Case comments/Vonnisbesprekings

Company directors — fiduciary duties, corporate opportunities and confidential information

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The recent decision in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988(2) SA 54(T) once again focuses attention on the general duty owed by a director to his company not to make personal use of confidential information, which he acquired by reason of and in the execution of his office, to acquire a business opportunity for himself. (*Cook v Deeks* [1916] 1 AC 554; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; [1942] 1 All ER 378. In *Phipps v Boardman* [1967] 2 AC 46 at 123 it was regarded as a fundamental rule of equity that a person in a fiduciary position must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict. See also Farrar, Furey et al *Farrar's Company Law* 2 ed (1988) 360; Boyle and Sykes (eds) *Gore-Browne on Companies* 44 ed (1986) par 27.21; Gower *Gower's Principles of Modern Company Law* 4 ed (1979) 583; Pennington *Company Law* 5 ed (1985) 667; Cilliers & Benade (eds) *Corporate Law* (1987) 288; Blackman *The Fiduciary Doctrine and its Application to Directors of Companies* (1970) PhD Thesis University of Cape Town; Naudé *Die Regsposisie van die Maatskappydirekteur* (1970) 107; Beuthin 'Corporate opportunities and the no-profit rule' (1979) 96 *SALJ* 458 as well as the cases mentioned below for general authority in this regard.)

In *Sibex* the first applicant (hereafter referred to as 'Sibex'), a wholly owned subsidiary of the second applicant, conducted as its sole business, on-line maintenance sealing. This entails a unique process whereby on-line leaks in a plant or equipment are sealed without the necessity of shutting down such plant or equipment. The first respondent, Injectaseal CC, had as founding members B and C. Both these members of the close corporation had previously been involved in the management of Sibex — B as managing director and C as general manager of this company. It was common cause that the business conducted by Injectaseal CC was in direct competition with that of Sibex (at 58A). From the facts it appeared that the founding

statement of the close corporation had been signed on 8 July 1987, only five days after B had left the employ of Sibex (at 57F and 58A). C had tendered his resignation on 24 June 1987, but had remained in the company's service until 31 July 1987. The majority of skilled technicians in the employ of Sibex had also left the company at the end of July 1987 to join Injectaseal CC (at 57I).

During July 1987 and on behalf of Sibex, C, whilst he was still in the employ of Sibex, had submitted a tender for work to Sasol and Natref, its main clients. Later in the same month Injectaseal CC sent a letter with price schedule attached to Sasol, inviting their business. The prices set out in the schedule were somewhat lower than those which had been tendered by Sibex.

Sibex applied to court for limited relief, namely to interdict Injectaseal CC from benefiting from the current quotations to Sasol and Natref pendente lite. Goldstone J distinguished two distinct causes of action and ordered the respondent to withdraw any quotation or tender submitted in respect of both the Sasol and Natref contracts, also prohibiting submission of any further such quotations pending the determination of an action by the applicants for a final interdict.

In its discussion of the first possible cause of action, unfair competition, the learned judge entertained no doubt that in the circumstances of the case before the court the information concerning tender prices constituted confidential information. Had such information been used by the close corporation, it would have constituted unfair and unlawful competition (at 64D-F). The court was of the opinion that a very substantial probability existed that the information had been used as aforesaid (at 67F-G).

The remarks pertaining to the second possible cause of action, namely the breach of the fiduciary duty owed to his company by a director, form the subject of this analysis.

In *Sibex* the court doubted the correctness of the statement by Van Dijkhorst J in *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano* 1981(2) SA 173(T) that in our law the fiduciary duty of a director arises only in situations where the director acts as an agent for the company (at 198D-F). Goldstone J pointed out that both in South Africa and elsewhere authority exists for the proposition that a director is a trustee for his company and that his fiduciary duty arises from this. Unfortunately, however, his lordship did not make use of the opportunity to pursue this proposition any further and because of the urgency of the matter before him assumed that the fiduciary duty of a director of a company and that of a member of its top management arises only where he acts as an agent for the company. The positions of B and C were treated similarly for purposes of consideration of the possible breach of their fiduciary duties. The court held that the facts before it were more than sufficient to justify the limited relief claimed

by the applicants. It is therefore submitted that the indication by Goldstone J that the fiduciary duties of a director might arise from his 'trusteeship' is only obiter. His remarks are, however, of significance as this would imply that the fiduciary duty of a company director extends beyond instances where he acts as an agent for his company.

In *Atlas Organic Fertilizers* Van Dijkhorst J considered the fiduciary duty of a managing director, whose services had been terminated and who was serving his month's notice, to be no greater than that of an ordinary director serving on the board of two competing companies. In respect of the position of such an ordinary director the court qualified the general (and perhaps universal) principle stated in *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 177 that where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to place himself in a position where his interests conflict with his duty. In the field of company law, stated the learned judge, this statement is narrowed down as an individual director is not as such an agent of a company and is therefore as a rule free to transact business on his own account even in competition with the company of which he is a director. The position of trust and fiduciary duty of such a director were thus clearly connected to his position as 'agent' of the company. (See also Naudé 'Mededinging deur 'n direkteur met sy maatskappy' 1970 (87) *SALJ* 193; *Bell v Lever Brothers Ltd* [1932] AC 161.) McLennan, however, finds it 'eminently more satisfactory to apply the "no power without responsibility" principle, and simply to say that if a person is in fact in a position of trust — be he agent, mandatory, director or whatever — he cannot escape the duty that inevitably attaches to the trust' (McLennan 'Directors' duties and misapplication of company funds' (1982) 99 *SALJ* 394 403). This stricter approach is supported by Goldstone J in *Sibex*, who held that there is high authority in South Africa and other countries where similar legal principles obtain for the proposition that a director of a company is a trustee for his company and that a fiduciary relationship arises therefrom (at 65C). There is a difference between the position of a company director who is a fiduciary and a trustee in the strict sense of the word — 'To describe a mere fiduciary as a trustee is to create confusion, because it would widen the concept of the trust so much that it would not be possible to express the principles governing the law of trusts in any concise form . . .. To describe a mere fiduciary as a trustee is at best a metaphor'. (*Electrical Enterprises Retail Pty Ltd v Rodgers* 12 February 1988, Supreme Court of New South Wales, not reported, quoted in (1988) 7 *BCLB* 145 from *Jacobs' Law of Trusts in Australia* 5 ed par 207.) It is submitted that it is in this metaphoric sense that Goldstone J used the word trustee in *Sibex*. According to the learned judge the fiduciary duty owed by a company director is therefore not linked to his acting as agent for the company, as stated

in *Atlas Organic Fertilizers*, but stems from his position of power in relation to the company. (see also Naudé *Maatskappydirekteur* 110.)

The approach indicated in *Sibex* has several implications. Firstly, it serves as confirmation that the fiduciary duties are not restricted to those who serve as company directors, but similarly apply to any company officials who are authorised to act on behalf of the company. Particularly they would also apply to persons acting in managerial capacity. (Gower 574; *Canadian Aero Service Ltd v O'Malley* (1974) 40 DLR (3d) 371 (SCC); Beck 'The quickening of fiduciary obligation: Canadian Aero Services v O'Malley' (1975) 53 *Canadian Bar Review* 771. In Canada the same fiduciary standard for directors and officers is prescribed by statute — Canada Business Corporations Act SC 1974-75 s 117.) Certain duties can, of course, depend on statutory provisions expressly limited to directors, in which case they would be limited to the directors of a company.

In the second instance this would imply that a director could well be in breach of the fiduciary duty owed by him to his company even when he has ceased to be a director or when his period of office has terminated. The facts in *Cooley* illustrate the continued existence of the fiduciary duty after resignation by the company director. The plaintiff company in *Cooley* could not be regarded as having been deprived of a business opportunity, as it could not make use of the particular opportunity itself. Nevertheless the court held that it had been the duty of the managing director to disclose to the plaintiffs information which was of concern to them and which had come to his attention in his private capacity while he held this position. The fiduciary duty was also held to have continued after resignation in *O'Malley*. The allegation against the defendants in *O'Malley* was that whilst being directors or officers of one company they had devoted effort and planning in respect of a particular corporate opportunity as representatives of the company, but had subsequently wrongfully taken the benefit thereof for themselves in breach of a fiduciary duty to the company. Laskin J held that a fiduciary relationship existed between the defendants and the particular company, and found the general implication to be that they owed loyalty, good faith and avoidance of a conflict of duty and self-interest to this company. More specifically this meant that a director or senior officer (as the defendants in *O'Malley*) was precluded from obtaining for himself, either secretly or without the approval of the company, any property or business advantage either belonging to the company or for which it had been negotiating. This would especially be the case where the director or officer had been a participant in the negotiations on behalf of the company, as such negotiations, according to the learned judge, disqualifies a director or senior officer from usurping a maturing business opportunity pursued by the company for himself or from diverting it to any other person or company with whom or with which

he is associated. The disqualification continues even after resignation by the director (or official) where it may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company; or where it was his position with the company rather than a fresh initiative that led the director to the opportunity which he later acquired. (*O'Malley* is discussed by Prentice 'The corporate opportunity doctrine' (1974) 37 *MLR* 464; see also Weinrib 'The fiduciary obligation' (1975) 25 *University of Toronto Law Journal* 1 and Beck 'The quickening of fiduciary obligation' 771.)

The issue is relatively straightforward when, as in *Sibex*, companies had been actively pursuing the contracts and opportunities which their directors or managerial officers subsequently obtained for themselves. There is, however, still much doubt regarding the question whether directors and officers are prohibited from taking all opportunities (including those which their companies had not been seeking) which come their way or whether a more limited corporate opportunity doctrine applies (Farrar 361). In accordance with Lord Russell's judgment in *Regal (Hastings) Ltd v Gulliver* the approach would be to concentrate on the capacity of the profiteers (cf Weinrib 19 for criticism of the strict capacity approach). In *Regal* it was stated that the profit or opportunity must have been acquired by reason of their positions as directors and in the course of their fiduciary relationship. This approach was followed in *Cooley*. In *O'Malley* Laskin J, however, considered the capacity approach too restrictive and based his decision on the consideration of various factors such as the particular office or position held, the nature of the corporate opportunity and the amount of knowledge possessed by the director or managerial officer (at 391; see also Beck 'The quickening of fiduciary obligation' 775; Beuthin 469). Beck also considers the insistence that a director must be acting in the course of his office for liability to be imposed inadequate to deal with the corporate opportunity problem (Beck 'The saga of Peso Silver Mines: Corporate opportunity reconsidered' (1971) 49 *Canadian Bar Review* 80 160). Prentice discusses the various possible tests formulated in the United States of America for imposition of the fiduciary duty, namely limitation of the doctrine to situations where the company is considered to have an expectancy or inchoate interest in the particular transaction, extension thereof to all opportunities which fall within the company's line of business or the determination of liability by the application of certain ethical standards of what is fair and equitable to particular sets of facts (Prentice 464).

The recent English decision in *Island Export Finance Ltd v Umunna* [1986] BCLC 460 confirms the approach in *O'Malley*. The managing director had obtained a contract for the plaintiff company for postal caller boxes from the Cameroons postal authorities. No further

contracts were obtained from this client and, although it entertained the hope of further contracts, the company did nothing to secure such contracts. Some two and a half months after resignation by the managing director, because of his dissatisfaction with the way he was being treated in the company, and due to his own sales initiative, he obtained further contracts from the Cameroons postal authorities. Hoffman J held that a director's duty did not cease upon resignation. On the facts, however, it was found that the director had in this case not acted in breach of his fiduciary duty. The company's claim for recovery of profits was accordingly dismissed. Referring also to *Cooley*, the court distinguished a *deliberate* effort to divert a *mature* business venture from the company to the person owing the fiduciary duty to such company from the situation which arises when directors use information which forms part of their general fund of knowledge and of their stock-in-trade for themselves or for a new employer after their resignation. The court maintained that the business information which he had acquired in his previous dealings with the client formed part of this director's skill and knowledge. He was therefore entitled to use it for his own benefit. Directors, no less than employees, were held to acquire a general fund of knowledge and expertise in the course of their work. The court found it plainly in the public interest that they should be free to exploit this knowledge in a new position. This decision stresses that a policy which draws the principles of a continuing fiduciary duty so wide as to categorise as a breach of duty any use by a former director of business knowledge and skill acquired in the course of work for that company, would operate in restraint of trade. (See also *New Zealand Netherlands Society Oranje Inc v Kuys* [1973] 2 All ER 1222, where, although at least a potential fiduciary relationship was acknowledged, the position and responsibilities of the particular manager involved left the way open for a special agreement and it was held that such an agreement had indeed been made.)

A further question which arises, although not decided in *Sibex*, is whether, once directors have bona fide decided not to enter into a particular contract, a director who subsequently does pursue this transaction would be accountable for any profits made. The implication of *Regal (Hastings)* is that he would (*Regal (Hastings) Ltd v Gulliver* 144, Farrar 362). This question arose in *Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1 (cf Beck 'The saga of Peso Silver Mines' 80). The board of a mining company had bona fide rejected an offer by a prospector to sell his claims adjoining the ground belonging to the company. At the suggestion of the company's geologist some of the directors then agreed to purchase the shares themselves. The supreme court held that the defendant, one of the directors of the plaintiff company, was not liable for profits made in the transaction since there had been no use of confidential information and that the

later approach to the directors was not in their capacity as directors but as individual members of the public. The court arrived at this conclusion by examining the circumstances of the particular case to ascertain whether the director's fiduciary obligation in fact still existed. This was also the approach indicated in the minority judgment in *Phipps v Boardman* [1967] 2 AC 46 and followed in *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399. Farrar contends that the decision in *Queensland Mines* could be explained as 'simply an example of the general meeting unanimously releasing a director from his liability to account', as the shareholders had been informed throughout of all relevant facts (Farrar 363). The shareholders had, however, not been informed of the position in general meeting, although the relevant facts had received wide coverage in the Australian press. (Sullivan: 'Going it alone — Queensland Mines v Hudson' (1979) *MLR* 711.) It is submitted, however, that consent should not be ascribed to the shareholders merely because they could have been informed of the relevant issue. Effective dispensation can only be given by fully informed shareholders voting in general meeting (Sullivan 713). Beck 'The quickening of fiduciary obligation' points out that even after full disclosure to and rejection by the corporation, the fiduciary may still be banned from taking up the opportunity if there has been a significant change in circumstances prior to the time of the fiduciary's action which might affect the corporation's decision. Should the company therefore decide not to pursue a particular transaction because of a lack of finance, the director will still be accountable for profits made if he took up the opportunity for himself at a time when the company's financial position had improved to such an extent that it would have been able to pursue the opportunity. He contends that this might well have been the case in *Peso* (Beck 'The quickening of fiduciary obligation' 785).

The major criticism of the approach in *Peso* is that it requires a determination by the court as to whether the rejection of the opportunity by the company board was bona fide or not (Farrar 363). The courts themselves have expressed their doubt about their ability to make this assessment (Farrar 363). Beck suggests that whatever the requirements of bona fide rejection should be, it should not be satisfied on facts where the controlling directors, one of whom is responsible for financial policy, decide that the company is financially unable to purchase, and then within a week make use of the opportunity to purchase themselves in order to protect the interests of the company, as was the case in *Peso* (Beck 'The saga of Peso Silver Mines' 114. See also *Regal (Hastings)* 154). A further point of criticism is that the evidence which would establish the company's financial ability or inability to take the opportunity is in the control of those persons who would benefit personally if the company decides to reject the opportunity. Their efforts should be directed at obtaining the

finance for the company and not at preparing to take the opportunity for themselves should it arise. (Corkery *Directors' Powers and Duties* (1988) 93; Sullivan 714.) Thus, in both *O'Malley* and *Cooley* the courts found that the fiduciary was not really in a position to say that it was unlikely or impossible for the company to exploit the opportunity when it was his first duty to attempt to make this exploitation possible rather than take it up himself. (Beck 'The quickening of fiduciary obligation' 785.) It is further argued that anything less than an absolute rule could place the directors in a position to consider the opportunity for their own profit and would tempt them not to be totally committed to obtaining the opportunity on behalf of the company. Corkery maintains that if a director stands to gain from a rejection of the opportunity, a shadow lies over the board's decision to reject (Corkery 93). Directors should not be allowed to be put into positions that may compromise their fidelity. They should not even be placed in a position of possible conflict of duty and self-interest. They, unlike other fiduciaries, 'do not go unrewarded and liability is imposed on them not to proscribe unjust enrichment but to stifle the siren call of temptation' (Prentice 468). This stricter approach would have the advantage of clarity and avoid difficult, and sometimes rather artificial, distinctions on fact. Beck, for instance, correctly indicates that the positions of the respective companies do not really differ in *Regal* and *Peso*, as the latter company also wanted the property but could not finance the purchase thereof. (Beck 'The saga of Peso Silver Mines' 101.)

It could be argued that if company directors wish to be involved in this way, they should make full disclosure to the shareholders or seek subsequent ratification. It seems that the shareholders may unanimously consent to misappropriation, at least where the company is solvent and no element of fraud on creditors arises. (Farrar 364 and authority quoted; *Queensland Mines Ltd v Hudson*; *New Zealand Netherlands Society Oranje Inc v Kuys*; *Bellairs v Hodnett* 1978 (1) SA 1109 (A); Van Rooyen 'Bellairs v Hodnett' 1978 *TSAR* 160; Naudé 'Toestemming deur 'n maatskappy tot mededinging deur 'n direkteur' (1972) 89 *SALJ* 217; Beuthin 463.) The fiduciary will, however, often also be a shareholder. A director qua shareholder is of course entitled to the same rights as his fellow shareholders, including the right to the unfettered exercise of his vote. (*North-West Transportation v Beatty* (1887) 12 SCR 598.) In instances where such a director is a fiduciary who is asking permission or absolution, it has been contended that special rules ought to apply. (See Beck 'The quickening of fiduciary obligation' 786.) Beck suggests that if the director involved is not part of the control group, whether of directors and senior officers or shareholders, then disclosure to and unanimous approval by his fellow directors seems an adequate precaution. There is then no need for shareholder approval. The author maintains that where the director

does form part of the control group, or if he is not but there is dissenting opinion among his fellow directors, then the requirement suggested by this author is that the matter must be placed before the general meeting. He admits that this may in certain cases mean that the opportunity will no longer be available by the time such a shareholder's meeting has been held. It should be accepted that, as in the case of other trustees, certain commercial activities may be foreclosed to them as a result of their fiduciary position. However, the author concludes that '[t]he other side of this coin is that directors and senior officers occupy positions of power and prestige in society which carry privileges and monetary and psychic rewards that well compensate for such minor disabilities that they may be under as fiduciaries'. (Beck 'The quickening of fiduciary obligation' 787 n 76.) In reply to the possible argument that in the public company the directors will in any event be able to control the shareholder vote by means of proxies, he contends that the essential check is the requirement of full, public disclosure, and not the fact of the vote itself.

Ratification also poses problems. It is not clear whether the general meeting can be asked to whitewash a decision which the board was improperly forced to take (Gower 148). The question of which breaches of fiduciary duty are ratifiable and which are not, is one of the most difficult in company law. (Beck 'The saga of Peso Silver Mines' 114; Van Rooyen 'Bellairs v Hodnett' 1978 *TSAR* 160; Beuthin 463; *Bellairs v Hodnett*.) The effect of the decision in *Cook v Deeks* is that although the shareholders may vote as they please, the majority cannot appropriate the company's assets to themselves at the expense of the minority. (Cf Beck 'The saga of Peso Silver Mines' 116.) The courts might insist that the director's acts be approved by a majority of disinterested shareholders. Directors should not be allowed to solicit proxies in support of the ratification, for as indicated by Beck any director who is truly acting bona fide should not object to, and has nothing to fear from, the votes of his fellow, disinterested shareholders. (Beck 'The saga of Peso Silver Mines' 119; see also McPherson 'Duties of directors and the powers of shareholders' (1977) 51 *ALJ* 460.)

Other suggested solutions to the problems in this regard have been to set different rules depending on the type of company or a close corporation (Farrar 363) or to set no rules at all, relying instead on the market to regulate managerial wrongdoing and on shareholders to remove executives who deflect corporate assets to themselves. Beck suggests that all formulations 'reduce to asking whether the fiduciary has put himself in a position where his duty and his interest conflict, subject to the limiting qualification that he must have been acting in his official capacity when the information came his way'. (Beck 'The quickening of fiduciary obligation' 780.) This corporate opportunity doctrine requires that if the corporation has a present interest in the

opportunity or an expectancy in the sense that it is an opportunity that it has begun to look for, or is an opportunity which it may reasonably be expected to be interested in, then the fiduciary must present it to the corporation for its consideration prior to exploiting it himself. He argues that the corporate opportunity doctrine is really no more vague or difficult to apply than the test in *Regal (Hastings)* while at the same time recognizing the functional reality of commercial life. It is submitted that the problem with this suggested solution is that it still does not resolve the question of by whom and how the ratification should take place. (Beck 'the quickening of fiduciary obligation' 780.)

In *Sibex* the application was only for limited relief. It was thus not necessary for the court to consider whether the fiduciaries were liable to account to the company. This is another aspect which requires careful consideration, as such a fiduciary seems to be accountable to the company for the amount of the profit. It would furthermore appear that the director would be liable in damages to the company for any loss it suffered in consequence of his acts, which would appear to be in breach of his implied obligations under his service contract (Pennington 665). When the profit arises out of a contract between the director and a third party there will be no question of rescinding that contract at the instance of the company as the company is not a party to the contract. Here an account of profits will, according to Gower, be the sole remedy. Recovery of the profit does not depend on proof of any loss suffered by the company. It is recoverable not as damages or compensation but because the company is entitled to call upon the director to account to it (Gower 610; *Phipps v Boardman*). The amount recoverable is therefore not linked to damages and differs from the normal claim in delict. This is another aspect which may still merit further consideration.

The decision in *Sibex* is a welcome indication of the attitude of South African courts and once again stresses the importance of avoidance of conflict of interest by company directors and the need to define the parameters of this principle. In view of the relative scarcity of South African authority it is a pity that because of the urgency of the matter the court could not address the issues more comprehensively.

Overtime bans: Urgent interim relief

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Macsteel (Pty) Ltd v National Union of Metalworkers of South Africa (NH 12/3/146) is an as yet unreported decision of the President and Deputy President of the Industrial Court who presided at the return day of an application for an order, in terms of s 17(11)(a) of the