



Burnell v Trans-Tag Ltd: Directors' Duty to Avoid Conflict of Interest and Its Application on Former Director

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ABSTRACT

A recent landmark *Burnell v Trans-Tag Ltd* validated that the former director of a company is bound by the duty to avoid conflict of interest and his fiduciary duty will breach when he exploits the property, opportunity, and information that he acquired during his tenure of directorship in a company. Further, the combined effect of sections 175 and 170(2)(a) of the Companies Act 2006 has been explored in the case. This comment scrutinises and highlights this recent noteworthy development in the English courts' jurisprudence on directors' duty to avoid conflict of interest

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INTRODUCTION

It is a well-settled principle that a company's director does not solely resign with the intent to exploit the property, opportunity, or information of the company which he acquired when he was holding the position of the director of the company. However, recently *Alan Burnell v. Trans-Tag Limited and Robert Aird* evinces that in light of section 175 of the Companies Act 2006 (hereinafter 2006 Act), the director will breach his fiduciary duty to avoid conflict of interest following his departure from his position and directorship under section 170(2)(a) of the 2006

Act, even though where the conduct completely relates to the time after the departure of the company's director from his job. This case comment scrutinizes *Burnell v Trans-Tag Limited* to inspect how the court has interpreted sections 175 and 170(2)(a) of the Companies Act 2006.

Facts

A company named Trans-Tag Limited assembles, manufactures, designs, and sells Tag devices that function in the monitoring, tracking, and analysing the equipment, instruments, goods, and people. Monogram Capital Limited is another company that was the majority shareholder in the Trans-Tag Limited (TTL). Mr. Arid, the owner of Monogram Capital Limited, was the defendant in the case. The Claimant, CEO of Trans-Tag Limited, was Mr. Burnell who was an investor in this company. It was alleged by the defendant that the claimant was working as the director of Trans-Tag Limited. However, the claimant has never been appointed as the director of this company. Trans-Tag System is an Estonian Company that works in developing and designing the Tag's programs including its software and hardware. Further, various rights of intellectual property have been licenced by the Trans-Tag System to Trans-Tag Limited in the form of an agreement known as the "licence agreement." In 2017, discordant fallout arose between Trans-Tag Limited and Trans-Tag System. In March 2017, the claimant left the office of CEO and resigned from his position. Trans-Tag System sued Trans-Tag limited in April 2017 on the ground that Trans-Tag limited had infringed the Licence Agreement. The proceedings for declaration, injunction, and damages were initiated by the Trans-Tag Limited against the Trans-Tag System on the ground that Trans-Tag System could not terminate the agreement. The shares in the Trans-Tag System were acquired by the claimant in June 2017. Moreover, the claimant had not only acquired the shares but also became the director of the Trans-Tag System.

Decision and Reasons

The claimant, in May 2018, issued the proceedings in the court against Trans-Tag Limited for the repayment of the amount of £250,000. This amount was a loan given by him in two tranches. Another claim against the defendant for the breach of the licence agreement concerning the shares in the Trans-Tag Limited that the claimant alleged the defendant has acquired and such shares were issued to him due to a loan. However, a counterclaim was issued by Trans-Tag Limited against the claimant in whom it was alleged that the claimant had breached his duties as the director of Trans-Tag Limited. It was further alleged that the claimant had breached the duty of confidence to the Trans-Tag Limited on the ground of his conduct and his involvement in the Trans-Tag System. Specifically, it was alleged that the claimant had breached his equitable duties by exploiting the confidential information and the opportunities that legally and fairly belong to Trans-Tag Limited in subscribing the shares in Trans-Tag System and causing Trans-Tag System to seek the agreement's termination.

The High Court held that the claimant was entitled to reimbursement of the loan. The contract was breached by the defendant hence; the claimant was entitled to recovery of damages against

him to be assessed under his recovery from Trans-Tag Limited. The counterclaim was summarised by the High Courts as follows: “Mr. Burnell was a director of TTL, whether *de jure* or *de facto* and as such owed duties to TTL during and after the termination of his directorship. Mr. Burnell engaged in various acts (including the acquisition of TTS after he resigned as director) aimed at destabilising TTL so that Mr. Burnell could obtain control of the valuable right to develop, manufacture and sell the Tags and Restore which were in breach of those duties. The acquisition of TTS also involved a breach of his equitable duty of confidence. Mr. Burnell’s actions damaged TTL’s business and resulted in a loss to the value of its assets of up to £9,895,000. TTL claims damages and or equitable compensation, interest, an account of profits, and/or a declaration of trust.”

The High Court considered whether the claimant was the director of Trans-Tag Limited. It was asserted by the company that the claimant was appointed as the director of Trans-Tag Limited in either July 2016 or between February and March 2017. The High Court stated that the claimant was not appointed as the director of Trans-Tag Limited. He had never been appointed as a company’s director either by any informal decision of the company or under the Articles of Associations of Trans-Tag Limited. However, the court held that the claimant acted as the *de facto* director of the company by February 28, 2017, whereas in the latest holding that “he acted as a director, was treated by others as a director and sought to exercise his powers as a purported director.”

The High Court considered another question at which time the claimant had ceased to be the *de facto* director. The High Court stated that the last date when the claimant stopped to act as the Trans-Tag Limited director was March 29, 2017. Moreover, from April 2017, all the other directors considered and treated him as a former director of Trans-Tag Limited. Further, the High Court discussed the fiduciary duties of the claimant as the director of Trans-Tag Limited under the 2006 Act that are enshrined in Chapter 2, Part 10 of the 2006 Act. The High Court referred *McKillen v Misland (Cyprus) Investments Limited* and held that the claimant as the *de facto* director owed all the duties preserved in the 2006 Act. The claimant owed all the duties that would be applied to him if he would be appointed as a director of Trans-Tag Limited (McKillen, 2012).

More specifically, the claimant was bound to perform the duty to avoid a conflict of interest with his former company Trans-Tag Limited under section 175 of the 2006 Act.

Section 175 reads as follows:

“(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. (2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).”

Moreover, the claimant had ceased to act as the director of Trans-Tag Limited but he was obliged to avoid a conflict of interest under section 170(2)(a) of the 2006 Act.

Section 170(2)(a) provides:

“(2) A person who ceases to be a director continues to be subject— (a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director.”

To this extent, under section 170(2)(a), the duty to avoid conflict of interest should necessarily be adopted by the former director of the company.

The High Court referred to *Foster Bryant Surveying Ltd v Bryant* (Foster, 2007) and *Recovery Partners GP Limited v Rukhadz* (Partners, 2018). These cases reflected “the Court’s attempts to balance the need to prevent the emasculation of fiduciary duties, which might occur if a fiduciary was free to exploit opportunities which arose during the course of the fiduciary relationship by the simple expedient of resigning, with public policy issues in relation to the restraint of trade (Foster v Bryant, 2007).” Where it was agreed that the “the extension of the duty to avoid conflicts of interest in s175 CA 2006 by s170(2)(a) is intended to extract the essence of the principles which underlie the case law governing the circumstances in which a former director may be found to be in breach of duty by reference to post-resignation acts.”

Moreover, the interpretation of the phrase “any property, information or opportunity” mentioned in section 170(2)(a) of the 2006 Act has been done after reading it along with section 175 of the 2006 Act. It was held by the court that: “it was common ground between the parties that the phrase any property, information or opportunity in s170(2)(a) (and accordingly when applying s175 in accordance with s170(2)(a)) should be given a narrower meaning consistent with the existing case law and, in particular, the case law concerning the need for a maturing business opportunity (such as *Canaero* and *CMS*). To my mind, that is the correct approach; it is consistent with the interpretation of the scope of the duty in s175 as extended by s170(2)(a) in accordance with the principles of s170(4) and permitted by the application of s175 in those circumstances with necessary adaptations in accordance with s170(2).”

The parties disagreed on the question of whether section 170(2)(a) of the 2006 Act has its effect on the preserved duties of the director under Section 175 of the 2006 Act lasts after the director is terminated from his job and, if so, whether liability could result from it or whether the duty is breached from the acts which happened thereafter. Whereas common law describes that the director’s conduct after termination or leaving his office would never cause the breach of duty, section 170(2)(a) explicitly states that the duty to avoid conflict of interest lasts after the director of the company ceases to hold his position. It was noted by the High Court that “notwithstanding the instruction in s170(4) and the ability to apply s175 with necessary adaptations, in my view, it is not permissible as a matter of construction to ignore the plain words of the statute” and it

should consequently be probable for the relevant infringement to occur exclusively on the actions that occur after the resignation of the company's director.

The High Court considered whether the act of the claimant made him liable for breaching his fiduciary duties. The High Court stated that it can be observed from the act of the claimant that he breached his duty to avoid conflict of interest enshrined in section 175 of the 2006 Act as extended by the section 170(2)(a) of the 2006 Act, with the effect from when the claimant ceased to act as the *de facto* director of the Trans-Tag Limited albeit the court did not consider that the opportunity arose for Trans-Tag Limited to subscribe the shares of Trans-Tag System and hence there existed no breach in this context, the High Court stated that by considering: "(i) his knowledge of the circumstances in which the Licence Agreement might be terminated and legal advice received by TTL in this regard; (ii) some of the information surrounding the target market for Tags; and (iii) by acquiring shares in TTS and then taking action to terminate the Licence Agreement whether pursuant to the Chancery Division Proceedings or otherwise, Mr. Burnell put himself in a position in which his personal interests conflicted with the interests of TTL as regards the exploitation of property of TTL – its rights under the Licence Agreement – of which he was aware when he was a director. In my view, Mr. Burnell acted in breach of his continuing duty under s175 CA 2006 in doing so."

The Court limited the loss of Trans-Tag Limited to its right in the light of the Licence agreement, which was quantified as £200,000. This was set off against the claim of the claimant against Trans-Tag Limited regarding the repayment loan of £250,000 and the claimant's claim against the defendant for breaching the Licence agreement.

Comment

There are two equitable rules enshrined in the 2006 Act that preserve undivided loyalty (Ultra, 2005) concerning the duty of the director to avoid conflict of interest. These rules are the no-conflict rule and the no-profit rule. The no-conflict rule debars the director from entering into an engagement or contract without the consent in which his interest is or may be conflicting with the company's interest (Don, 1998). Similarly, another inflexible rule called the no-profit rule that debars the director from gaining profit from his position (Bhullar, 2003). Where the director resigns or has been terminated, the director is not allowed to exploit information, property, and opportunity that he came to know at the time of being a director (Quarter, 2004). English courts adopt these equitable principles for the interpretation of the statute on directors' duties (Genor, 2000). These rules are applied to promote unyielding rigidity (Philip, 2011) and never permit the directors to breach these duties which are exactly enforced (Murad, 2005). Moreover, the inflexible approach is a reasonable method to address the companies' agency problems (when it became difficult for shareholders to monitor directors' conduct) (Item, 2004). The strictness of these rules protects the interest that is potentially at risk from the company's director that failed in giving undivided loyalty (Philip, 2011).

Section 175(1) of the 2006 Act provides that a director should avoid a situation in which his direct or indirect interest conflicts with the interest of the company and he is bound to protect himself from the whirlpool of such situations (Aberdeen, 1854). If it is read with section 170(2)(a) of the 2006 Act, the former director is obliged to perform his duty to avoid a conflict of interest. There will be the application of no-conflict duty where the conflict lies between the “duty” and the “interest” that means between directors’ direct or indirect interest and the company’s interest and the duty of the director to advance such interests and also where is the existence of conflict between his duties (Transvaal, 1914). The liability is imposed in breach of section 175(1) where there is the existence of a situation of conflict or where the situation of possible conflict arises (Cowan, 1992).

Even in the situation of multiple directorships, there is a conflict of duty and the duty enshrined in section 175(7) of the 2006 Act arises. There is no principle or doctrine that a director cannot hold multiple directorships although where the companies are engaged within the competition of the same business (Bell, 1931). In this scenario, there are chances of a conflict of interest. The director holding multiple directorships could infringe the undivided loyalty obligations unless he acquires each company’s consent and discloses the situation of multiple directorships (Mothew, 1996). Even then, it is very difficult for a single director to serve many masters (Plus, 2002). To that extent, he has to work in good faith with all principals and must not perform any action that may affect the interest of the other. Moreover, if the former director holds the office of another company, he is bound to not reveal the information of the former company and he is bound to avoid conflict of interest.

The application of section 175(2) in the form of the no-profit rule is that the director when to earn profit due to his office or engage in any arrangement in course of his management or where he uses the special knowledge and the opportunity as director. Then he will be liable for breaching his duty albeit he acted with bona fide intention. These were the situations of conflict between his duty and his personal interest and he exploited his duty over his interest. In short, the well-intent or honest happening of such a situation will make the director liable and this applies to the former director as he cannot utilise the information that he gained during his directorship for his future enterprises (Mary, 2009).

CONCLUSION

The judgment of *Burnell v Trans-Tag* is a commendable job and it has provided lucidity and clarity to the directors’ duties preserved in the 2006 Act and it has cleared the position of new jurisprudence that has been established after the enactment of the 2006 Act from the jurisprudence prior to the promulgation of the 2006 Act. More precisely, the High Court did a commendable job by explicitly declaring that the director after his termination will be bound to perform his duty to avoid conflict of interest as codified under the 2006 Act. Under this duty, the former director is restricted from utilising the information and knowledge in a future enterprise that he acquired while he was holding a directorship.

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