HOW TO STOP AN EX-DIRECTOR FROM COMPETING WITH YOU

“…the default position is that an executive director or a senior employee may not carry on business activities which fall within the scope of his company’s business during the time when he serves as director or works as employee. The default position however changes on resignation.” (Extract from judgment below)

What happens if relations between you and your fellow company directors sour to the extent that a director leaves? Can he or she immediately open up a new business in direct competition to you?

A recent High Court decision both addresses that knotty question, and highlights a quick and easy solution.

Fishing for business: “Big Catch” claims R24m

* Big Catch Fishing Tackle (Pty) Ltd markets and hosts fishing and fly fishing tours in both local and international waters.

* The company’s two directors and shareholders fell out, culminating in one director accusing the other of serious breaches of his duties as director.

* Although hotly disputing any wrongdoing he resigned his directorship (under, he says, duress and coercion). He remains a shareholder.

* Big Catch is now suing the ex-director for some R24m in “past” and “future” damages, relying on disputed claims of improper or unlawful conduct which include the channeling away of business from Big Catch, misappropriating stock, diverting payment of commissions and acting recklessly and without authority. Whether or not these allegations will be proved eventually will only be determined when the main case finally goes to trial.

* What is of interest to us at this stage is Big Catch’s interim application to the High Court to interdict the ex-director and his new business (Upstream Fly Fishing) from competing with Big Catch.

Ex-director off the hook

* Directors have a range of fiduciary duties towards their companies. They must at all times act in good faith and in the best interests of the company. They must avoid conflicts of interest. They cannot compete with the company nor make secret profits. “The default position”, as the Court in this case put it, “is that an executive director or a senior employee may not carry on business activities which fall within the scope of his company’s business during the time when he serves as director or works as employee.”

* Big Catch had to convince the Court that those duties survive resignation unchanged. But, held the Court, that “default position” changes on resignation and “the director or employee does not commit a breach of his fiduciary duty merely because he takes steps to ensure that, on ceasing to be a director or employee, he can continue to make a living even by setting up a business in competition with his former company or by joining a competitor and then pursuing opportunities similar in nature to those targeted by his former company.”

* Although a director’s fiduciary duty does indeed survive departure, “the content of that duty does not remain the same … The duty will only be breached after resignation if it involves the use of confidential information or violates an interest of the company that is worthy of protection in some other way” (emphasis supplied).

* In other words, a company cannot simply say “our ex-director is breaching an ongoing fiduciary duty towards us”, it must go further and actively prove a right to protection. Big Catch in this case being unable to make out its case, the Court dismissed the application with costs and the ex-director is off the hook, at least for now.

Big Catch’s big mistake – no restraints of trade

Round 1 therefore to the ex-director; a victory made easier by Big Catch’s failure to put restraints of trade in place for all its directors and senior employees.

As the Court put it “…in the absence of a restraint of trade, the onus shifts to the director’s former company to justify the interdict both in law and in fact” and “…a company that wishes to prevent a director or employee from competing with it after resignation should either do so by way of imposing a reasonable restraint of trade or it will have to persuade a Court that it has an interest worthy of protection, such as confidential information, client lists or connections, that justifies an interdict.”

Bottom line – make protecting your company easy with restraints of trade!