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# Corporate Opportunities: A South African Update (Part 2)\*

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## 4 Corporate Opportunities and Former Directors

The fiduciary duties of a director arise only once the appointment as director takes effect.<sup>1</sup> The leading authorities suggest that they may extend beyond resignation from office, which will hold a director accountable for the appropriation of corporate opportunities which occur after his or her resignation.<sup>2</sup> Where a director's resignation is influenced by a wish to acquire an opportunity personally, or where his or her position with the company, rather than a fresh initiative, led to the opportunity, the director remains precluded from taking it.<sup>3</sup> In *Island Export Finance Ltd v Umunna*, it was explained that otherwise 'a director, provided he does nothing contrary to his employer's interests while employed, may with impunity conceive the idea of resigning so that he may exploit some opportunity of the employees and, having resigned, proceed to exploit it for himself'.<sup>4</sup>

The Canadian Supreme Court confirmed this principle in *Roper v Murdoch et al*,<sup>5</sup> where the corporate asset at issue was the right or opportunity to produce and distribute a certain television show. When an agree-

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<sup>1</sup> Thus a prospective director or 'director-elect' does not occupy a fiduciary position: Michael Larkin 'The Fiduciary Duties of the Company Director' 1979 *South African Company LJ* E-1 at E-2; JL van Dorsten *Rights, Powers and Duties of Directors* (1992) 180. This was confirmed in respect of English law in *Lindgren v L & P Estates Ltd* [1968] Ch 572 (CA) at 596.

<sup>2</sup> *Cranleigh Precision Engineering Ltd v Bryant & another* [1965] 1 WLR 1293, [1964] 3 All ER 289; *Curtis's Furnishing Stores Ltd (in liquidation) v Freedman* [1966] 1 WLR 1219 at 1224; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162; *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371 at 391; *Island Export Finance Ltd v Umunna & another* [1986] BCLC 460 at 480. The fiduciary duties are not limited to directors, but apply equally to any officers of the company who are authorized to act on its behalf, especially those acting in a managerial capacity: *O'Malley* at 381.

<sup>3</sup> *Henochsberg on the Companies Act* 5 ed by Phillip M Meskin (ed) (1994) at 472; Robert R Pennington *Company Law* 6 ed (1990) 589; *Cranleigh Precision Engineering Ltd v Bryant* supra note 2; *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* 1909 ORC 65 at 81-82; *Industrial Development Consultants Ltd v Cooley* supra note 2; *Canadian Aero Service Ltd v O'Malley* supra note 2 at 382; *Thomas Marshall (Exporters) Ltd v Guinle* [1979] Ch 227, [1978] 3 All ER 193; *Balston Limited & another v Headline Filters Limited & another* (1990) 17 FSR 385 (Ch); *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd* [1982] WAR 1, (1982) 1 ACLC 1. It should be noted that directors' fiduciary duties, except in so far as they depend on statutory provisions expressly limited to directors, are not so restricted. They apply equally to any officers of the company who are authorized to act on its behalf, especially those acting in a managerial capacity: *O'Malley* supra note 2 at 381.

<sup>4</sup> Supra note 2 at 460. This statement applies to all directors. The terms 'employer' and 'employment' are used rather loosely.

<sup>5</sup> (1987) 39 DLR (4th) 684 (BCSC).

ment had practically been concluded with a television personality, the defendant (a senior executive of the plaintiff company) resigned and entered into a private agreement with the same personality. He was held in breach of his fiduciary duty to the company and liable to account for profits. A former director may also be restrained from using confidential information, acquired whilst being a director, to the prejudice of the company.<sup>6</sup>

These cases were decided correctly. Yet a former director is not a fiduciary, since he or she no longer holds the position from which the fiduciary obligation derives.<sup>7</sup> Accountability can be explained on the basis that, in some instances, a former director may be accountable for certain competitive activities which occurred after his or her resignation.<sup>8</sup> Also, if a director is guilty of a breach of duty while an officer of a company and he or she completes the transaction, from which a profit is derived after resignation, by acts which would amount to breaches of fiduciary duties if he or she were still a director, the company may recover the whole profit.<sup>9</sup> For example, where the fiduciary starts negotiations during his or her term of office, or resigns to take up an opportunity, the breach of duty has already occurred, although the consequences of that breach are perpetuated or come to fruition after the resignation.<sup>10</sup> This was confirmed in the Australian decision in *Sali v SPC Ltd & another*.<sup>11</sup> Ormiston J confirmed that the special duties imposed upon directors arise because of the powers they have in relation to the company's affairs. Once that relationship terminates, there is no reason to require a former director to account as a fiduciary except in respect of that which was obtained whilst a director, or in consequence of his or her acts as a director.

The interim Constitution provides that every person shall have the right freely to engage in economic activity and to pursue a livelihood anywhere in the national territory.<sup>12</sup> A former director may in appropriate circumstances rely on this right. The company must prove that any limitation of that right is reasonable, justifiable, and that it does not negate the essential content of the right in question.<sup>13</sup> It is suggested that former directors should in principle be accountable for profit made when either a conflict

<sup>6</sup> *Thomas Marshall (Exports) Ltd v Guinle* [1979] Ch 227, [1978] 3 All ER 193; LCB Gower *Gower's Principles of Modern Company Law* 5 ed (1992) 553. See also 6 below.

<sup>7</sup> Bruce Welling 'Former Corporate Managers, Fiduciary Obligations, and the Public Policy in Favor of Competition' (1990) 31 *Cahiers de Droit* 1095 at 1121:

'A fiduciary is someone in a position of *legally* condoned power who can affect the *legal* position of someone else by *legal* means and who, *for those reasons*, is obliged to consider the best interests of that other person before doing so. Corporate managers fit that description; former managers don't. That's why corporate managers fall within one of the traditional categories of fiduciaries, but former corporate managers don't.'

<sup>8</sup> See also 6 below.

<sup>9</sup> Pennington *op cit* note 3 at 589-590.

<sup>10</sup> Welling *op cit* note 7 at 1121.

<sup>11</sup> (1991) 9 ACLC 1511.

<sup>12</sup> Section 26(1) of the Constitution of the Republic of South Africa Act 200 of 1993. On the effect of s 26 on restraints of trade, see Tanya Woker 'Restraints of Trade and the New Constitution' (1994) 6 *SA Merc LJ* 329.

<sup>13</sup> Section 33(1)(a).

between self-interest and fiduciary duty led to the situation in which the profit was made, or the opportunity to make the profit can be attributed to the fiduciary position formerly occupied.<sup>14</sup> Limitless accountability would, however, set too harsh a standard.<sup>15</sup> Factors to be considered include the passage of time, the nature of the company's business, the nature of the information involved, and the circumstances which resulted in the director's resignation. For example, information which comes to corporate managers by virtue of their positions may be general in nature. It would be unrealistic to expect former directors to refrain from using such information indefinitely. Also, if the director was unlawfully dismissed by the company it cannot reasonably be expected of him or her to abstain from using business contacts or information acquired during his or her term of office to establish alternative employment. The director may, moreover, be indemnified, in the articles of association or a separate contract with the company, from liability which would otherwise arise from competition with the company after the termination of his office.<sup>16</sup> This would not fall under the prohibition of s 247 of the Companies Act,<sup>17</sup> since it does not divest the director of any fiduciary obligation owed to the company during his or her term of office.

## 5 Inability or Unwillingness of the Corporation to Pursue the Opportunity

The question arises whether directors and officers are precluded from taking all opportunities which come their way, or whether a more limited restriction applies. Thus, for example, the question posed, but left un-

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<sup>14</sup> See also Welling op cit note 7 at 1109.

<sup>15</sup> For example, in *57134 Manitoba Ltd v Palmer* (1985) 7 CPR (3d) 477 (BC), the defendant was the manager of the plaintiff company's sales operations. He resigned and, with several other employees, joined a competitor. The competitor later stopped carrying on that aspect of the business and helped the defendant to set up a retail packaging business of his own. The court concluded that managers could not solicit the clients of their former employer. On the assessment of damages the court commented (at 495):

'I do not think it is possible to arrive at an accurate mathematical calculation of the plaintiff's damages. . . . This is not a case like *Canadian Aero v O'Malley*, where a single specific business opportunity was wrongfully obtained from the plaintiff. The repeating nature of the plaintiff's business from year to year and the vagaries of commerce and customer connection require that damages be assessed rather than calculated.'

The defendant was ordered to pay five years' estimated lost revenue and four months' projected future losses to the plaintiff.

<sup>16</sup> On unlawful competition, see 6 below.

<sup>17</sup> Act 61 of 1973 as amended. Section 247(1) provides that, subject to certain exceptions contained in s 247(2), any provision, whether contained in the articles of a company or in any contract with a company, and whether expressed or implied, which purports to exempt any director or officer of the company from any liability which by law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company or to indemnify him against such liability, shall be void. On s 247 generally, see *Barlows Manufacturing Co Ltd & others v RN Barrie (Pty) Ltd & others* 1990 (4) SA 608 (C), discussed by JS McLennan 'No Contracting out of Fiduciary Duty' (1991) 3 SA Merc LJ 86; MS Blackman 'Exemption of Directors from Liability and Section 247(1) of the Companies Act, 1973' (1993) 56 THRHR 537.

answered in *Regal (Hastings) Ltd v Gulliver*,<sup>18</sup> was whether a director who pursues an opportunity with his or her own financial resources after the directors have decided in good faith not to invest their company's funds in it, is accountable to the company for any profits so derived.

Various reasons may cause a company's inability to pursue an opportunity. They include restrictions in the company's constitution or separate contracts, other legal constraints, inability to finance the venture, absence of adequate physical facilities to make use of the opportunity, and unwillingness of the party offering the opportunity to deal with the corporation.<sup>19</sup>

### 5.1 Ultra Vires Transactions

In American law there is some support for the rule that a director or officer of a corporation may avail him- or herself of opportunities acquired through his or her position in the corporation, if they are ultra vires the corporation.<sup>20</sup> This rule is qualified by the principle that corporate officers who wrongfully use corporate assets for their own benefit are liable, at the election of the corporation, either for the diversion of the corporate assets or as constructive trustees with respect to the profits made in the transactions in which they wrongfully used those assets.<sup>21</sup> This approach seems correct. It was seen above that in order to constitute a corporate opportunity, the opportunity should not only be in the line of business of the company, but also that in all the 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. This cannot be so in the event of a transaction which is ultra vires the company. The director should therefore be able to take that opportunity, provided that the fiduciary obligation to act in the company's best interests is not violated.

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<sup>18</sup> [1942] 1 All ER 378 (HL) at 391, [1967] 2 AC 134 (HL) at 152 per Lord Russell of Killowen. The decision seems to suggest that the director may be liable: *Farrar's Company Law* 3 ed by John H Farrar, Nigel E Furey & Brenda M Hannigan (1991) 362. However, *Regal* is an application of the 'secret profit' rule rather than that relating to corporate opportunities.

<sup>19</sup> Anon 'Fiduciary Duty of Officers and Directors Not to Compete with the Corporation' (1941) 54 *Harvard LR* 1191 at 1192; RP Austin 'Fiduciary Accountability for Business Opportunities' in *Equity and Commercial Relationships* by PD Finn (ed) (1987) 141 at 176; William E Knepper & Dan A Bailey *Liability of Corporate Officers and Directors* 4 ed (1988) at 103-104.

<sup>20</sup> *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).

<sup>21</sup> Anon 'Corporate Opportunity' (1961) *Harvard LR* 765; Anon 'Corporate Opportunity in the Close Corporation — A Different Result?' (1967) 56 *Georgetown LJ* 381; anon op cit note 19 at 1192; anon 'Liability of Directors for Taking Corporate Opportunities, Using Corporate Facilities, or Engaging in a Competing Business' (1939) 39 *Columbia LR* 219 at 233; Rod Acchiardo 'Close Corporations — International House of Talent Inc v Alabama: Directors' Fiduciary Duty not to Compete' (1987) 17 *Memphis State Univ LR* 599 at 600; David Clayton Carrad 'The Corporate Opportunity Doctrine in Delaware: A Guide to Corporate Planning and Anticipatory Defensive Measures' (1977) 2 *Delaware J of Corporate Law* 1 at 4; William L Cary & Melvin Aron Eisenberg *Cases and Materials on Corporations* 6 ed (1988) 571; Jodi L Popofsky 'Corporate Opportunity and Corporate Competition: A Double-Barreled Theory of Fiduciary Liability' (1982) 10 *Hofstra LR* 1193 at 1194 and 1214; John H Tovey Jr 'A Survey of Corporate Opportunity' (1956) 45 *Georgetown LJ* 99 at 108; Susan Webber 'Arkansas Corporate Fiduciary Standards — Interested Directors' Contracts and the Doctrine of Corporate

## 5.2 Financial Inability and Rejection of the Opportunity by the Corporation

The corporation's financial ability to undertake the specific business opportunity is one of the factors frequently considered to determine whether the opportunity belongs to the corporation.<sup>22</sup>

American courts disagree on the issue of liability in these instances. Some take the view that the fact that a corporation is financially unable to take advantage of an opportunity does not necessarily allow a corporate director to take the opportunity for his personal benefit. In one of the earliest cases in which the defence was denied, *Irving Trust Co v Deutch*,<sup>23</sup> the directors had created the financial inability by failing to repay debts which they owed to the corporation. The court did not base its decision on this aspect, but chose to state the principle broadly: 'If directors are permitted to justify their conduct on such a theory [of financial inability], there will be a temptation to refrain from exerting their best efforts on behalf of the corporation since, if it does not meet the obligations, an opportunity of profit will be open to them personally'.<sup>24</sup> The strict rule generally applied by courts of equity in decisions on the duty of undivided loyalty was upheld.<sup>25</sup>

Commentators and courts supporting this decision have pointed out that, if financial disability excuses the director, the inevitable result will be to allow the diversion.<sup>26</sup> The rationale is that if directors are permitted to justify their conduct on the basis of financial inability, there will be temp-

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Opportunity' (1982) 5 *Univ of Arkansas at Little Rock LJ* 39 at 65. See also *Guth v Loft, Inc* 5 A 2d 503 (Del 1939) at 510; *Central Ry Signal Co v Longden* 194 F 2d 310 (CA 1952) at 319; *International Bankers Life Insurance Company v Holloway* 368 SW 2d 567 (Tex 1963) at 577; *Brown v Presbyterian Ministers Fund* 484 F 2d 998 (3rd Cir 1973) at 1004; *Miller v Miller* 222 NW 2d 71 (Minn 1974) at 78; *Patient Care Services SC v Segal* 337 NE 2d 471 (Ill 1975) at 481; *Canion v Texas Cycle Supply, Inc* 537 SW 2d 510 (Tex 1976) at 513; *Farber v Servan Land Company, Inc* 662 F 2d 371 (5th Cir 1981) at 380; *Poling Transportation Corporation v A & P Tanker Corporation* 443 NYS 2d 895 (1981) at 897; *Graham v Mimms* 444 NE 2d 549 (Ill 1982) at 556.

<sup>22</sup> See, generally, the annotation 'Financial Inability of Corporation to Take Advantage of Business Opportunity as Affecting Determination Whether "Corporate Opportunity" Was Presented' 16 *ALR* 4th 185 (1982); anon op cit note 19 at 1199; Pat K Chew 'Competing Interests in the Corporate Opportunity Doctrine' (1989) 67 *North Carolina LR* 435 at 472-473; Robert Charles Clark *Corporate Law* (1986) 242; Mortimer Feuer *Personal Liabilities of Corporate Officers and Directors* (1961) 88ff; Harry G Henn & John R Alexander *Laws of Corporations and Other Business Enterprises* 3 ed (1983) 636.

<sup>23</sup> 73 F 2d 121 (2nd Cir 1934).

<sup>24</sup> At 124.

<sup>25</sup> *Ibid.* In *Meinhard v Salmon* 164 NE 545 (NY 1928) the court explained the strictness of the rule: 'Uncompromising rigidity has been the attitude of the courts of equity when petitioned to undermine the rules of undivided loyalty by the "disintegrating erosion" of particular exceptions' (at 546). *Irving Trust Co v Deutch* was applied in, inter alia, *Durfee v Durfee & Canning, Inc* 80 NE 2d 522 (Mass 1948) at 530; *Foley v D'Agostino* 248 NYS 2d 121 (AD 1964) at 129 and approved in *Paulman v Kritzer* 219 NE 2d 541 (Ill 1966) at 545-546. According to Knepper & Bailey op cit note 19 at 102, this view appears to reflect the trend of the decisions of the 1980's.

<sup>26</sup> Victor Brudney & Robert Charles Clark 'A New Look at Corporate Opportunities' (1981) 94 *Harvard LR* 998 at 1021; Clark op cit note 22 at 242; Knepper & Bailey op cit note 19 at 102; *WH Elliott & Sons Co, Inc v Gotthardt* 305 F2d 544 (1st Cir 1962) at 547; *Foley v D'Agostino* supra note 25 at 129; *Klinikci v Lundgren* 678 P2d 1250 (Or 1984) at 1253-1254.

tations to refrain from exerting their strongest efforts on behalf of the corporation, since an opportunity for profit will be available to them personally.

The contrary view, which appears to reflect the trend in more recent cases, is that financial inability of a corporation to take advantage of a corporate opportunity absolves directors from liability for making personal use of that opportunity.<sup>27</sup> This seems to be the accepted position in Delaware, where it has been held that a corporate manager has no obligation to offer a corporate opportunity to the corporation if it is financially unable to avail itself of the opportunity at the time or it is clearly undesirable for the corporation to attempt to undertake the opportunity because of other factors.<sup>28</sup> The application of 'the rule of uncompromising rigidity' is considered too harsh.<sup>29</sup> But the corporation's financial inability must apparently amount to insolvency,<sup>30</sup> to the point where the corporation is practically defunct, because such a condition is ascertainable and not easily feigned.<sup>31</sup> A corporation which is not going to continue in existence can have no interest in future transactions.<sup>32</sup> Mere technical insolvency, such as an inability to pay current bills when due, or mere inability to obtain credit, is insufficient.<sup>33</sup> The corporation must actually be insolvent.<sup>34</sup> A director has no specific duty to use or loan his or her own funds to assist the corporation to take advantage of a business opportunity.<sup>35</sup> However, the directors may not rely on the corporation's financial inability to utilize an opportunity if their own lack of diligence was responsible

<sup>27</sup> Chew op cit note 22 at 472; James C Slaughter 'The Corporate Opportunity Doctrine' (1964) 18 *Southwestern LJ* 96 at 100; Tovey op cit note 21 at 110; *Urban J Alexander Co v Trinkle* supra note 20 at 926; *AC Petters Company Inc v St Cloud Enterprises, Inc* 222 NW 2d 83 (Minn 1974) at 86; *Canion v Texas Cycle Supply, Inc* supra note 21 at 513; *Fliiegler v Lawrence* 361 A 2d 218 (Del 1976) at 224; *Ellzey v Fyr-Pruf Inc* 376 So 2d 1328 (Miss 1979) at 1334; *Anderson v Clemens Mobile Homes Inc* 333 NW 2d 900 (Neb 1983) at 905. In *Ellzey* 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 (at 1334).

<sup>28</sup> *Fliiegler v Lawrence* supra note 27. For a comprehensive discussion of the position under Delaware law, see Carrad op cit note 21 at 16.

<sup>29</sup> See note 25 above.

<sup>30</sup> David J Brown 'When Opportunity Knocks: An Analysis of the Brudney & Clark and ALI Principles of Corporate Governance Proposals for Deciding Corporate Opportunity Claims' (1986-1987) *Corporate Practice Commentator* 507 at 516 suggests that 'only when the corporation is insolvent is financial inability so palpably clear that the law should allow a fiduciary to determine on his own that the corporation is financially unable to exploit the opportunity and to develop the opportunity without tendering it to the corporation'. See also *Hart v Bell* 23 NW 2d 375 (Minn 1946) at 382. In this case, the purchase had been made to save the corporation from a lawsuit and possible receivership. The director was held not to be in breach of his fiduciary duty.

<sup>31</sup> Anon op cit note 19 at 1193. See also *Electronic Development Co v Robson* 28 NW 2d 130 (Neb 1947) at 138; *Nicholson v Evans* 642 P 2d 727 (Utah 1982) at 731.

<sup>32</sup> Tovey op cit note 21 at 111.

<sup>33</sup> *Nicholson v Evans* supra note 31 at 731-732.

<sup>34</sup> *Klinicki v Lundgren* supra note 26 at 1253.

<sup>35</sup> *Urban J Alexander Co v Trinkle* supra note 20 at 927; *Knepper & Bailey* op cit note 19 at 104; *Slaughter* op cit note 27 at 101; *Webber* op cit note 21 at 67.

for the corporation's fiscal position.<sup>36</sup> The insolvency must have arisen despite the proper exercise by the defendant fiduciaries of their duties.<sup>37</sup> A director who relies on the corporation's financial inability must, moreover, be able to show that attempts have been made to finance the acquisition of the particular opportunity.<sup>38</sup>

The latter view has been endorsed by the American Law Institute proposal that a director or senior executive may appropriate an opportunity for personal use if that opportunity has been rejected by the corporation after proper disclosure.<sup>39</sup> Commenting on this proposal, writers make it clear that rejection in the context of this recommendation may be based, *inter alia*, on the financial inability of the corporation to pursue the opportunity.<sup>40</sup>

In the evaluation of the financial status of a company to determine whether the corporate opportunity doctrine has been violated, American courts have considered the assets immediately available to the corporation, including cash, credit, or other saleable commodities.<sup>41</sup> In *Knutsen v Frushour*<sup>42</sup> a director of a real estate company purchased certain land for himself. His defence — that the corporation had no funds to offer the seller — was rejected on the basis that the corporation owned other land which the seller was prepared to accept.<sup>43</sup>

American decisions also indicate that where the opportunity in question has been formally rejected by the corporation, the fiduciary may make use of it, unless the fiduciary has connived to effect the rejection, or the board is under his or her domination.<sup>44</sup> The rejection by the corporation must be by a disinterested vote of the board of directors after full disclosure to it.

<sup>36</sup> *Daloisio v Peninsula Land Co* 127 A 2d 885 (NJ 1956) at 892; *Knepper & Bailey* op cit note 19 at 104.

<sup>37</sup> *Ellzey v Fyr-Pruf Inc* supra note 27 at 1335; *Slaughter* op cit note 27 at 101.

<sup>38</sup> *Borden v Sinskey* 530 F 2d 478 (3rd Cir 1976) at 493; *Hill v Hill* 420 A 2d 1078 (Penn 1980) at 1083.

<sup>39</sup> *Principles of Corporate Governance: Analysis and Recommendations* Tentative Draft No 5 (1986) para 5. The institute's corporate governance project originated in the intense interest in corporate governance that followed disclosures during the aftermath of Watergate about corporate misconduct. The proposals consist of various tentative drafts, which culminated in a final draft published appeared in 1993. On this project generally, see Kathryn N Fine 'The Corporate Governance Debate and the ALI Proposals: Reform or Restatement?' in Christopher C Whitson (ed) 'Special Project: Director and Officer Liability' (1987) 40 *Vanderbilt LR* 693.

<sup>40</sup> This principle, based on the similarly worded Tentative Draft No 3 (1984), was approved in *Klinicki v Lundgren* supra note 26.

<sup>41</sup> *Melgard v Moscow Idaho Seed Co Inc* 251 P 2d 546 (Idaho 1953) at 551; *Higgins v Shenango Pottery Company* 279 F 2d 46 (3rd Cir 1960) at 51; *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 Sinskey* supra note 38 at 493. See also *Chew* op cit note 22 at 472-473, who suggests various ways in which courts may attempt to determine the corporation's financial inability. The most direct way evaluates the financial feasibility of the corporation's undertaking of the particular opportunity.

<sup>42</sup> *Supra* note 41.

<sup>43</sup> At 526.

<sup>44</sup> See Michele Kyra Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (unpublished LLD thesis, University of South Africa 1995) at 191-192 and the authorities there.

Most Commonwealth decisions have previously refused corporate inability, or rejection of the particular opportunity by the company, as a defense to a claim based on the conflict or secret profit rules.<sup>45</sup> For example, the defence raised in *Cooley*<sup>46</sup> — that the defendant should not be held accountable since the contracting party would not have entered into any contractual relationship with the plaintiff company<sup>47</sup> — was rejected, even though the effect was to confer on the plaintiffs a benefit which it is unlikely that they would have got for themselves had the defendant discharged his duty to them.<sup>48</sup> But recently many jurisdictions have indicated a more flexible approach.<sup>49</sup>

The effect of inability to pursue an opportunity and its rejection have not yet received pertinent attention in South Africa.<sup>50</sup> Various considerations apply.<sup>51</sup> The strongest argument in favour of permitting directors to retain any profit made from the appropriation of an opportunity that the company was unable to pursue is that this will lead to the development of a more flexible doctrine which will go beyond the capacity of the individual concerned to examine the nature of the opportunity in question.<sup>52</sup> Also, it has been suggested that it may be unwise to lump honest and diligent directors together with dishonest ones.<sup>53</sup> The major criticism of this

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<sup>45</sup> *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592 (Australia); *Regal (Hastings) Ltd v Gulliver* supra note 18 (England); *Boardman & another v Phipps* [1967] 2 AC 46; [1966] 3 All ER 721 (HL) (England); *Industrial Development Consultants Ltd v Cooley* supra note 2 (England); *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 395, (1975) 5 ALR 231 per Gibbs J (Australia); *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd* supra note 3 (Australia).

<sup>46</sup> Supra note 2.

<sup>47</sup> Roskill J accepted evidence to this effect and found that there was only a ten per cent chance that the board would have contracted with the plaintiffs (at 484 of [1972] 1 WLR, 176 of [1972] 2 All ER).

<sup>48</sup> Roskill J held that 'the question whether or not benefit would have been obtained but for the breach of trust has always been treated as irrelevant' (at 483 of [1972] 1 WLR, 175 of [1972] 2 All ER). DD Prentice 'Directors' Fiduciary Duties — The Corporate Opportunity Doctrine' (1972) 50 *Canadian Bar Review* 623 at 630 argues that there are sound policy reasons why this defence in *Cooley* was rejected — any other conclusion would tempt the directors to refrain from exerting their strongest efforts on behalf of the corporation by affording them an opportunity to profit at what may be the expense of the company.

<sup>49</sup> See *Island Export Finance Ltd v Umunna* supra note 2 (England); *Peso-Silver Mines Ltd v Cropper* (1966) 56 DLR (2d) 117, (1960) 58 DLR (2d) 1 (Canada); *New Zealand Netherlands Society 'Oranje' Incorporated v Kuys & another* [1973] 1 WLR 1127 (PC), [1973] 2 All ER 1222, [1973] 2 NZLR 163 (New Zealand).

<sup>50</sup> In WA Joubert (founding ed) *The Law of South Africa* vol 4(1) first reissue (1995) sv 'Companies' (by MS Blackman) par 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.

<sup>51</sup> See also Leon van Rooyen *Die Geldigheid van die Besluite van 'n Algemene Vergadering in die Maatskappyereg* (unpublished LLD thesis, Rand Afrikaans University 1983) 533–537 for an exposition of the three main arguments in this regard.

<sup>52</sup> NA Bastin 'The Honest Director and Secret Profits' (1978) 128 *New LJ* 527; Farrar op cit note 18 at 362; Ernest J Weinrib 'The Fiduciary Obligation' (1975) 25 *Univ of Toronto LJ* 1 at 7.

<sup>53</sup> Bastin op cit note 52 at 528. See also *Cook v GC Deeks & others* [1916] 1 AC 554 (PC) and *Barnes v Addy* (1874) 9 Ch App 244 at 251, where Lord Selborne indicated that there would be 'no better mode of undermining sound doctrines of equity than to make unreasonable and inequitable applications to them'.

approach is that allowing directors to retain profits made in these circumstances inevitably involves the courts in the company's business decisions, an area of directors' duties which they have traditionally been reluctant to enter.<sup>54</sup> If the board's rejection of a particular opportunity enables a director to take it for his own advantage, the courts will inevitably have to become involved in determinations regarding the bona fides of that rejection.<sup>55</sup> The problem is exacerbated by the fact that evidence which would establish the financial ability or inability of the company to pursue the opportunity is exclusively within the control of those people who will personally benefit should the company decide to reject it. Also, rejection of the business opportunity does not eliminate the conflict of interest problem. On the contrary, the decision to reject has the dual characteristic of not only depriving the company of that opportunity, but also of facilitating its subsequent exploitation by the directors, who are the very persons who decided on behalf of the company to reject the opportunity.<sup>56</sup>

Another argument regards an opportunity as corporate in nature only for as long as the board of directors is of the opinion that the company should continue its efforts to obtain it.<sup>57</sup> As soon as the board has decided no longer to pursue the opportunity, it cannot be regarded as corporate. A director will, therefore, be able to pursue it for his or her personal profit, subject to possible liability under the no-profit rule. The general meeting will be able to ratify the making of a profit in such circumstances, as there is no expropriation of company assets.<sup>58</sup> This view carries a large risk of prejudice to the company if the directors are able to formulate policy at a general meeting. It may be very difficult to prove that a decision not to pursue an opportunity was not taken in good faith. If bad faith cannot be proved, the opportunity will not be regarded as corporate and the general meeting will as a result be able to authorize the director to retain the benefit derived from it. Often the directors themselves exercise the majority vote at these meetings.

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<sup>54</sup> Bastin op cit note 52 at 528; Stanley M Beck 'The Saga of Peso Mines: Corporate Opportunity Reconsidered' (1971) 49 *Canadian Bar R* 80 at 102; W Bishop & DD Prentice 'Some Legal and Economic Aspects of Fiduciary Remuneration' (1983) 46 *Modern LR* 289 at 303; Farrar op cit note 18 at 425; DD Prentice '*Regal (Hastings) v Gulliver* — The Canadian Experience' (1967) 30 *Modern LR* 450 at 451ff. The courts themselves have expressed doubts about their ability to make such decisions: *Regal (Hastings) Ltd v Gulliver* supra note 18 at 392 of [1942] 1 All ER, 154 of [1967] 2 AC.

<sup>55</sup> The board of directors is generally entrusted with managing the company and will, therefore, be the appropriate organ to decide whether to pursue the opportunity. To require the general meeting to decide on these matters would not resolve the matter, as the directors are often able to control this meeting: Van Rooyen op cit note 51 at 636n145.

<sup>56</sup> Prentice op cit note 54 at 454. The decisions in cases such as *Boardman v Phipps* supra note 45 and *Regal (Hastings) Ltd v Gulliver* supra note 18 do not allow fiduciaries to exploit opportunities which have arisen in the course and performance of their office, even when those with the necessary authority have turned down the venture on behalf of the principal.

<sup>57</sup> For example, by trying to obtain the required capital or amending the constitution of the company if it prevents the acquisition of the opportunity: Van Rooyen op cit note 51 at 535.

<sup>58</sup> Bastin op cit note 52 at 527ff; RC Beuthin 'Corporate Opportunities and the No-profit Rule' (1978) 95 *SALJ* 458 at 465; HR Hahlo 'The Missed Opportunity' (1968) 85 *SALJ* 71ff; Van Rooyen op cit note 51 at 535-536. See also 7 below.

Yet another argument suggests that the mere fact of financial inability, or a decision by the board not to pursue an opportunity, does not of itself imply that the opportunity is no longer corporate in nature. Directors can therefore not freely be authorized to appropriate such an opportunity.<sup>59</sup>

Other solutions to the problem should be considered. One recommendation is that different rules should apply depending upon whether the company is a public or a small private company.<sup>60</sup> It has also been suggested that actually no rules are required at all. This view is based upon the contention that the market will regulate managerial wrongdoing by the identification of wrongdoers as such in the market and the removal by shareholders of executives who deflect corporate assets to themselves.<sup>61</sup>

I believe that the principles at the root of directors' fiduciary obligations suggest the answer. Their fiduciary duties serve primarily to prevent abuse of their privileged position in the company.<sup>62</sup> Directors should not be subjected to a temptation to refrain from exerting their strongest efforts on behalf of the company.<sup>63</sup> They are also usually handsomely compensated, although they have no right to compensation merely because of their appointment.<sup>64</sup> So a director should not be placed in a position where he or she is tempted to abuse that office. If a conflict of interest is found to exist, rejection of the opportunity or the company's financial inability does not allow its appropriation by a director personally.<sup>65</sup> This strict approach is warranted by the need to balance and protect the various interests involved.<sup>66</sup> The director is not prejudiced, for he or she retains the

<sup>59</sup> Stanley M Beck 'Corporate Opportunity Revisited' in Jacob S Ziegel (ed) *Studies in Canadian Company Law* vol 2 (1973) 236; Van Rooyen op cit note 51 at 536-537.

<sup>60</sup> Farrar op cit note 18 at 363 suggests that public companies should be covered by a categorical rule in view of, inter alia, their widely dispersed shareholdings and the adequate managerial compensation schemes in those companies. The author believes that private companies, in contrast, should be free to regulate this problem as a matter of contract between the parties, in view of the fact that the parties involved are likely to be a closer, more intimate group and that lavish managerial compensation plans are not as common. See also *Boyle & Birds' Company Law* 2 ed by AJ Boyle, John Birds & Graham Penn (eds) (1987) 617; Brudney & Clark op cit note 26 at 997.

<sup>61</sup> Farrar op cit note 18 at 364; N Wolfson 'A Critique of Corporate Law' (1980) 34 *Univ of Miami LR* 959 at 980-982.

<sup>62</sup> See also *Canadian Aero Service Ltd v O'Malley* supra note 2 where Laskin J referred to the 'pervasiveness of a strict ethic in this area of the law'. However, Gareth Jones 'Unjust Enrichment and the Fiduciary's Duty of Loyalty' (1968) 84 *Law Quarterly Review* 472 suggests that the notion of unjust enrichment is paramount when a fiduciary has acted with proven dishonesty or has otherwise manifestly acted contrary to his principal's interests.

<sup>63</sup> Bastin op cit note 52 at 528 warns that this could open the way to fraud and weaken the confidence which ordinary men should have when dealing with registered companies.

<sup>64</sup> HS Cilliers, ML Benade, JJ Henning, JJ du Plessis & PA Delpont *Corporate Law* (1992) 133-134; *Hahlo's South African Company Law Through the Cases: A Source Book* 5 ed by JT Pretorius (gen ed), PA Delpont, Michele Havenga & Maria Vermaas (1991) 369ff.

<sup>65</sup> Financial inability as such should not eliminate a conflict of interest if the director who appropriates the opportunity was involved in or influential in bringing about the decision. See also Van Rooyen op cit note 51 at 545.

<sup>66</sup> The same underlying policy is relevant to insider trading. Here the interests to be balanced concern the encouragement of a free enterprise economy and the freedom to contract, on the one hand, and the fact that shareholders must not be put at too great a disadvantage and receive some measure of protection when a take-over scheme is proposed and carried out, on the other. *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* 1982 (1) SA 65 (A) at 71G. On insider trading generally, see Derek Botha 'Control of Insider Trading in South Africa: A Comparative

option of obtaining the approval of the shareholders before taking up the opportunity. Prior authorization will be ineffective if the directors do not make adequate disclosure, or if the general meeting's consent is invalid, because it lacks the power to give the consent or gives it for improper purposes.<sup>67</sup> The suggested approach also does away with the problems of proof in respect of financial inability, the effect of the passage of time between the rejection of an opportunity by a company and its pursuit by the director, and changing circumstances intervening after the rejection by the company. There may be situations where there is no conflict of interest, such as where it is illegal for the company to pursue the particular opportunity. In such a situation the director should be allowed to take it up, as there is no breach of fiduciary duty. In all other instances, the director should obtain the approval of the company, acting through the majority of shareholders, before taking up the opportunity.

## 6 Corporate Opportunities, Competition and Confidential Information

It is accepted in South African law that directors may not use confidential information to compete with their company.<sup>68</sup> The appropriation of corporate opportunities frequently overlaps with the misuse of confidential information. However, for various reasons, the appropriation of a corporate opportunity and the misuse of confidential information should not be confused.

In the first instance, the appropriation of a corporate opportunity may also involve information which is not confidential in nature. It was stated earlier that the South African courts favour the 'line of business' test, the essence of which is that an opportunity, to be corporate in nature, must agree with the existing and prospective interests or activities of the corporation concerned.<sup>69</sup> Such an opportunity must be presented to the com-

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Analysis' (1991) 3 *SA Merc LJ* 1; Derek Botha 'The Economics of the Crime and Punishment of Insider Trading in South Africa' (1992) 4 *SA Merc LJ* 145; Cilliers *ao op cit* note 64 at 145ff; Roelof du Plessis 'Binnekennistransaksies by Oornames en Samesmeltings' (1989) 1 *SA Merc LJ* 46; Roelof du Plessis 'Binnekennistransaksies: 'n Evaluasie van die Huidige Statutêre Bepalings' (1993) 7 *SA Merc LJ* 19; Hahlo *op cit* note 64 at 441-442; Stephanie M Luiz 'Insider Trading: A Transplant to Cure a Chronic Illness?' (1990) 2 *SA Merc LJ* 59; Stephanie M Luiz 'Prohibition Against Trading on Inside Information — The Saga Continues' (1990) 2 *SA Merc LJ* 328; Henochsberg *op cit* note 3 at 961ff; FH van Zyl 'Die Bekamping van Binnekennistransaksies in Suid-Afrika' 1989 *TSAR* 77.

<sup>67</sup> See also Sarah Worthington 'Directors' Duties, Creditors' Rights and Shareholder Intervention' (1991) 18 *Melbourne Univ LR* 121 at 148.

<sup>68</sup> This is confirmed in the *Report of the Committee on the Financial Aspects of Corporate Governance* (1994) § 2.14 (the King Report): 'Confidential matters of the company, learned in their capacity as a director, should be treated as such and not divulged to anyone without the authority of the company.' The *Code of Ethics for Enterprises*, compiled by the King Committee, contains a similar provision in § 7.3.1: it provides that managers shall not divulge confidential information of the enterprise to its competitors or otherwise make improper use of such information.

<sup>69</sup> See Michele Havenga 'Corporate Opportunities: A South African Update (Part 1) (1996) 8 *SA Merc LJ* 40 at 45.

pany, irrespective of how the director gained information regarding it, because of the obligation to advance the company's interests above his or her own benefit. The relevant issue in corporate opportunity matters is thus not whether the particular information was confidential, but what use the director has made of it. If this were not the case, a distinction would have to be drawn between the different capacities in which information about an opportunity is received. This is not always possible, and also opens the door to abuse.<sup>70</sup>

Secondly, the bases of liability may differ. Liability for the misuse of confidential information arises from various sources. One of them is an existing fiduciary obligation.<sup>71</sup> The misuse of confidential information is also one of the established categories of unlawful competition.<sup>72</sup> To constitute confidential information, the information must be confidential and of economic value. If these two requirements are met, the information is regarded as intellectual property belonging to the plaintiff<sup>73</sup> and protected by the Aquilian action. Whether the particular information meets these requirements, must be determined by the circumstances of each case.<sup>74</sup> In certain circumstances the law of contract may be the basis of an action for misuse of confidential information. In *Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg*,<sup>75</sup> a company relied on an implied term of a service contract to restrain an employer from using confidential information to its detriment.<sup>76</sup> Also, in limited circumstances the protection afforded by

<sup>70</sup> For example, it is quite simple to stage a friendly game of golf for the purpose of inviting a director personally to do business instead of dealing through the company.

<sup>71</sup> In *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* supra note 3 the defendants, while directors and managers of a company, acquired information about the value of certain diamondiferous property. They later purchased the property in competition with the company without disclosing their intention to the company. The court held that the defendants were obliged to transfer the property to the company and to account to it for profits already received. English law, too, acknowledges the remedy of accounting for profits in exceptional cases where there has been a breach of confidence: *Peter Pan Manufacturing Corporation v Corsets Silhouette Ltd* [1964] 1 WLR 96 at 108. See also *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC & others* 1988 (2) SA 54 (T).

<sup>72</sup> *Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd* 1968 (1) SA 209 (C); *Stellenbosch Wine Trust Ltd & another v Oude Meester Group Ltd; Oude Meester Group Ltd v Stellenbosch Wine Trust Ltd & another* 1972 (3) SA 152 (C); *Prok Africa (Pty) Ltd & another v NTH (Pty) Ltd & others* 1980 (3) SA 687 (W) at 696-697; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd & others* 1981 (2) SA 173 (T) at 189-196; *Rectifier and Communication Systems (Pty) Ltd v Harrison & others* 1981 (2) SA 283 (C); JC Knobel 'Die Beskerming van Handelsgeheime in die Deliktereg' (1990) 53 *THRHR* 488; J Neethling 'Die Reg Aangaande Onregmatige Mededinging Sedert 1983' (1991) 54 *THRHR* 554 at 559ff; HJO van Heerden & J Neethling *Unlawful Competition* (1995) 229.

<sup>73</sup> *Harchris Heat Treatment (Pty) Ltd v Iscor* 1983 (1) SA 548 (T) at 554G-H.

<sup>74</sup> Van Heerden & Neethling op cit note 72 at 225ff.

<sup>75</sup> 1967 (1) SA 686 (W).

<sup>76</sup> Marais J held (at 691):

'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.'

Directors should be aware of the danger of such an implied term being inferred in their service contracts.

copyright law may protect confidential information.<sup>77</sup> Liability for the appropriation of a corporate opportunity, in contrast, is necessarily based on a director's fiduciary obligation.

Thirdly, where a director uses or conveys confidential information, he incurs liability because of that fact. It is then irrelevant whether he uses the information to compete with the company.<sup>78</sup> When a director appropriates a corporate opportunity, his action is, by virtue of the fact that the opportunity is regarded as 'corporate', in competition with the company.

The most important distinction between misuse of confidential information and appropriation of corporate opportunities lies in their respective remedies. The remedies for misuse of confidential information are damages, an interdict to restrain the director, delivery up,<sup>79</sup> and possibly Anton Piller orders,<sup>80</sup> but not an account of profits.<sup>81</sup> Thus a company's remedies for a director's misuse of confidential information include an interdict to restrain the director and an action for damages.<sup>82</sup> Where a director has appropriated an economic opportunity for him- or herself instead of for the company, the company may claim an account of profits.<sup>83</sup>

The situation where an employee, after leaving his or her employment, uses knowledge and skills which the previous employer alleges are confidential in nature in his or her own enterprise or in someone else's employment, poses special problems. This situation may arise when a person ceases to be a director and then takes an opportunity which, had he or she still been a director, would have been regarded as a corporate opportunity. The general rule is that the employee is free to use his or her own knowledge and skills, provided that confidential information is not disclosed.<sup>84</sup> Information which can readily be classified as not being of a confidential nature may be used in competition with a previous employer, even if it

<sup>77</sup> Knobel op cit note 72 at 489, with reference to the Copyright Act 98 of 1978 as amended.

<sup>78</sup> MS Blackman *The Fiduciary Doctrine and Its Application to Directors of Companies* (unpublished PhD thesis, University of Cape Town 1970) 397.

<sup>79</sup> On this remedy, see, generally, R Kelbrick 'Delivery Up in Trade Mark Litigation' (1987) 9 *Modern Business Law* 12ff, who concludes that, in South African law, it is a type of mandatory interdict.

<sup>80</sup> The validity and scope of these orders is uncertain: Knobel op cit note 72 at 501.

<sup>81</sup> *Victor Products (SA) (Pty) Ltd v Lateulere Manufacturing (Pty) Ltd* 1975 (1) SA 961 (W) at 963 (claimant not entitled to an enquiry as to the quantum of damages); *Rectifier and Communication Systems (Pty) Ltd v Harrison* supra note 72 at 289; Knobel op cit note 72 at 501; Neethling op cit note 72 at 562; Van Heerden & Neethling op cit note 72 at 73-74 (they suggest that this remedy should be introduced through legislation).

<sup>82</sup> *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* supra note 72 at 190-191; *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* supra note 71 at 64-68; Van Dorsten op cit note 1 at 218; Van Heerden & Neethling op cit note 72 at 73. If the breach has the result that someone who does not owe the company a fiduciary duty obtains a benefit at its expense, the company also has these remedies: *Rectifier and Communication Systems (Pty) Ltd v Harrison* supra note 72 at 286-287.

<sup>83</sup> See Havenga op cit note 69 at 42.

<sup>84</sup> *Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd & another* 1977 (1) SA 316 (T) at 326-327; *Northern Office Micro Computers (Pty) Ltd & others v Rosenstein* 1981 (4) SA 123 (C) at 127-128; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* supra note 72 at 193; *SA Historical Mint (Pty) Ltd v Sutcliffe* 1983 (2) SA 84 (C) at 255-256; Knobel op cit note 72 at 497.

was acquired during the term of the previous employment,<sup>85</sup> unless a restraint of trade has been agreed upon.<sup>86</sup> Where the information can indeed be classified as confidential there may be factors indicating that the extent of the interest which the previous employee has in it is such that it cannot be ignored. For example, the previous employer may have been a key person and obtained highly specialized knowledge and skills. The knowledge and skills may be important assets which he can use in other employment. The person's own interest in using the confidential information to realize his or her full potential in the marketplace must then be balanced against the interest of the previous employer in remaining the sole user of the information. In a delictual action this affects the requirement of unlawfulness, which will be determined by applying the *boni mores* criterion.<sup>87</sup> Where a company bases its action against a former director on the breach of his or her fiduciary obligation, the determination of the duty to act in good faith in the interests of the company will similarly be based on the *boni mores* criterion, which includes the constitutional right of every person freely to engage in economic activity.<sup>88</sup>

A director sometimes uses confidential information acquired during his or her term of office to compete with the company, before or after his or her term of office expires.<sup>89</sup> If the offender remains a director, the company may choose to base its action on the director's fiduciary obligation or on the misuse of confidential information based on one of the other causes mentioned earlier. If the person is no longer a director, he or she is no longer a fiduciary,<sup>90</sup> and the company will not be able to avail itself of that cause of action. Information about an economic opportunity may itself constitute confidential information. Where a director uses that information for personal benefit, the company may, likewise, base its action on the fiduciary obligation or on one of the other bases of an action for breach of confidential information. That is also the position where the director uses the information to resign and then to compete with his or her previous company by using the opportunity.<sup>91</sup>

I believe that the existing South African law adequately protects a company's confidential information from being misused by directors.

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<sup>85</sup> Case law distinguishes between information generally known in the particular trade and information privy to the particular enterprise: *Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg* supra note 75 at 689; Knobel op cit note 72 at 497.

<sup>86</sup> In this situation one is no longer concerned with the protection of confidential information.

<sup>87</sup> *Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd* supra note 84 at 327; *Multi Tube Systems (Pty) Ltd v Ponting & others* 1984 (3) SA 182 (D) at 187; *Northern Office Micro Computers (Pty) Ltd v Rosenstein* supra note 84 at 136; Knobel op cit note 72 at 497.

<sup>88</sup> Section 26 of the interim Constitution; see also text at notes 12 and 13 above.

<sup>89</sup> Other competitive aspects, such as multiple directorships, are not discussed here.

<sup>90</sup> See 4 above.

<sup>91</sup> See also 4 above.

## 7 Corporate Opportunities and Ratification

One aspect of the fiduciary obligation of company directors which has proved particularly complex, is ratification of breaches of duty. The general meeting of shareholders is the appropriate organ to ratify breaches of duty, provided that these breaches can actually be ratified.<sup>92</sup> Unratifiable wrongs include acts in breach of the rights of the company as set out in its constitution, unlawful conduct and conduct in breach of the common law, and those acts which are said to constitute 'fraud on the minority'. Directors' fiduciary duties are more directly affected by this third type — acts which are said to constitute 'fraud on the minority'. The term derives from English law and is often used to indicate a ground which will entitle a personal action by a member against majority conduct.<sup>93</sup> It is also encountered in respect of majority shareholders' conduct which allows a derivative action, although the term 'fraud on the company' is probably more correct in this regard.<sup>94</sup> Its exact content is uncertain,<sup>95</sup> but it is clear that the terms 'fraud' and 'minority' are not restricted to their usual meanings.<sup>96</sup> The application of this exception is almost exclusively in areas where a director has committed a wrong against the company in his or her capacity as director.<sup>97</sup> The reason is that directors are almost always entrusted with the management of the company and are, accordingly, in a position to prejudice the company and to enrich themselves or others at the company's expense.

Traditionally two sets of circumstances are held to constitute a 'fraud on the minority'.<sup>98</sup>

First, a mala fide wrong done by a director to his or her company may not be ratified. This concept includes actions by directors who have not complied with their subjective duty to act in the interests of the company,

<sup>92</sup> See, generally, Havenga op cit note 44 at 394ff and the authorities cited there.

<sup>93</sup> *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350; *Attwool v Merryweather* (1867) LR 5 Eq 464; Colin Jack Cohen 'The Distribution of Powers in a Company as a Matter of Law' (1973) 90 *SALJ* 262 at 284; Cilliers ao op cit note 64 at 292.

<sup>94</sup> SJ Naudé *Die Regsposisie van die Maatskappydirekteur met Besondere Verwysing na die Interne Maatskappyverband* (1970) 183ff; Van Rooyen op cit note 51 at 218; KW Wedderburn 'Shareholders' Rights and the Rule in *Foss v Harbottle*' (1958) 1 *Cambridge LJ* at 93–94.

<sup>95</sup> Cilliers ao op cit note 64 at 293–294 describe the term 'fraud on the minority' as 'a specialised term of English law which conveys more than appears from the meaning of the words and yet has an uncertain content'.

<sup>96</sup> Cilliers ao op cit note 64 at 294; Gower op cit note 6 at 593; Van Rooyen op cit note 51 at 217ff.

<sup>97</sup> Naudé op cit note 94 at 186; Van Rooyen op cit note 51 at 463.

<sup>98</sup> *Pavliades v Jensen* [1956] 1 Ch 565, [1956] 2 All ER 518 (Ch); *Daniels v Daniels* [1978] Ch 406, [1978] 2 All ER 89; Allen B Afterman *Company Directors and Controllers* (1970) 148ff; John Birds 'Making Directors Do Their Duties' (1980) 1 *Company Lawyer* 67 at 69; MS Blackman 'Majority Rule and the New Statutory Derivative Action' (1976) 39 *THRHR* 27 at 31; Cilliers ao op cit note 64 at 296; Ross Cranston 'Limiting Directors' Liability' 1992 *J of Business Law* 197 at 200; Harvey Mason 'Ratification of the Directors' Acts: An Anglo-Australian Comparison' (1978) 41 *Modern LR* 161 at 163–164; Naudé op cit note 94 at 188ff; Van Rooyen op cit note 51 at 467ff; KW Wedderburn 'Shareholders' Control of Directors' Powers: A Judicial Innovation?' (1967) 30 *Modern LR* 77 at 81. Compare *Bamford v Bamford* [1970] Ch 212 (CA), [1969] 2 WLR 1107, where Harman LJ held that the directors had allotted shares in bad faith but that their actions were still ratifiable. Some attempts have been made to explain

and have placed their own interests or those of another before the interests of the company.<sup>99</sup> The wrong is unratifiable because the majority who has to decide whether or not to ratify it, will, almost without exception, not be acting in the best interests of the company.<sup>100</sup> This situation often overlaps with the appropriation of company assets, confirmation of which is generally regarded as invalid.<sup>101</sup> The test to be applied to determine whether the majority could validly ratify a particular wrong is whether the resolution to ratify was, in the particular circumstances of each case, taken in the best interests of the company. The appropriation of corporate opportunities is regarded as a fraud on the minority because a resolution to ratify results in the wrongdoer receiving a benefit at the expense of the company, in the sense that the company acts to its prejudice by placing assets in the hands of the wrongdoer. So the ratifying majority will, almost without exception, not be acting in the best interests of the company. The making of a secret profit can, however, be ratified.

Second, a wrong is regarded as unratifiable if the resolution to ratify results in the wrongdoer receiving a benefit at the expense of the company, in the sense that the company is prejudiced so as to place assets in the hands of the wrongdoer.<sup>102</sup>

Van Rooyen regards it as unfortunate that the practice has developed to distinguish only between the above two classes of unratifiable wrongs.<sup>103</sup> He suggests — correctly, I believe — that the real question remains whether the majority has acted in accordance with the common-law rule

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this decision on the basis that the term 'bad faith' was used to refer to the fact that the directors had exceeded their powers, and not that they had acted otherwise than in good faith: R Baxt 'Mala Fide Actions of Directors — Ratification by Shareholders' (1969) 43 *Australian LJ* 395; Beck op cit note 54 at 118–119; Cohen op cit note 93 at 285; BAK Rider 'Amiable Lunatics and the Rule in Foss v Harbottle' 1978 *Cambridge LJ* 270 at 275n33; Van Rooyen op cit note 51 at 484–485. The decision in *Bamford* is at least confusing and, if meant to indicate that mala fide actions are ratifiable, also incorrect.

<sup>99</sup> John Birds 'The Permissible Scope of Articles Excluding the Duties of Company Directors' (1976) 39 *Modern LR* 394 at 396; Van Rooyen op cit note 51 at 469–470; *Attwool v Merryweather* supra note 93; *Mason v Harris* (1879) 11 ChD 97 (CA).

<sup>100</sup> Van Rooyen op cit note 51 at 495. Other reasons have been suggested. Afterman op cit note 98 at 151 argues that to allow an ordinary resolution to waive the duty of good faith will destroy the foundations of the fiduciary relationship. He also maintains that it will conflict with the policy embodied in the statutory prohibition on provisions purporting to relieve directors of their duty of good faith (similar to the provisions of s 247 of the Companies Act 61 of 1973). For reasons that have been advanced by American authorities, see Havenga op cit note 44 at 158–163; Van Rooyen op cit note 51 at 492ff.

<sup>101</sup> Naudé op cit note 94 at 189; Van Rooyen op cit note 51 at 471.

<sup>102</sup> *Menier v Hooper's Telegraph Works* supra note 93; *Burland & others v Earle & others* [1902] AC 83 (PC); *Cohen v Directors of Rand Collieries Ltd* 1906 TS 197 at 203; *Cook v GC Deeks* supra note 53; *Moti v Moti and Hassim Moti Ltd* 1934 TPD 428 at 441; *Garment Workers' Union & others v Smith* 1935 CPD 249 at 257–258; *Gundelfinger v African Textile Manufacturers Ltd* 1939 AD 314 at 324–326; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257, [1980] 2 All ER 841; Cilliers ao op cit note 64 at 296; Farrar op cit note 18 at 426; Gower op cit note 6 at 593ff; Naudé op cit note 94 at 188–189; Van Rooyen op cit note 51 at 467–468.

<sup>103</sup> L van Rooyen 'Enkele Perspektiewe oor die Reël dat die Lede van 'n Maatskappy Hul Stemreg Na Wens Kan Uitoefen en die Ongeldigheid van Meerderheidsbesluite Weens Magsmisbruik' 1989 *TSAR* 593 at 613.

that it must act honestly in the interests of the company.<sup>104</sup> The test for compliance with this rule should be objective. Any decision by the majority which adversely affects members' rights should be tested with regard to the interests or needs of the company. If it cannot be regarded as beneficial to the company, the decision is a fraud on the minority and is so invalid. A resolution which does not actually prejudice the company, but is also not reasonably necessary and cannot be related to the interests of the company, is one example of such a decision.<sup>105</sup> The type of conduct to which the majority's resolution pertains is, according to Van Rooyen, only a *factum probans*, as is the existence of an independent majority.<sup>106</sup> So it is unnecessary to distinguish between ratifiable and unratifiable wrongs. All wrongs to a company can be condoned, provided that the condonation and release of the directors from liability can reasonably be regarded as in the interests of the company. Courts are more likely to afford relief where the condonation concerns *mala fide* conduct or wrongs which resulted in the wrongdoer receiving a benefit at the expense of the company.<sup>107</sup>

Against this background it must be considered whether a director's appropriation of an economic opportunity in which his or her company was interested, can be ratified. Some authorities indicate that ratification may be possible, either by ordinary resolution,<sup>108</sup> or by a unanimous resolution,<sup>109</sup> and provided that the decision of the majority does not amount to a fraud on the minority.<sup>110</sup> The problem with this approach is that it is almost impossible for frank and full disclosure to be made in such circum-

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<sup>104</sup> *Idem* at 602. See also *Peters' American Delicacy Company Limited v Heath & others* (1939) 61 CLR 457 at 480; *Garden Province Investments v Aleph (Pty) Ltd* 1979 (2) SA 525 (D) at 533-535; *Sammel & others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 686-687; *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2, [1982] 1 All ER 437 (ChD); *Mutual Life Assurance Co of New York v The Rank Organization Ltd* 1985 BCLC 11 at 18, 21; *Smith & others v Croft & others (No 2)* [1988] Ch 114, [1987] 3 All ER 909; Pennington *op cit* note 3 at 657.

<sup>105</sup> Van Rooyen *op cit* note 51 at 377ff; Van Rooyen *op cit* note 102 at 606-607.

<sup>106</sup> Van Rooyen *op cit* note 102 at 613-614.

<sup>107</sup> Van Rooyen *op cit* note 51 at 613.

<sup>108</sup> *Cowling v Stableford & Co Ltd* (1905) 22 SC 363 at 372; *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* *supra* note 3; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 197, 200 and 229; *Canadian Aero Service Ltd v O'Malley* *supra* note 2.

<sup>109</sup> *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295 at 321; *In re Duomatic Ltd* [1969] 2 Ch 365, [1969] 1 All ER 161; *Re Compaction Pty Ltd* [1976] 2 NSWLR 477; *Cane v Jones* [1980] 1 WLR 1451. In *Pressings and Plastics (Pty) Ltd & another v Sohnius* 1985 (4) SA 524 (T) it was indicated that where the company has only one member who is also its sole director, his knowledge would, ordinarily, be the company's knowledge. Consequently, through him the company would know of the corporate opportunity and if he were to intend that such opportunity be acquired by himself to the exclusion of the company, there would exist (ordinarily) tacit consent to the acquisition.

<sup>110</sup> Joubert *op cit* note 50 par 228. A director who wishes to retain the opportunity and holds or controls the majority of the shares would, for example, be making a present of it to himself: *Alexander v Automatic Telephone Company* [1900] 2 Ch 56 (CA); *Cook v GC Deeks* *supra* note 53; *Prudential Assurance Co Ltd v Newman Industries Ltd* *supra* note 102.

stances.<sup>111</sup> Attempts to reconcile the different approaches to ratification are often forced.<sup>112</sup>

Some differences between the appropriation of corporate opportunities and the 'secret profit' rule were noted earlier.<sup>113</sup> The fundamental distinction is that a secret profit is not necessarily made at the expense of the company but is obtained in some way as a result of the director's office. The majority in general meeting may allow directors who have acted in good faith to retain their profits, provided that they fully disclose the relevant facts.<sup>114</sup> When a corporate opportunity is appropriated, it is deemed at the expense of the company, but the opportunity was not necessarily acquired by virtue of the director's position as such. In other words, the wrong causes a patrimonial benefit at the expense of the company. It cannot be ratified, first, because it falls in the second category of unratifiable wrongs mentioned above — where the wrongdoer receives a benefit at the expense of the company in the sense that the company is prejudiced so as to place assets in the hands of the wrongdoer.<sup>115</sup> It may also be unratifiable because it constitutes a mala fide wrong to the company. A large number of corporate opportunity situations fall in this category, for example where the director resigns on some pretext to take up an opportunity, but this will not necessarily be the case.<sup>116</sup>

I believe that the appropriation of corporate opportunities will also be unratifiable according to the approach recommended by Van Rooyen, as the majority's obligation to act in the best interests of the company will not allow the director to retain a profit made in these circumstances. The financial inability of the company to pursue an opportunity should not alter the fact that the director is contravening his or her obligation to act in

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<sup>111</sup> R Baxt 'Judges in Their Own Cause: The Ratification of Directors' Breaches of Duty' (1978) 5 *Monash Univ LR* 16 at 18 notes that directors are in control of the proxy machinery, and that the cost of litigation is likely to deter prejudiced shareholders from challenging the accuracy and fairness of the disclosed information. See also RJC Partridge 'Ratification and the Release of Directors from Personal Liability' (1987) 46 *Cambridge LJ* 122 at 142, where he suggests that where a director's breach of fiduciary duty gives rise to a right to an account of profits which are in equity the company's property, the majority cannot prevent the minority from bringing an action to recover them. So no question of ratification in relation to the director's personal liability arises. See further *S v De Jager & another* 1965 (2) 616 (A) at 624–625, where Holmes JA indicated that any general right of a shareholder to agree to the company being despoiled by a director offends against the principles of company law basic to the notion of limited liability.

<sup>112</sup> Baxt op cit note 111 at 49. For a cogent discussion of the various approaches in case law, see Van Rooyen op cit note 51 at 495ff.

<sup>113</sup> Havenga op cit note 69 at 52–53.

<sup>114</sup> *Beuthin's Basic Company Law* 2 ed by RC Beuthin & SM Luiz (1992) 228; Joubert op cit note 50 par 279; Rider op cit note 98 at 275. This is why the transaction in *Regal* supra note 18 might have been ratifiable.

<sup>115</sup> Van Rooyen op cit note 51 at 495ff distinguishes three situations: the appropriation may concern assets which form part of the company's estate, assets or advantages may be obtained in competition with the company, and contracts may be concluded with the company. The appropriation of corporate opportunities concerns the second situation.

<sup>116</sup> Naudé op cit note 94 at 189. In *Industrial Development Consultants Ltd v Cooley* supra note 2, for example, the director falsely represented ill health, obtained a release from his company, and later appropriated an opportunity on his own behalf.

the best interests of the company if such an opportunity is pursued for the director's own benefit.<sup>117</sup>

## 8 Conclusion

I believe that in South African law the application of the recognized fiduciary principles is sufficient to resolve corporate opportunity matters. Essentially, the application of these rules amount to a determination whether the director has complied with his or her fundamental duty to act in the best interests of the company. That information belonging to the company has been used or the director has unlawfully competed with the company, may indicate a breach of the fiduciary obligation. There seems to be no need to develop a separate doctrine of corporate opportunities as has been done in America and, to a lesser extent, in some other Commonwealth countries.

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<sup>117</sup> See 5 above.

### THE TEST OF TRUTH

'If you have no doubt of your premises or your power and want a certain result with all your heart you naturally express your wishes in law and sweep away all opposition. . . . But when men have realized that time has upset many fighting faiths, they may come to believe even more than they believe the very foundations of their own conduct that the ultimate good desired is better reached by free trade in ideas — that the best test of truth is the power of thought to get itself accepted in the competition of the market, and the truth is the only ground upon which their wishes safely can be carried out.'

[Per Holmes J in *Abrams et al v United States* 250 US 616 (1919) at 630]