

ENGLAND AND WALES / JUDGMENT

Smithton Ltd v Naggar

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Neutral Citation Number: [2014] EWCA Civ 939 IN THE COURT OF APPEAL (CIVIL DIVISION) ON APPEAL FROM HIGH COURT OF JUSTICE Mrs Justice Rose

[2013] EWHC 1961 (Ch) Case No: A3/2013/2488 Royal Courts of Justice Strand, London, WC2A 2LL
Date: Thursday 10 th July 2014 Before: Lady Justice Arden Lord Justice Elias and Lord Justice Tomlinson

- ----- Between: Smithton Limited

- and - Guy Naggar -and-

(1) Barry Townsley

(2) Colin Thomas

(3) Jason Berry

- ----- (Transcript of the Handed Down Judgment of WordWave International Limited A Merrill Communications Company 165 Fleet Street, London EC4A 2DY Tel No: 020 7404 1400, Fax No: 020 7831 8838 Official Shorthand Writers to the Court)

- ----- Appellant Respondent Third Party Fourth Party Fifth Party Mr Philip Marshall QC and Ms Mary Stokes (instructed by Dechert LLP) for the Appellant and the Third, Fourth and Fifth Parties Mr Michael Crystal QC, Mr David Alexander QC, Mr Tom Smith and Professor Dan Prentice (instructed by Isadore Goldman Solicitors) for the Respondent Hearing dates: 11-12 March 2014

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Judgment

Lady Justice Arden : Issues on this appeal 1. The appellant (“Hobart”) has brought proceedings against Mr Guy Naggar, a director of its former holding company (Dawnay Day International Ltd or “DDI”), to recoup losses which it incurred (on its case) in consequence of transactions with clients introduced to it through Mr Naggar. It seeks to recoup its losses by seeking damages on the basis that, while Mr Naggar was not one of the duly appointed directors of Hobart, he was a de facto or shadow director of it or alternatively on the basis that he was a director of DDI and the arrangements in question infringed section 190 of the Companies Act 2006 (“CA 2006”), (providing for the avoidance of substantial property transactions) giving rise to a statutory

liability on his part to indemnify Hobart. The claims are for some £4m. By her order dated 11 July 2013, Rose J rejected both claims: she held that (1) Mr Naggar was not a de facto and shadow director and (2) the transactions did not fall within section 190. Hobart now appeals on these issues. 2. In my judgment, for the reasons set out in detail below, this appeal should be dismissed: i) ii) There is no basis for setting aside the judge's conclusion that Mr Naggar had been involved with Hobart's affairs but this was in his capacity as a director of DDI or some other capacity than that of director of Hobart; Section 190 did not apply to the relevant arrangements whereby Hobart acquired shares in connection with transactions with persons connected with Mr Naggar. 3. I analyse the de facto/shadow director issue and the section 190 issues separately below. The former turns on how Hobart was run and the second on the nature of the arrangements in question. So I next set out the material facts about Hobart's governance structure and business. HOBART'S GOVERNANCE STRUCTURE AND BUSINESS Governance structure 4. 5. 6. Hobart was a joint venture company and was therefore subject to strong shareholder control. Prior to incorporation it was run as a division of Dawnay Day Brokers Limited ("DD Brokers") a subsidiary of DDI. The two main businesses of the DDI group were financial services and property investment. Mr Naggar was responsible for financial services, and a Mr Peter Klimt was responsible for the property investment business. The net assets of DDI were over £1bn. Mr Naggar was appointed a director of DDI and other group companies, including (from 2004 to 1 October 2007) Dawnay Day Brokers Limited ("DD Brokers"). On 1 October 2007 Hobart was incorporated as a separate company, Dawnay Day Capital Markets Ltd ("DDCM"), and carried on business as a subsidiary of DDI. 7. 8. 9. 10. 11. 12. The interests and responsibilities of those involved in Hobart were set out in a joint venture agreement dated 12 September 2007 ("the JVA"). Under that agreement, DDI held just over 50% of the voting rights. The rest was held by the management of DDCM, principally Mr Townsley. Under the JVA the directors of Hobart were to be Mr Townsley, Mr Warnford-Davis, Mr Thomas, Mr Berry and Mr Kelly. There were also three appointees of DDI: Mr Pincus, Mr Keane and Mr Morley ("the DDI-nominated directors"). I will call the directors named in the JVA "the agreed directors". The JVA did not provide for Mr Naggar to be a director of Hobart. Under clause 4 of the JVA the shareholders agreed to act reasonably and in good faith towards one another to use their reasonable endeavours to promote the DDCM business generally. Dawnay Day group agreed to provide various services to Hobart, including secretarial services, human resources, administrative services, accounting services and office space (clause 15). Under the JVA, Hobart undertook continuing obligations contained in schedule 1, including providing shareholders with detailed financial information such as monthly management and progress reports, monthly management accounts, returns to regulators and "such further information as was reasonably required by any shareholder as to all matters relating to the business or affairs of the company". In addition, the management of Hobart agreed that certain matters, known as reserved matters, would not be done without the consent of the majority shareholder, DDI. The reserved matters were set out in schedule 2 to the JVA. The principal reserved matter was any change in the nature of Hobart's business, which was to consist exclusively of the previous business of the division of DDCM, being "the provision of full range brokering services to investors, including... the creation of long and short contracts for difference...". That business had to be carried out in accordance with the agreed business plan.

The appointment and removal of directors was a reserved matter, as was the incurring of any capital expenditure over £20,000. It appears, however, that nothing much of significance was discussed or decided at board meetings. Important decisions were in fact taken by Mr Townsley and Mr Naggar acting effectively as partners in the business outside of formal board meetings. Hobart applied for its own Stock Exchange and regulatory permissions and did not seek permission for Mr Naggar. Mr Naggar never attended board meetings or meetings of its principal board committee, Exco. Mr Naggar never held himself out as a director of Hobart and no-one ever held him out as a director. He was a busy individual. When Mr Klimt's son had an accident he had to take over the property side of DDI as well. In addition, Mr Naggar did not get closely involved in management. The judge called him a "deal" person. Hobart's business of writing CFDs

13. In February 2007 Mr Naggar concluded that shares in Foreign & Colonial Asset Management Limited ('F&C') were undervalued. Hobart began writing "contracts for differences" ("CFDs") for F&C shares on behalf of its clients, many of whom were connected to Mr Naggar. I refer to them below as "connected persons". 14. Under a CFD, the provider agrees to pay a sum equal to the increase in value at the date the contract is "closed out". The investor correspondingly agrees to pay a sum equal to the fall in value in the shares at the date the contract is "closed out". He also agrees to accept the continuing obligation to meet demands ("calls") to provide margin to secure his obligations. So, if the value of the shares changes and in particular if it falls, he is obligated to provide more margin. In the case of the CFDs written by Hobart with its clients, including connected persons of Mr Naggar, there was no fixed date for closing out. CFDs may be contrasted with options to buy or sell shares whereby the investor agrees to buy or sell shares in question. However, the judge found that the client could when closing out decide whether to acquire the shares that were referenced by the provider. In this case, Hobart as did other providers hedged its position by taking out a contract with another provider referencing the same number and volume of shares as it wrote for its own client. In those circumstances, if on closing out the client wished to acquire the shares in question, Hobart would have sold those shares to the holder. The process of taking shares is called "taking the shares physical". Hobart ceases to be part of DDI group

15. In April to June 2008 DDI began to suffer cash-flow problems and in July 2008 it collapsed. Hobart carried on business as a subsidiary of DDI for about ten months ("the Period") before DDI collapsed in July 2008. Hobart is now called Smithton Limited. DE FACTO/SHADOW DIRECTOR

16. 17. The question who is a director of a company is important because of the substantial duties which a director has. It is usually easy to tell if a person is a director if he has been duly appointed as such by the company (and is then a de jure director or "director in law"), but much less easy if he has not been even purportedly appointed as a director but has simply acted as a director on occasions (when he might be a de facto director or director "in fact") or if he has persuaded the directors to act in a particular way (when he might be a "shadow" director). A question which often arises in practice is whether a director of the holding company of a group of companies has become a director of its subsidiary. As explained below, the expressions de facto director and shadow director have been defined by statute and considered by the courts in recent case law. Directors must declare conflicts with their interest in accordance with section 177 of the Companies Act 2006 ("CA06"). That duty is buttressed by section 190 of the CA 06, which renders voidable arrangements under which a director of a company or its holding

company or persons connected with him are to acquire assets from the company. Section 190 gives rise to subsidiary issues on this appeal. It is common ground that some of Hobart's clients were connected persons of Mr Naggar (as defined in section 190). Hobart claims that the hedging transactions, which it entered into when it entered "contracts for differences" (explained below) with those clients, fell within section 190. The judge also rejected this argument and held that the arrangements in question did not breach section 190. Statutory definitions of de facto and shadow director 18. The statutory definitions of de facto director and shadow director appear in sections 250 and 251 of the CA 06 respectively: "250 "Director" In the Companies Acts "director" includes any person occupying the position of director, by whatever name called. 251 "Shadow director"

- (1) In the Companies Acts "shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.
- (2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity..." 19. Section 251(3) contains an exception which prevents holding companies from becoming shadow directors of their subsidiaries: "(3) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of— Chapter 2 (general duties of directors), Chapter 4 (transactions requiring members' approval), or Chapter 6 (contract with sole member who is also a director), by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions." Case law on whether a person is a de facto and shadow director 20. 21. The leading case is HMRC v Holland [2010] 1 WLR 2793 and it is not now necessary to consider many cases in addition to this. In the Holland case, the Supreme Court (by a majority) decided that Mr Holland, a director of a corporate director, which was the sole director of some 43 trading companies, was nonetheless not a de facto director of those other companies. He had acted only in his capacity as a director of the corporate director. The corporate director acted as a director in employing employees (whose services were contracted out), arranging for the payment to them of a salary and in their capacity as shareholders distributions and other administrative services. Lord Hope's analysis treats the separate legal personality of the corporate director as the key consideration. Accordingly he held that the question whether the director was a de facto director of the other company had to be approached on the basis that the companies were separate legal persons. Lord Hope held that there was no definitive test to determine who was a de facto director. He held that all the facts had to be considered and in addition the purpose of the statutory provision there in question, section 212. 22. Lord Hope held: "So long as the relevant acts are done by the individual entirely within the ambit of the discharge of his duties and responsibilities as a director of the corporate director, it is to that capacity that his acts must be attributed." (judgment, [42]) (emphasis added) 23. 24. On the facts the director had done no more than discharge his duties as a director of the corporate director. As they had been done "within the ambit" of the discharge of those duties, his acts were required to be attributed to that capacity without any further inquiry as to whether

they also fell “within the ambit” of what a director of the composite companies would have done. Lord Collins came to the same conclusion by different reasoning. He held that the original basis of liability as a de facto director was that a person had been appointed a director by an invalid process and acted as such. On that footing, the original basis of liability was thus the assumption of responsibility as a director. Where a person had never been even invalidly appointed a director, it was necessary to examine the governance system of the company in order to assess whether he acted as a director (judgment, [93]). Otherwise the breadth of liability would go beyond that which a court could impose by development of the concept of de facto director. Thus, at [96] Lord Collins held: “[96] There is no material to suggest that Mr Holland was doing anything other than discharging his duties as the director of the corporate director of the composite companies. It does not follow from the fact that he was taking all the relevant decisions that he was part of the corporate governance of the composite companies or that he assumed fiduciary duties in respect of them. If he was a de facto director of the composite companies simply because he was the guiding mind behind their sole corporate director, then that would be so in the case of every company with a sole corporate director. The development of the law of de facto directors from *Re Lo-Line Electric Motors Ltd* and *Re Hydrodam (Corby) Ltd* onwards was a significant judicial innovation given that for some 150 years de facto directors meant individuals who had actually been appointed, or purportedly appointed, as directors. As has been seen, in two of the three older cases which dealt with the liability of de facto directors, an analogy was drawn with executors de son tort: *Gibson v Barton* (1875) LR 10 QB 329 and *Re Canadian Land Reclaiming and Colonizing Co, Coventry and Dixon's Case* (1880) 14 Ch D 660. That suggests strongly that the basis of liability was the assumption of responsibility. The legislature has already intervened in the 2006 Act to ensure that there is a natural person to whom responsibility is attributed. The purpose of what became s 155(1) of the 2006 Act, was to ensure that every company would have at least one individual who could, if necessary, be held to account for the company's actions: Department of Trade and Industry, *Company Law Reform* (Cm 6456, 2005), para 3.3. For the court to hold that every significant decision of individual directors of a corporate director is to be regarded as being taken as if they were directors of the company of which it is the corporate director goes considerably beyond the law as it has been developed at first instance and by the Court of Appeal in the modern de facto director cases, and beyond what I would regard as the function of the court. I would not wish to question the modern judicial development of the de facto director concept, and I well understand the policy reasons why in such a case as this a person in the position of Mr Holland should be liable, although those reasons may not be as powerful as they were prior to the enactment of s 155(1) of the 2006 Act. The legislature could have intervened to require that all directors be natural persons, as under s 201B of the Corporations Act 2001 (Australia), s 105(1)(c) of the Canada Business Corporations Act 1985, s 701 of the New York Business Corporation Law, and s 141(b) of the Delaware General Corporate Law. But it did not, and in my judgment the proposed extension which is inherent in HMRC's case is a matter for the legislature and not for this court.” 25. 26. 27. The penultimate sentence may be a case of “be careful what you wish for lest it become true”. Lord Collins refers to the fact

that Parliament had not legislated to prohibit corporate directors but there is now a bill before Parliament which contains a clause which (if it becomes law) would have the effect of preventing the appointment of corporate directors (Small Business, Enterprise and Employment Bill 2014, clause 76). Lord Saville agreed with both judgments. Lord Walker dissented on the basis that Mr Holland acted both as a de jure director of the corporate director and as de facto director of the trading companies. Lord Clarke agreed with the analysis of the law by Lord Collins but came to the same conclusion on the facts as Lord Walker. In those circumstances, the judgment of Lord Collins contains the ratio of the decision. It is notable that the majority placed no weight on the fact that Mr Holland was involved in all the directorial decisions made on behalf of the composite companies, so that the volume of decisions in which a person is said to have made as a de facto director will not have significance if those decisions were made in some other capacity. In Holland, the issue was therefore whether Mr Holland had acted as a director of the “composite companies” or as a director of the corporate director. In other cases, the director has no alternative capacity and must have acted either as an individual person or as a director. One such case is *Secretary of State v Jones* [1999] BCC 336, where Jonathan Parker J held that a management consultant was a de facto director of his client company. He had signed a letter to the client’s auditors to confirm their appointment on the headed notepaper of the client, describing himself as “joint managing director”. He had also become a signatory on the company’s bank account, dealt directly with the company’s creditors and agreed prices with supplier of the company. 28. But another issue that may arise is whether the acts relied on are actually the acts of a director at all. Holland did not address the question what actions make a person a 29. 30. 31. director, save insofar as the majority clearly make it clear that the court should ask whether the defendant formed part of the corporate governance structure of the company. However, that is merely to restate the question. The real issue in some contexts will be whether the acts demonstrate the assumption of acts as a director. That question was not explored in this case. There was simply no argument as to whether the acts on which Hobart relied lacked the quality of directorial acts. In Holland and Jones, the acts in question were plainly directorial in nature. In Holland, the corporate director was the sole director: there was no evidence of any other person taking management decisions on its behalf or on behalf of the composite companies. In this case, Hobart challenges the judge’s failure to make findings about its corporate governance structure. This case raises the fundamental point of why the court needs to undertake that exercise and (in consequence) what makes a person a director. The Companies Act definition does not elucidate that matter. Provisionally it seems to me that that term is to be tested against the usual split of powers between shareholders and directors under Table A i.e. on the basis that the powers of management of the company’s business are delegated to the directors and the shareholders cannot intervene except by special resolution. On that basis it means a person who either alone or with others has ultimate control of the management of any part of the company’s business. In the usual case, in my judgment, it would not include a purely negative role of giving or receiving permission for some business activity. 32. The role of a de facto or shadow director need not extend over the whole range of a company’s activities

(see *Re Mea Corporation Ltd* [2003] 1 BCLC 618; *Secretary of State v Deverell* [2001] Ch 340). A person may be both a shadow director and a de facto director at the same time (*Re Mea Corporation*). Practical points: what makes a person a de facto director? 33. 34. 35. 36. Lord Collins sensibly held that there was no one definitive test for a de facto director. The question is whether he was part of the corporate governance system of the company and whether he assumed the status and function of a director so as to make himself responsible as if he were a director. However, a number of points arise out of *Holland* and the previous cases which are of general practical importance in determining who is a de facto director. I note these points in the following paragraphs. The concepts of shadow director and de facto are different but there is some overlap. A person may be de facto director even if there was no invalid appointment. The question is whether he has assumed responsibility to act as a director. To answer that question, the court may have to determine in what capacity the director was acting (as in *Holland*). 37. 38. 39. 40. 41. The court will in general also have to determine the corporate governance structure of the company so as to decide in relation to the company's business whether the defendant's acts were directorial in nature. The court is required to look at what the director actually did and not any job title actually given to him. A defendant does not avoid liability if he shows that he in good faith thought he was not acting as a director. The question whether or not he acted as a director is to be determined objectively and irrespective of the defendant's motivation or belief. The court must look at the cumulative effect of the activities relied on. The court should look at all the circumstances "in the round" (per Jonathan Parker J in *Secretary of State v Jones*). It is also important to look at the acts in their context. A single act might lead to liability in an exceptional case. 42. Relevant factors include: i) whether the company considered him to be a director and held him out as such; ii) whether third parties considered that he was a director; 43. 44. 45. The fact that a person is consulted about directorial decisions or his approval does not in general make him a director because he is not making the decision. Acts outside the period when he is said to have been a de facto director may throw light on whether he was a de facto director in the relevant period. In my judgment, the question whether a director is a de facto or shadow director is a question of fact and degree. The principles of appellate review are well-established. I need only summarise those applicable here. Where the decision depends upon the judge's assessment of weight to be attached to various facts, the test to be satisfied on appeal is that in most cases the judge was plainly wrong. Where the appellant contends that the judge misdirected herself as to the law, the court must determine what the law is and whether the judge applied it. Judge's findings on the de facto/shadow director issue 46. As Mr Naggar held many directorships, the judge approached the question of de facto and shadow directorship as one of "hat" identification. In other words she approached the matter on the basis that he had a hat for each office he held and that the question to be decided was which hat he was wearing at any particular point in time. This meant looking at what he actually did. She gave less weight to incidents before the incorporation of Hobart. She accepted Mr Marshall's concession that Mr Naggar's actions before 31 October 2007 were not evidence to support him being a de facto director of Hobart after its incorporation but continued to influence how the business was run. She also

accepted his submission that it was important to examine the way the company was governed, citing my judgment in *Re Mumtaz Properties Ltd* in these terms: “[51] Subsequent to the *Holland* case was *In the Matter of Mumtaz Properties Ltd* [2011] EWCA Civ 610, [2012] 2 BCLC 109, [2011] NLJR 779. In that case Arden LJ (with whom Aikens and Patten LJ agreed) said that the first step in approaching the question of whether a person is a *de facto* director is to examine the governance structure of the company. That case concerned a family company which was “. . . run with a high degree of informality with decisions not necessarily being taken at board meetings but whenever relevant family members were in communication with each other.

- [52] Arden LJ held that the judge had been entitled to be satisfied looking at the evidence as a whole that the Respondent was part of the corporate governance structure of the company. In her words he was “one of the nerve centres from which the activities of the Company radiated” (see para 47 of her judgment).” 47. The judge found as a fact that in the case of Hobart important issues were discussed and decided not at board meetings or at meetings of Exco but through a structure laid down in the JVA (judgment, [70]). She held that, although the parties may not have referred to the JVA when things were going well, it had an important effect on management’s participation in the business. The judge considered that the JVA governed the relationships between the parties. It showed that the parties expressly agreed that Mr Naggar should not be appointed a director of Hobart. Moreover, Hobart required authorisation from the Financial Services Authority (“the FSA”) in order to carry on its business and it never reported to it that Mr Naggar was one of its directors. She attached importance to that point and did not think that it could be brushed aside. The judge rejected the suggestion that allegations made by Hobart in proceedings against MF Global (a CFD provider) helped her understand Mr Naggar’s role in Hobart’s business. No party has appealed against her conclusions on that point. 48. The judge identified four main elements in Hobart’s case on this issue: A. The DDI-nominated directors of Hobart simply acted as nominees of Mr Naggar. B. Mr Naggar exerted control over the day-to-day business of Hobart. C. Mr Naggar, rather than the board of Hobart, would make decisions on important aspects of Hobart’s business. D. Hobart entered into CFDs with connected persons of Mr Naggar upon Mr Naggar’s instructions. 49. The judge observed that these were very general allegations, and she approached the case by reference to the particular instances of acts relied on by Hobart in a document called the Factors Document at the start of the trial. A. Conduct of DDI-nominated directors 50. 51. 52. 53. 54. Since major decisions were not made at board meetings, Hobart relied on the particular instances as showing that Mr Pincus and Mr Keane (two of the DDI- nominated directors) referred back to Mr Naggar and implemented his instructions. For instance, they referred for his approval a contract to acquire an electronic trading platform (the Fidessa contract). She thought this was natural for them to consult him since they wanted group support for the decision. It was not, therefore, an instance of Mr Naggar giving instructions to Hobart directors. The same pattern was repeated with the appointment of senior employees and other matters. The judge concluded that there was no evidence to support the contention that the DDI-

nominated directors acted in accordance with Mr Naggar's instructions (judgment, [103]). B. Mr Naggar exerted control over the management of the day-to-day business of Hobart. Hobart contended that Mr Naggar exerted control over the management of the day-to-day business of Hobart by reference to Open Position Reports ("OPRs"), the weekly figures and Mr Naggar's instructions to employees. Hobart produced the OPRs daily. OPRs listed every client of Hobart and set out information about their CFDs with Hobart including confidential information as to the margin which they were due to pay. Mr Naggar was keen to see the OPRs. Hobart contended that the fact that Mr Naggar was shown these reports, including confidential information, was an indication that Hobart's directors regarded him as a director, rather than client. Mr Naggar insisted on being told the margin rates being obtained by Hobart from its providers. The judge accepted that a mere client could not normally have access to this information. However, she held that Mr Naggar had an interest in making sure that money was moved around group companies in a reasonable way. Furthermore she held that the OPRs were important to Mr Naggar to enable him to keep an eye on the exposure of DDI group to the risks of Hobart's business. An exchange of emails showed that Mr Naggar's interest in the payment of margin was driven by his interest on behalf of DDI. Hobart also relied on comments which Mr Naggar made when reading the OPRs. There were written comments on about 8% of the OPRs in evidence, but the judge accepted that he made comments in other ways. The comments in evidence were analysed during the trial. The judge concluded that neither the provision of OPRs to Mr Naggar nor his comments on them indicated that he was a de facto director. She did not deal with all of the documents individually but held that in two specified cases Mr Naggar's comments were justified by his concern as chairman of DDI in the financial position of the group. The weekly figures showed the turnover of Hobart. The judge considered that the comments were anodyne and they were in the event made before the incorporation of Hobart. As to instructions to Hobart employees, there were nine kinds of instruction which the judge examined in detail. The judge stated that she had considered each instruction carefully and had concluded that all of Mr Naggar's interventions were "readily explicable either on the basis of his role as a client or as chairman of DDI or because they were one-off incidents arising from a particular situation." (judgment, [121]). Whether considered individually or taken as a whole, they did not, in the judge's judgment, show that Mr Naggar was a de facto director. C. Mr Naggar and not the board made decisions about important aspects of Hobart's business 55. 56. 57. Hobart relied on some eleven kinds of conduct in support of its allegation as showing that Mr Naggar, and not the Hobart board, made decisions. The judge came to a global decision on these instances: she did not deal with them individually. She concluded that, in all the instances, Mr Naggar was acting in another capacity, or again, that they were particular one-off situations "in which his involvement was unremarkable" (judgment, [123]). C. Mr Naggar's instructions causing Hobart to enter into CFDs with his connected persons. Again the judge concluded that Mr Naggar could only give these instructions as representative of the connected persons and not in his capacity as a director of Hobart. The judge therefore concluded that the evidence fell far short of showing that Mr Naggar was involved in the management of Hobart after 1 October 2007 to any

significant extent. Likewise she rejected the allegation that he was a shadow director, there being no evidence that the majority of the board were accustomed to act in accordance with his instructions. ISSUE 1: SHOULD THIS COURT SET ASIDE THE JUDGE'S FINDING THAT MR NAGGAR WAS NEITHER A DE FACTO NOR SHADOW DIRECTOR OF HOBART?

58. Mr Philip Marshall QC appears, with Ms Mary Stokes for Hobart. The respondents were represented by Mr Michael Crystal QC, Mr David Alexander QC, Mr Tom Smith and Professor Dan Prentice. Mr Alexander led for Mr Naggar on this issue. Mr Marshall's submissions fall into five parts. Mr Alexander's submissions were mainly directed to the second of these five parts. First submission: failure to analyse corporate governance structure of Hobart
59. Mr Marshall's first submission is that the judge failed to make findings about the corporate governance structure of Hobart and to take it into account. She was right to say that the Hobart board did not make the important decisions. As in Mumtaz, Hobart's business had been run informally and major corporate decisions had been taken by Mr Naggar and Mr Townsley, who had operated like partners in Hobart's business. There was only one board minute. There was not even a board meeting to deal with the interim dividend. There were meetings of a board committee called Exco. That was set up before Hobart was incorporated and while it was still a division of DD Brokers. But, submits Mr Marshall, that committee did not deal with any important matters.
60. Mr Marshall submits that the de jure directors of Hobart did not make any significant decision, whether as to IT, investment, staffing, premises or otherwise, without Mr Naggar's agreement. Mr Naggar received regular information and gave regular instruction concerning the day to day operation of Hobart's business. Mr Naggar for instance exercised considerable control over the hiring and firing of staff. 61. 62. In my judgment, Mr Marshall is correct to say that the judge focused on "hat identification" rather than on ascertaining the corporate governance system of Hobart. He is also correct in his submission that determining whether Mr Naggar was part of the corporate governance system was an important step in deciding whether he had assumed the responsibility of a director. The corporate governance system will vary from company to company. Therefore in the normal course, it is vital that the trial judge makes findings about the role which the defendant played in running the company in question. However, in this case, Mr Naggar did not at trial dispute that he performed directorial acts. He sought to run his defence on the basis of "hat identification" i.e. that he had multiple roles and that he had acted in a different capacity at all times from that of a Hobart director. In those circumstances, there is no material error of law on the judge's part in not seeking to meet a defence which was not run. Second submission: "hat identification"
63. Mr Marshall's second submission is that the judge was wrong in her approach to "hat identification". He submits that the judge proceeded on the basis that, if a person could possibly have acted wearing some other hat than that of director, his acts should be attributed to the role represented by that hat. This, he submits, was an error of principle. Mr

Marshall submits that the weight which the judge gave to the position as a representative investor meant that the act could not also make him liable as de facto director. The correct approach would have been to determine in what capacity any act was actually done. 64. The judge's conclusion was not in terms that at the material times Mr Naggar acted as chairman of DDI or as an investor but rather that nothing which the judge had seen: "goes beyond the involvement one would expect to see from a person who combined the roles of major client and chairman of the majority shareholder." (judgment, [125])

65. Mr Marshall interprets this as a holding that all the acts were ones to be expected of a client and chairman of the major shareholder and that they were to be attributed to that capacity without considering whether they were actually done in that capacity. While I accept that those words read on their own can be interpreted in this way, in my judgment they have to be read in the context of the judgment as a whole. In particular the judge took the view that in the light of the JVA and the need for directors of Hobart to be authorised by the FSA it was unlikely that Hobart would have permitted Mr Naggar to act as a de facto director (judgment, [73]). In other words, the passage on which Mr Marshall relies is to be read as saying that she had considered Mr Naggar's involvement objectively against the conduct to be expected of a major client and chairman of the majority shareholder, that his involvement was consistent with that conduct and that he had in fact acted in that capacity. So read, her conclusion is in my judgment unassailable. 66. The assessment of the capacity in which a person acts is one of fact and degree and all the circumstances must be taken into account. Mr Marshall relies on this appeal on passages in his closing submissions in respect of a considerable number of specific categories of acts or specific episodes as showing that the judge came to the wrong conclusion. He does not contend that the judge was not entitled to come to the conclusion to which she came, and so it is clear that the challenge is in reality a disagreement with the judge's findings. As such, it does not amount to a good ground of appeal.
67. Mr Marshall relies in particular on the inferences to be drawn from the evidence about the OPRs. I take Mr Marshall's submissions on the OPRs separately under the next part of Mr Marshall's submissions.
68. Mr Marshall also submits that the incidents which the judge held were one-off incidents were not such. Furthermore the actions which Mr Naggar took were actions in a management role in respect of the company. The fact that he had other interests as a director of DDI or as a shareholder of DDI did not prevent those acts from making him a de facto director. The position remains, however, that the judge came to conclusions on these points which were open to her.
69. Mr Marshall additionally submits that DDI had no rights under the JVA or otherwise to information but it is clear from my summary of the JVA that schedule 1 gave a right to information in terms sufficiently wide to cover the OPRs.

70. Mr Marshall accepts that there must be a cogent reason to attribute an act to a person as a de facto director if there are other capacities in which he could lawfully have acted. However, he submits that this burden is discharged by showing that the defendant performed acts which a director of that company would normally do, as in Jones. The judge should therefore have looked at the nature of the acts relied on and asked whether they were acts which a director would normally do. I do not accept this submission as it seems to be the analogue of the argument which he contends the judge wrongly accepted, namely that, if an act might have been done in a particular capacity which would not result in his being a de facto director, it ought to be attributed to him in that capacity. This submission again is predicated on the basis that the test is one of possibility rather than one of assessing what actually happened.
71. The judge's answer to the point that it was enough that the act in question could have been done by a director was that the management of the business of Hobart was governed by the JVA. Mr Marshall submits that the judge failed to analyse the JVA in the context of the evidence. He contends that it was entirely ignored. Mr Marshall contends that Mr Naggar remained involved in the business even though he was not one of the directors named in the JVA. However, the judge did not so find. There is a difference between ignoring an agreement and not referring to it. We were not taken to any evidence to undermine the judge's finding that it had an important effect on the management of the business (judgment, [71]). Take for instance the apparently mundane subject of hiring and firing staff. This was a reserved matter if it would involve expenditure in excess of £20,000 which must have been the case for the appointment of at least most members of staff. Mr Marshall submits that this court should take account of matters and determine whether the judge correctly categorised the facts she found, but that is clearly not the function of this court on appeal: the appellant must demonstrate that there is an error.
72. Mr Alexander submits that the mere fact that an act is capable of being done by someone in their capacity as a de facto director does not establish that they were such. The burden was on Hobart to establish that he did indeed do that act in that capacity. The case did not therefore turn on making assumptions about the role in which activities were to be attributed.
73. Mr Alexander's submission was that it was a significant factor that Hobart applied for its own regulatory and stock exchange permissions and that it did not identify Mr Naggar as a director. Moreover Mr Naggar did not attend board meetings or meetings of the executive committee of the board known as Exco.
74. Mr Alexander went through the judge's findings on the various categories of acts on which Hobart relied for making him a de facto director.
75. 76. In my judgment, on the overarching question of capacity, there is a subtle difference of expression between Lord Hope and Lord Collins. As explained, in my judgment, Lord Collins' view is that of the majority. The court does not make an artificial attribution of a director's act to some particular role of his. It simply asks whether the claimant has discharged its burden of showing that he acted in some particular capacity. On that basis, the determination of capacity thus boils down to a

question of assessing the evidence. In making findings, the judge was entitled as a matter of common sense to take the view that, where there had been an agreement as to who would be on the board of Hobart, other parties to that agreement would not take on that role but would act within the roles to which they had been lawfully appointed. The JVA was not necessarily a complete answer. Mr Naggar could have acted as director despite the thrust of the JVA, but, in the absence of other factors, the likelihood is that he would not do so. 77. I conclude that the judge made no error of principle and that the appellant's challenge is really no more than a disagreement with the judge's findings of fact about the capacity in which Mr Naggar acted. She was entitled to make those findings. Third submission: OPRs 78. The OPRs were important documents so far as Hobart's business was concerned because they assisted in the management of the risk created by the CFD business. Mr Marshall submits that Mr Naggar was keen to receive these reports and from time to time he commented on them both in writing and orally. On Mr Marshall's submission, these comments amounted to Mr Naggar giving instructions about calling margin to the directors.

79. Mr Kelly gave evidence about Mr Naggar making comments on the weekly financial figures supplied by Hobart. However the judge found that those comments were entirely anodyne. All of Mr Naggar's conversations with employees of Hobart were explicable on the basis that he was giving instructions on behalf of his connected persons, i.e. as a client.
80. With regard to the OPRs, essentially Mr Marshall submits that in giving these reports to Mr Naggar Hobart breached its duty of confidence to its clients (because they included information as to the level of margins clients had given and any margin deficiency) and the regulatory rules applying to its business. The judge did not take this into account. Therefore the judge failed to consider all the relevant circumstances. The fact that Mr Naggar had access to this confidential information was a powerful indicator that Hobart regarded him as a director. 81. The judge rejected this argument. In my judgment, the judge was entitled to give the fact that the information was confidential little weight because it was not a point which received any contemporary attention. There is no evidence that the Hobart directors considered any question of breach of confidence or disposed of any concern on the basis that Mr Naggar was in the position of a director. The fact was that he received the OPRs. The fact that they contained information which should not have been disclosed does not mean that he was a de facto director or that he necessarily became one. The judge considered the evidence about his comments on them and was satisfied that he made comments because of his overall concern as the chairman of DDI for the group's financial position. Fourth submission: judge's fact-finding was vitiated by error
82. Mr Marshall informed us that the appellant's case does not extend to challenging the primary facts found by the judge but (as already indicated above) he makes a number of challenges to the judge's fact-finding.

83. Mr Marshall submits that there was no evidence that DDI made any request under the JVA for copies of the OPRs. There was also no evidence that DDI gave him authority to ask for the OPRs. I agree that this is one of the strands of relevant evidence in this case, but it is not a point which of itself can undermine the judge's conclusion.
84. Mr Marshall submits that there were a number of matters with which the judge simply did not deal, such as episodes when Mr Naggar gave instructions to Mr Fraser, one of Hobart's brokers, about trades in F&C shares. These instructions included directions to retain certain shares in the course of trading. Mr Marshall contends that only a director of Hobart could have given these instructions. These matters were extensively canvassed in written submissions yet the judge concluded that she had not seen anything that went beyond actions by Mr Naggar in some other capacity. She must therefore have rejected this evidence as showing action as a director of Hobart. We were not taken to any evidence showing that this conclusion was not open to her. Furthermore, it would be wrong to criticise the judge for not dealing separately with each and every incident.
85. Mr Marshall submits that the evidence of the executive directors was consistent. However, it was not confirmed by the non-executive directors and it was for the judge to decide whose evidence she preferred. Mr Alexander submits that none of the witnesses called by Hobart could say that any of them had been present when Mr Pincus or Mr Keane had ever reported anything to Mr Naggar or had sought his approval for anything or that they had ever received instructions from Mr Naggar. Mr Marshall did not correct him.
86. Mr Marshall criticises the judge's rejection of the evidence that Mr Naggar was the dominating force as impressionistic and difficult to refute. He submits that in *Re Mea Corporation* the court did not discount evidence simply because it was general in nature. Again, questions as to the weight to be given to such evidence were for the judge and the appellant has not demonstrated that the judge's decision to give this evidence no weight was not one which she could properly have made.
87. Mr Marshall criticises the judge's decision to give little weight to what happened before Hobart was incorporated. He submits that things did not change then: Mr Naggar continued to be the dominating force. In my judgment, but for the same reasons as I gave in relation to the judge's treatment of the general allegations, that ground of challenge must fail. Fifth: Judge's failure to find that Mr Naggar was a shadow director 88. I can take the question whether Mr Naggar was a shadow director shortly. Mr Marshall was content to rely on his written submissions. He submits that in any event Mr Naggar was a shadow director: the Hobart directors or at least a majority of them were accustomed to act in accordance with his instructions. The appellant relies on the same evidence as has been discussed above in relation to the judge's finding that Mr Naggar was not a de facto director.
89. Mr Alexander relies on the judge's judgment and contends that the shadow director case was hopeless. The DDI-nominated directors gave evidence on Hobart's behalf but they were in any event a minority on the board. There was no evidence that the majority acted in

accordance with Mr Naggar's instructions. Therefore Mr Naggar was not a shadow director. 90. If the judge was entitled to come to the conclusion that Mr Naggar was not a de facto director because he was protecting his or others' interests in some other capacity, she was similarly entitled to come to the conclusion that he was also not a shadow director. 91. In conclusion, for the reasons given above, I would dismiss the appeal on Issue 1. SECTION 190 ISSUE 92. The issue here is whether the judge was wrong to reject Hobart's argument that section 190 of the Companies Act 2006 was infringed when it entered into arrangements with Mr Naggar in connection with CFDs for clients who were Mr Naggar's connected persons for the purposes of that section. If this argument succeeds, those contacts were voidable and Mr Naggar is obliged to indemnify Hobart for its loss. If section 190 applies, it does so because Mr Naggar was a director of Hobart's holding company and not because Mr Naggar was a de facto or shadow director of Hobart. 93. As in force at the material time, section 190 provides: "190 Substantial property transactions: requirement of members' approval

- (1) A company may not enter into an arrangement under which– (a) (b) a director of the company or of its holding company, or a person connected with such a director, acquires or is to acquire from the company (directly or indirectly) a substantial non-cash asset, or the company acquires or is to acquire a substantial non-cash asset (directly or indirectly) from such a director or a person so connected, (2) unless the arrangement has been approved by a resolution of the members of the company or is conditional on such approval being obtained. For the meaning of "substantial non-cash asset" see section 191. If the director or connected person is a director of the company's holding company or a person connected with such a director, the arrangement must also have been approved by a resolution of the members of the holding company or be conditional on such approval being obtained." 94. 95. 96. The words in subsection (1) "or is conditional on such approval being obtained" did not appear in section 190 when originally enacted. That produced the inconvenient result that arrangements could not be made conditionally on shareholder approval subsequently being obtained. As Lewison J held in *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 Ch, [1392] with respect to the predecessor section (section 320 of the Companies Act 1985), the question whether an arrangement falls within the section must be asked on the basis of the arrangement as at its inception. It is not said that the CFDs were non-cash assets of the requisite value but that the shares by which they were referenced were "substantial non-cash assets" as those expressions are defined for the purposes of section 190: see CA 2006, sections 191(2) and 1163(1). Two bases for finding infringement of section 190 97. As before the judge, the claim against Mr Naggar under section 190 is put on two bases. For the purposes of this appeal, they are in essence: i) ii) The "narrow" basis: when Hobart acquired shares (on Mr Naggar's instructions) to be used in back-to-back transactions for CFDs, it did so prior to the purchaser being identified and therefore it itself acquired shares or an interest in shares. The "wide" basis: the arrangements between Mr Naggar and Hobart for writing CFDs for Mr Naggar's connected persons fell within section 190 because there was a real prospect that on closing out Mr Naggar's connected persons would acquire the referenced shares. Judge's conclusions on the section 190 issues Narrow basis

98. When Mr Naggar gave instructions for CFDs, he rang up Hobart and stated the volume of F&C shares that he wished to buy. He did not state whether the shares would be referenced by a CFD with Hobart or via CFD with another provider and he did not indicate who the counterparty would be. So, when Hobart went into the market to buy shares to be used to hedge the CFD, it was not known who would ultimately hold the shares.
99. Moreover, Hobart did not have authorisation from the FSA to take a risk on share positions even for a moment. It could only act as a riskless principal. So Hobart had to know who was buying the shares by the end of the day.
100. Hobart argued that, since, when it bought the shares, it did not know the identity of the purchaser, it must have bought and sold as a principal on behalf of Mr Naggar personally. Therefore, Mr Naggar must have acquired a beneficial interest in the shares at that point. Otherwise Hobart would breach the limitations imposed on it by the FSA.
101. Both sides led evidence about the effect of these transactions. The judge accepted the evidence of a Dr May that beneficial ownership did not pass from Hobart to Mr Naggar and that the shares remained on Hobart's principal account until they were transferred to the CFD provider once the CFD was opened. The judge noted that the FSA treated the counterparty identified at the end of the day as having assumed the market risk from the time of purchase of the shares. Therefore, the narrow basis failed since Mr Naggar did not acquire an asset from Hobart or Hobart from him in the course of the trading day. Wider basis 102. The judge rejected Hobart's submission that Mr Naggar had a settled intention either that the DDI group would itself bid for the share capital of F & C or that it would take part in a consortium bid. Mr Naggar might, for instance, have decided to cut his losses and close out the CFDs without taking the shares. The judge accepted the submission of Mr Crystal QC that the wording of section 190(1) requires a high degree of certainty at a time when the arrangement is entered into that the asset will be acquired. The possibility that there might be successful negotiations with the bidder was not enough to bring the arrangements within the wording of section 190 because they were not arrangements under which Mr Naggar acquired or was to acquire the shares. Submissions on this appeal Appellant's submissions
103. Mr Marshall focuses in his oral submissions on the wider basis. He submits that section 190 should be interpreted so as to cast the net widely in order to achieve its statutory purpose and that the fact that it covers conditional arrangements shows that the judge was wrong to hold that a high degree of certainty is required.
104. Mr Marshall submits that section 190 is engaged if there was a real prospect that the connected person would opt to take the shares on closing out. If so, where Hobart was the CFD provider, the shares would be sold to Hobart and Hobart would on sell them to the CFD holder who would be Mr Naggar or one of his connected persons. In practice, submits Mr Marshall, Mr Naggar and his connected companies had worked to build up a stake in F&C and thereby to encourage takeover activity so it was likely that they would exercise their

option to take the physical referenced shares.

105. Mr Marshall relies on *Re Duckwari plc* [1999] Ch 253 where a company bought the right to complete a contract for the purchase of a property from a company which was a connected person of one of its directors and this court heard an appeal as to the amount of the director's statutory liability. Mr Marshall makes the point that, under that arrangement, there was clearly no requirement for the company to acquire the property if it did not wish to do so (see per Nourse LJ at 259-260). In my judgment, that case does not assist Mr Marshall because the right was itself a non-cash asset of the requisite value. This may be seen from the earlier decision in *Re Duckwari plc* (No
- 1) [1997] 2 BCLC 713, in which this court held that the statutory predecessor of section 190 applied to that arrangement. In the present case, Hobart does not contend that the CFDs were non-cash assets of the requisite value.
106. Mr Michael Crystal QC presented the case for Mr Naggar on the section 190 issue. It is not necessary to deal with all of his submissions. On the wider basis, Mr Crystal submits that the CFD holder had no legal entitlement to the referenced shares but the judge held that in practice he would have been allowed to take them should he wish to do so. However, Mr Crystal also submits that it was not certain that the CFD holder would be able to fund the purchase: the purchase of the referenced shares when the CFDs were finally closed out would have required some £151m. The effect of the words "is to acquire" is that until Mr Naggar decided to acquire the referenced shares it cannot be said that he entered into an arrangement which met the requirements of the section. On his submission there has to be an objective manifestation of an intention for the acquisition of an asset. Otherwise the arrangement is not within the section.
107. As to the narrower basis, Mr Marshall's written submissions contended that Dr May's evidence supporting the finding of a rule or practice was plainly a wrong interpretation of the relevant rule on waivers from the riskless principal rule. Mr Crystal relied on the judge's finding and other points. 108. In my judgment, the appeal should be dismissed on both the wider and the narrower basis.
109. As to the narrower basis, the argument turns on the fact that a purchaser was not identified until the end of the day on which the shares were purchased. But by the end of the day the purchaser was ascertained and therefore its acquisition of the shares operated with effect from the earliest moment in the day under the law of ratification. So in the end the CFD provider acquired shares and ratified the purchase and section 190 was never on this basis engaged. Furthermore the judge found as a fact that Hobart would in those circumstances be treated under the rules of the market as not having acquired any interest, and there has been no effective challenge to that finding.
110. As to the wider basis, in my judgment the judge was correct in her conclusion. It is only necessary to focus on one point. Section 190 requires an arrangement (which can be a non-contractual arrangement) under which a director or connected person acquires "or is to

acquire” an interest in shares. There is no basis for interpreting the words “is to acquire” as “may acquire”. The fact that conditional arrangements are permitted does not require this interpretation since even a conditional arrangement must still satisfy the words quoted even if it is conditional. Since, when the arrangement was made for the CFDs to be written there was no certainty that on closing out the CFD holder would opt to acquire the referenced shares, section 190 does not apply. The arrangement was not said to be made on closing out and election to take the referenced shares.

CONCLUSION

111. I would dismiss the appeal on both issues raised on this appeal. The judge held that Mr Naggar was not a de facto or shadow director of Hobart and there is no basis for setting aside that finding on this appeal. The claim by Hobart against Mr Naggar under Companies Act 2006, section 190 for indemnification on the grounds that the arrangements between him and Hobart for the acquisition of F&C shares to be used to hedge CFDs fails because (1) the technical grounds for saying that an acquisition by Hobart of an interest in shares occurred in the course of purchase fail in law and on the evidence, and (2) the arrangements themselves provided only a means whereby the CFD holders might ultimately acquire non-cash assets of the requisite value, namely shares by which the contracts for differences were referenced, not that they would do so. Lord Justice Elias 112. I agree. Lord Justice Tomlinson 113. I also agree.

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