



DRUCES^{LLP}

Litigation & Dispute Resolution Briefing Note: Directors and their fiduciary duties

Relevant to

Company directors, parties to commercial contracts, legal practitioners

Summary

In the case of *GHLM Trading Limited v Maroo and others* [2012] EWHC 61 (Ch) the High Court considered claims brought by a company against its directors and found that the burden of proof in relation to credit entries in a director's loan account and in relation to expenses said to have been incurred on the company's behalf was on the director. The Court also considered and made a finding that where a director caused his company to enter into a contract in his own interests and contrary to the interests of the company, its shareholders or creditors, and the counterparty had notice of that, the contract was void.

Facts

Mr and Mrs Maroo, the First and Second Defendants, were the directors and shareholders of several companies, including GHLM Trading Ltd ("GHLM"), the Claimant, and Brocade International Limited ("Brocade"), the Third Defendant. In 2005, Mr Binani acquired the shares in GHLM and invested heavily in it, while Mr and Mrs Maroo remained its only directors.

The business of GHLM was unsuccessful. Mr Binani, having lost faith in Mr Maroo, sought to achieve the removal of Mr and Mrs Maroo as directors of GHLM. Mr and Mrs Maroo refused to resign and instead took steps to sell quantities of GHLM's stock to Brocade, purportedly to off-set against sums said to be owed by GHLM to Brocade. Mr and Mrs Maroo were removed as directors of GHLM in 2009 and it shortly thereafter ceased trading.

Of GHLM's claims in the action, two are notable and addressed in this briefing note, namely:

- (i) a claim in respect of sums said to be owing on the directors' loan account, in particular on the basis that credit entries on the account were not justified; and
- (ii) a claim that the sale of stock to Brocade shortly before Mr and Mrs Maroo were removed as directors of GHLM involved breaches of duty on the part of Mr and Mrs Maroo.

The Court's decision

With regard to the claim in respect of sums said to be owing on the directors' loan account, the Court held that once it is shown that a company director has received company money, it is for the director to show that the payment was proper and that where debit entries have been made to a director's loan account, it must be incumbent on the director to justify the credit entries. This is plainly right since the director will have been (one of those) responsible for the management of the company's business and for ensuring its compliance with the duty, in section 386 of the Companies Act 2006, to keep adequate accounting records, records that are sufficient to show and explain the company's transactions.

In *Burke (Liquidator of Idessa (UK) Ltd v Morrison* [2011] EWHC 804 (Ch), and in relation to a liquidator's allegation of misfeasance in respect of payments made out of company funds, Ms Lesley Anderson QC, sitting as a deputy High Court judge said this:

"...once the liquidator proves the relevant payment has been made the evidential burden is on the Respondents to explain the transactions in question."

In *Gillman & Soame Ltd v Young* [2007] EWCA 145 (TCC), in relation to a claim that a former director was liable for breach of fiduciary duty for misappropriating company assets, Mr Robert Miles QC, also sitting as a deputy High Court judge put it thus:

"Where a person in a fiduciary position receives property of his principal the burden is on him to account...This principle applies to company directors as it does to trustees..."

Applying these principals to the facts of this case and the evidence, the Court held that credit entries in the directors' loan account of approximately £774,000 had not been justified and should be disregarded.

In relation to the sale of stock to Brocade, a company of which Mr and Mrs Maroo were directors and of which Mrs Maroo the sole shareholder, the Court held that the contract for the sale was void.

In his judgment, Newey J reminds us that while the interests of a company are normally identified with those of its shareholders, the interests of creditors can become relevant if a company has financial difficulties. The Court considered the statement of Street CJ in *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, approved by Dillon LJ in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 that:

"In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise...But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets."

Section 172 of the Companies Act 2006, imposes on a director of a company a duty to "act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole", subject however "to any enactment or

rule of law requiring directors, in certain circumstances, to consider or act in the interests of the creditors of the company” (s. 172(3) Companies Act 2006).

The Court held that where creditors’ interests are relevant, it is a director’s duty to have regard to the interests of the creditors as a class. Acting to advance the interests of a particular creditor, without believing the action to be in the interests of creditors as a class, would constitute a breach of duty.

In this case, the Court found that at the date of the sale of stock to Brocade in December 2008/January 2009, GHLM was insolvent (or at least of doubtful solvency or on the verge of insolvency). The Court further found that Mr and Mrs Maroo had acted in breach of their duties as directors of GHLM by causing GHLM to enter into a contract for the sale of stock with a view to advancing their own interests and those of Brocade, rather than those of GHLM, its owner and its creditors (as a class). Furthermore, the counterparty, Brocade, had knowledge of the directors’ breach since Mr and Mrs Maroo were also directors of that company. Consequently, the Court held that the contract for the sale of stock between GHLM and Brocade was void.

GHLM Trading Limited v Maroo and others is a useful reminder of the duties of directors, and the remedies available where such duties are breached.

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This note does not constitute legal advice but is intended as general guidance only. It is based on the law in force in May 2012. If you would like further information please contact Marie-Louise King at m.king@druces.com or on 020 7216 5562.