

# With great power comes great responsibility

May 30 2018 | Contributed by [Howse Williams Bowers](#)

## Introduction

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### Introduction

A *de facto* director is someone who acts as a company director, but has not been formally appointed as one. Acting as a director (despite not being appointed as one) comes with the responsibility of complying with various directors' duties under both common law and Hong Kong legislation. These duties include:

- acting in the company's best interests;
- exercising care, skill and diligence in making decisions;
- avoiding conflicts of interest with the company; and
- not gaining any personal advantages or benefits by virtue of being a director.

In the recent case of *South China Media Ltd v Kwok, Yee Ning*,<sup>(1)</sup> a senior employee was found to have acted as a *de facto* director of the plaintiff company as a result of her position and responsibilities within the company. Consequently, the employee was held to have breached the fiduciary duties which she owed to the company by diverting business opportunities away from it and making unauthorised use of its resources.

### Facts

Kwok was employed by the second plaintiff, SCM Management, as its advertising director. She was primarily responsible for a magazine published by the third plaintiff, Whiz Kids.

### Decision

The court held that although Kwok had not been formally appointed as a director of Whiz Kids, she was a *de facto* director as she had assumed the powers and functions thereof. The court applied the objective test by looking at what Kwok had actually done to assess whether she had assumed the responsibilities of a director and disregarded her personal motivation and belief. The court emphasised Kwok's authority to negotiate and enter into contracts with clients, as well as the fact that she had been presented as a director to clients (given her title of advertising director) in concluding that she had acted as a *de facto* director of Whiz Kids.

As a *de facto* director, Kwok owed fiduciary duties to Whiz Kids, which included a duty not to usurp or divert business opportunities to another person or company with whom she was associated. Kwok was found to have diverted business opportunities to a company controlled by her husband by providing him with a copy of a draft contract, which he had subsequently used to make a similar offer to a mutual target client on behalf of his company.

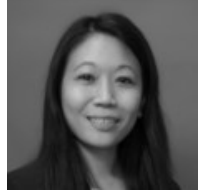
Kwok was also found to have breached her duties of loyalty and fidelity to the company by allowing unauthorised use of the Whiz Kids name and logo by her husband's company. As a result of this conduct, Kwok was found to have breached a number of duties that a director owes to a company –

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namely:

- placing herself in a position of conflict;
- acting for the benefit of a third party without the informed consent of her principal; and
- failing to act with single-minded loyalty to Whiz Kids.

In addition to breaching her fiduciary duties, Kwok was found to have breached her post-termination restrictive covenants. The court rejected Kwok's argument that the non-solicitation and non-competition clauses that had formed part of the terms of her employment were too unreasonable, wide or restrictive. The restrictions ran for 12 months from the date of termination of Kwok's employment and were held to be no greater than reasonably necessary to protect the group's legitimate business interests.

Kwok's husband and his company were also held liable for dishonest assistance and procuring Kwok's breach of contract. Kwok's husband had been aware of Kwok's position and responsibility with regard to Whiz Kids and should have known that it would be unlawful for a senior employee of the company to divert business opportunities to a competitor. The court held that, at the very least, Kwok's husband had "closed his eyes and ears; and deliberately refrained from asking questions about Kwok's misconduct". Kwok's husband's knowledge was imputed to his company. The defendants were ordered to pay Whiz Kids equitable compensation and SCM Management damages with interest.

## **Comment**

Senior employees (who are not formally appointed as a company director) should be aware of the risk of being liable as *de facto* directors once they assume the full responsibilities and authorities of a director.

Although there is no one definitive test for a *de facto* director, the courts will consider the position, functions and responsibilities of an employee in making a determination. Liability cannot be avoided by demonstrating that the employee truly believed, in good faith, that he or she was not acting as a director. Employees should therefore ensure that their role and functions are clearly defined and should not deviate from this in practice. They should also refrain from presenting themselves to clients and other third parties as directors.

Employers should also be aware of this risk and clearly define the role and functions of each employee. They should also ascertain whether their director and officer liability insurance policies cover shadow and *de facto* directors.

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## **Endnotes**

(1) [2018] HKCU 580.

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