Court of Appeal confirms that cases on breach of directors' duties will be highly fact-sensitive

In the recent case of *Cheshire Estate & Legal Limited (CEL) v Blanchfield & Ors* the Court of Appeal considered the issue of whether two directors were in breach of their statutory and fiduciary duties in preparing to set up a new competitor firm prior to resigning.

What happened in this case?

Mr Blanchfield and Mr Montaldo (the **Directors**) were Directors of CEL, a corporate firm of solicitors. Prior to resigning from their positions, the Directors had taken preparatory steps to set up a new law firm in competition with CEL, including:

- registering a trading name;
- incorporating a corporate vehicle for the new company;
- seeking professional indemnity insurance for the new company;
- applying to the Solicitors Regulation Authority (the **SRA**) to register the company;

- setting up a website;
- opening a bank account; and
- entering discussions with litigation funders, including one with whom the Directors had previously negotiated with on behalf of CEL (albeit those negotiations had failed with CEL entering into an exclusive deal with another funder).

Upon discovering this, CEL applied for an interim injunction. This was granted pending an expedited trial of the issues. At that trial, the judge found that the Directors' preparatory steps had not "crossed the line" or put them in a position of conflict so as to breach their fiduciary duties, and that there was no conspiracy between them or intention to injure the firm. CEL appealed to the Court of Appeal.

What was decided?

The appeal judge considered the case law in this area, which suggested that a director should resign as soon as his intention to compete becomes irrevocable. The judge concluded that this was too prescriptive. Instead, the court needed to consider whether preparatory steps, short of active competition, are consistent with a director's fiduciary duty to the company. This would be highly fact-sensitive in every case.

The judge described a spectrum with at the one end, discussing an intention to compete with friends and family (clearly consistent with a fiduciary duty) and at the other, actively soliciting clients from the company and diverting them to the director's new competing business (clearly inconsistent with a fiduciary duty). The court's role is to map the facts of the particular case onto this spectrum and make a decision accordingly as to whether the director is in breach.

In this case the appeal judge agreed with the trial judge that the Directors' actions had not crossed the line into breach of fiduciary duty. This was because:

- trading of the new company was not expected to start until six months after the Directors resigned;
- the venture was only capable of proceeding after getting clearance from the SRA;
- the Directors resigned four days *after* getting that clearance; and
- in the meantime, they served CEL faithfully and carried out all their duties.

CEL also failed to establish that the Directors' negotiations with the litigation funder were a conflict, as by that point CEL had entered into an exclusive relationship with a different funder and, in any event, the first litigation

funder could have worked with both CEL and the Directors' new company.

What does this mean for employers?

This case does not fundamentally change the law on directors' duties but is potentially unwelcome for employers as it illustrates how surprisingly far directors can go in taking preparatory steps to compete before they are deemed to be in breach of their fiduciary duties.

Given how fact-sensitive these cases are, companies will need to produce comprehensive evidence to persuade a court that there has been a breach and that the company has, or will, suffer loss.

Companies should also consider whether the restrictive covenants in directors' service agreements provide adequate protection against this kind of scenario and ensure these are regularly reviewed so they are relevant to the individuals' positions in the company.

Cheshire Estate & Legal Limited (CEL) v Blanchfield & Ors

BDBF is a leading employment law firm based at Bank in the City of London. If you would like to discuss any issues relating to the content of this article, please contact Connie Berry (ConnieBerry@bdbf.co.uk), Amanda Steadman (AmandaSteadman@bdbf.co.uk) or your usual BDBF contact.