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UPDATE

Director's Wilful Neglect or Default and Vicarious Liability

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In *Goodman v DMS Governance Ltd*[1] the Cayman Islands Court of Appeal recently considered the distinction between mere negligence and wilful neglect or default arising from a director's breach of duty. The Court of Appeal also considered whether an employer is liable for the actions of an employee who has been appointed as a director of another company and acts in breach of duty as a director.

Facts

At the relevant time, Ms. Cummings was employed by DMS Governance Ltd (**DMS**) and was appointed as a director of Tangerine Investment Management Limited (**Tangerine**). Tangerine acted as investment manager for two funds which collapsed as a result of a significant fraud by the owner and controller of Tangerine

Mr. Goodman acquired from Tangerine the right to bring certain claims, including breach of common law and fiduciary duties claims, against Ms. Cummings and a claim against DMS that it was vicariously liable for the acts of Ms. Cummings as a director of Tangerine. Mr. Goodman brought proceedings in the Grand Court, alleging that investors had lost money because of the acts and omissions of Ms. Cummings.

Ms. Cummings denied that her conduct caused any loss or damage and also contended that she was able to rely on various indemnity provisions in Tangerine's articles of association. Following a trial on preliminary issues[2], the Grand Court determined that Ms. Cummings was entitled to rely on the articles of association, in which, absent her wilful neglect or default, Tangerine was obliged to indemnify her in respect of any liability or loss incurred in the conduct of her duties as director and waived any claim or right against her (as to which see our previous update linked here).

Following the Grand Court's ruling, Mr. Goodman discontinued proceedings against Ms. Cummings but continued his actions against DMS on the basis that DMS was vicariously liable for the acts of Ms. Cummings which were carried out in the course of her employment with DMS, or in the course of a relationship akin to employment where it had assumed responsibility such as to give rise to a duty of care.

In a further hearing, the Grand Court acceded to an application by DMS and struck out the claims issued by Mr. Goodman[3]. The court held that DMS could not be vicariously liable where Ms. Cummings was not herself liable owing to the indemnity. The court also found that the pleadings did not establish wilful neglect or default on the part of Ms. Cummings, or alternatively that DMS would not in any event be vicariously liable, since Ms. Cummings was acting in her capacity as a director for Tangerine, rather than an employee of DMS.

[1] Unreported, 30 April 2020.

[2] Unreported, 13 September 2018.

[3] Unreported, 2 July 2019.

Issues on appeal

The principle issues on appeal were as follows:

1 In the absence of wilful neglect or default by Ms. Cummings could DMS be vicariously liable for the actions of Ms. Cummings, notwithstanding the indemnity?

In the appeal it was argued by DMS that vicarious liability was a secondary liability and could only be established against the employer if the employee was liable. Since, by virtue of the indemnity, Ms. Cummings was not liable, her employer could not be held liable. However, it was argued by Mr. Goodman that the terms of the indemnity and waiver of liability were such that they did not absolve Ms. Cummings from liability at all, but that, on the contrary, the terms indemnified her in respect of liability or waived liability once it had been established. Ms Cummings, they argued, was therefore liable albeit that Tangerine was barred in terms of enforcement against her. Since primary liability was established, DMS would remain vicariously liable for her actions.

The indemnity included terms that, save in the case of wilful neglect or default, the director -

(i) '*be indemnified and held harmless out of the assets of the Company against all liabilities, loss, damage, cost or expense……incurred or suffered by him… in the conduct of the Company's business or in the discharge of his duties*'; and

(ii) '*Each Member and the Company agree to waive any claim or right of action he or it may have whether individually or by or in the right of the Company, against any indemnified person…*'.

The court swiftly dealt with this issue, following the Judicial Committee of the Privy Council in *Viscount of the Royal Court v Shelton*[4], a decision which was based on similar provisions in company articles of association. It confirmed that a director is *prima facie* liable to the company but is entitled to indemnity against such liability and in those circumstances there is no cause of action against a director. Accordingly there can be no secondary liability for the employer, unless the director is found liable for actions not covered by the indemnity.

2 Did the alleged breaches of her duties as a director amount to wilful neglect or default?

The issue at hand was whether Mr. Goodman had sufficiently pleaded the case in alleging wilful neglect or default by the director. The Grand Court had struck out the relevant allegations on the basis that Mr. Goodman had failed to sufficiently plead wilful neglect or default, and such allegations amounted to more than a claim for negligence. On appeal, it was argued by Mr. Goodman that the allegations were sufficiently pleaded. The court was therefore required to consider the distinction between negligence and wilful neglect or default for a director's breach of duty.

The court confirmed the established position that a negligent breach of duty does not amount to wilful negligence unless the director knows he is committing and intends to commit a breach of duty, or is recklessly careless as to whether his act or omission is or is not a breach of duty.

As to establishing whether a director is 'recklessly careless' in that regard, the court affirmed the comments made by Chadwick P in *Peterson and Ekstrom v Weavering Macro Fixed Income Fund Ltd (In Liquidation)*[5] that:

'it is necessary to satisfy the court that the director appreciated (at the very least) that his or her conduct might be a breach of duty and made a conscious decision that, nevertheless, he or she would do (or omit to do) the act complained of without regard to the consequences; and that if the evidence does not establish that the defendant at least suspected that his neglect or default might constitute a breach of duty, it is not appropriate to characterize his breach of duty as 'wilful neglect or default''

The allegations of wilful neglect or default related to a pleaded course of conduct in which there was a repeated lack of the requisite due diligence by the director in respect of numerous loan transactions. On this point the court overturned the Grand Court decision and found that allegations that Ms. Cummings appreciated that her conduct might be a breach of duty but made a conscious decision to proceed were

[4] [1986] 1 WLR 985.

[5] [2015] (1) CILR 45.

adequately pleaded. Moreover, the court held that while a few failures in duty might be regarded as no more than negligence, however woeful and inadequate, but where, as was alleged, nothing whatsoever is done despite the relevant rules of investment, over and over again, it would be open to the court to take the view that the conduct was conscious and deliberate.

In explaining this view the court drew a comparison to a motorist, stating that it becomes difficult to the point of impossibility to believe that a driver who on one journey shoots every one of ten red lights has merely allowed his mind to wonder. Such a repeated course of conduct smacks of a deliberate intention to take no notice of the warning signs.

3 Was DMS vicariously liable for the wilful neglect or default of Ms. Cummings in breaching her duties as a director of Tangerine?

It was argued in the appeal that there was such a high level of control and supervision provided by DMS to Ms. Cummings, that in effect she was carrying out her duties as director of Tangerine 'as a direct activity of' her employer.

Examples of this control and supervision were cited by Mr. Goodman, including:

(i) marketing documents which indicated that the directors appointed to a fund will be supported by an associate director and associate to assist in discharging her governance duties and responsibilities to the fund, though a tri-level review system;

(ii) an employment contract with Ms. Cummings (albeit not with DMS directly but a related company) which stipulated, that directorships are held in her capacity as an employee of the employer, not in her own right; that the employee is required to resign any directorships if asked to do so by her employer; and the employee may not resign any directorships without prior written consent of her employer; and

(iii) Tangerine's Offering Memorandum which described Ms. Cummings's role as being supported by a team of qualified and experienced associate directors and associates using proprietary market leading technology to assist her in discharging her duties and responsibilities to Tangerine.

However the court was not persuaded that DMS were liable. The court confirmed that the general principle established by the leading authority of *Kuwait Asia Bank E.C v National Mutual Nominees Ltd*[6] and followed by *Paget-Brown & Co Ltd v Omni Securities Ltd*[7], was not affected by these factors. That principle being that whatever other duties Ms. Cummings had as an employee, her duties *as a director* were owed to Tangerine, the company on whose board she served. An employer was therefore not responsible to Tangerine for any breach of duty by her as director.

In particular, the court confirmed that:

(i) No duty arose because her employer remunerated her or could dismiss her. Even if it was in her employer's interests that she performed her duties to Tangerine, it did not give rise to liability on the part of her employer.

(ii) The support DMS suggested it would give to companies to whom it offered its administrative services did not alter the legal principle. In the absence of any interference in the performance of her duties by her employer, liability would not be established.

(iii) The principle was not affected by whether the allegation was one of wilful neglect as opposed to mere negligence. The identification of the entity to which those duties were owed cannot differ because those breaches turned out to be not merely negligent, but wilful.

The court confirmed that the fundamental principle is that duties owed by Ms. Cummings, whether wilfully breached or merely negligently, were owed in her capacity as a director of Tangerine, whatever the nature of her other employments.

The court also dismissed the suggestion that the principle was affected by the line of authority that extended vicarious liability in order to provide a remedy against those who were not employers (where in the course of a relationship akin to employment it had assumed responsibility such as to give rise to a duty

[6] [1991] 1 AC 187 (PC).

[7] [1991] CILR 184.

of care). The court determined that if the employer cannot be liable, then vicarious liability could not extend to those who may be considered in an analogous situation.

Conclusion

The Court of Appeal judgment therefore provides confirmation on the limits of vicarious liability for an employer, particularly in the context of businesses which provide independent directorships. The Court of Appeal was ultimately unwilling to accept arguments that would have extended the circumstances in which an employer can be held responsible for the acts of an employee acting as a director. In the absence of interference with their duties, businesses which provide independent directorships therefore continue to be protected against liability for defaults by their employees acting in their capacities as directors on the boards of other companies.

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