

Ignorance isn't bliss: The risks facing company directors who don't know their business

The recent case of *Weaverling Capital (UK) Limited v Dabhia and Platt* serves as a reminder of the need for company directors to actively ensure that they hold the knowledge required to discharge their legal duties to the company. If a director blindly follows the word of a supposed expert, he or she may be at risk of liability for breach of duty.

The Facts

Mr Peterson and Mr Dabhia were directors of Weaverling Capital (UK) Limited ("WCUK"), a highly profitable English investment management company which advised hedge funds.

While Mr Peterson was the founding and principal director of WCUK, Mr Dabhia's role was in marketing. He attended meetings with investors and potential investors to discuss strategy and performance, produced and distributed marketing materials and dealt with queries from investors, *"usually, but not invariably, after consultation with Mr Peterson. He did not question instructions or information given to him by Mr Peterson"*.

A company called Weaverling Macro Fixed Income Fund Limited ("Macro") was incorporated in the Cayman Islands in April 2003. Macro, which was managed by WCUK, carried on business as a hedge fund. It attracted millions of dollars in investment from banks, funds and wealthy individuals.

Macro collapsed in 2009. It had been making losses from the time it began to trade in August 2003, but Mr Peterson had sought to cover those losses by operating a series of fraudulent schemes. Throughout the period in question, WCUK made a number of untruthful representations to investors in its offering memorandum, portfolio summaries, risk reports and other marketing materials for which Mr Dabhia was responsible. The documents presented to investors a picture of a low-risk, low volatility and high liquidity fund. These misrepresentations attracted continuing investments and enabled Macro to stay active until it eventually collapsed under the weight of redemption demands.

The case against Mr Dabhia by WCUK and its liquidators was that he acted in breach of his fiduciary duties as a director of the company by failing to acquire or maintain sufficient knowledge of the true nature of the Macro business, failing to investigate the schemes being operated by Mr Peterson and failing to disclose the true position to the WCUK board, shareholders or investors.

The Consequences

Mr Dabhia argued at trial that he was not an investment manager and had no knowledge or experience in hedge fund trading. His responsibility was establishing and implementing

marketing strategy, and he reasonably and honestly relied upon the information provided to him by Mr Peterson when it came to Macro's investments.

The judge hearing the case in the first instance rejected Mr Dabhia's defence. She found that he had failed to acquire a sufficient knowledge and understanding of the business and failed to act with reasonable care and skill in making the representations that he did to investors.

Mr Dabhia appealed the decision on the grounds that the judge was wrong to have found him in breach of duty.

Under section 174 of the Companies Act 2006 a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out his or her particular functions. Mr Dabhia's argument was that the judge did not properly consider the level of knowledge to be expected of him *as the marketing principal*. He argued that when it came to the understanding the investment side of the business, he should be subject to a lower standard than certain other directors and it was perfectly reasonable for him to rely on their expertise. Moreover, Mr Peterson was a charismatic man with an exceptional track record whose explanations were swallowed uncritically by many people involved in the business of Macro.

The Court of Appeal held that the judge at the initial hearing was correct in stating that by accepting the role of marketing Macro to investors, Mr Dabhia took on the responsibility of understanding its investment strategy. Although it was accepted that Mr Dabhia's appreciation of Mr Peterson's dishonest schemes was "foggy", he still could have realised that something was seriously wrong if he had properly applied his mind. Mr Dabhia, therefore, did in fact breach his duty to WCUK and his appeal was dismissed.

The Lesson

All company directors should be aware of their duties as a director. Unfortunately many are not, and even those who are often tend to regard those duties as legal rules which are unlikely to apply to them in practice, particularly where they act in good faith.

However, the risk of liability for breaching directors' duties is a real one. The *Weaving Capital* case highlights the fact that an absence of dishonest intent will not prevent a director from being subject to liability, but equally it should not be read as an indication that Mr Dabhia was required to have exactly the same knowledge and expertise as Mr Peterson. The key point is that Mr Dabhia had a responsibility to ensure he had properly applied his mind to the business of the company rather than relying exclusively on Mr Peterson.

Applying this principle to a more general example, the law does not expect each director to have the same level of technical accounting knowledge as a Finance Director, but will be unsympathetic to directors who have not considered company accounts and their business' financial position on the basis it was someone else's responsibility.

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