. As made clear in *Regal*, such a position is forbidden in equity: resulting in the liability of the director to account for the profits made, regardless of the fact that the Claimant had suffered no loss.

77. *Cooley* is treated as the leading case in relation to the diversion of business opportunities but is in many ways no more than a simple application of a breach of the duty of fidelity with a concomitant obligation to account for the profits obtained through that breach. Given *Robb v Green*, the same conclusion could have been reached in relation to the contractual duty of fidelity.

78. In *Island Export Finance Ltd v Umunna and another* [1986] BCLC 460, the Defendant was the managing director of the Claimant (a company which pursued business in West Africa). In 1976, the Defendant secured a contract for the Claimant from the Cameroon

Postal Authority (CPA) for postal caller boxes. The contract was for a fixed duration, and although the Claimant hoped for further orders, it had no such assurance from CPA that any further orders would be forthcoming. In 1977, the Defendant resigned as managing director (due to his dissatisfaction with the Claimant rather than his desire to appropriate the Claimant's postal call box business) and set up his own company. At this time, the Claimant was not actively seeking repeat orders from CPA. The Defendant subsequently secured a new contract with CPA for his own company. The Claimant sued for the Defendant's alleged breach of fiduciary duty.

79. The importance of this case arises from the fact that during his judgment, Hutchison J recognised that the law as set out in the Canadian case of *Canadian Aero Service v O'Malley* (1973) 40 DLR (3d) 371, was an accurate description of the present law in England. In particular, Hutchison J relied on the following excerpt of Laskin J's judgment in *Canaero*:

"...a...director is precluded from obtaining for himself, either secretly or without the approval of the company...any property or business advantage either belonging to the company or for which it has been negotiating...In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where his resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, **or [and]** where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired"

80. Hutchison J recognised the above to represent the law of England, with the exception that it was his belief that it was likely that Laskin J meant 'and' rather than 'or' in the above passage, in that the use of this word was probably meant as indicating the element of causation necessary to make the resignation to make the director liable, and not indicating a separate ground for making him liable. However, as Hutchison went on to state:

"It would...be surprising to find that directors alone, because of the fiduciary nature of their relationship with the company, were restrained from exploiting after they had ceased to be such, any

opportunity of which they had acquired knowledge while directors. Directors, no less, than employees, acquire a general fund of knowledge and expertise in the course of their work, and it is plainly in the public interest that they should be free to exploit it in a new position”.

81. Thus, the effect of *Umunna* is to hold that the ordinary fiduciary duties owed by a director to his company are capable of surviving the director’s resignation *in certain circumstances*. These circumstances being:
 - 81.1. Where there exists ‘a maturing business opportunity’ enjoyed by the company; and
 - 81.2. Where this opportunity is being actively pursued by the company; and
 - 81.3. Where the director’s resignation was prompted/influenced by his wish to acquire for himself the opportunity/where it is the directors position with the company rather than a fresh initiative that led him to the opportunity.
82. Hutchison J applied these principles to the facts of the case and held that the Claimant’s claim failed for three simple reasons. Firstly, the hope of obtaining further orders from CPA could not, in any realistic sense be said to be ‘a maturing business opportunity’; secondly at the time of the Defendant’s resignation the Claimant was not actively pursuing the matter; and thirdly, Hutchison J found that the reason why the Defendant resigned was due to his dissatisfaction with the Claimant, rather than his desire to steal their business.
83. At first reading there appears to be a possible tension between this decision, and the law as stated in *Regal*. In *Regal* it was held that *the only* issue was whether the fiduciary had profited from his breach of duty - whereas *Umunna* suggests that a director can defend a claim of breach of fiduciary duty by showing that the company was not actively pursuing the business at the time of his resignation. This appears to be at variance with the *Regal* decision because it is clear from that case that such factors are irrelevant, and regardless of the actions of the company, the fiduciary is forbidden from profiting from his position.

84. In my opinion, this tension is illusory. *Umunna* is not authority that in general the fiduciary duties of a director continue regardless of his resignation. As was acknowledged in *Simonet* and in *A-G v Blake (Jonathan Cape Ltd, third Party)* [1998] 1 All ER 833 at 841:
- 84.1. A director's power to resign from office is not a fiduciary power; and
- 84.2. In general a fiduciary relationship does not continue after the determination of the relationship which gives rise to it.
85. *Umunna* is authority for the principle that only in the circumstances outlined above in paragraph 81 will a director owe duties arising out of the fiduciary relationship with his ex-employers notwithstanding his resignation. The issues raised by *Umunna* are therefore, on one view, considerations in relation to whether or not a fiduciary relationship continues to exist. Once the continuing fiduciary relationship is established (under *Umunna*) then the director's liability to account is confirmed, and questions of causation and whether the company has suffered a loss cease to be relevant. However, it is submitted that these very issues that are irrelevant *after* the establishment of the relationship, may be fundamental to the question of whether or not the fiduciary relationship continues after the director's resignation.
86. In my view, the cases of *Regal* and *Umunna/Canaero* deal with different considerations: the former dealing with the effect of a breach of fiduciary duty by a director, and the latter deciding whether or not such a relationship existed between the company and the director, after he had resigned.
87. To a significant extent, *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 supports the above interpretation of the law but puts it in different terms. In expressly applying the law set out in *Canaero*, Lawrence Collins J held that a director is disqualified from usurping for himself or diverting to a company with which he is associated a 'maturing business opportunity' of his company, not only while he is still a director, but also even after his resignation, where the resignation may fairly be said to have been prompted or influenced by his wish to acquire the opportunity for himself.

88. In fact, Lawrence Collins J went further, holding that:

“In my judgment the underlying basis of the liability of a director who exploits after his resignation a maturing business opportunity of the company is that the opportunity is to be treated as if it were the property of the company in relation to which the director had fiduciary duties. By seeking to exploit the opportunity after resignation he is appropriating for himself that property. He is just as accountable as a trustee who retires without properly accounting for the trust property. In the case of the director he becomes a constructive trustee of the fruits of his abuse of the company’s property, which he has acquired in circumstances where he knowingly had a conflict of interest, and exploited it by resigning from the company”

89. On the one hand therefore, *Simonet* represented a whole-hearted concurrence (with *Umunna*) that *Canaero* represents the current state of English law regarding the fiduciary duties owed by directors to their companies after resignation.

90. On the other hand, however, it seems that by treating the business opportunity as the ‘property’ of the company, there is a good chance that Lawrence Collins J has significantly widened the principle. As the company ‘owns’ this opportunity, it could well be argued that by reason of the knowledge obtained during his employment, a director who has decided to resign from his company in order to compete for that company’s business may well be barred from taking such action for an indeterminate period.

91. Indeed, in the *Simonet* case, the majority of the contracts that were taken were advertising contracts in relation to which CMS Dolphin held a retainer. In that sense, they were not maturing business opportunities at all. Rather, they were existing contracts of which CMS Dolphin was fully aware and yet were usurped by Mr Simonet (along with the entirety of the staff) following his summary resignation.

92. Equally, *Simonet* offers little guidance regarding how a court would calculate the amount of profit that a director would need to account to the company where he had breached his fiduciary duty by successfully taking on a ‘rolling’ contract with one of the company’s current customers. In such a situation, where the life of the contract is

capable of continuing into the distant future, the only guidance offered by *Simonet* is that “there must be some reasonable connection between the breach of the duty and the profits for which the fiduciary was accountable”.

93. Such practical issues aside, in my opinion, *Simonet* confuses the basic issues involved in demarcating the duties owed by directors. At paragraph 87 of his judgment, Lawrence Collins J describes the basic issue of law involved in the above case in the following terms:

“The present case concerns the question of how far the principle in *Regal (Hastings) Ltd v Gulliver* extends to a director who resigns his office to take advantage of a business opportunity of which he has knowledge as a result of having been a director”.

94. As has been seen, he analysed the principles as a function of the property rights of the company in what was, in essence, its goodwill. In a sense, as a result of *Simonet* directors must account for the goodwill to the company because it is trust property. It is hard to reconcile this with the proposition of Hutchison J as to a director’s ability to use his own skill and experience.
95. In a very real sense it creates restrictive covenants that affect a director in an uncertain manner and for an uncertain length of time, in much the same way as applies to partners as seen in *Trego v Hunt* [1896] AC 7 and more recently *Lindsley v Woodfull* [2004] 2 BCLC 131.
96. It is hard to reconcile these cases with *Framlington v Anderson* [1995] 1 BCLC 475. In that case, the directors were private client stockbrokers who were subject to no restrictive covenants. In that case it was held that the directors were entitled to solicit the clients they had managed immediately on resignation of their directorships – 479f, 480 f-I, 498a-b. It was further held that the interest in ongoing business of clients was not a maturing business opportunity within the meaning of *Cooley* – 496f-h.
97. In the titanic judgment in the case of *Ultraframe UK) Limited v Fielding* [2005] EWHC 1638, Lewison J considered the authorities in this area and adopted a subtly different analysis. At paragraphs 1332 and following, he considered there to be three separate but interlinked duties applying to directors that might create very different results:

- 97.1. the no conflicts rule applies only until the termination of a directorship but cannot apply beyond, termination of the directorship being the principal means to bring such conflicts to an end;
- 97.2. the no profits rule applies to profits obtained by reason of the directorship and thus may outlast the termination of the relationship;
- 97.3. the obligation to account for trust property applies only in relation to matters in relation to which the company already has proprietary rights, so will not generally apply to maturing business opportunities but will apply to contracts as in the *Simonet* case.
98. This analysis is valuable though does not necessarily make the giving of advice much easier. As Lewison J states, the law relating to the accountability of a director for profits derived from diversion of corporate opportunities is still developing. Indeed, a notice of appeal has been lodged in *Ultraframe* that is pending before the Court of Appeal at the time of writing.

Springboard Relief

99. Others will be dealing with springboard injunctions. These are generally (and traditionally) sought in cases involving misuse of confidential information. It should be noted that there is a wholly unreported but well reasoned decision of Blackburne J to the effect that breaches of fiduciary duty may ground a claim for springboard relief - *Midas IT Services v Opus Portfolio Limited*, 21st December 1999.
100. In addition, injunctive relief is available to prevent breaches of fiduciary duties e.g. *Hunter Kane v Watkins* [2003] EWHC 186, Bernard Livesey QC. The power of the court to enjoin such conduct has also been recently approved by Sedley LJ in *In Plus Group v Pyke* [2002] EWCA Civ 370 at paragraphs 85-87.

The Liability of Third Parties

101. The recent case of *Mainstream Properties v Young* [2005] EWCA Civ 861 has clarified the law in relation to the liability of a party for inducing breach of contract (and the genus tort of interfering with contractual relations).
102. Arden LJ, with whom Sedley LJ and Aikens J agreed, held that the requirements of the tort include a specific requirement that the third party must intend to harm the putative claimant. In this context, that means that before a new employer can be held liable for inducing breaches of the duties of fidelity, the new employer must:
- 102.1. know of the contract and the fact that it contains a duty of fidelity;
 - 102.2. know that the act in question will cause breach of that duty (i.e. know that the employee is not entitled to act in the manner sought by the new employer); and
 - 102.3. intend to cause economic harm to the old employer.
103. In particular, it is not enough that the new employer merely knows that the course of conduct he is adopting will have the inevitable consequence of causing harm; rather the harm itself must be intended.
104. It is also relevant to note, in passing, that a subjective belief on the part of the new employer that restrictive covenants are unenforceable, will prevent liability accruing for interference with contractual relations even if the covenants are later proved to be enforceable.
105. It is understood that the House of Lords has been petitioned in this case and is likely to hear the substantive appeal towards the end of 2006.

Restitutionary Remedies

106. *AG v. Blake* [2001] 1 AC 268:

“Equity reinforces the duty of fidelity owed by a trustee or fiduciary by requiring him to account for any profits he derives from his office or position. This ensures that trustees and fiduciaries are financially disinterested in carrying out their duties. They may not put themselves in a position where their duty and interest conflict. To this end they must not make any unauthorised profit. If they do, they are accountable. Whether the beneficiaries or persons to whom the fiduciary duty is owed suffered any loss by the impugned transaction is altogether irrelevant. The accountability of the army sergeant in *Reading v Attorney General* [1951] AC 507 is a familiar application of this principle to a servant of the Crown.” p.280 per Lord Nicholls.

“My conclusion is that there seems to be no reason, in principle, why the court must in all circumstances rule out an account of profits as a remedy for breach of contract. I prefer to avoid the unhappy expression "restitutionary damages". Remedies are the law's response to a wrong (or, more precisely, to a cause of action). When, exceptionally, a just response to a breach of contract so requires, the court should be able to grant the discretionary remedy of requiring a defendant to account to the plaintiff for the benefits he has received from his breach of contract. In the same way as a plaintiff's interest in performance of a contract may render it just and equitable for the court to make an order for specific performance or grant an injunction, so the plaintiff's interest in performance may make it just and equitable that the defendant should retain no benefit from his breach of contract.” (284-285 per Lord Nicholls)

107. In so holding the House of Lords blurred the distinction between fiduciaries and mere contractors/employees. Significantly the analogy relied upon to justify the court's ability to award an “account” – which is an equitable remedy – was specific performance – which is, of course, also an equitable remedy.
108. Blake's case was held to be exceptional because he had used confidential information, against repeated instructions, for his own benefit and to great damage to the public interest (supposedly). Lord Steyn stated that he was “in a very similar position to a fiduciary. The reason of the rule applying to fiduciaries applies to him.” (p.292).
109. The precise nature of the award of an account and its extent was left to be “hammered out on the anvil of decided cases” (per Lord Steyn p. 291)
110. *Experience Hendrix LLC v. PPX Enterprises Inc* [2003] EWCA Civ 232. As in *Blake*:

- 110.1. There was a breach of a negative obligation, and PPX had done the very thing it had contracted not to do.
 - 110.2. PPX knew that it was doing something which it had contracted not to do.
 - 110.3. Injunction or specific performance could not provide an effective remedy and the failure to claim one in the past is not the claimant's fault.
111. However, at paragraph 37 Mance LJ outlined some important difference with *Blake*:
- 111.1. Not concerned with a subject anything like as special or sensitive as national security.
 - 111.2. The notoriety which accounted for the magnitude of Blake's royalty earning capacity derived from his prior breaches of secrecy, and that too had no present parallel.
 - 111.3. No direct analogy between PPX's position and that of a fiduciary.
112. In addition, great weight was put on the fact that, though deliberate, the breaches were in the "commercial context" in the course of business to make a profit and had to expend some skill and money (at[44]).
113. For these reasons the Court of Appeal ordered only that PPX pay a reasonable sum to Hendrix. Mance LJ:
- "For the past, in the absence of any proven loss, I would confine any financial remedy to an order that PPX pay a reasonable sum for its use of material in breach of the settlement agreement. That sum can properly be described as being "such sum as might reasonably have been demanded" by Jimi Hendrix's estate "as a quid pro quo for agreeing to permit the two licences into which PPX entered in breach of the settlement agreement", which was the approach adopted by Brightman J in *Wrotham Park* (cf paragraph 22 above). This involves an element of artificiality, if, as in *Wrotham Park*, no permission would ever have been given on any terms."([45])
114. Peter-Gibson LJ stated:

“I do not think the present case an appropriate one for ordering an account of profits. He has drawn attention in para. 37 above to the features of the present case which distinguish it from the circumstances in *Blake*. No doubt deliberate breaches of contract occur frequently in the commercial world; yet something more is needed to make the circumstances exceptional enough to justify ordering an account of profits, particularly when another remedy is available.” ([55])

“In my judgment, because (1) there has been a deliberate breach by PPX of its contractual obligations for its own reward, (2) the claimant would have difficulty in establishing financial loss therefrom, and (3) the claimant has a legitimate interest in preventing PPX's profit-making activity carried out in breach of PPX's contractual obligations, the present case is a suitable one (as envisaged by Lord Nicholls ([2001] 1 AC at pp. 283H - 284A) in which damages for breach of contract may be measured by the benefits gained by the wrongdoer from the breach. To avoid injustice I would require PPX to make a reasonable payment in respect of the benefit it has gained.” ([58])

115. As such, these two remedies are particularly important in breach of confidence and covenant cases where damage to the claimant may be hard to prove but profit may have been obtained by the defendant.

Scope of the liability to account in fiduciary duty cases

116. The scope of the fiduciaries' liability to account is seen by many as being near penal in nature. In *Regal*, the directors were required to account for all profits regardless of the fact that the company had suffered no loss and would probably have authorised the dealings had it known in advance.
117. On this basis, the mere fact that a claimant is unjustly enriched by the award of such an account is of no relevance.
118. This view has been upheld and restated in a majority decision of the Court of Appeal in *Murad v Al Saraj* [2005] EWCA Civ 959. It should be noted that this is inconsistent with the decision of Lewison J in *Ultraframe* at paragraphs 1588 and 1601. It should also be noted that Clarke LJ's dissenting judgment is a strong and well-argued judgment from a well respected judge.

119. One other point worth noting is in relation to profits made by someone other than the defendant. The point arose for decision in *Simonet* in the context that Mr Simonet had transferred the diverted business not to himself but to a new agency. Lawrence Collins J held that this was irrelevant and that he was liable to account for all the profits made as a result of the diversion rather than merely the profits received by him.
120. In *Ultraframe* at paragraph 1576, this approach was considered to be unjustifiable, and the orthodox position set out in *Regal* was restated.