DIRECTOR'S FIDUCIARY DUTY TO ACCOUNT FOR CORPORATE OPPORTUNITIES

Submitted by

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Dedication.

I dedicate this dissertation to my two little treasures Lebone le Letago.

Acknowledgements.

This dissertation signifies the end in one of the phases of my life of studies. It prompts me to be in nostalgic state of mind, in a sense that I am bound to embark on a journey down the memory lane, tracing my torrid times as a pupil, a leaner and a student.

It is a moment for me to pause and reflect on my past of excruciating pain and sorrow and at the same time marvel at the miraculous beauty brought about by the fact that out of such abysmal circumstances and conditions, there was born what is today an Attorney and an LL M graduate. It constitutes the sum total of what may convince anyone that in most cases, it takes such depths of weeping and gnashing of teeth to produce such heights and quality of characters.

Most fundamentally, it presents an opportune moment for me to acknowledge those who took part in shaping my life, pulling it from where it was and putting it on a pedestal of hope. In a sea of despair, they invigorated me with hope that it is possible, in a web of bewilderment; they helped me curve my path towards the desired future.

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Thank you.

DECLARATION

I declare that the mini-dissertation hereby submitted to the University of Limpopo, for the degree Master of Laws in management and development has not previously been submitted by me for a degree at this or any other University; that it is my work in design and in execution; and that all material contained herein has been duly acknowledged.

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P K LEGODI (Mr.) Date

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DIRECTOR'S FIDUCIARY DUTY TO ACCOUNT FOR CORPORATE OPPORTUNITIES

1. INTRODUCTION

Since Berle and Means published their path breaking book, *The Modern Corporation and Private Property*[1] 78 years ago, corporate law's central dilemma has been the separation of ownership and control in public corporation. Put simply, on the one side are shareholders, the ostensible owners; on the other side are corporate officers, the shareholders' ostensible fiduciaries.[2] Between shareholders and directors is the board of directors.[3] The Berle-Means thesis suggested that managers enjoy broad discretion in running public companies. Unconstrained by shareholders' demands for maximum profits, managers might be lazy or *divert profits* from shareholders to others, *principally themselves*.[4] This implied that economic production was inefficient. It also implied that investors were being mistreated, which not only was unfair, but also meant capital markets were inefficient.[5]Notwithstanding of the ongoing academic debate whereby the legitimacy of the Berle-Means thesis[6] is questioned in the light new theories,[7] it is ironical that the ubiquitous role of directors as a

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[1] Berle, A & Means, G *The Modern Corporation and Private Property* (1932).
[2] See generally, Dent Jr, GW 'Toward unifying ownership and control in the public corporation' (1989) *Wisconsin LR* 881;
[3] See generally, Brudney, V The independent director-Heavenly city or Potemkin village?' (1982) 95 *Harvard LR* 597; Black, BS 'Agents watching agents: the Promise of institutional voice' (1992) 39 *UCLA LR* 811; Hetherington, JAC 'When the sleeper wakes: Reflections on corporate governance and shareholder rights' (1979) *8 Hofstra LR* 183; Fischel, DR & Easterbrook, FH 'Limited liability and the corporation' (1985) 52 *University of Chicago LR* 89;
[4] See Dwight 'Liability for corporate directors' (1907) 17 *Yale LJ* 33; Note 'Liability of the inactive corporate director (1908) 8 *Columbia L*R 18.
[5] Eisenberg, MA 'The modernisation of corporate law: An essay for Bill Cary' (1983) 37 *University of Miami LR* 187.
[6] The "old paradigm" of public corporation rests on two basic structural pillars: (1) the view of the public corporation as a private and largely contractual undertaking and thus devoid of much "public law" significance, see, eg. Fischel, DR & Easterbrook, FH 'The corporate contract' (1989) 89 *Columbia LR* 1416, and the view that the separation of ownership and control is both inevitable and efficient.
[7] Recent theorists have argued that separation of ownership and control is efficient because it allows entrepreneurs to obtain capital from risk-neutral shareholders

situs of corporate power has become an essential feature of corporate.[8]

One of the incidents of corporate directorship is that the director is subject to certain fiduciary obligations.[9] The most central undoubtedly are the implied terms of loyalty and good faith, which from the perspective of the fiduciary obligations imposed upon directors, individually or collectively, is the obligation to exercise their powers in good faith and in the best interest of the company.[10] One only need to refer to the oft-quoted passage of Laskin J (as he then was) in *Canadian Aero Services v O'Malley*[11] to understand why fiduciary doctrine is so deeply entrenched:

> '[T]he general standards of loyalty, good faith and avoidance of a conflict of duty and self interest to which the conduct of a director or senior officer must conform, must be tested in each case by any factors which it would be reckless to attempt to enumerate

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who, because they are diversified, can accept business risks that would deter undiversified shareholder/manager. See generally, Roe, MJ 'A political theory of American corporate finance' (1991) 91 *Columbia LR* 10; Coffee, Jr, JC 'Liquidity versus control: The institutional investor as corporate monitor (1991) 91 *Columbia LR* 1277.

[8] See generally, Coffee, Jr, JC 'Shareholders versus managers: The strain in the corporate web' (1986) *Michigan LR* 1.

[9] There is no magic in the term "fiduciary duty" the existence of such a duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship. The *sui generis* basis of these obligations is widely recognised and has been confirmed by the Supreme Court of Canada in *Guerin v Canada* [1984] 2 SCR 335; 13 DLR (4th) 321 at 341 where Dickson J (as he then was) said:

> "It is sometimes said that the nature of fiduciary relationships is both established and exhausted by the standard categories of agent, trustee, partner, director, and the like. I do not agree. It is the nature of the relationship, not the specific category of actor involved that gives rise to the fiduciary category."

See too *Frame v Smith* [1987] 2 SCR 99 at 98-99; *Du Plessis NO v Phelps* 1995 (4) SA 165 (C) at 171A-B; *Phillips v Fieldstone Africa (Pty) Ltd & another* 2004 (3) SA 465 (SCA) at para 27. See also Havenga, M 'Corporate opportunities: A South African update (Part 1)' 1996 (8) *SA Merc LJ* 40, 41.

[10] The "interests" in this context are only those of the company itself as a corporate entity and those of its members as such as a body. See eg *South African Fabrics Ltd v Millman* 1972 (4) SA 592 (AD) at 596; *Alexander v Automatic Telephone Co* [1990] 2 CH 56 (CA) at 67, 72; *Coronation Syndicate Ltd v Lilienfeld* 1903 TS 489 at 497; *Parke v Daily News Ltd* [1962] Ch 927 at 963; [1962] 2 All ER 929 at 948; *Gaiman v National Association for Mental Health* [1971] Ch 317 at 330; [1970] 2 All ER 362 at 367. For further discussion:

[11] (1973) 40 DLR (3d) 371.

> exhaustively…Descending from the generality, the fiduciary relationship goes at least this far; a director or senior officer … is precluded from obtaining for himself either secretly or without approval of the company (which would have been properly manifested upon full disclosure of the facts), any property or business advantage either belonging to the company or for which it has been negotiating; and especially is this so where the director or officer is a participant in the negotiation on behalf of the company'.[12]

In addition to this succinct passage, there is ample authority for the proposition that the all-encompassing fiduciary doctrine includes the director's duty to exercise care and skill,[13] duty to exercise independent discretion;[14] duty to act under available powers;[15] duty not to improperly compete with the company;[16] duty to account for

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[12] *Canadian Aero Services v O'Malley* 390..

[13] See eg *Lindgreen & others v L & P Estates Co Ltd* [1968] 1 Al ER 917 (CA); *Winthrop Investments Ltd v Winns Ltd* 1975 2 NSWLR 666 (CA). See also McLennan, JS 'Director's duties and misapplication of company funds' (1982) S*ALJ* 349

[14] A director may not be a mere dummy or puppet. See *S v Shaban* 1965 (4) SA 646 (W) at 651-652; *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) at 163; *Scottish Co-operative Society Ltd v Meyer* [1959] AC 324 (HL) at 341-342' 363-368; [1958] 2 All ER 66 at 70-71; 85-86; *Novick v Comair Ltd* 1972 (2) SA 116 (W) at 130; *Selangor United Rubber Estates Ltd v Cradock (3*) [1968] 2 All ER 1073 (Ch) at 1095, 1123.

[15] See *Cullerne v The London & Suburban General Permanent Building Society* (1890) 25 QB 485 (CA) at 488, 490; *Sparks & Young Ltd v John Hoatson* (1906) 27 NLR 634 at 642; *In re Exchange Banking Co; Flitcroft's Case* (1882) 21 Ch 519 (CA) at 533-534; 535; *In re Sharpe* [1892] 1 Ch 154 (CA) at 165-166; *In re Kingston Cotton Mill Co (2)* [1896] 2 Ch 279 (CA); *In re Duomatic Ltd* [1996] 2 Ch 365 at 374-375; [1969] 1 All ER 161 at 169; *Jacobson v Liquidator M Bulkin & Co Ltd 1976* (3) SA 781 (T) at 790-791.

[16] See *Bell v Lever Brothers Ltd* [1932] AC 161 (HL) at 195; *Robinson v Randfontein Estates Gold Mining Co* 1921 AD 168 at 216; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981 (2) SA 173 (T) at 198; *Rectifier & Communication Systems (Pty) Ltd v Harrison* 1981 (2) SA 283 (C) at 286-287. For discussion: Havenga, M 'Directors in competition with their companies' 2004 (16) *SA Merc LJ* 275.

secret profits;[17] duty to avoid conflict of interests and duty;[18] as well as duty to disclose interest in a contract with the company.[19]

One of the issues of mystifying complexity which confronts courts in relation to corporate directors is setting the limits of loyalty, which the law expects them to display towards their companies.[20] The issues presented to courts in different jurisdictions are a variant of familiar problems of breach of fiduciary duty involving an executive who has diverted business or property away from his company and utilised it for his own benefit.[21] At the heart of this intractable dilemma is the fact that a company cannot act on its own behalf, its act are conducted through representatives – the board of directors vested with the management of the company's business.[22]

Another strand to the vexed issue of fiduciary obligation relates to the very nature of corporate capitalism.[23] At issue is the that fact that in the public company the corporate executive is required to be

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[17] See *Parker v McKenna* (1874) LR 10 Ch App 96 at 118; *Transvaal Cold Storage Co Ltd v Palmer* 1904 TS 3 at 33-34; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL) at 153; [1942] 1 Al ER 378 at 391-392; *Boston Deep Sea Fishing & Ice Co v Ansell* (1888) 39 Ch 339 (CA)at 158; 395. See further, Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215;

[18] See *Robinson v Randfontein Estates Gold Mining Co* 1921 AD 168 at 177-179; *Boardman v Phipps* [1967] 2 AC 46 (HL) at 123-124; [1966] 3 All ER 721 at 756; *Aberdeen Rail Co v Blaikie Bro*s (1854) 1 Macq 461 at 473, (1854) 2 Eq Rep 1281 (HL) at 1286; *Bray v Ford* [1886] AC 44 (HL) at 51. For excellent discussion: Blackman, MS 'Duties of directors and officers: Ratification or condonation of director's breach of duty and prior consent and release' in *LAWSA First Reissue* Vol 4(2) Part 2.

[19] S 234 of the Companies Act 61 1973.

[20] Generally, *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Regal (Hastings) Ltd v Gulliver* (1942) 1 All ER 378;

[21] See generally, Brusser, R 'The director's duty of loyalty: Corporate opportunities revisited' (1982) *SALJ* 198; Brews, P 'Defining corporate opportunity: In search of an acceptable approach' 1986 (10) *SACLJ* 4;

[22] See *Salomon v A Salomon & Co Ltd* 1897 AC22; 1895-99 All ER Rep 33; S v De Jager 2 SA 616 (A);*Attorney-General's Reference (No 2 of 1982*) 1984 QB 624; 1984 2 All ER 216, *Belmont Finance Corp Ltd v William Furniture Ltd* 1979 Ch 250; 1979 1 All ER 118; *R v Roffel* 1984 9 ACLR 433 SC (Vic); *R v Gomez* 1933 AC 442 496; 1993 1 Al ER 1 (HL);

[23] According Dodd what troubles the courts in such situations is that corporate capitalism sets before its managers in the public company the 'peculiar ideal of vicarious acquisitiveness". "Is effective enforcement of fiduciary duties of corporate managers practicable' (1934-35) 2 *University of Chicago LR* 194.

acquisitive on behalf of a group of persons, the shareholders, with whom they have no real connection. The right to freely engage in economic activity is enshrined in the Bill of Rights.[24] It is unarguable that control is essential in the interests of the company itself, its shareholders, and its creditors. The central role of management is underscored by the fact that the company directorship is aptly regarded as one of the most complex and difficult fiduciary offices.[25]

The breach of director's fiduciary duty in relation to corporate opportunities and competition is an issue which has enjoyed much attention in our law. The issues which have arisen for adjudication in recent times concerning the circumstances in which a director may be held liable to account to his or her company for secret or incidental profits and for corporate opportunities consequent to violation of fiduciary duties in South Africa and comparative jurisdictions have been enormous and can be examined from four angles.

In the first place, there is an interesting and difficult question of definition concerning what constitutes corporate opportunity. The phrase corporate opportunity is an elastic concept. In turn, this raises the question of when and under what circumstances particular opportunities should be regarded as corporate in nature, and in what circumstances a director may be said to have made a profit out of his office.

Secondly, there is practical consideration of the numerous tests that have been employed to determine whether a particular economic opportunity is corporate in nature. In search for the most suitable test in this context, the following contentious approaches naturally call for attention: the widest approach and narrower approach. The widest

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[25] *Cooks v Deeks* (1916) 1 AC 554 (PC). See also Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215. 216.

approach proceeds on the basis that directors should pass on to the company any and all the economic opportunities of which they become aware, regardless of the nature of the corporate opportunity and its connection to the company's interests, and regardless of the manner in which knowledge of such opportunity was obtained. In contradistinction, the narrower approach is to state that only those opportunities in which a company has an existing legal right are considered to be corporate opportunities.

Thirdly, there is a fine line between the circumstance where a director who pursues an opportunity with his or her own financial resources after the directors have decided in good faith not invest their company's funds in it, is accountable for any secret or incidental profits so derived, and the situation where a director may usurp a business opportunity and is absolved from liability to the company. In effect, the question is: in what circumstances may a corporate fiduciary appropriate business opportunity that has been formally rejected by the company? In an attempt to answer this question, it is important to consider not only in what circumstances was the company unable to pursue the opportunity but also examine whether the acquisitive fiduciaries were not the *causa causans* of corporate incapacity. Similar questions are also encountered in relation to the power of members in a general meeting to prospectively consent to the directors acting for the company in a matter in which they have interest or otherwise putting themselves in a situation where their interests conflict with their duties, or to their retention of profits to be made by them in the course of acting for the company or by use of their office. Can the members prospectively release directors from their duties (or from liability for breach of them) to act for the purpose of furthering the interests of the company as a whole, not to act for an unauthorised or collateral purpose, and to acquire a particular business opportunity for the company if they acquire it all?

A related question is the liability of a former director whose resignation has been prompted by a desire to personally acquire corporate opportunity. In effect, the question is: when is a departing director prohibited from taking for himself or herself or diverting to an associate a maturing business opportunity even after his where the resignation is actuated by a wish to acquire for himself or herself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired? Also arising from the question of usurpation of corporate opportunity are the problem areas involving competition and confidential information.

Finally, there are the perennial problems often associated with breach of duty not to misappropriate corporate opportunities, which in this context, surfaces in the guise of a *sui generis* liability[26] for damages in respect of loss caused to the company, and in appropriate circumstances a liability to restore to the company its property or to account to it for secret profits. In view of paucity of South African decisions, an inquiry into the vexed issue of directors who divert corporate opportunities and abuse their positions by profiteering at their company's' expense calls for a review of developments of the law in other jurisdictions.

2. DEFINING CORPORATE OPPORTUNITY

Although there is no settled definition of corporate opportunity, corporate opportunity in general terms may be defined as any economic or business opportunity, material or immaterial property to which the company has a claim. The duty not to usurp such an opportunity arises from the particular relationship which exists

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[26] The liability for breach of a fiduciary duty is not delictual but *sui generis*. See *Robinson v Estates Gold Mining Co Ltd* 1921 AD 168 at 1999, 242; *Cohen v Segal* 1970 (3) SA 702 (W) at 706.

between the corporate fiduciary and his or her company or between the company and the particular opportunity.[27]

Blackman in *LAWSA*[28] suggests that there are at least three situations in which the duty attaches to a director. These are:

(i) If the director has been expressly or impliedly given a specific mandate either to acquire a particular opportunity for the company or to inform the company as to its suitability.

(ii) If he alone, or together with other directors, is given expressly or impliedly a general mandate to acquire opportunities for the company, or to pass on information to it about opportunities, or if he in fact controls the company or those in power to manage its affairs.

(iii) If he usurps an opportunity which the company is actively pursuing or an opportunity which at least in so far as its directors are concerned can be said to belong to the company.

It accordingly becomes imperative to enquire in what circumstances opportunities should be regarded as corporate in nature, in what circumstances they should cease to be regarded as such.

Welling[29] rejects the "corporate opportunity doctrine" as unnecessary complication. He suggests the two "touchstones" are conflict of interest and connection with the fiduciary position. He sets out the following propositions as the current law on fiduciaries in Canada:

(i) Where there is actual conflict and interest and the information or opportunity is acquired by virtue of the

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[27] Havenga, M 'Corporate opportunities: A South African update (Part 2)' (1996) (8) *SA Merc LJ* 43, 42-43.

[28] "Duties of Directors and Officers' *LAWSA* Vol 4(2) First Reissue at para 135 at 224.

[29] *Corporate Law in Canada* (1984), 380.

fiduciary's position, the fiduciary is clearly liable to account for any profit.

(ii) Where there is a potential conflict of duty and interest and the information is acquired by virtue of the fiduciary's position, the fiduciary is accountable for any profit.

(iii) Where there is no conflict of duty and interest, real or potential, and the information or opportunity is acquired independently, the fiduciary is clearly not accountable.

(iv) Where there is potential conflict of duty and interest, but the information or opportunity is acquired independently, the fiduciary is not accountable.

(v) Where there is an actual conflict of duty and interest, but the information or opportunity is acquired independently, the fiduciary is accountable.

(vi) Where there is no conflict of duty and interest, but the information or opportunity is acquired by virtue of the fiduciary position, the fiduciary is accountable.

It is submitted that Welling's view that a proper dividing line between the director's right to compete with the corporation and the corporation's right to have fiduciaries' personally acquired opportunities is the factual distinction between propositions (iv) and (v), is a commendable one. Where information or an opportunity is acquired independently, directors may compete, though there is a potential conflict of duty and interest, but must account if there is an actual conflict.

3. THE TESTS

3.1 The Position test

The primary test places emphasis on the surrounding circumstances in which the director became aware of the opportunity. In terms of

this test the court is required to determine in any given circumstance whether the director was acting in a fiduciary or a personal capacity.[30] The gist of the position test is the equity principle which states that an agent or trustee should not be allowed to benefit from an opportunity which was acquired by virtue of the office of agency or trusteeship. The impact of the equity principle is well illustrated by the approach of Lord Russell in *Regal (Hastings) Ltd*:[31]

> 'the rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of *bona fides*; or upon such questions or considerations as whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account'.

Lord Russell formulated the test as follows:[32]

> 'the plaintiff company has to establish two things … (i) that what the directors did was so related to the affairs of the company that it can be properly said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors; and (ii) that what they did resulted in a profit to themselves'.

Beck discusses *Regal (Hastings)* and states:[33]

> 'If the facts of *Regal* were that one of the directors heard of an available theatre and personally when he knew the company was looking for another location, can it be seriously contended that he would not be liable to account? It is submitted that he should be liable even if the knowledge of the availability of the theatre did not come to him in his capacity as a director, *although it is recognised that the cases do not go that far*. He is a fiduciary, and if the circumstances are such that the interests of his principal call for protection, he should be required to look first to those interests rather than his own. Equity's negative "do not" takes too narrow a view of the director's function, and is inadequate to meet the corporate opportunity problem. The directors should be considered to have an affirmative obligation to advance the interests of the corporation and, at times, to put the corporation's interests ahead of their own.

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[30] Brusser, R "The directors' duty of loyalty: Corporate opportunities revisited' (1982) 198 *SALJ* 69. 71.

[31] *Regal (Hastings) Ltd v Gulliver* at 386.

[32] *Regal (Hastings) Ltd* at 392.

[33] "Corporate Opportunity Revisited" in Ziegel (ed) *Studies in Canadian Company Law* Vol 2.(1973) c. 5, 205, 224-5 [emphasis added].

Welling,[34] agrees that the rule against personal profit from a fiduciary position "was conceived as a prophylactic rule, designed to inhibit fiduciaries from taking advantage of conflict of interest opportunities. He suggests that the "much criticised" decision in *Peso Silver Mines Ltd v Cropper*[35] may be distinguished from *Regal (Hastings*) if the latter case is viewed as establishing that "it is the degree to which the opportunity to profit was connected with a corporate manager's position that makes seizing the opportunity a breach of fiduciary duty".[36] In *Peso* the court found no connection while in *Regal (Hastings)* the opportunity came not only as a result of a fiduciary position, but also in the course of carrying out managerial duties, i.e. direct connection. In considering the degree of connection required, Welling considers the basis of the fiduciary principle. Does it seek to prevent a conflict between duty and interest? Or is the accountability principle prophylactic in nature to avoid temptation? If the latter, connection with the position would be the only issue and actual conflict of duty and interest would not be necessary. Potential conflict would be sufficient.

3.2 The Conflict test

Unlike the primary test where the decisive factor is the circumstances under which the corporate fiduciary became aware of the business opportunity, the rationale of the conflict test is that the pursuit of an opportunity should not place the director in acting for the company in a position where his or her interests conflict with his/her duties. Where there is conflict of interest between the director's personal

[34] *Corporate Law in Canada* (1984), 380.
[35] (1966) 58 DLR (2nd) S.C.C.
[36] *Corporate Law in Canada* (1984), 387-389.

interest and his duty to the corporation, then the opportunity, which is the cause of this conflict, would then become corporate in nature.[37]

In finding the delinquent trustee liable on the basis of the profit rule, the House of Lords in *Boardman v Phipps*[38] went further by stating that liability could also be based on the conflict rule. This would be so if it could be proved that there was a "possibility of conflict'[39] between their own interests and their duty to the trust. It will be recalled that in *Boardman* the trustees did not wish to acquire the shares and in fact had no legal power to do so. Furthermore, they had specifically given Boardman and Phipps their approval for their course of action. Although this was an opportunity which the trust neither wished to acquire nor utilise, nonetheless the court found the fiduciaries liable to account for the profit by giving a broad interpretation to profit and conflict rules.

3.3 The Expectancy Test

In terms of the interest or expectancy test, one asks whether the corporation need or was the business opportunity in question. In other words, the overriding consideration is whether the company has developed an interest or is actively pursuing the opportunity.[40] There must be expectancy on the part of the corporation which must grow out of the existing right. Liability for usurping a corporate opportunity will arise if the company had developed an interest or is actively pursuing the corporate opportunity.[41]

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[37] Brews, P 'Defining corporate opportunity – In search of an acceptable approach' 1986 (10) *SACLJ* 4, 6.
[38] (1967) 2 AC 46 (HL).
[39] *Boardman v Phipps* (1967) 2 AC 46 (HL) at 103.
[40] Brews, P 'Defining corporate opportunity – In search of an acceptable approach' 1986 (10) *SACLJ* 4, 6.
[41] Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215.

The test places emphasis on whether the company has an interest in the opportunity or was actively pursuing the opportunity when the director diverted it. The nature of the opportunity itself plays an important role rather than the manner in which the opportunity came to the knowledge of the director. The test is viewed as narrow as it establishes nothing new but what is already in the public domain, which the corporation is interested in and has been actively pursuing will be a corporate opportunity.[42]

It was the American Court in *Lagarde v Anniston Lime and Stone Co*[43] that formulated the interest or expectancy test by adopting a narrow approach. The court held that a business opportunity was an opportunity in which the corporation had an expectancy growing out of an existing right. Furthermore, the court held that the legal restrictions which rest upon directors in their acquisitions are generally limited to property wherein the company has an already existing right, or to cases where the directors' interference will in some degree thwart the company in effecting the purposes of its creation. In *Abbey Glen Property Corp v Stumborg*[44] the Alberta Supreme Court in determining whether the corporate officers had breached their duty by usurping a corporate opportunity, favoured the "expectancy test".

A major criticism levelled at the expectancy test is that it articulates the something that is evident. Put bluntly, that which the company is interested in or actively pursuing will naturally constitute a corporate

[42] Havenga, M 'Corporate opportunities: A South African update (Part 1)' 1996 (8) *SA Merc LJ* 42, 44.
[43] 126 Ala 26 (1900). For discussion: Havenga, M 'Corporate opportunities: A South African update (Part 1)' 1996 (8) *SA Merc LJ* 42, 44-45.
[44] (1976) 65 DLR (3d) 235 (Alt. HC); (1978) 85 DLR (3d) 35 (Alt. SC). For excellent discussion see Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215.

opportunity.[45] However, it is the opportunities, which the company may be interested in pursuing that present the actual problem.

3.4 The Line of Business Test

The line of business test has much to commend it as it recognises the fact that directors constitute the business eyes and ears of the company and therefore they should be obliged to relay to the company all corporate opportunities of potential benefit to it.[46] No one has expressed this position better than Beck:[47]

> 'Information that directors and officers receive does not come marked for them in their different capacities. They are men who are engaged in a particular business and they receive information relevant to that business and they receive information relevant to that business because of that fact, whether the information is received in their offices, in the boardroom or on the golf course. A corporation is not a receptacle of information apart from its senior management; directors and officers are almost invariably the pipeline through which information is filtered to directional management as a whole. The corporate opportunity doctrine, or an expectancy in the sense that it is an opportunity that it has begun to look for, or is an opportunity in which it has no present interest or expectancy but is one which it might reasonably be expected to be interested given its present line of business, then the fiduciary must present it to the corporation for its consideration prior to exploiting it himself.'

In terms of the line of business test, one asks whether the opportunity embraces an area where the corporation has fundamental knowledge, practical experience and ability to pursue the opportunity and it is one that is consonant with its reasonable needs and aspirations. It follows that for an opportunity to become corporate in nature it must be linked with the existing and prospective interest or activities of the

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[45] See generally Havenga, M 'Corporate opportunities: A South African update (Part 1)' 1996 (8) *SA Merc LJ* 42, 44; Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215.

[46] Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215, 216.

[47] Beck, SM "The Quickening of Fiduciary Obligation: *Canadian Aero Services v O'Malley*' (19875) *Canadian Bar Review* 771, 782-283.

corporation. [48] The line of business test does not only include the current business interest but include also the future interest.

The line of business test is closely linked with the interest or expectancy test. The line of business test casts the net too wide so as to make it difficult for the delinquent director to divert an opportunity which may belong to the corporation. For instance, in *Burg v Horn*[49] it was held that a New York court would, in each case, by consideration of the relationship between the director and the corporation, have to determine whether a duty to offer the corporation all opportunities within its 'line of business' can fairly be implied'.[50] The present and the potential business of the company should be established in order to determine whether a particular opportunity falls within the line of business test.

3.5 The General Fairness Test

The fairness test, where one asks whether on the particular test the fiduciary is taking advantage of an opportunity when the interests of the corporation justly call for protection. The test is predicated on what is fair and equitable in the particular circumstances of the case. Accordingly if the circumstances indicate that it would be unconscionable for the fiduciary officer to exploit a particular corporate opportunity, the opportunity will be deemed to be corporate. The fairness test is the one applied in *Canaero.*[51] Given the fact that fairness is an elastic concept, no guiding principles have been

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[48] Menzies, D 'Corporate opportunity' (1961) *Harvard LR* 765.

[49] 380 F 2d 897 (2nd Cir 1967). See also *Guth v Loft Inc* 5 A2d 503 (Del 1939). See also CBK 'Corporations – Corporate expectancy – Executive's duty to embrace opportunity on behalf of the corporation' (1939) 13 *Temple University LQ* 534' Mahoney, P 'Corporations – Doctrine of corporate opportunity' (1951) 35 *Marquette LR* 44.

[50] *Burg v Horn* 380 F 2d 897 (2nd Cir 1967) at 900.

[51] Ziegel, Daniels, Johnston & MacIntosh, P*artnerships and Business Corporations* vol. 1 (1989), 556.

developed by the courts[52] in respect of defining a corporate opportunity.

It is clear from the preceding discussion that the issue of which opportunity constitutes corporate opportunity a notoriously difficult question in corporate law. No single legal system seems to have been able to clearly define the concept of business or corporate opportunity beyond providing a broad definition.[53] Equally, courts have been unable to develop a clear and consistently applicable test for distinguishing corporate from non-corporate opportunities in order to deal with the highly variable patterns of complex corporate economy. The complexities of contemporary corporate structures are such that a narrow formulation of the extent allows a large number of abuses to go unchecked.

4. THE GENESIS OF THE TREND TO HOLD DIRECTORS ACCOUNTABLE FOR MISAPPROPRIATION OF CORPORATE OPPORTUNITIES

4.1 The English Approach

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[52] See generally *Durfee v Durfee & Canning Inc* 80 NE 2d 522 (Mass 1948); *Miller v Miller* 222 NW 2d 71 (Minn 1974); *Industrial Development Consultants v Cooley* (1972) 1 WLR 443 (1972) 2 All ER 162.

[53]Havenga, M 'Corporate opportunities: A South African update (Part 1)' 1996 (8) *SA Merc LJ* 42, 46 makes the following pertinent observations:

> 'South African court have not yet laid down conclusive guidelines in respect of defining a corporate opportunity. However, decisions here and in other Commonwealth countries indicate that generally the test that should be applied is whether an opportunity can in all circumstances be said to actually belong to the company, or whether the company was justifiably relying upon the director either to acquire the opportunity for it, or to give the company the chance of acquiring it or at least of attempting to acquire it. The opportunity should therefore not only be in the line of business of the company, but in all circumstances the company should be seen to have been justifiably relying upon the director(s) to acquire it or to assist in its acquisition for the company.'

It was in the early cases of *Menier v Hooper's Telegraph Works*[54] and *Burland v Earle*[55] that the foundations of corporate opportunity doctrine were laid. The facts in *Menier* were that the company had obtained a licence from the government of Brazil to lay transatlantic cables. However, one of the company's officers obtained a licence in his own name and he formed another company to exploit the licence. An interdict to prevent the director from exploiting the contract was dismissed and before an appeal could be lodged the director who was a majority shareholder caused the company to abandon the appeal and put the company into liquidation. He received a large payment from a company associated with the new company. In an action brought by minority shareholders the court did not make a determination whether there was a breach of fiduciary duty by the directors. The court however came near to saying the opportunity belonged to the company but said the directors "obtained certain advantages by dealing with something which was the property of the whole company."[56]

The factual matrix in *Burland* bore resemblance to the 1921 landmark South African case of *Robinson v Randfontein Estates Gold Mining Co Ltd.* At issue in *Burland* was the conduct of the president and the general manager in purchasing the plant of a related business with the predominant aim of later reselling it to the company at exorbitant price. The Ontario Appeal court found the director to have been liable for a breach of fiduciary duty. The Privy Council did not agree with the conclusion of the court a quo that the director breached fiduciary duty. Lord Davey reasoned that:

> 'there is no evidence whatever of any commission or mandate to Burland to purchase on behalf of the company, or that he was in any sense a trustee of the company the purchased property. It may be that the he had an intention to resell it to the company, but was at liberty to carry out or abandon at his own will.'[57]

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[54] (1874) L R 9 Ch App 350.

[55] (1902) AC 83 (PC).

[56] *Menier v Hooper Telegraph Works* (1874) L R 9 Ch App 350at 353

[57] *Burland v Earle* (1902) AC 83 (PC) at 98-99.

The opportunity for the Privy Council to provide directive and overall structure for the corporate opportunity doctrine came in 1916, in the dispute in *Cook v Deeks*.[58] It concerned three of the four corporate officers of the Toronto Construction Company who had negotiated a major contract, ostensibly on behalf of the company, and then obtained the contract in their own names. The directors then called a general meeting, in which they held and exercised a controlling vote, and passed a resolution that the company had no interests in the contract. The Privy Council found that the directors in so doing misappropriated a corporate opportunity. They held that the benefit of the contract belonged in equity to the company.

The same principle was invoked in *Industrial Development Consultants Ltd v Cooley*[59]in which a managing director attempted to negotiate contracts on behalf of his company, was unsuccessful because the third party disliked the corporate set-up, and then resigned his position and contracted personally, after the third party confirmed it would only contract with him personally, and not with the company. The Court held the director accountable for breach of fiduciary duty. Roskill J found the director liable to account on the basis of conflict of interest. He held the director had an obligation to pass on to his corporation all information received by him "which was of concern to the plaintiffs and relevant for the plaintiffs to know".[60] The director, Cooley was paid for the very purpose of securing this type of contract for his corporation.

The doctrine of corporate opportunity reached its development journey in the *Regal*, *Cooley* and *Boardman* decisions. It will be recalled that the three judgements placed the issue of liability of corporate officers for misappropriation of corporate opportunities on firm legal ground.

[58] (1916) 1 AC 554 (PC)
[59] (1972) 2 All ER 162. Cf *Tombill Gold Mines Ltd v Hamilton & others* [1955] 1 DLR 101 (Ont SC); *Slate Venture Inc v Hurley*, 1996 *CanLII* 6616 (NL S.C.T.D.).
[60] *Industrial Development Consultants Ltd v Cooley* at175.

The legacy of *Regal*, *Cooley* and *Boardman* seems to suggest that corporate incapacity, even *ultra vires*, is no defence to a claim against a director who has exploited such corporate opportunity.

4.2 The Canadian Approach

The development of the corporate opportunity doctrine has been the subject of penetrating analysis in Canada. This was evident in the celebrated pronouncements of Laskin J (as he then was) in *Canada Aero Services*,[61] where following extensive review of Commonwealth authorities he concluded that:

> '... the principle, or, indeed, principles, as stated, grew out of older cases concerned with fiduciaries other than directors or managing officers of a modern corporation, and I do not therefore regard them as providing a rigid measure whose literal terms must be met in assessing succeeding cases. In my opinion, neither the conflict test, ... nor the test of accountability for profits acquired by reason only of being directors and in the course of execution of the office, ... should be considered as the exclusive touchstone of liability. In this, as in other branches of the law, new fact situations may require a reformulation of existing principle to maintain its vigour in the new setting'.[62]

The facts in a nutshell were that the defendants were directors and senior officers of the company involved in topographical mapping and geophysical exploration. The plaintiff company submitted tenders for extensive aerial mapping project in Guyana. Both defendants were closely involved on behalf of their company in preparation of the preliminary reports for the tender. Prior to the tenders being considered the defendants resigned their positions with the company and formed their own company, TS Ltd. A tender which was almost identical as that which the defendants had prepared for their former company, was submitted to the Guyana government in competition with that of Canadian Aero Services. When the contract was awarded

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[61] For discussion see Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215; Beck, SM "The Quickening of Fiduciary Obligation: *Canadian Aero Services v O'Malley*' (1975) *Canadian Bar Review* 771; Brusser, R "The directors' duty of loyalty: Corporate opportunities revisited' (1982) 198 *SALJ* 69, 75-76;

[62] *Canada Aero Services v O'Malley* (1973) 40 DLR (3d) 371 at 383.

to TS Ltd, the plaintiffs commenced action against the defendants alleging that they had breached their fiduciary duty by depriving the company of 'the corporate opportunity, which it had been developing.'[63]

The court justified its finding of liability on the basis that offending fiduciaries were precluded from obtaining for themselves, either secretly or without approval of the company, any business advantage belonging to the company for which it has been negotiating. This is amplified by the fact that directors were participants in the negotiations on behalf of the company. Laskin J wrote:[64]

> 'An examination of the case law in this Court and in the Courts of other like jurisdictions on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this *ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company rather than a fresh initiative that led him to the opportunity which he later acquired.*'

Welling suggests that the "corporate opportunity" doctrine enunciated by Laskin J is vaguely stated. He submits that *Canaero* "can be narrowly interpreted as standing for the proposition that the fiduciary will be accountable, without proof of an actual conflict, if he profits from a situation in which there might have been a conflict".[65] Welling asks how Laskin J's "maturing business opportunity" concept can be reconciled "with the well-known principle that a corporate manager is not precluded from competing with his corporation". Welling asserts that the issue should be "whether the fiduciary's position with the corporation gave him any advantage in the competition". Welling criticises the way Laskin J suggests there might be an extension of the

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[63] *Canada Aero Services v O'Malley* (1973) 40 DLR (3d) 371 at 373.
[64] Can*ada Aero Services v O'Malley* (1973) 40 DLR (3d) 371 at 382 (Emphasis added).
[65] *Corporate Law in Canada* (1984), 390-394.

then existing test of whether corporate managers utilised special knowledge acquired through the corporation and whether the benefits were acquired by reason of and during the holding of their offices, without going on to clearly set out a new standard of behaviour for corporate managers.

A fair reading of the Canadian case law suggests that insofar as the touchstone of liability is that the reaping of a profit by a person at a company's expense while a director thereof is, of course, an adequate basis upon which to hold the director accountable. Yet there may be a situation where a profit must be disgorged, although not obtained at the expense of the company, on the basis that a corporate fiduciary must not be allowed to use his position as such to make a profit even if it was not open to the company, as for instance, by reason of legal disability, to participate in the transaction.

4.3 The South African Approach

The principles which govern the actions of a person who occupies a position of trust towards another were adopted in South Africa from the equitable remedy of English law.[66] The Roman and Roman-Dutch law provided equivalent relief. In *Transvaal Cold Storage Co Ltd v Palmer*[67] the sources were considered and the conclusion was expressed that the extension and refinement of the civil law by English courts was a development of sound doctrine suited to "modern conditions".

However, South African approach to corporate opportunity doctrine is a result of the legacy of *Robinson v Randfontein Estates Gold Mining Co Ltd*. Although this was not a classic corporate opportunity case, the company was given an opportunity to acquire the asset, which was a

[66] For detailed discussion: Zimmermann, R 'Good faith and equity' in Zimmerman & Visser (eds) *Civil Law and Common Law* (1996), 217.
[67] 1904 TS 4 at 18-20 and 34-35.

farm, but unfortunately the chairperson acquired the farm and subsequently sold it to the company at a higher price. The court in deciding the matter relied squarely on the no-profit rule and Innes CJ articulated the general principle in several ways:[68]

> 'Where a man stands to another in a position of confidence involving a duty to protect the interest of the other is not allowed to make a secret profit at the expense of the other or he place himself in a position where his interest conflicts with his duty. The principle underlies an extensive field of legal relationship. A guardian to his ward, a solicitor to his client, an agent to his principal afford examples of persons occupying such a position. As was pointed out in *The Aberdeen Railway Company v Blaikie Bros* (1 Macqueen 474), the doctrine is to be found in the civil law (Digest 18.1.34.7), and must of necessity form part of every civilized system of jurisprudence. It prevents an agent from properly entering into any transaction which would cause his interests and his duty to clash. If employed to buy, he cannot sell his own property, if employed to sell, he cannot buy his own property; nor can he make any profit from his agency save the agreed remuneration; all such profit belongs not to him, but to his principal. There is only one way by which such transactions can be validated, and that is by the free consent of the principal following upon a full disclosure by the agent … Whether a fiduciary relationship is established will depend upon the circumstances of each case … But, so far as I am aware, it is nowhere laid down that in these transactions there can be no fiduciary relationship to let in the remedy without agency. And it seems hardly possible on principle to confine the relationship to agency cases.'

In 1978 the chance to remove barriers in the way to founding the modern law of corporate opportunity presented itself to the Appellate Division in *Bellair*s *v Hodnett.*[69] The case concerned acquisition by a company director, B, an experienced property developer in his own right of property N20 for which the director had opted not to bring it to the attention of the company, this happening at the time the company was developing adjacent land, N19. B was actively engaged in developing a number of townships by means of separate companies and later embarked upon a joint venture with H. They used the form of a company to give effect to their joint venture. The joint venture was originally limited to the development of property owned known as N15, which at that time was the only property owned by the company, but,

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[68] *Robinson v Randfontein Estates Gold Mining Co Ltd* at 177-180.

[69] 1978 (1) SA 1109 (D). For critical discussion see Beuthin, RC 'Corporate opportunity and the no-profit rule' (1978) 95 *SALJ* 458.

subsequently by mutual agreement, the joint venture was expanded to include also the acquisition and development of another property, N19.

In the court *a quo*, in affirming H's claim, Botha J relied on the fundamental principle established in *Robinson v Randfontein Estates Gold Mining Co Ltd* that a fiduciary is prohibited from appropriating to himself business opportunity which in fairness belong to the company. It is trite that a possible conflict of personal interest and duty will establish a basis for relief.[70] It followed that in the very process of deciding to acquire the property for himself, B had placed himself in a position of conflict between interest and duty. As was pointed out B's acquisition of N20 has been an acquisition of property 'intimately connected with the business of the company, and which it was potentially detrimental to its interests to hold for himself, and that the acquisition and development of it was a matter directly concerning the company'.[71]

After examination of all the grounds upon which Botha J's finding that at the relevant time the company's business had been the acquisition and development of township properties in the N area, the Full Bench of the Appellate Division adopted a narrow approach to the issue of fiduciary accountability for misappropriation of corporate opportunity. It held that 'B did not at the time owe his co-shareholder and co-partner any fiduciary duty of the kind contended for, he did not owe it to the company either'.[72] With the scope of the business of a company having been limited to the development and exploitation of N15 and N19, there had been no fiduciary duty upon B to pass on to

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[70] See eg *Smith v Harrison & 0thers* (1872) 27 LTR 188; *Whitcote v Lawrence* (1798) 3 Ves Jun 740; 30 ER 1248; *GE Smith Ltd v Smith; Smith v Solnik* [1952] NZLR 470; *Furs Ltd v Tomkies & others* (1936) 54 CLR 583; *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL). See further Slaughter, JC 'The corporate opportunity doctrine' (1964) 18 *Southwestern LJ* 96; Note 'Corporate opportunity' (1961) 74 *Harvard LR* 765.

[71] *Bellairs v Hodnett* at 1127G.

[72] *Bellairs v Hodnett* at 1130F.

the company any fresh opportunities of obtaining further ground. B's duty to disclose in utmost good faith in terms of a shareholder's agreement related to the operations of the company within the scope of its business, and did not extend to transactions beyond that scope.

It is submitted that the restrictive attitude illustrated by the Appellate Division in *Bellair*s *v Hodnett* represents a low watermark as far as the modernization of the corporate opportunity doctrine is concerned. The approach of the Appellate Division goes against the progressive trend in comparative jurisprudence, and stands in stark contrast to the celebrated pronouncements of Laskin J in *Canada Aero Services.*

5. THE PROBLEM OF DEPARTING ENTREPRENEURIAL FIDUCIARIES

The question whether fiduciary obligations survive resignation is a troublesome one.[73] It is settled that the fiduciary duties of a director arise only once the appointment of the director takes effect.[74] There is also authority[75] to the effect that provided that the director does nothing contrary to his employer's interest whilst in the employment he may with impunity entertain the idea of resignation so that he may exploit some commercial opportunity, and after he has resigned he may proceed to acquire the opportunity for himself. In *Aberdeen Railway Co v Blakie Bros*,[76] the House of Lords did not allow a company director to be a member of the contracting partnership. That case laid down the rule that a fiduciary shall not be allowed to enter into engagements in which the fiduciary has or can have a personal

[73] Welling, B 'Former corporate managers, fiduciary obligations, and the public policy in favour of competition' (1990) 31 *Cahiers de Droit* 1095.
[74] Thus a prospective director or 'director-elect does not occupy a fiduciary position: Havenga, M 'Corporate opportunities: A South African update (Part 2)' 1996 (8) *SA Merc LJ* 233; Larkin, M 'The fiduciary duties of the company director' (1979) *SACLJ* E-1 at E-2; Van Dorsten, JL *Rights, Powers and duties of Directors* (1992) 180.
[75] *Island Export Finance Ltd v Umunna & another* [1986] BCLC 460; *Sali v SPC Ltd & another* [1991] ACLC 1511.
[76] *Bros* [1843-60] Al ER Rep. 249, 2 Eq. Rep. 1282 (HL).

interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect.

Despite this clearly expressed rule, Chitty J in *London and Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd*,[77] dismissed a company's application to restrain its chairman and director from acting as director of a rival company, on the ground that the chairman had no contract, express or implied, to give his personal services to the applicant. *London and Mashonaland* was applied in B*ell v Lever Bros Ltd*.[78] Then in *Scottish Co-operative Wholesale Society Ltd v Meyer*,[79] Denning LJ stated:[80]

> 'Your lordships were referred to *Bell v Lever Brothers Ltd.*, where Lord Blanesburg said that a director of one company was at liberty to become a director also of a rival company. That may have been so at that time. But it is at risk now of an application under section 210 [the oppression] if he subordinates the interests of the one company to those of the other.'

Academic writers[81] do not agree on when a director is in breach of the director's fiduciary duty by engaging in the same line of business. Beck, for instance, reviewed the law on the fiduciary duty of directors and points out, that "the evil that Equity set its face rigidly against was *possible* conflict of interests."[82] Beck concludes that the early cases imposed fiduciary obligations upon directors "because confidence is reposed in them to manage property that, ultimately,

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[77] [1881] WW 165 (ChD). Cf *Re Thomson* [1930] 1 Ch 203.
[78] [1932] AC 161 (HL).
[79] [1958] 3 All ER 66 (HL).
[80] *Scottish Co-operative Wholesale Society Ltd v Meyer* at 88.
[81] "Directors in competition with their companies" (2004) 16 *SA Merc LJ* 275, 281-282 and "Competing with the company – When does a director breach his or her fiduciary obligation?" (1995) 7 *SA Merc LJ* 435; Christie, M 'the director's fiduciary duty not to compete' (1992) 55 *Modern LR* 506; Davies, PL (ed) *Gower's Principles of Company Law* (6d, 1997) 622; King Report – *Report of the Committee on the Financial Aspects of Corporate Governance* (1994) 2.1.4. See further *Plus Group Ltd & others v Pyke* [2002] 2 BCLC 201 (CA) at paras 79 and 227.
[82] "Corporate Opportunity Revisited" in Ziegel (ed) *Studies in Canadian Company Law* Vol 2.(1973) c. 5, 205 (Emphasis added].

belongs to others", citing *In re The French Protestant Hospital*[83] where Dankwerts J referred to the directors and stated:[84]

> '… those are the persons who in fact control the corporation and decide what shall be done. It is plain that those persons are as much in a fiduciary position as trustees in regard to any acts which are done respecting the corporation and its property … Therefore it seems to me plain that they are, to all intents and purposes bound by the rule which affects trustees.'

Beck points out that in addition to the rule that a fiduciary must not use a position for personal advantage, there is a wider rule, often ignored in company law:[85]

> '… the wider rule that a fiduciary obligation is that a man may not occupy a position in which his interest and duty may conflict. This principle has been almost completely abandoned in company law with legislation blessing interlocking boards through rules relating to transactions in which directors are interested, and through casual judicial dicta which has allowed directors to serve with competing firms. It is suggested that in a climate of company law reform it is time to take a realistic second look at interlocking boards and directors who are allowed to compete.'

Beck refers to *London and Mashonaland* and *Bell v Lever Bros Ltd* as two instances of this "casual judicial dicta". He states that the oppression remedy ameliorated some of the worst effects of this approach.

Manitoba Ltd v Palmer[86] concerned a corporate officer who had resigned together with several employees and joined a competitor. The plaintiff who was the successor of Mayer Limited sued defendant for breach of fiduciary duty in that the defendant diverted a corporate opportunity away from the plaintiff by enticing the plaintiff's customers to deal with plaintiff's competitor and plaintiff's employees to join the competitor.

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[83] [1961] Ch. 567.
[84] *In re The French Protestant Hospital* at 570.
[85] "Corporate Opportunity Revisited" in Ziegel (ed) *Studies in Canadian Company Law* Vol 2.(1973) c. 5, 206-207.
[86] (1985) 7 CPR (3d) 477 (BC). See also *Roper v Murdock & others* (1987) 39 DLR (4th) 684 (BCSC).

Of cardinal importance was for the court to determine whether no restraint of trade agreements had been entered into with the employee and whether the employee owe any fiduciary duty to the company as is in the case of a director. It is this fiduciary duty which will limit how he could compete with the company after resignation. The court had to strike a balance between the need of a company to impose fiduciary duty upon its managerial employee against the need of the individual to earn a living and to be in productive employment. The court concluded that Palmer was in a fiduciary relationship with the plaintiff and this fiduciary duty continued and survived defendant's resignation.

In *Christie (WJ) & Co v Greer & Sussex Realty & Insurance Agency Ltd*,[87] the Manitoba Court of Appeal considered a situation similar to a case at bar. Greer was a high-ranking management employee as well as a director, officer and minority shareholder of the claimant insurance agency and real estate management company. He was found to occupy a fiduciary position which imposed a duty on him not to solicit business directly from the customers of his former employer after leaving the company. Huband K delivering the judgement of the court, made the following observations:[88]

> 'There is nothing to prevent an ordinary employee from terminating his employment, and normally that employee is free to compete with his former employer. The right to compete freely may be constrained by contract … *But it is different for a director/officer/key management person who occupies a fiduciary position. Upon his resignation and departure, that person is entitled to accept business from former client, but direct solicitation of that business is not permissible*. Having accepted a position of trust, the individual is not entitled to allow his own self-interest to collide with fiduciary responsibilities. The direct solicitation of former clients traverses the boundary of acceptable conduct. The defendant, Greer, and the co-defendant, Sussex, should have been content to allow news of Greer's departure and the establishment of Sussex to reach the clientele of W.J. Christie, without resort to direct approach.'

[87] 121 DLR 472.
[88] *Christie (WJ) & Co v Greer & Sussex Realty & Insurance Agency Ltd* at 477.

A similar approach was taken in *Metropolitan Commercial Carpet Centre Ltd v Donovan & Donovan (B) Interiors*.[89] There, the defendant Donovan, a shareholder and the general manager of the plaintiff company, resigned and then competed directly with his former employer. As a key employee of the plaintiff, the defendant was held to owe the plaintiff a fiduciary duty. Davison described the scope of the duty in these terms:[90]

> 'The extent of the fiduciary duty and the question as to whether there has been breach of such duty would differ with the factual situations in each individual case. If Donovan, by reason of his own qualifications and abilities attracts customer to his new business, such a result accrues from a personal asset of Donovan. On the other hand, if Donovan acquires a connection or a relationship with a customer of the plaintiff during the course of his employment with the plaintiff and, after resignation, he affirmatively approaches that customer with a view of enticing the customer to cease doing business with the plaintiff, that would pass over the boundary and constitute breach of a fiduciary duty.'

In *British Midland Tool Ltd v Midland International Tool Ltd & others* the court had to deal with issue of the scope of the obligation (if any) after the director's resignation, the extent to which a former director may compete with his company, and how far a such director may go in establishing up a competing business in contemplation of resignation of office. Hart J stated:[91]

> 'The situation was one, quite simply, where to the knowledge of three six members of the board of BMT, a determined attempt was being made by a potential competitor to poach the former company's workforce. The remaining three at best did nothing to discourage, and at worst actively promoted, the success of this process. In my judgement this was a plain breach of their duties as directors. Those duties required them to take active steps to thwart the process. Plainly their plan required the opposite. Active steps should have included alerting their fellow directors to what was going on. Their plan required, on the other hand, that their fellow directors be kept in the dark. This plan was formed, at the very least, by 13 March when Don Allen gave notice of retirement. At least from that date in my judgement the continuance in office of the remaining three without disclosing to their fellow directors what was afoot necessarily involved them in breach of their duties.'

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[89] (1989) 91 NSR (2d); 233 APR 99.

[90] *Metropolitan Commercial Carpet Centre Ltd v Donovan & Donovan (B) Interiors* at 103.

[91] *British Midland Tool Ltd v Midland International Tool Ltd & others* at para 90.

In the instant case, the Tamworth 4 were executive directors of the company, charged and trusted by the owners with its management on a semi-autonomous basis and having the primary responsibility for relations between the company and its employees, the fact any one of them was himself involved in a breach of duty did not release him from his duty to report breaches by the others.[92] The decision demonstrates that the fundamental duty of directors to act in good faith and in the best interest of the company is unquestionable. Although the extent of the duty to inform depends on the circumstances of each, mere passive standing by without disclosure, in itself constitutes a breach of directors' fiduciary obligations.

The principle articulated in *British Midland Tool Ltd, Christie (WJ) & Co* and *Metropolitan Commercial Carpet Centre Ltd* represents a correct statement of the law. Direct solicitation of the former employer's clients by the departing or departed employee is not acceptable where the employee is a fiduciary of the employer. Having been vested with a high degree of trust and confidence, the indicia of a fiduciary relationship, a key employee is not then at liberty to betray the trust by soliciting the employer's client and employees for his own account or for someone else to his indirect benefit. To suggest otherwise would be to weaken the strong sense of duty and obligation which the term fiduciary connotes.

In *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd& others*[93] and *Sibex Construction (SA) (Pty) Ltd & another v Injectaseal CC*[94] our courts were confronted with the problem of departing entrepreneurial corporate fiduciaries capitalizing on business opportunities. In *Atlas Organic Fertilizers*, for instance, the departing managing director had, resigned his office while serving out his period

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[92] *British Midland Tool Ltd v Midland International Tool Ltd & others* at para 91.
[93] 1981 (2) SA 173 (T).
[94] 1988 (2) SA 54 (T).

of notice, taken steps to set up new company under which he intended to do business. He also sabotaged Atlas Organic Fertilizers' chances of obtaining a long-term contract on raw materials and enticed certain employees of the plaintiff company to join his own company. The court held that the departing director had acted in violation of his fiduciary duties by diverting a contract belonging to the plaintiff company and inducing its employees to join his company.

Sibex Construction is also illustrative of the situation where a directors' departure is prompted by a decision to obtain for himself or his associate a business opportunity for which the company had been tendering. Like the corporate officers in *Canaero* and *Cooley*, in the instant case the offending officers were members of top management of the company, namely managing director and general manager. As senior officers of a working organisation they stood in fiduciary relationship with the company. While working for the company, the delinquents fiduciaries were heavily involved in tendering process as with the clients of the company. The directors later resigned and formed a company, Injectaseal, which submitted a lower tender to one of the clients of the plaintiff company.

The court considered the issue of fiduciary duty breach by the departing directors, and concluded that the courts should recognise and strictly enforce the 'strict ethic' in this area of the law to which Laskin J referred so that persons in positions of trust be less tempted to place themselves in a position where duty conflicts with interests'.[95]

The factual scenario in *Spieth & another v Nagel*[96] provides another variation of the theme. Here *Spieth* established a company (Lutro) the business of which was that of a supplier and installer of spray painting and plants for motor vehicles. The business acquired

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[95] *Sibex Construction (SA) (Pty) Ltd & another v Injectaseal CC* 1988 (2) SA 54 (T).
[96] [1997] 3 All 316 (W). For commentary see Salant, J (1999) *De Rebus* 34.

exclusive agency for the importation of certain products for distribution in Southern Africa. The business was run successfully as one-man concern by the applicant who was contemplating retirement in due course. Nagel was employed and became a director and shareholder. A series of incidents over a period of two years resulted in the respondent being suspended from his employment. The applicant contended that the respondent director had approached the distributor with the intention of having the distributorship awarded to him and that his solicitation of the distributorship amounted to breach of his fiduciary duty as a director. The applicants (Spieth and Lutro) sought an interdict to prevent the respondent director from usurping the business opportunity.

The court had no difficulty in concluding on the facts that the respondent had breached his fiduciary duties as a director and that the interdict sought by the applicant was appropriate in the circumstances. The significance of this decision is that it is the first South African case, which, in the context of a corporate opportunity, prevents a departing corporate officer from continuing to exploit such opportunity for himself after his resignation. In enunciating the principle that fiduciary duties survive any voluntary departure, Schwartzman J held:[97]

> ' … there is no reason in principle why in an appropriate case, a company should not while such duty survives, be protected by way of an interdict from an irreparable loss it may otherwise suffer if the director, following his resignation, is allowed to continue to exploit a commercial opportunity created in breach of his fiduciary duty.'

In articulating the general principles of equity and fairness, Jeff Salant[98] has argued that the *Canaero* and *Spieth* judgements have implications beyond the circumstances in which the decisions were rendered. He writes: [99]

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[97] *Spieth & another v Nagel* [1997] 3 All 316 (W) at para 20.
[98] 'The travails of corporate officers' (1999) *De Rebus* 34
[99] 'The travails of corporate officers' (1999) *De Rebus* footnote 62 supra page 38.

> "Applying the expanded concept of corporate opportunity presented in these decisions which prescribe that a fiduciary must not put himself in a position where his duty and interest may conflict, there will no doubt be hard cases and decisions with which our courts will need to grapple in the future. The evidentiary difficulties alone (not to mention the discharging of the onus of proof on a balance of probabilities) may leave the applicant without remedy. It may well be prudent for a company in its articles of association or service contracts to detail comprehensively the fiduciary duties of its directors and senior officers both during and after their term of employment and to spell out clearly the consequences which follow upon a breach being committed. This could alleviate some of the difficulties which might be encountered in subsequent litigation."

However, where a former director's resignation was not prompted by the need to exploit a commercial opportunity that the company has been actively pursuing, a breach of fiduciary duty will not arise. In one of the leading cases,[100] the court held that the former director's resignation was not part of any deliberate strategy or intention to set himself in competition with his former company. Thus on the facts the resignation was brought about by his unhappiness working for the plaintiff company and in particular their failure to deal with the period of his restraint and their refusal to hand him his shares.[101]

A similar line was taken in *Ont. Ltd v Tyrell*[102] wherein the former manager was allowed to compete for the plaintiff's customers. The court concluded that Tyrell was allowed to compete with plaintiff for customers as Tyrell's resignation was prompted by the plaintiff in circumstances amounting to constructive dismissal and Tyrell's resignation was not influenced by a desire to acquire for himself a business opportunity pursued by his employer.

Havenga is of the opinion that limitless accountability would be too harsh and several factors like the passage of time, the nature of the business, the nature of the information involved and more importantly

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[100] *Movie Camera Company (Pty) Ltd v Van Wyk* [2003] 2 All SA 291(C).
[101] *Movie Camera Company (Pty) Ltd v Van Wyk* footnote 64 *supra* at para 54.
[102] (1981) 127 DLR (3rd) 99 (Ont H.C.).

the circumstances which led to the director's resignation should be taken into consideration. She elaborates:[103]

> "It would be unreasonable to expect a director who has been unlawfully dismissed by the company to abstain from using business contacts or information acquired during his term of office, more importantly a director may be indemnified in the article of association or a separate contract with the company from liability which would arise from competition with the company after termination of his office."

The *Symington & others v Pretoria-Oos Privaat Hospital Bedryfs (Pty) Ltd*[104] case provides another example of a situation in which defaulting corporate fiduciary faced a claim for disgorgement of profits for receiving benefit from a sublease. Briefly stated, the relevant facts were that the respondent company was formed to operate a newly established private hospital. The appellant directors were shareholders in the company. The shareholders' agreement provided that Symington, the first appellant would utilise the premises for conducting a radiologist practice and a lease agreement was concluded to this effect. Another company (IA) was then nominated by Symington to be the lessee in his place and IA thereafter entered into a sublease with a partnership of radiologists. At the time the lease and sublease was concluded, the appellants were shareholders and directors of IA. Subsequently the shares in the respondent company were sold to Netcare. In terms of the sale agreement, all directors were obliged to resign. The appellants handed in their letter of resignation as directors of the respondent company to a representative of Netcare on the same day. The Registrar of Companies received notification of their resignation at a later date.

The respondent company's claim for damages was based on the proposition that the appellants, by permitting IA to enter into a sublease had deprived them of a corporate opportunity to let out the

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[103] Havenga, M 'Corporate opportunities: A South African update (Part 2)' 1996 (8) *SA Merc LJ* 233, 235.
[104] [2005] 4 All SA 403 (SCA).

premises for a commercial rental. They also contended that by allowing IA to enter into the sublease, the appellants had breached their fiduciary duty as directors of the respondent. On appeal, the court held that since the respondent's claim for damages was pursuant to breach of fiduciary duty, it followed that the damages would only become due when the sublease constituting such breach was concluded, namely 8 November 1996. Since summons was only served in November 2000, then respondent's claim was incorrectly framed as one of disgorgement of profits as there was no evidence that the appellants had received any benefit from the sublease.

In 2003 *Phillips v Fieldstone Africa (Pty) Ltd & another*[105] was decided. In issue was the appellant director's liability to account to his employer for secret profits made out of a corporate opportunity arsing out of an empowerment transaction. The essence of the judgement is expressed in the following instructive comments by Heher JA which, it is submitted, apply the authorities correctly:[106]

> 'The duties of the appellant which were inherent in his relationship with the respondents included the promotion of the respondents' interests and the disclosure to them of such information as came to his knowledge which might reasonably be thought to have a bearing on their business.
>
> That the appellant breached his duty is manifest. He failed to inform the respondents of the offer to him or its terms; he took it for himself without their consent. In both respects he succumbed to a potential conflict of interest between his duty and his self-interest.
>
> It is irrelevant … that the opportunity "properly belonged to the company" unless this means no more than that it was an opportunity which arose in the context of the appellant's fiduciary duty to the respondents and of which he was required to inform them.'

The facts in this matter can be summarised as follows: Phillips had been employed by the respondents, an American-based group of companies, Fieldstone Private Capital Group. The respondents sued

[105] 2003 SA (SCA).
[106] *Phillips v Fieldstone Africa (Pty) Ltd & another* 2004 (3) SA 465 (SCA) at paras 38-40. See also *Ganes & another v Telecom Namibia Ltd* 2004 (3) SA 615 (SCA) at para [16].

the appellant after he had resigned, when they discovered that he had used his position within the company to obtain shares in an empowerment company with which the respondents were doing business. They contended that the appellant had acted in breach of his duty of loyalty to the respondents in not accounting to them for the shares.

When the issue of availability of an equity stake in the empowerment company, was raised the respondents advised Phillips that he could acquire shares in his personal capacity since he was a corporate fiduciary.[107] His response was that the empowerment company was prepared to issue shares for purposes of raising capital to selected black empowerment individuals. After a survey of comparative authorities and legal principles, the court held that the director had appropriated an opportunity belonging to the company as he stood in a fiduciary relationship to the respondents when the opportunity became available to him. Consequently the delinquent corporate fiduciary was deemed to have acquired the shares on behalf of the respondents and in terms of his fiduciary duty, was obliged to account to them in respect thereof.

The twin questions of corporate opportunity and confidential information is addressed by the King Report. That Report[108] provides that confidential matters of a company acquired by directors in their capacity as directors should be treated as such and not be divulged to anyone without the authority of the company. The appropriation of corporate opportunity at times overlaps with the misuse of confidential information. However the appropriation of a corporate opportunity may also involve information which is not of a confidential nature. In order to determine whether an opportunity is a corporate opportunity our courts use the line of business test. Once the

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[107] *Phillips v Fieldstone Africa (Pty) Ltd & another* 2004 (3) SA 465 (SCA). at para 11.
[108] *Report of the Committee on the Financial Aspects of Corporate Governance* (1994) 2.1.4. The Code of Ethics for Enterprises 7.3.1.

opportunity fits in with the existing and prospective interests or the activity of the corporation then the opportunity must be passed over to the company. What is of outmost importance is not whether the particular information was confidential but is what use the director made of the information.[109] For the information to constitute confidential information the information must be confidential and of economic value. Liability for use of confidential information arises from various sources, a fiduciary obligation being one source and also from unlawful competition or from the law of contract. Once the information is classified as confidential information then it is regarded as intellectual property and belongs to the plaintiff and is protected by common law remedy of Aquillan action.

6. THE PROBLEM OF CORPORATE INACAPCITY

6.1 Financial Inability and Rejection of the Opportunity by the Corporation

One of the factors considered when determining whether the opportunity belongs to the corporation is the financial ability to pursue the obligation. Does proof of commercial impossibility provide a defence to directors who appropriate to their own use a maturing corporate opportunity? The desirability of permitting such a defence is problematic as it could chill a director's enthusiasm to use his best efforts for the company.[110] There are divergent views in the American

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[109] *Coolair Ventilator CO (SA) (Pty) Ltd* v *Liebenberg* 1967 (1) SA 686 (W) at 691 the court held:

> "An employer is entitled to be protected from unfair competition brought about by confidential information of his business having been conveyed to a trade rival by an employee or ex employee, what would constitute information of a confidential nature would depend on the circumstances of each case, and in this regard the potential or actual usefulness of the information to a rival would be an important consideration in determining whether it was confidential or not."

[110] Prentice, D 'Corporate opportunity – Windfall profits' (1979) 42 *Modern LR* 215, 217. It will be recalled that in *Industrial Development Consultants Ltd v Cooley*, the court rejected Cooley's defence that the contracting party would not have entered into any contractual relationship with the company even if he had complied with his

courts; some hold the view that the fact that a corporation is financially unable to pursue the obligation does not necessarily justify the director to divert the opportunity for personal use.

Peso Silver Mines Ltd (N.P.L.) v Cropper[111] illustrates the extraordinarily difficult situation in which directors with conflicting obligations may find themselves. Cropper, the controlling director, and his associates purchased the claims, which were rejected by Peso company. In P*eso* there was a finding of good faith in the rejection by its directors of an offer of mining claims because of the company's parlous financial position. The subsequent acquisition of those claims by the managing director and his associates, albeit without seeking shareholder approval was held to be proper because the company's interest in them ceased. There is some analogy to *Queensland Mines Ltd v Hudson*[112] where Lord Scarman said that when the company renounced its interest in the venture:

> 'It can be said that from that date when company renounced its interest in the venture based on the licences was "outside the scope of the trust and outside the scope of the agency" created by the relation of director and company … Or it can be said that on that date the company gave their informed consent to pursue the matter further and to leave the director to what he wished or could with the licences'

Peso Silver Mines also bears close resemblance to *Burg v Horn* because there was evidence that Peso had received many offers of mining properties and, as in *Burg v Horn*, the acquisition of particular claims out of which the litigation arose could not be said to be essential to the success of the company.

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duty to the plaintiff. In *Phillips v Fieldstone Africa (Pty) Ltd & another*, the Supreme Court of Appeal rejected Phillips defence that the client was only prepared to issue shares to selected black empowerment individuals.

[111] (1966) 58 DLR (2d) 1; [1966] SCR 673, 56 WWR 641. For critical for commentary: Beck, SM "The saga of *Peso Silver Mines*: Corporate opportunity reconsidered" (1971) 49 *Canadian Bar Review* 80.

[112] (1978) 18 ALR 1 (PC).

The next relevant case is that of *Irving Trust v Deuth*,[113] is particularly helpful because the corporation's financial inability was created by directors by failing to repay the debt they owed to the corporation. Although the court did not deal with the matter *per se* but sought to address the principle broadly and came to the conclusion that the directors should not be allowed to plead financial inability as this will put the temptation high for the director not to put more effort in an attempt to secure funding for the corporation since they will stand to benefit personally if the corporation does not meet its obligation as the corporate opportunity will then pass over to the directors. The American courts are in support of the strict rule generally applied by the courts of equity in decisions on the duty of undivided loyalty.[114] Commentators and courts supporting this decision have indicated that if financial inability will excuse the director from accounting for the profit made the end result will be as good as allowing diversion. The opposite view which seems to be followed in recent cases is that financial inability of a corporation to take advantage of a corporate opportunity will absolve a director who makes personal use of the opportunity.[115]

In Delaware the practice is that a corporate manager has no obligation to offer a corporate opportunity to the corporation if it is financially not in a position to pursue the opportunity or is unable to avail itself of the opportunity due to other factors. The accepted position in Delaware is that not only should the corporation be unable to pay the bills as they become due, but also the corporation's financial inability should amount to insolvency. The corporation should be practically

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[113] 73 FZ 121 (2nd Cir 1934).

[114] Anon "Fiduciary duty of officers and directors not to compete with the corporation' (1941) 54 *Harvard LR* 1191; Anon "Corporate opportunity" (161) *Harvard LR* 765; Anon "Corporate opportunity in close corporation – A different result?" (1967) 56 *Georgetown LJ* 381.

[115] Brown, DJ 'When opportunity knocks: An analysis of the Brudney & Clark and ALI principles of corporate governance proposals for declaring opportunity claims' (1986-1987) *Corporate Practice Commentator* 507, 516.

defunct as the condition could be ascertainable and cannot easily be feigned.[116]

What is interesting in the Delaware approach is that while a director has no obligation to loan his or her funds to the corporation to assist it to acquire a corporate opportunity, the director may not rely on the corporation's financial inability to acquire an opportunity if his/her lack of diligence was the cause of the corporation's financial mishap. The corporation's insolvency must have arisen despite the director's diligent exercise of his or her fiduciary duty. It stands to logic that where the insolvency is due to a lack of proper exercise of fiduciary duty by a director, then the director cannot raise the defence of financial inability when called upon to account for profit made. The view endorsed by the American Law Institute is that a director may only avail himself or herself of the corporate opportunity only if the opportunity has been rejected by the corporation after proper disclosure.[117] The rejection may be based inter alia on the financial inability of the corporation to pursue the opportunity. When determining the financial status of the corporation, the American Courts consider the assets immediately available to the corporation which may include cash, credit or other saleable commodities. The American Courts[118] have put a safety valve in place by requiring that where the corporation has formally rejected the opportunity the director may only utilize the opportunity if he did not connive in the rejection of the opportunity and the opportunity must have been rejected by some disinterested votes of the board of directors after full disclosure. Most commonwealth decisions have rejected the defence of

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[116] See *Fleigler v Lawrence* 361 A 2d 21 (Del 1976).
[117] Slaughter, JC 'The corporate opportunity doctrine' (1964) 18 *Southwestern LJ* 96, 101.
[118] See eg *Knutsen v Frushour* 436 P 2d 521 (Idaho 1968) at 526; *Katz Corporation v TH Canty & Co Inc* 362 A 2d 975 (Conn 1975) at 980; *Borden v Sunskey* 530 F 2d 478 (3rd Cir 1976) at 493.

financial inability or rejection of the particular opportunity by the corporation.[119]

A decision has not yet been taken by the South African Courts whether financial inability to pursue the opportunity and the rejection of the opportunity by a board of directors to acquire the opportunity will be a defence by a director who is required to account for the profit made.[120] There is however strong indication or agreement in favour of allowing directors to retain profit made from the appropriation of an opportunity that the company was unable to pursue.

The reason is that there are honest and diligent directors and if financial inability is rejected as a defence available to a director who must account for corporate opportunity there will be no differentiation between diligent and honest directors on the one side and dishonest and delinquent directors on the other side.[121] The main purpose of rejecting financial inability is to protect shareholders from unscrupulous and delinquent directors who may abuse their privileged position in their companies. The rejection of the defence will amount to painting honest and diligent directors as well as dishonest and delinquent directors with the same brush.

The major criticism of the approach of allowing directors to retain the profits made will inevitably be inviting the courts to run the company's business, an area which is the director's duty and courts

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[119] *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592; *Regal (Hastings) Ltd v Gulliver* (1942) 1 All ER (1967) 2 AC 134 (HL); *Boardman v Phipps* (1967) 2 AC 46 (HL); *Industrial Development Consultants v Cooley* (1972) 1 WLR 443 (1972) 2 All ER 162; *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 395. But recently many jurisdictions have indicated a more flexible approach: *Island Export Finance Ltd v Umunna & another* [1986] BCLC 460; *Peso Silver Mines Ltd v Cropper* (1966) 56 DLR (2d) 117, (1960 58 DLR (2d) 1; *New Zealand Netherlands Society 'Oranje' Incorporated v Kuys & another* [1973] 1 WLR 1127 (PC), [1973] 1 All ER 122, [1973] 2 NZLR 164.

[120] Havenga, M 'Corporate opportunities: A South African update (Part 2)' 1996 (8) *SA Merc LJ* 233, 240-243.

[121] Basin, NA 'The dishonest director and secret profits' (1978) 128 *New LJ* 527; Weinrib, EJ 'The fiduciary obligation' (1975) 25 *University of Toronto LJ* 1.

have long ago expressed their unwillingness to enter into the company's business decisions.[122] If the board's rejection of a particular opportunity enables a director to take it for his own personal use then the court will inevitably have to enter the arena and determine whether the rejection by the board was *bona fide*. The problem for the court to determine the *bona fide* of the board in rejecting the opportunity is that it is the same board which is in possession of the evidence relating to the company's financial ability or inability to pursue the opportunity, and it is the same board which will personally benefit should the company decide to reject the opportunity. The rejection of the opportunity does not eliminate the conflict of interest problem.

On the other side the decision to reject the business opportunity not only deprives the company of the business opportunity but also facilitates its subsequent exploitation by the directors who are the very persons who decided on behalf of the company to reject the opportunity.

The other problematic area is that an opportunity remains a business opportunity as long as the board of directors is of the opinion that the company should continue to obtain it. The moment the board of directors decides not to pursue the opportunity then it lies open for the director to appropriate it and is no longer a corporate opportunity. If a director appropriates such opportunity then he may be liable under the no profit rule, but the general meeting may ratify the making of profit. This view carries large risk to the company because in most cases it is very difficult for the general meeting to find that the

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[122] Beck, SM "The saga of *Peso Silver Mines*: Corporate opportunity reconsidered" (1971) 49 *Canadian Bar Review* 80, 102; Bishop, W & Prentice, D 'Some legal economic aspects of fiduciary remuneration' (1983) 46 *Modern LR* 289, 303; Prentice, D '*Regal (Hastings) Ltd v Gulliver* – The Canadian experience' (1967) 30 *Modern LR* 450, 451.

decision not to pursue an opportunity was not taken in good faith.[123] If bad faith cannot be proved the opportunity will not be regarded as corporate and the general meeting will authorize the director to retain the benefit. The unfortunate part is that the majority of directors exercise the majority of votes in the general meeting which should determine the *bona fide* of the rejection of the opportunity.[124] Another school of thought is that financial inability and the rejection of the opportunity does not imply that the opportunity is no longer corporate in nature and the director has a free hand to pursue the opportunity for personal use.

It is submitted that the principles at the root suggest the answer the fiduciary duties of company directors serve primarily to prevent abuse of the director's privileged position in his company. Directors should not fall into the temptation of not putting their strongest efforts on behalf of the company. The need to protect the various interests involved warrants that once conflict of interest is found to exist, the rejection of the opportunity or the company's financial inability will not allow the director to appropriate the opportunity for personal use. The director should always obtain the approval of the shareholders before taking up the opportunity.

6.2 Unauthorised Transactions

In American Law there is authority[125] for the proposition that a director or officer of the corporation may avail himself or herself of opportunities, which he acquires through his position in the

[123] Beuthin, RC 'Corporate opportunity and the no-profit rule' (1978) 95 *SALJ* 458;,465; Hahlo, HR 'The missed opportunity' (1986) 85 *SALJ* 71.
[124] In Joubert (founding ed) *LAWSA* vol 4(1) 'Companies' (By Blackman, MS) para 228 it is suggested that where the board of directors has honestly decided not to take an opportunity because it is unsuitable or because the company has insufficient finance, a director may take the opportunity for himself.
[125] *Diedrick v Helm* 14 NW 2d 913 (Minn 1944) at 920; *Urban J Alexander Co v Trinkle* 224 SW 2d 923 (Ky 1949) at 926; *Hawaiian International Finances , Inc v Pablo* 488 P 2d 1172 (Hawaii 1971).

corporation if those opportunities are *ultra vires* the corporation. This rule is based on the principle that corporate officers who wrongfully make use of corporate assets for their own benefit are liable to account for the profit[126] made but at the election of the corporation either for the diversion of the corporate assets or as constructive trustees with respect to the profit made in the transaction in which they wrongfully used those assets.

In order for the opportunity to qualify as a corporate opportunity the opportunity should not only be in the line of business of the company but the company should in all circumstances be seen to have been relying on the director to acquire it or to assist the company in the acquisition. In the event of a transaction been *ultra vires* the company, the director should be allowed to take the opportunity provided there is no breach of fiduciary obligation by the director to act in the interest of the company.

6.3 Ratification

One of the most complex fiduciary obligations of a company is the ratification of breach of fiduciary duty. The general meeting of shareholders may ratify wrongs committed by a director after full disclosure provided the wrong or breach is ratifiable. Some wrongs are unratifiable; such wrongs are usually set out in the company's constitution. The general meeting of shareholders cannot ratify breaches of the common law which amounts to "fraud on the minority."[127] The general meeting of shareholders may not ratify *mala*

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[126] Slaughter, JC 'The corporate opportunity doctrine' (1964) 18 *Southwestern LJ* 96, 100. In *Ellzey v Fry-Pruf Inc* 376 So 2d 1328 (Miss 1979) at 11334 the court warned, however, that a plaintiff's case should not be deemed deficient by reason of the corporation's financial inability if the fiduciary is unable to rebut evidence that such inability resulted either from the fiduciary's failure to pay a debt owing to the corporation or from his or her failure to exert his or her best efforts to prevent or cure the inability.

[127] *Attwool v Merryweather* (1867) LR 5 Eq 464; Cohen, CJ 'The distribution of powers in a company as a matter of law' (1973) 90 *SALJ* 262, 284.

fide wrongs by the directors, where the directors failed to act in the best interest of the company.[128] The majority shareholders when deciding on ratification must always act in the best interest of the company.

The general meeting is precluded to decide on ratification where appropriation of company assets are involved as this may not be in the best interest of the company as the wrongdoer will receive a benefit at the expense of the company, therefore this will amount to fraud on the minority.[129] The touchstone is that a wrong is unratifiable if ratification will result in the wrongdoer receiving a benefit at the expense of the company and the company suffer prejudice as it place its assets in the hands of the wrongdoer. The question to be answered in cases of ratification is whether the majority shareholders acted in accordance with the common law rule that it must act honestly and in the interest of the company. In determining whether the general meeting acted in the interest of the company the question is whether the decision is beneficial to the company, if not then it is a fraud on the minority and is invalid.[130] Directors can only be released from liability if condonation of the wrong will be in the interest of the company. The making of secret profit by a director can be condoned by the general meeting as in most cases the making of the secret profit is not at the expense of the company, but is obtained as a result of the director's office. The majority shareholders may allow directors who acted in good faith to retain the profit.

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[128] Wedderburn, KW 'Shareholders' rights and the rule in *Foss v Harbottle'* (1958) Cambridge LJ 93-94.

[129] Birds, J 'Making directors do their duties' (1980) 1 *Company Lawyer* 67, 69; Wedderburn, KW 'Shareholders' control of directors' powers: A judicial innovation?' (1967) 30 *Modern LR* 77, 81; Blackman, MS 'Majority rule and the new statutory derivative action' (1976) *THRHR* 27, 31.

[130] Havenga, M 'Corporate opportunities: A South African update (Part 2)' 1996 (8) *SA Merc LJ* 233, 247-250.

The appropriation of a corporate opportunity is deemed to be at the expense of the company and can therefore not be ratified. Where the wrongdoer receives the benefit at the expense of the company the company is prejudiced as it places its assets in the hands of the wrongdoer and is unratifiable, as it constitutes a *mala fide* wrong.[131] Where the company is unable to pursue the obligation due to financial inability the majority shareholders cannot ratify the acquisition of the corporate opportunity by the director for own benefit.

7. SUMMARY AND CONCLUSION

Three principal conclusions can be drawn from this study. To define corporate opportunity has proved to be elusive but however it may be defined as any economic or business opportunity, whether property or rights, which rightfully "belongs" to the company. The duty not to usurp such an opportunity arises from the particular relationship which exists between the corporate fiduciary and his or her company or between the company and the particular opportunity. An examination of the various tests applied by courts in different jurisdictions seems to suggest that there are at least three situations in which the duty attaches to a director. Firstly, where the directors have been expressly or impliedly given a specific mandate either to acquire a particular opportunity for the company or to inform the company as to its suitability. Secondly, where the director alone, or together with other directors, are given expressly or impliedly a general mandate to acquire opportunities for the company, or to pass on information to it about opportunities, or if they in fact control the company or those in power to manage its affairs. Thirdly, where the directors appropriate an opportunity, which the company is actively

[131] *Menier v Hopper's Telegraph Works* (1874) L R 9 Ch App 350; *Burland v Earle* (1902) AC 83 PC; *Cohen v Directors of Rand Colliers Ltd* 1906 TS 197 at 203; *Moti v Moti & Hassim Moti Ltd* 1934 TPD 428 at 441; *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1981] Ch 257, [1980] 2 All ER 841.

pursuing, or an opportunity which at least in so far as its directors are concerned can be said to belong to the company.

Second, an examination of recent case law in South Africa as well as the experience in other countries on the fiduciary obligations of directors and officers demonstrates a progressive trend toward an enforcement of a strict ethical standard in this area of corporate law. It is now generally accepted that corporate fiduciaries are precluded from exploiting for themselves or diverting to a third party a maturing corporate opportunity which their company is actively pursuing. The same applies in relation to a former director whose resignation may be fairly said to have been motivated by a wish to acquire for themselves the opportunity sought by the company, particularly where it was their fiduciary position rather than fresh initiatives that led them to the opportunity which they later misappropriated.

The third conclusion is that corporate incapacity, or even *ultra vires*, is no defence to a claim against directors who have usurped corporate opportunity at the expense of the company. In relation to corporate incapacity, it is important to consider not only in what circumstances the company was unable to pursue a commercial opportunity but also whether the directors were not responsible for the company's financial or legal disability. If the directors were the cause of the company's inability or they exercised their powers in such manner that the company is unable to pursue the business opportunity, then they are disqualified from acquiring the corporate opportunity lost by the company. Even where the company has found the opportunity to be unsuitable, it is advisable that directors obtain the approval of shareholders before acquiring such an opportunity.

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