SLEEPING WITH THE ENEMY –
INFIDELITY IN EMPLOYMENT RELATIONSHIPS

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THE DUTY OF LOYALTY

1. In recent years, there has been a plethora of cases involving employees leaving one employer to join or set up a competing business. These cases take many forms. Sometimes the employee acts alone, sometimes as part of a team move. The leaver may be an employee and director owing fiduciary duties, an employee who owes fiduciary as well as contractual duties, or an employee who owes only contractual duties. Disputes frequently arise as to how far the leaver can legitimately go in furthering his competitive intention. What can he say to clients and colleagues about his plans? Must he tell his employer about the potential or likely departure, whether of himself or others, and, if so, when does he have an obligation to disclose this risk.

2. The conceptual tool which is ostensibly used to decide many of these cases is the duty of loyalty. The terminology varies between the duty of fidelity, the duty of good faith, the duty of loyalty, the duty of co-operation or even the duty of trust and confidence. There is little, if any, difference of substance between these different terms. The duty may, however, be a contractual duty or it may be a fiduciary duty, with associated differences of content and consequence. The central question with which the courts grapple in these cases is whether the employee has breached his duty of loyalty or, in other words, whether he has conducted himself with such a degree of disloyalty or infidelity as to justify the court's intervention.

3. However, the disloyalty cases are not always easy to reconcile. It is difficult to discern a consistent set of principles which guides the courts' approach to the

[1] Blackstone Chambers. Editor of *Employee Competition: Covenants, Confidentiality, and Garden Leave* (OUP, 2007). More details can be found at http://www.oup.com/uk/catalogue/?ci=9780199208623

myriad of factual situations in which these problems arise. The purpose of this paper is three-fold:

a. first, to identify the conflicting statements and approaches in the disloyalty cases;

b. secondly, to examine an approach to disloyalty cases based on pragmatism; and

c. thirdly, to examine an approach to disloyalty cases based on principle.

THE CONFLICTING AUTHORITIES

Two conflicting statements

4. In Searle & Co Ltd v Celltech Ltd [1982] FSR 92 (CA), Cumming-Bruce LJ said at p101:

> "The law has always looked with favour upon efforts of employees to advance themselves, provided that they do not steal or use the secrets of their former employer. In the absence of restrictive covenants, there is nothing in the general law to prevent a number of employees in concert deciding to leave their employer and set themselves up in competition with him."

5. In UBS Wealth Management (UK) Ltd v Vestra Wealth LLP [2008] EWHC 1974 (QB), [2008] IRLR 965, Openshaw J said at [24]:

> "I cannot accept that employees, in particular senior managers, can keep silent when they know of planned poaching raids upon the company's existing staff or client base and when these are encouraged and facilitated from within the company itself, the more so when they are themselves party to these plots and plans. It seems to me that that would be an obvious breach of their duties of loyalty and fidelity"

6. On their face, these statements suggest as a minimum divergent emphases, and arguably inconsistent approaches. It would, of course, be wrong to take these statements out of context and hold them up as embodying contradictory approaches.

7. Searle v Celltech concerned a director of research of a company engaged in research and development in the field of genetic engineering. Shortly before his employment ended, following his resignation to join a competitor, the

employee provided the names of a number of his fellow research employees to the person responsible for recruitment to the rival business. Injunctions were sought to restrain the use of the names, qualifications and experience of these employees on the basis that such information was confidential. The Court of Appeal, by a majority, decided that such information was not confidential and no injunctions were granted. It was in that context that Cumming-Bruce LJ made his statement.

8. In UBS v Vestra, a former employee of UBS set up a rival business. He recruited employees of UBS and presented UBS with letters of resignation from 52 of its employees. A further 23 UBS employees joined the exodus making a total of 75 defections. At an interim hearing, the judge concluded that UBS had put together a formidable case that there had been an unlawful plan to poach both staff and clients from UBS, formulated and actively managed by its former employee, assisted and encouraged by senior staff.

9. The judge granted an interim springboard injunction to restrain former UBS staff from dealing with former UBS clients pending speedy trial. There has always been some doubt as to whether springboard relief was confined to cases where there is a misuse of confidential information (Balston Ltd v Headline Filters Ltd [1987] FSR 330, 340; cf Midas IT Services v Opus Portfolio Ltd, unrep, 21.12.99).

10. Openshaw J held ([4]) that springboard relief is not confined to cases where former employees threaten to abuse confidential information acquired during the currency of their employment. It is available to prevent any future or further serious economic loss to a previous employer caused by former staff members taking an unfair advantage, an 'unfair start', of any serious breaches of their contract of employment (or if they are acting in concert with others, of any breach by any of those others). That unfair advantage must still exist at the time that the injunction is sought, and it must be shown that it would continue unless restrained. Injunctions are to protect against and to prevent future and further losses and must not be used merely to punish past breaches of contract.

11. Thus, the facts of these two cases may go some way towards explaining the different approaches reflected in the statements set out above. Nevertheless, these two cases are not unique in illustrating the contrasting, if not conflicting, approaches of the courts to this type of problem.

Further support for the freedom to compete

12. The passage cited above from Cumming-Bruce LJ's judgment in Searle v Celltech has not been expressly doubted by later cases. On the contrary, it was cited without disapproval by Hart J in British Midland Tool Ltd v Midland International Tooling Ltd [2003] EWHC 466 (Ch), [2003] BCLC 523, 562g-i, and also by Etherton J in Shepherds Investments Ltd v Walters [2006] EWHC 836 (Ch), [2007] IRLR 110, [150] (both of which are considered further below).

13. It should be noted, however, that notwithstanding the citation of Cumming-Bruce LJ's dicta without disapproval in these cases, the result in both was the same, namely that the team moves which took place involved breaches by the employees of their duties.

14. Other cases can be cited in line with Cumming-Bruce LJ's ethic, where employees took steps to further their competitive intention, whilst remaining in their current employment, without breaching their duty of loyalty. See, for example, Saatchi & Saatchi Co Plc v Saatchi & Ors, unrep, 1995; Helmet Integrated Systems Ltd v Tunnard [2006] EWCA Civ 1735, [2007] IRLR 126.

15. In Helmet v Tunnard, the employee was a salesman for protective headgear. He hit upon an idea for a new helmet and took steps to advance the idea. He obtained DTI funding (naming his employer's rival as his preferred business partner in his application for funding), and procured concept drawings which were sent to the employer's rival, all whilst he remained an employee. Notwithstanding the fact that Tunnard owed his employer a fiduciary duty to report on competitive activity, his conduct did not amount to a breach of his duty of loyalty.

The high-water mark of the loyalty requirement?

16. In contrast, a recent decision of Wyn Williams J, following a trial, suggests that the duty of loyalty may impose very strict standards on departing employees.

17. In Kynixa Ltd v Hynes, Preston & Smith [2008] EWHC 1495 (QB)[2], the claimant provided rehabilitation and case management services for people injured at work or on the roads. The first defendant was a director and Chief Operating Officer of the claimant; the second defendant was Head of Business Development and an extremely important employee; the third defendant was employed as Relationship Manager.

18. The three defendants all left to join a competitor. There came a point in time when all three knew that the competitor's aim was to recruit them all if it could: [217]. The real issue for the judge was what each employee should have disclosed to the claimant once it had become clear to them that there was a real possibility that each would join the competitor: [221].

19. The judge found that the first and second defendants were in breach of their fiduciary duty in failing to disclose the competitor's approach to them individually and the approach to the other: [262], [273]-[275].

20. The third defendant did not owe fiduciary duties. However, the judge found that once the third defendant knew of the fact that approaches had been made to the other defendants as well as herself, her duty of fidelity was such that she should have informed the claimant of the approaches: [283].

21. This decision suggests a strict requirement of disclosure of approaches by a potential employer as part of the duty of loyalty. Whether it will be followed in future cases remains to be seen.

22. Do the authorities referred to above betray a fundamental difference of approach by the courts? Or can they be reconciled? And, if so, on what basis?

[2] See, also, [2008] EWHC 1646 (QB) on costs.

23. There are two bases on which they might arguably be reconciled. One is on the basis of pragmatism. The other is on the basis of principle.

THE PRAGMATIC APPROACH

24. On one view, the courts approach this type of case not on the basis of any set of inflexible principles which prescribe the outcome but rather on a pragmatic basis in light of the merits of the case. Some support for this view can be found in the Court of Appeal decision in Foster Bryant Surveying Ltd v Bryant [2007] EWCA Civ 200, [2007] IRLR 425.

25. Bryant and Foster were chartered surveyors who operated through the claimant of which they were directors. The claimant's main client, Alliance Leisure Services, was managed by a Mrs Watts. Following a falling out between Bryant and Foster, Bryant resigned. He told Mrs Watts who asked him if he would carry on working for Alliance which he agreed to do, incorporating a company for this purpose. Bryant's employment then terminated, and he started working for Alliance. The claimant sued Bryant for breach of fiduciary duties as a director during his notice period. The claim was dismissed at first instance and in the Court of Appeal.

26. Rix LJ summarised the relevant legal principles on a director's fiduciary duties: [8]-[10]. He then reviewed the leading authorities in this field: [48]-[77]. Having done so, Rix LJ stated that he would find it difficult accurately to encapsulate the circumstances in which a retiring director may or may not be found to have breached his fiduciary duty. He added that, as has been frequently stated, "the problem is highly fact sensitive".

27. There is no doubt, he continued, that the twin principles, that a director must act towards his company with honesty, good faith, and loyalty and must avoid any conflict of interest, are firmly in place, and are exacting requirements, exactingly enforced. Nevertheless, the jurisprudence has shown that, while the principles remain unamended, their application in different circumstances has required care and sensitivity both to the facts and to other principles, such as that of personal freedom to compete. For reasons

such as these, there has been some flexibility, both in the reach and extent of the duties imposed and in the findings of liability or non-liability.

28. Rix LJ added at [76]:

> "The jurisprudence also demonstrates, to my mind, that in the present context of retiring directors, where the critical line between a defendant being or not being a director becomes hard to police, the courts have adopted pragmatic solutions based on a common-sense and merits based approach." (emphasis added)

29. Rix LJ then identified three classes of case which illustrate the courts' development of merits based solutions: [77].

Class 1: the nominal director

30. The first class of case is where the defendant is a director in name only. An example is In Plus Group Ltd v Pyke [2002] 2 BCLC 201 (CA). There the claimant company sought over a period of many months, but without success, to force the defendant director to resign following a bout of severe illness. The relationship between him and his partner in the business broke down, he was deprived of remuneration and information, and denied repayment of loans to the company. The defendant refused to resign and, while still a director, set up his own company and began competing with the claimant, even to the extent of working for its major client. The trial judge and the Court of Appeal held there was no breach of fiduciary duty.

Class 2: the destructive director

31. The second class of case is at the other extreme. Here, the director has planned his resignation having in mind the destruction of his company or at least the exploitation of its property in the form of business opportunities in which he is currently involved. Rix LJ gave as examples of this class, IDC v Cooley [1972] 2 All ER 162; Canadian Aero Service Ltd v O'Malley (1973) 40 DLR (3d) 371; CMS Dolphin Ltd v Simonet [2001] 2 BCLC 704; and British Midland Tool Ltd v Midland International Tooling Ltd [2003] 2 BCLC 523.

32. In British Midland Tool, four directors decided to leave and joining a competitor. Having made this decision, one director resigned and was held

not to be in breach of his fiduciary duties. However, the other three remained in post whilst conspiring with the first to poach the claimant's employees. The three were thereby in breach of their fiduciary duties.

Class 3: the nuanced cases

33. Rix LJ described his third class as the more nuanced cases which go both ways. He identified two sub-classes illustrative of the division.

34. On the one side is Shepherds Investments v Walters (above). As to this, Rix LJ stated that the combination of disloyalty, active promotion of the planned business, and exploitation of a business opportunity, all while the directors remained in office, brought liability.

35. In Shepherds Investments v Walters, two directors and a third employee who held himself out as a director took a number of steps towards setting up a competing business. They produced a draft business plan, appointed offshore attorneys, auditors and prepared a draft offering memorandum before they resigned. Etherton J held that by the time they had contacted offshore attorneys, all individual defendants had formed the irrevocable intention to launch the new business. From that date they acted in such a manner as to bring about a plain conflict between their personal interests and the best interests of the Shepherds group.

36. On the other side, Rix LJ listed the cases of Island Export Finance Ltd v Ummuna [1986] BCLC 460; Balston Ltd v Headline Filters Ltd [1990] FSR 385; and Framlington Group Plc v Anderson [1995] 1 BCLC 475 He described these as cases where the resignations were unaccompanied by disloyalty, with the result that there was no liability.

37. In Balston, a director took a lease of premises which he subsequently used for his competing business before he resigned as a director or employee. Whilst he was on garden leave, but had ceased to be a director, he took active steps to further his new business in dealing with a client and soliciting a former colleague to join him. He had not breached his fiduciary duties as a director,

but his actions whilst on garden leave breached his contractual duty of fidelity as an employee.

38. The analysis in Foster Bryant was specifically developed by reference to directors and their fiduciary duties for the good reason that the departing employee in that case (Mr Bryant) was a director. However, there seems to be no reason why Rix LJ's pragmatism is any less applicable where the leaver is an ordinary employee owing contractual but not fiduciary duties.

39. Such an approach is likely to be prayed in aid by those who believe the merits are on their side. It undoubtedly has the advantage of flexibility. It also has the merit of making express what judges often seek to achieve even if unstated, namely to reach a result which accords with the justice of the situation.

40. The flexibility inherent in the pragmatic approach is, however, not only a virtue but also a vice. It means that outcomes are often unpredictable, which is generally unsatisfactory for clients and their lawyers alike.

THE PRINCIPLED APPROACH

41. An alternative to the pragmatic approach is to identify the core legal principles concerning the duty of loyalty to see whether that route serves as a better aid to reconciling the existing authorities and a more useful guide to the outcome of future cases.

42. With that aim in mind, there are three key features of the duty of loyalty which require examination.

The difference between the fiduciary and contractual duty of loyalty

43. The first point to be made is that a director owes a fiduciary duty of loyalty and an employee owes a contractual duty of loyalty but they do not amount in all respects to the same thing. This can lead to some confusion.

44. It is not uncommon to see reference to a director owing "fiduciary duties" which are often said to be "stricter" or "more demanding" than an employee's duty of fidelity. Certainly, a breach of fiduciary duties may give

rise to remedies, such as an account of profits or tracing, which are generally not available for a breach of contractual duties. The remedial advantages of a breach of fiduciary duties is beyond the scope of this paper, although their significance is illustrated by Shepherds Investments v Walters (above), in which the successful claim could demonstrate no loss sounding in compensatory damages but was held entitled to an account of profits for breach of fiduciary duties. It must be remembered, however, that fiduciary duties should not be superimposed on common law duties simply to improve the nature or extent of the remedy: University of Nottingham v Fishel [2000] ICR 1462, 1490E.

45. A director's fiduciary duties take a number of particular forms, such as the no conflict rule and the no profit rule, and are now codified in the Companies Act 2008. However, the focus of the present discussion is the duty of loyalty, and the difference between its fiduciary and contractual form.

46. An employee's contractual duty of loyalty was central to a number of the early cases on unlawful competition such as Robb v Green [1895] 2 QB 315 (CA) (where the copying by an employee of a list of customers for use in competition after the employment ended breached the employee's duty of good faith), and Wessex Dairies Ltd v Smith [1935] 2 KB 80 (CA) (where the soliciting of customers for a future competitive business breached the duty of good faith). In Hivac Ltd v Park Royal Scientific Instruments Ltd [1946] 1 Ch 169 (CA), Lord Greene MR considered it indisputable that an employee owes a duty of fidelity to his employer. The practical difficulty in any given case, he thought, "is to find exactly how far that rather vague duty of fidelity extends".

47. So much for the employee's contractual duty of loyalty. The director's fiduciary duty of loyalty was the basis for a recent decision of the Court of Appeal that a director owed a duty to disclose his own misconduct: Item Software (UK) Ltd v Fassihi [2005] ICR 450. Arden LJ based her decision on what she described as the time-honoured duty of loyalty or the fundamental duty to act in what he in good faith considers to be the best interests of his company.

48. What, then, is the difference between an employee's contractual duty of loyalty and a director's fiduciary duty of loyalty. It is not always easy to discern in the authorities.

49. In Bristol and West Building Society v Mothew [1998] 1 Ch 1, 18, Lord Millett referred to the fiduciary's distinguishing obligation of loyalty, which meant that the principal is entitled to the "single-minded loyalty" of his fiduciary.

50. Elias J explained this further in Fishel (above). The key feature of the fiduciary duty of loyalty is the duty "to act in the interests of another" (1490D). By contrast, the essence of the employment relationship is not typically fiduciary but contractual. 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" (1491E).

51. Thus, the distinction appears to be between a situation where a person undertakes to act solely in the interests of another, disregarding his own interests (fiduciary duty of loyalty), on the one hand, and a situation where a person merely has to take into consideration the interests of another, but does not have to act in the interests of that other (the contractual duty of loyalty) (1492E).

52. As Moses LJ explained in Helmet v Tunnard (above), applying Elias J's analysis in Fishel, the distinguishing mark of the obligation of a fiduciary, in the context of employment, is not merely that the employee owes a duty of loyalty "but of single-minded or exclusive loyalty" ([36]). He also described it as "that exclusive obligation of loyalty, to act in his employer's interest and not in his own, which is the hallmark of any fiduciary duty owed by an employee to his employer" ([36]).

When does an employee owe a fiduciary duty of loyalty?

53. The answer to the question as to when an employee owes a fiduciary duty of loyalty was answered by Elias J in Fishel. Moses LJ in Helmet v Tunnard ([37]) said he could do no better than recite Elias J's statement of principle in Fishel at 1493E-F:

"..in determining whether a fiduciary relationship arises in the context of an employment relationship, it 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."

54. Since Fishel, it has become commonplace to find allegations that an employee owed fiduciary duties, in addition to the normal contractual duties. This is normally accompanied by for equitable remedies such as an account of profit. It is interesting, therefore, to see how the courts have approached the issue as to whether an employee, who is not a director, owes fiduciary duties.

55. It is possible to identify a number of factors which have led courts to conclude that an employee owes fiduciary duties in addition to contractual duties.

De facto director

56. Where an employee assumes the role of director, even if he is not formally appointed as such, he may be a de facto director and, as such, owes fiduciary duties.

57. This was the position in Shepherds v Walters (above). Of the three defendants, two were directors but Simmons was never formally appointed as a director. However, Simmons held himself out as, and was held out by the company as, a director in fact. Etherton J cited a passage from Re Hydrodam (Corby) Ltd [1994] 2 BCLC 180, in which Millett J said that to establish that a person was a de facto director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the company's affairs or undertook tasks in relation to its business which can properly be performed by a manager below board level: [78].

58. On the facts, following the resignation of the managing director, Simmons became one of a very limited number of senior managers who were responsible for the business. He was described as the sales director on his business cards and in the start-up's business plan: [79]-[80].

The nature of the contractual duty

59. In certain cases, it follows from the nature of the employee's contractual duty that, in relation to that duty, he must act solely in the interests of the employer.

60. Thus, in Fishel itself, it was the defendant's duty to direct the other embryologists what to do and where to do it. By accepting work for them from which the defendant directly benefitted, he was clearly putting himself where there was a potential conflict between his specific duty to the university to direct the embryologists to work in the interests of the university, and his own financial interest in directing them abroad. The fact that he did not in fact act contrary to the interests of the university is irrelevant: it is trite law that the potential conflict is enough: [200] ICR 1462, 1498A-C.

Vulnerability

61. Where an employer is dependent on the employee to perform one of his duties, and has no control over how he does so, the employer is in a vulnerable position being reliant on the employee's trustworthiness. Such vulnerability was described by Lord Millett as a "defining characteristic" of a fiduciary relationship: Equity's Place in the Law of Commerce (1998) 114 LQR 214, 219.

62. It was for this reason that the Court of Appeal in Helmet v Tunnard (above) held that Mr Tunnard owed a fiduciary duty to report to his employer on third party competitor activity. Amongst his duties set out in his job specification was the duty "to advise on competitor activity". Mr Tunnard was under an obligation to deploy any information he obtained about third party competitor activity exclusively in the interests of his employer, who would be dependent upon him to pass on this information: [42]-[45].

63. Where the employer's argument broke down in Helmet v Tunnard was that it did not follow from the fiduciary duty identified above, that Mr Tunnard was under any obligation, be it fiduciary or otherwise, to inform his employer of

his own competitive activities. This was for two reasons. First, the words of the job specification did not restrict Mr Tunnard's freedom to prepare for competition on leaving. Secondly, he was under no relevant fiduciary obligation to his employer: [46]-[47].

Seniority of the employee's role or status

64. It has also been said that some special role or status is required for an employee to be held to be a fiduciary. Following this approach, where an employee is not a director it is essential to look at the role of that employee and determine whether or not the nature of that role is sufficiently senior for the court to conclude that in addition to his normal duties as an employee he owed fiduciary duties. This approach was taken by Peter Smith J in Crowson Fabrics Ltd v Rider [2007] EWHC 2942 (Ch), [2008] IRLR 288 at [79]-[80].

65. There were two employee defendants in Crowson v Rider neither of whom was a director. The first, Mr Rider, had a senior role beyond that of a mere employee and was entrusted with senior tasks because he could be trusted. The judge concluded that he was a fiduciary. The second employee, Mr Stimson, was described as a senior and experienced salesman but, the judge concluded, his duties were no more than that. He did not owe fiduciary duties.

What the duty of loyalty requires of an employee joining a competitor

66. Having identified the core duty of loyalty owed by employees, established the difference between the fiduciary and contractual duty of loyalty, and noted the circumstances in which an employee might owe fiduciary duties, do these principles provide a useful guide to the outcome of past and future cases? There are three points to be made.

It is easier to establish breach of fiduciary duties than breach of contractual duties

67. Whilst it may be difficult to establish the existence of fiduciary duties in the case of an employee who is not a director, once established it is easier to prove breach of them than of the contractual duty of loyalty.

68. This was remarked upon by Moses LJ in Helmet v Tunnard (above) at [33]:

> "Since the essence of the obligation of an employee as fiduciary is that the employee must act solely or exclusively in the interest of his employer, it will be easier for an employer to establish that activities in preparation for competition were themselves in breach of a fiduciary obligation."

See also, to like effect, Peter Smith J in Crowson Fabrics v Rider (above) at [82].

69. Having said that, in some cases it might not make much difference whether fiduciary duties are super-imposed on contractual duties: the conduct will amount to a breach of both.

Whether the steps are "preparatory" is not the test

70. At one time, it was thought that a neat dividing line could be drawn between steps taken in preparation for future competition, on the one hand, and actual competition on the other. Preparatory steps were permissible, competitive steps were not.

71. The Wright brothers were involved in the manufacture of artificial coals and logs for use in gas fires: Lancashire Fires Ltd v SA Lyons & Co Ltd [1997] IRLR 113 (CA). The younger brother, Arthur, was employed as new projects manager by a company which was owned by his older brother, Jim. Arthur planned to set up a competitive business, entered into an agreement to sell exclusively to a North American company who also provided funds for research and development, acquired equipment and rented premises for the purpose. Jim found out and sacked Arthur.

72. The Court of Appeal held that there was a breach of the duty of fidelity. Arthur Wright was not simply seeking employment with a competitor or taking "preliminary steps to set up his own business". His activities placed himself "well on the wrong side of the line".

73. The validity of a clear distinction between preparatory and competitive activities was firmly dispelled, however, by the Court of Appeal in Helmet v Tunnard. As Moses LJ said at [28]:

"...it is important not to be beguiled into thinking that the mere fact that activities are preparatory to future competition will conclude the issue in a former employee's favour. The authorities establish that no such clear line can be drawn between that which is legitimate and that which breaches an employee's obligations."

74. There are cases which show that the mere fact that activities during the course of employment may be described as "preparatory" will not necessarily be dispositve of the issue as to whether the employee breached his duty of fidelity. Moses LJ cited Shepherds v Walters as affording an example, on its facts, of works of preparation. Moses LJ concluded at [32]:

"I agree that it is insufficient merely to cloak activities with legitimacy by describing them as preparatory. The first task...is to identify the nature of the employee's obligations. Once they have been identified, the court is then in a proper position to discern whether the activities of an employee undertaken in pursuance of a plan to be fulfilled on his departure is a breach of his duty to his employer or not."

75. If the preparatory/competitive dichotomy is not determinative, what is? True it might be that it is easier to prove a breach of fiduciary duties than of contractual duties of loyalty, but the question still remains: what amounts to a breach when an employee is leaving? Once the employee's obligations have been identified, as Moses LJ suggests, how exactly is the court to discern, and legal advisers to advise, whether the departing employee is being impermissibly unfaithful to his employer?

Disclosing an intention to leave

76. Since these cases are fact-specific, it remains difficult to give any clear-cut or general answers to these questions. However, there is one aspect of these cases which has been the subject of examination in recent cases and merits particular attention. That is, whether an employee is required by his duty of loyalty to disclose the mere fact of his intention to join a competitor. This issue requires consideration, first, in relation to those owing a fiduciary duty of loyalty and, secondly, those owing merely a contractual duty of loyalty.

77. First, consider the position of those owing fiduciary duties, such as directors. A useful starting-point in this regard is Balston v Headline Filters. It will be recalled that the defendant in that case resigned as a director on 18 April

1986. Six months prior to this, by October 1985, he was considering his position and what he could do if he left Balston. He approached accountants, prepared a business plan for a competing business, and acquired suitable small industrial premises. The defendant did not disclose to Balston that he might set up in competition. He described his forebearing from telling Balston that he might do so as "an act of self-preservation". He feared a vindictive reaction, a fear that proved to be well-founded (396).

78. It was alleged against the defendant that (i) while still a director of Balston he had formed the intention to set up in competition with Balston; (ii) this put him in direct conflict between his interest and the interest of Balston of which he was a director; (iii) it was his duty as a director to report to the company any knowledge he acquired concerning competition, including relating to his own competition; and (iv) in failing to disclose that conflict of interest and his intention to set up in competition, he acted against the interests of Balston and in breach of his fiduciary duty (403-4).

79. Falconer J reviewed some of the leading authorities (Bell v Lever Brothers Ltd [1932] AC 161; IDC Ltd v Cooley [1972] 2 All ER 162; and Island Export Finance Ltd v Umunna [1986] BCLC), and reached the following conclusion (412):

> "an intention by a director of a company to set up business in competition with the company after his directorship has ceased is not to be regarded as a conflicting interest within the context of the principle [that a director must not put himself in a position where his duty and interests conflict], having regard to the rules of public policy as to restraint of trade, nor is the taking of any preliminary steps to investigate or forward that intention so long as there is no actual competitive activity…while he remains a director."

80. It followed that the defendant was not in breach of his fiduciary duty owed to Balston as a director of the company in not disclosing to Balston his intention to set up in business in competition.

81. Hart J had occasion to consider whether a director owes a duty to disclose his competitive intention in British Midland Tool. That was the case of "the Tamworth 4", where three directors remained behind to further their plan to

poach employees for their new business. The claim against them was primarily put as an unlawful means conspiracy ([77]).

82. Having considered Balston, Hart J stated (560i):

> "A director who wishes to engage in a competing business and not to disclose his intentions to the company ought, in my judgment, to resign his office as soon as his intention has been irrevocably formed and he has launched himself in the actual taking of preparatory steps."

83. In Shepherds Investments v W Ltd v Walters [2006] EWHC 836 (Ch), [2007] IRLR 110, Etherton J considered whether there was a conflict between the approach of Falconer J in Balston and Hart J in British Midland Tool. He approved Hart J's approach and added "in so far as" there is any conflict between the two, the approach of Hart J is to be preferred.

84. However, when considering where the line is to be drawn between what is permissible and what is impermissible by way of pre-resignation activities, suggested that Hart J may have been "too prescriptive" in saying that the director must resign once he has irrevocably formed the intention to engage in the future of a competing business and, without disclosing his intentions to the company, takes any preparatory steps (although the decision was correct on its facts): [108].

85. There remains, therefore, some tension between Balston, British Midland Tool, and Shepherds v Walters on the question when a director must disclose his intention to compete. No disclosure is required before the intention to complete is settled. Even then, no disclosure is required, according to Hart J, until in addition the director launches on the taking of preparatory steps. But, still then, it is unclear on the authorities whether the director must then resign or disclose until the activities he undertakes gives rise to an actual or potential conflict between his duties to the company and his competitive interests.

86. What of an employee who does not owe fiduciary duties? Will his failure to disclose his intention to join a competitor, or to set up a competing business, amount to a breach of his contractual duty of loyalty?

87. This question brings us back to the recent decision in Kynixa v Hynes. The third defendant in that case did not owe fiduciary duties to the claimant. She was approached by the competitor in November 2006. The judge decided that when she became aware that approaches had been made to the other two defendants as well, which was by the end of January 2007, her duty of fidelity required her to disclose this fact to her employer. This was notwithstanding the fact that she resigned her employment on 14 March, and did not return her contract of employment with the competitor until 19 March. When she did resign, the third defendant told the claimant that she was considering several job options and was intending to take some time out. The judge found this to be misleading.

88. The finding that the third defendant was in breach of her duty of fidelity in failing to disclose that she and two colleagues had been approached by a competitor seems to be at the limit of what the duty of loyalty requires form an employee joining (or considering joining) a competitor. Kynixa is not, however, authority for a requirement that an employee must disclose to his employer approaches by a competitor to him alone or even that he has decided to join a competitor.

CONCLUSIONS

89. What are the lessons to be learned from these cases?

90. First, it is difficult to discern any clear or consistent pattern to the recent authorities. In so far as a trend emerges, it would appear to be in favour of a more demanding duty of loyalty in terms of what steps directors and (to a lesser extent) employees are free to take before resigning or disclosing their competitive intentions.

91. Secondly, disloyalty cases are fact-specific and the courts have developed merits-based solutions in the difficult cases.

92. Thirdly, in so far as any principles do emerge, it is broadly speaking easier to show a breach of fiduciary duties than contractual duties of loyalty when an employee joins a competitor. A director or employee owing fiduciary duties

must exercise great caution once he has a settled intention to leave in the active steps that he takes to further that intention. Although the contractual duty of loyalty does not set such high standards as fiduciary duties, even an employee owing merely a contractual duty of loyalty should be cautious in his behaviour once he has decided to leave, and would be well-advised to consider what he might disclose to his employer.

93. Fourthly, a principled approach will only go so far in determining the outcome of disloyalty cases. In the difficult cases, the court is likely to be strongly influenced by its perceptions of the conduct of the parties so as to reach a merits-based solution.

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