The dangers for directors with interests in other companies

The contrasting verdicts in two recent cases illustrate the need for directors with interests outside their main office to tread carefully. The judgments in Invideous Ltd & others v Jack Thorogood & others and Anushika Sharma v Jagesh Kumar Sharma & others illustrate the Court's current approach to directors who divert business away from companies.

Invideous Ltd & Others v Jack Thorogood

Facts

In his capacity as director and employee of Invideous Ltd ("Invideous"), Jack Thorogood ("JT") frequently dealt with customer enquiries regarding Invideous' range of products linked to the monetising of video content on the internet. In particular, JT engaged in many discussions with a particular media company (X).

Around the time of these discussions, JT secretly set up a second company providing products and services within the same field as Invideous and hiring a number of Invideous' ex-employees.

Over the course of a year, JT then utilised the contacts he had gained during his office to successfully divert business opportunities away from Invideous to his new company, including most notably a project with X.

JT proceeded to resign from his office at Invideous, at which stage the other directors became aware of the new company and sought injunctive relief.

Consequences

Invideous obtained an injunction preventing JT from carrying on a competing business pending the Court's decision as to whether, in establishing his new company during the course of his directorship at Invideous, JT had been acting in breach of his fiduciary duties.

After some deliberation over the nature of the two businesses, the Court found in favour of the claimants and held that JT's conduct in setting up a competing business in secret, and specifically his diversion of the opportunity in X away from Invideous, amounted to a serious breach of the no conflict and no secret profit obligations imposed on him as a director under sections 170 – 177 of the Act.

Anushika Sharma v Jagesh Kumar Sharma & others

Facts

Through her marriage to Jagesh Kumar Sharma ("JKS"), Anushika Sharma ("AS"), a dentist by trade, acquired two dental practices with the opportunity to acquire a third through a company (X) in which JKS and two members of his family (also claimants to this action) would each benefit from a 25% shareholding. As the only qualified dentist, AS was to be the sole director and was to run X as she saw fit.

During the course of a family meeting prior to her appointment, AS requested and it was agreed by the shareholders (one of whom expressly agreed and the other two remained silent on the matter) that she should also be able to acquire further practices in her own name should she wish to do so in the future. X was set up in accordance with this agreement.

X went on to acquire a further five practices whilst AS took on another five in her own name.

AS's marriage to JKS broke down and during divorce proceedings it was alleged that, in acquiring the five practices in her own name, AS had exploited for her own benefit opportunities which should have been used for the benefit of X.

Consequences

The Court noted that the starting point in a case of this nature was that a company director would be in breach of his fiduciary or statutory duty (under s.175 of the Act) to avoid a conflict of interest if he exploited for his personal gain opportunities which came to his attention through his role as director or any other opportunities which he could and should exploit for the company's benefit.

However, if, as was the case here, the shareholders with full knowledge of the relevant facts consented to the director's conduct then it was not a breach of fiduciary or statutory duty and even if they had merely acquiesced, that acquiescence may still constitute consent.

In this case the Court found in favour of the defendant, in part due to the shareholders' knowledge and apparent agreement to AS's conduct (and this was regardless of whether they had understood the legal effect of such conduct), but also because the whole arrangement had been highly favourable to the claimants who retained 75% of the shares of a potentially valuable company in which they had invested no capital and only minimal effort.

The Lesson

The rules on directors' duties can be difficult to apply in practice, and are supplemented by case law which is not always consistent. However, the courts will not generally rush to impose sanctions on individuals who have acted in good faith and tried to obtain the informed consent of other participants, even if that has not been done in compliance with all the relevant requirements of the Companies Act.

The decision in the *Sharma* case reflects this principle, whilst conversely the *Invideous* judgment demonstrates that the courts will maintain a strict approach in response to behaviour which contains an element of deceit and a clear intention to make a personal secret profit.

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