FIDUCIARY DUTIES OF COMPANY DIRECTORS WITH SPECIFIC REGARD TO CORPORATE OPPORTUNITIES

by

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To Peter, with my love and thanks
SUMMARY

South African company law is currently the object of comprehensive review. One of the areas under scrutiny is that of corporate governance. Control over management is vital in the interests of the company itself, its shareholders and its creditors. Effective accountability should be balanced against the need to allow those who manage a certain measure of freedom and discretion in the exercise of their function.

Company directors are subject to various duties. This thesis concentrates on their fiduciary obligation. It is suggested that this *sui generis* obligation is owed to the company as a separate entity. Interests of other groups may sometimes merit consideration.

Against the background of a comparative investigation, a "corporate opportunity" is defined as any property or economic opportunity to which the company has a claim. South African law protects a company's claim to an opportunity if it is in the company's line of business and if the company has justifiably been relying upon the director(s) to acquire it or to assist in its acquisition for the company. The application of established fiduciary principles suffice to resolve corporate opportunity matters. Essentially the application of these rules amount to a determination whether the director has complied with his fundamental duty to act in the company's best interests. There seems to be no need for a separate doctrine of corporate opportunities.

A director should only be absolved from liability on account of the company's inability to pursue an opportunity or its rejection by the company if there was no real conflict of interest. The appropriation of corporate opportunities should not be ratifiable, both because the ratification constitutes a fraud on the minority, and because the decision to ratify cannot be regarded as being in the interests of the company.

The relationship between the appropriation of corporate opportunities, misuse of confidential information and competition is investigated. These aspects frequently overlap, but should be distinguished because their bases, and accordingly their appropriate remedies, may differ.

Effective control may benefit by a restatement of directors' fiduciary duties in the Companies Act. To this end certain amendments to the Act are recommended.

Key Terms:

Corporate opportunities; Directors; Fiduciary duties; Codification; Codes of conduct; Ratification; Competition; Confidential information; Multiple directorships; Secret profits; Corporate opportunity doctrine; Conflicts of interest
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1 INTRODUCTION

A company is a legal entity or juristic person which exists separately from its management and shareholders.\(^1\) The functions and responsibilities of corporate directors arise by virtue of this nature of a company.

Since it cannot act on its own behalf, company acts are conducted through representatives, namely its organs. One of the organs, the board of directors, is entrusted with management of the company's business.\(^2\)

Company management can only be effective if those who manage are allowed a certain measure of freedom and discretion in the exercise of their function. On the other hand, effective control of management is vital in the interests of the company itself, its shareholders and its creditors. This basic philosophy was recently reiterated by the Cadbury Committee in England:

No system of corporate governance can be totally proof against fraud or incompetence. The test is how far such aberrations can be discouraged and how quickly they can be brought to light. The risks can be reduced by making the participants in the governance process as effectively accountable as possible.\(^3\)

Company directors are therefore subject to various duties, which are generally categorised into duties of care, diligence and skill, and other obligations which arise either because of the recognition of the fiduciary nature of their office, or by reason of express statutory provisions. Effective control is, furthermore, dependent upon the efficient enforcement of these duties.

In this thesis, the focus is on one aspect of directors' duties, namely their fiduciary obligation. In particular, the appropriation of what is generally known as a "corporate opportunity" is considered.

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\(^1\) See, in general, Hahlo Cases 9ff and authorities cited.

\(^2\) *Lennards Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 at 713; *Robinson v Imroth and Others* 1917 WLD 159 at 173; *Ngcwase and Others v Terblanche NO and Others* 1977 (3) SA 796 (A) at 803-804; *CIR v Malcomess Properties (Isando) (Pty) Ltd* 1991 (2) SA 27 (A) at 37.

\(^3\) Report of the Committee on the Financial Aspects of Corporate Governance (1992) par 7.2. See also chapter 4 par 2.2.1 below.
2 COMPANY DIRECTORS AND THEIR FIDUCIARY DUTIES

The law of fiduciaries has existed for centuries as a fundamental assumption underlying various disciplines. In commercial context, a company directorship is widely regarded as the most complex fiduciary office. It is therefore not surprising that considerable research has been done on directors generally and on their fiduciary obligations.

A number of factors prompted the further research undertaken in this thesis. A large portion of the comprehensive research previously done in South Africa occurred more than twenty years ago. A number of important developments have since occurred. The beneficiary of the fiduciary duty has thus far been accepted to be "the company", although different meanings may be attached to that term. But modern management often takes the view that directors should also consider the interests of other interest groups and, possibly, also the State and the general public. This perception may contain important implications in respect of enforcement of the fiduciary duty. It was therefore considered important to reconsider this issue.

The proposed European Company for the European Union and the Draft Fifth Directives operative in that Union exercise considerable influence on the future development of company law in member countries, some of which have also been influential with respect to the development of South African company law. Not all the member countries recognise a fiduciary relationship between directors and their company. Future regulation of matters concerning directors' relationships with their companies will necessarily have to take this fact into account. This in turn should influence the extent to which South African company law will deviate from its traditional role model, the English law, and follow other, more appropriate, systems. Recent developments in South Africa may, furthermore, influence the future development of South African company law. The new South African Constitution which became operative on 27 April 1994 contains provisions which are relevant in the determination of good faith. South Africa has also rejoined the

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4 Shepherd Law of Fiduciaries 12.
5 Finn Fiduciary Obligations 64; Shepherd Law of Fiduciaries 347-348.
6 The following theses on aspects of South African law deserve specific mention: Blackman Fiduciary Doctrine; Du Plessis Grondslae; Naudé Maatskappydirekteur.
7 See, for example, Blackman Fiduciary Doctrine; Naudé Maatskappydirekteur.
8 See chapter 3 par 1 below.
9 See chapter 8 par 2 below.
10 See chapter 6 below.
11 See chapter 8 par 3 below.
12 See chapter 9 par 3.2.2.2 below.
British Commonwealth. Consequently the development of company law in other Commonwealth countries may become of increasing comparative value.

Existing research concentrated on general aspects regarding a company director’s office rather than on any specific duty. The research undertaken for purposes of this thesis considers certain general aspects of the fiduciary obligation as background perspective, but is focussed on one aspect, namely the appropriation of what is generally labelled "corporate opportunities".

3 DIRECTORS AND CORPORATE OPPORTUNITIES

A number of categorisations exist in respect of a director's fiduciary obligation. They are not comprehensive and, to some extent, overlap.13 One of the categorisations concerns the appropriation of so-called "corporate opportunities". In America a doctrine of corporate opportunities has been recognised for a considerable time.14 This approach has recently been recommended in several other Commonwealth countries.15 Since South Africa has rejoined the Commonwealth, it can be expected that the influence of the company law systems in these countries may become of increasing importance.

Against the background of the comparative investigation which was undertaken,16 it is attempted, in this thesis, to define a corporate opportunity.17 The need for a separate "corporate opportunity doctrine" and its required content are investigated.18 Should such a doctrine be deemed desirable, it is further considered whether it should be provided for by means of codification or by less formal recognition of a doctrine derived from general common law principles.19

Related aspects are considered. They include the liability of persons who are no longer directors of the company for appropriation of corporate opportunities,20 the effect of rejection of an opportunity by the company or its inability to pursue it,21 the relationship between appropriation of corporate opportunities and misuse of

13 See chapter 4 page 62ff below and chapter 9 page 331ff below.
14 See chapter 5 par 6 below.
15 See chapter 8 par 3 below.
16 See chapters 4, 5, 6, 7 and 8 below.
17 See chapter 9 par 4.2 below.
18 See chapter 9 pars 4.2 and 4.3 below.
19 See chapter 9 pars 4.9 and 4.10 below.
20 See chapter 9 par 4.4 below.
21 See chapter 9 par 4.5 below.
confidential information\(^{22}\) and personal competition by a director and his company.\(^{23}\) It is also considered whether appropriation of corporate opportunities may be ratified and, if so, by whom the ratification should be.\(^{24}\)

4 METHODOLOGY

At the outset, the origin and basis of the fiduciary duty owed by company directors are reconsidered.\(^{25}\) In the following chapter the focus is on the beneficiary of that duty.\(^{26}\)

A comparative survey of the laws in a number of countries is undertaken.\(^{27}\) The basic management structure in each country is investigated, after which managements' duties are considered. Specific attention is given to the situation where a director has used an economic opportunity for his own personal gain in circumstances where it can be said that the opportunity should have been appropriated to the advantage of the company. In these circumstances, the opportunity is often described as "belonging" to the company. In some countries it is, in fact, considered as an asset or property of the company, but that is not necessarily the case.

The countries surveyed represent the Anglo-American, the Romance and the Germanic legal families.\(^{28}\) They are England,\(^{29}\) America,\(^{30}\) France,\(^{31}\) Germany,\(^{32}\)

\(^{22}\) See chapter 9 par 4.7 below.

\(^{23}\) See chapter 9 par 4.6 below.

\(^{24}\) See chapter 9 par 4.8 below.

\(^{25}\) See chapter 2 below.

\(^{26}\) See chapter 3 below.

\(^{27}\) Comparative legal studies can be done with different objectives in mind: Van Zyl Regsvergelyking 17ff. One of the principal aims is to ascertain whether the comparative system will enable a better understanding of a legal system and whether it offers possible solutions to situations which are unclear in that system. It is with this object in mind that the comparative survey was undertaken in this thesis. On the general approach to comparative legal studies, see Venter Regsanvorsing chapter 8.

\(^{28}\) Western company systems are traditionally divided into these three families. The legal systems of the United States of America, England and the British Commonwealth belong to the Anglo-American family. The German, Austrian and Swiss legal systems are the principal representatives of the Germanic family, whereas the Romance family includes the legal systems of France, the Netherlands, Belgium, Portugal and Spain: Naudé Maatskappydirekteur 202; Van Zyl Regsvergelyking 47ff. (In respect of the possibility that, after the commencement of the new Netherlands Civil Code ("Nieuw Burgerlijk Wetboek"), the legal system of the Netherlands will belong to the Germanic legal family, see Hartkamp Wetboek XXV.)

\(^{29}\) See chapter 4 below.

\(^{30}\) See chapter 5 below.

\(^{31}\) See chapter 6 below.

\(^{32}\) See chapter 7 below.
Australia, Canada and New Zealand. In addition to the fact that these countries are representative of the principal legal families, each of the systems was chosen for specific reasons. Since South African company law is based on English law and this system remains influential in the development of our law, its inclusion is obvious. Furthermore, the fiduciary obligation, as a legal principle, originated in English rules of equity. American company law is an example of a system based upon English rules, but where changing needs have necessitated substantial deviation from that system. It is also the origin of the "corporate opportunity doctrine". The inclusion of that country in the survey is therefore also obvious. French company law is at the centre of the development of company law, since the first modern company legislation originated in that country. In addition, the legal system in France is indicative of an alternative approach, in the sense that no fiduciary relationship is recognised between a company director and his company. Statutory provisions regulate their relationship and considerable reliance is placed on regulation of criminal liability to enforce directors' duties. For these reasons, France was elected as representative of the Romance legal family. German company law too has exercised a great influence on modern company law, especially since the Second World War. Furthermore, German company law combines two approaches, namely recognition of a fiduciary obligation and extensive codification of law. This system is thus particularly suitable as representative of the Germanic legal family in a comparative legal study. Company law in Australia, New Zealand and Canada is based on English law. All three countries have recognised the need to deviate from that system. Their company laws have, moreover, been the subject of recent reforms and may contain important guidelines for future developments in South African law. Canadian law is also indicative of how principles deriving from both the English and American legal systems can successfully be combined. The laws of these three Commonwealth countries are influential with regard to developments in South African company law, especially in view of the fact that South Africa has recently been readmitted to the Commonwealth. Because of the similarities in respect of directors' fiduciary duties and appropriation of corporate opportunities in these countries, their laws are considered together.

The developments in the European Union are discussed to the extent that they may bring new perspectives to the resolution of corporate opportunity matters, and

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33 The developments in these Commonwealth countries are discussed in chapter 8 par 3 below. For purposes of convenience they are discussed together.

34 See chapter 2 par 1 below.

35 The public company was created by the Commercial Code of 1807.

36 Naudé Maatskappydirekteur 203.

37 See chapter 8 par 3 below.
because of the influence they will undoubtedly have on the future development of company law in member countries.\textsuperscript{38}

The investigation concludes with the consideration of South African company law.\textsuperscript{39} On the strength of developments here and in the other systems investigated, certain conclusions are drawn and a number of recommendations are made in the final chapter.\textsuperscript{40}

5 REFERENCE TECHNIQUES

Company directors are, for purposes of convenience, referred to in the masculine form. Authorities are referred to in footnotes by way of keywords taken from the titles referred to. The bibliography at the end of this work contains the full titles and references.

\textsuperscript{38} See chapter 8 par 2 below.

\textsuperscript{39} See chapter 9 below.

\textsuperscript{40} See chapter 10 below.
CHAPTER 2
THE ORIGIN AND BASIS OF DIRECTORS’ FIDUCIARY DUTIES

1 INTRODUCTION

The fiduciary obligation, as a legal principle, originated in English rules of equity.\(^1\) The original fiduciary was the trustee. Trusts, being creatures of the Court of Chancery, came under its exclusive jurisdiction.\(^2\) It became recognised that other relationships, such as partnerships and agency, also involve elements similar to those of express trusts. In numerous situations, where one person abused confidence that had been placed in him by another, equity granted relief when common law courts did not. The need for intervention by equity was greater where the parties concerned had not specifically arranged the powers and duties to be exercised by the fiduciary. As new forms of relationships involving trust and confidence emerged, equity thus ensured that these relationships would not be abused. The emerging relationships were also classified as “fiduciary” relationships. When companies developed,\(^3\) it was natural to seek redress against their defaulting directors in the courts of equity, who by that time already had a monopoly of the jurisdiction in partnership matters.\(^4\) Gradually concrete rules and established terms evolved, which guided the chancellors’ exercise of discretion, and which, in their turn, were also subject to the rules of equity.\(^5\) The fiduciary relationship is, however, widely recognised as an “illusory concept”,\(^6\) which is not definitive of a single class of relation-

\(^1\) See in general Blackman *Fiduciary Doctrine* 78; DeMott “Fiduciary Obligation” 880; Du Plessis *Grondoelae* 83; Finn *Fiduciary Obligations* 64; Gautreau “Fiduciary Principle” 1; Gill “Fiduciary Duties” 122; McClean “Duty of Loyalty” 218; Naudé *Maatskappidyrekteur* 108ff; Sealy “Fiduciary Relationships” 69; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL), [1967] 2 AC 134; Boardman and Another v Phipps [1967] 2 AC 46; Bellairs v Hodnett 1978 (1) SA 1109 (A). On the historical development of equity generally, see Hanbury & Martin *Modern Equity* 3-25; Meagher, Gummow & Lehane *Equity Doctrines and Remedies* 3-10.

\(^2\) Gautreau “Fiduciary Principle” 1.

\(^3\) On the early development of English company law, see Gower *Company Law* 19-49.

\(^4\) Pennington *Company Law* 33; Sealy “Trustee” 86.

\(^5\) For a discussion of the nature, history and courts of equity, see Baker & St J Langan *Snell’s Principles of Equity* 5-27.

\(^6\) Gill “Fiduciary Duties” 115, who states that whilst its existence is not doubted, the fiduciary relationship is not susceptible to precise definition, nor would it seem is its presence in any given situation guided by any discernible principle.
ships to which fixed rules and principles apply.7

In this chapter, the fiduciary principle and its application to company directors, are reviewed. The investigation shows that, although there are many similarities between directors and other fiduciaries, there are also significant differences. It is concluded that a director should be regarded as a fiduciary sui generis.

2 THE FIDUCIARY PRINCIPLE

It has long been accepted that fiduciary relationships may arise in a commercial context.8 The extent to which fiduciary relationships are being asserted and sometimes established in commercial relationships which are outside the traditional fiduciary categories has increased in recent years.9 This has inevitably led to reconsideration of the fiduciary principle. There have been many attempts to define a fiduciary relationship.10 The point of departure seems to be that a fiduciary is a person who undertakes to act in the interests of another person.11 Circumstances such as a relationship of confidence which may be abused, and inequality of bargaining power have been suggested as fundamental to the existence of the fiduciary duty.12 However, neither seems necessary for or conclusive of the existence of such a rela-

7 See also the preface in Shepherd Law of Fiduciaries, where it is stated: "In the panoply of human interaction, trust in each other remains the pervasive force which allows man to be the social animal his instincts demand. The law of fiducaries is the legal system's attempt to recognize the more blatant abuses of the trust we place in each other. It is undoubtedly the most human area of the legal system, and as such the most undefinable." Heyton Trusts 14 confirms that the categories of cases in which fiduciary duties and obligations are traditionally classified, arise from factual circumstances. Consequently the types of relationship in which the parties may stand are no more closed than the categories of negligence at common law.

8 See Blackman Fiduciary Doctrine 69ff for authority on the early development of the fiduciary doctrine.

9 Austin "Corporate Fiduciary" 100.

10 See in general Shepherd "Unified Concept" 51ff, who discusses various hypothetical theories. His conclusion is that identification and understanding of fiduciary relationships can be achieved by recognising that they are based on the transfer of powers encumbered by attached duties. Gautreau "Fiduciary Principle" 2 is of the opinion that the real question appears to be not who is a fiduciary, but what is a fiduciary. Kaplan "Fiduciary Responsibility" 886 states that "the very definition of a fiduciary is nebulous and uncertain; the meaning of the concept of fiduciary responsibility is likewise imprecise and unsure." See also Shepherd Law of Fiduciaries 3ff. Sappideen "Fiduciary Obligations" 382 submits that from an economic perspective, fiduciary principles are simply contractual devices. It should be remembered that any test can only be stated in the most general terms and that all the facts and circumstances must be carefully examined to see whether a fiduciary relationship exists: Hospital Products Ltd v United States Surgical Corporation (1984) 55 ALR 417 (HC Aust), (1984) 156 CLR 41.

11 The form of the undertaking, as well as the fact that it may be gratuitous, is immaterial: Scott "Fiduciary Principle" 540. There will not necessarily be a contractual relationship: Fourie "Vertrouenspligte" 125.

Origin and Basis of Directors' Fiduciary Duties

In Lloyds Bank v Bundy, where a fiduciary duty was imposed on a bank manager when advising a customer, the elements of such a relationship were noted:

Such cases tend to arise where someone relies on the guidance or advice of another, where the other is aware of that reliance and where the person upon whom reliance is placed obtains, or may well obtain, the benefit from the transaction or has some other interest in its being concluded. In addition, there must, of course, be shown to exist a vital element which in this judgment will for convenience be referred to as confidentiality.

In addition, it would seem as if discretion is often also an element. According to Weinrib where there is a fiduciary obligation

there is a relation in which the principal's interests can be affected by, and are therefore dependant on, the manner in which the fiduciary uses the discretion which has been delegated to him. The fiduciary obligation is the law's blunt tool for the control of this discretion.

In Hospital Products Ltd v United States Surgical Corporation Mason J also referred to the aspect of discretion:

The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.

Two characteristics are therefore required for the existence of a fiduciary relationship. In the first instance, the fiduciary should have scope for the exercise of

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13 [1975] QB 326 (CA) at 341.

14 In Standard Investments Ltd v Canadian Imperial Bank of Commerce (1985) 22 DLR (4th) 410 the Canadian Court of Appeal also referred to the aspect of confidentiality. The court cited Bundy and confirmed that a fiduciary duty had arisen between a bank and the plaintiffs, because the facts demonstrated that the plaintiffs were relying on the advice, assistance and guidance of the bank. The circumstances were held to have created a confidential relationship between the parties.

15 Weinrib "Fiduciary Obligation" 7.

16 The author states (at 4-8) that it is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed.


18 (1984) 55 ALR 417 (HC Aust) at 454. It is, however, suggested that power in a fiduciary situation may, but does not necessarily, include discretion: Flannigan "Fiduciary Obligation" 306-307; Gautreau "Fiduciary Principle" 4; Guerin v The Queen [1984] 2 SCR 335.
some discretion or power. Secondly, the fiduciary must be able to unilaterally exercise that power so as to affect the beneficiary's interests.19

The existence and extent of a fiduciary relationship will depend on the facts and circumstances involved. It may not be possible to define such a relationship universally, but it is submitted that the following description by Gautreau20 would always hold true:

A fiduciary relationship will occur where a person undertakes, either expressly or by implication, to act in relation to a matter in the interests of another, in a manner that is defined or understood by them, and is entrusted with a power to affect such interests. The other person relies on or is otherwise dependent on this undertaking, and, as a result, is in a position of vulnerability to the exercise of such power; and the first person knows, or should know, of such reliance and vulnerability. The nature and circumstances giving rise to the undertaking are such that loyalty and good faith are intrinsic elements of the consequent duty.

It is the nature of any particular relationship that may lead to a fiduciary duty. The existence of a fiduciary obligation does not depend on the existence of an identifiable class of relationship,21 although there are some classes of relationship where fiduciary relationships will always be involved.22 It is not necessary for persons to enter into a contract or agreement in order to establish a fiduciary relationship.23 The failure to identify and apply a general fiduciary principle has, however, resulted in the courts relying to a large extent on the established categories of fiduciary relationships.24 Since the word "fiduciary" is not definitive of a single class of relationships to which a fixed set of rules and principles apply, one must determine the rules which govern each class of fiduciary relationship.25

19 Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168. The Supreme Court of Canada recently added a further general characteristic. In Frame v Smith [1987] 42 DLR (4th) 81; [1987] AC 507 (HL) the possible existence of a fiduciary duty by a custodial parent was investigated. In the dissenting judgment by Wilson J, the beneficiary was, in addition to the requirements referred to above, also required to be peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power. It would seem as if vulnerability will often be present in advance, but that its presence is not essential. Gautreau "Fiduciary Principle" 5 therefore describes vulnerability not as an element leading to a fiduciary relationship, but rather a characteristic of the result of the relationship.

20 Gautreau "Fiduciary Principle" 7.


22 Flannigan "Fiduciary Obligation" 301; Gautreau "Fiduciary Principle" 8.


25 Sealy "Fiduciary Relationships" 78.
Well-established examples of commercial fiduciary relationships, which are also accepted in South African law, include the relationship of director to company. Their acknowledged duties are often based on different principles, but remain firmly entrenched in our law.

3 THE BASIS OF DIRECTORS' FIDUCIARY DUTIES

Although not all rules of equity were accepted in other legal systems, the rules pertaining to fiduciary obligations of company directors were largely accepted and further developed by courts of law in other countries, including South Africa. It is generally accepted that directors owe a fairly onerous fiduciary duty to the company they serve. There is, however, still uncertainty in respect of the exact basis of these duties. It is generally attempted to base the rules on the position of the company director as either trustee, agent or fiduciary sui generis. The suitability of these analogies is investigated below. Recently it has been suggested that, under South African law, the liability arising from directors' fiduciary duties should be based on Aquilian principles. This issue is discussed later.

3.1 The Director as Trustee

The description of a company director as a trustee has been greatly influenced by English law. In 1742, the "committee-men" or directors of the Charitable Corporation were found guilty of breaches of trust, for which they had to account to their corporation. It has since often been stated that directors are trustees and that the nature of their duties can be explained on this basis. Various explanations of how this analogy arose have been submitted. One possible explanation is that prior to

26 Blackman, Fiduciary Doctrine 239ff; Naudé, Maatskappydirekteur 106ff; S v Hepker 1973 (1) SA 472 (W).

27 Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168; S v De Jager and Another 1965 (2) SA 616 (A); S v Shaban 1965 (4) SA 646 (W); S v Ressel 1968 (4) SA 224 (A); Bellairs v Hodnett 1978 (1) SA 1109 (A); Novick v Comair Holdings Ltd 1979 (2) SA 116 (W); Timmers v Spansteel (Pty) Ltd 1979 (3) SA 242 (T); Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T); Sibex Construction (SA) (Pty) Ltd v Infectaseal CC 1988 (2) SA 54 (T). For examples of other fiduciaries recognised in South African law, see Fourie, "Vertrouenspligte" 123-124.

28 On the application of the fiduciary doctrine to company directors in South Africa, see Blackman, Fiduciary Doctrine 119ff; Naudé, Maatskappydirekteur 106ff; Fourie, "Vertrouenspligte" 119; Fourie, "Perspektiewe" 339. See also the cases referred to in footnote 27 above and chapter 9 par 3 below.

29 See, for example, Shepherd, Law of Fiduciaries 355, who states: "The fiduciary relationship between director and corporation is unquestioned. It is the cornerstone of the director's office, and as such has become trite law."

30 See chapter 9 par 3.1 below.

31 Charitable Corporation v Sutton (1742) 2 Atk 400. See also Sealy, "Trustee" 83.
1844 most of the joint stock companies in England were unincorporated and depended for their validity on a deed of settlement vesting the property of the company in trustees. This deed of settlement company was merely an enlarged partnership, with the partnership property vested in trustees. Often the directors were themselves the trustees. The courts later extended the description of directors of incorporated companies as "trustees" by analogy. In *In re Lands Allotment Co* the analogy was thus explained:

> Although directors are not, properly speaking, trustees, yet they have always been considered and treated as trustees of money which comes to their hands, or which is actually under their control, and ever since joint stock companies were invented directors have been held liable to make good moneys which they have misapplied, upon the same footing as if they were trustees...  

It was believed that the property of a corporation was held on trust by the corporation for its members. Since it would be the directors who managed the property, they would be liable as "constructive trustees" if they misapplied it.

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32 Blackman *Fiduciary Doctrine* 275ff; Gower *Company Law* 350; Sealy "Trustee" 83. On the development of English company law generally, see Gower *Company Law* 19-54; Naudé *Maatskappydirekteur* 44; Robinson *v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

33 [1894] 1 Ch 616 at 631.

34 See also *Great Eastern Railway Company v Turner* (1872) 8 Ch App 149 at 152; *Percival v Wright* [1902] 2 Ch 421 at 425; *Selangor United Rubber Estates Ltd v Craddock (No 3)* [1968] 1 WLR 1555, [1968] 2 All ER 1073 and *In re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 426, where Romer J stated: "It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading". In *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393 at 405 Goff and Waller LJJ referred to *In re Lands Allotment Co* and agreed that: "A limited company is of course not a trustee of its own funds: it is their beneficial owner; but in consequence of the fiduciary character of their duties the directors of a limited company are treated as if they were trustees of those funds of the company which are in their hands or under their control, and if they misapply them they commit a breach of trust." See also *Rolled Steel Products (Holdings) Ltd v British Steel Corporation and Others* [1986] 1 Ch 246.

35 Fourie "Perspektiewe" 341; Gower *Company Law* 550. Under the law of constructive trusts, a person who has not been appointed as a trustee may so conduct himself in relation to a trust or other fiduciary relationship, that the liabilities of trusteeship are imposed upon him: Harpum "Constructive Trustee I" 114. On constructive trusts in general, see Austin "Constructive Trusts" 196; Baker & St J Langan *Snell's Principles of Equity* 192ff; Burn *Trust and Trustees* 237ff; Heyton *Trusts* 301-377; *Underhill & Heyton Trusts* 14, 28. On constructive trusts in company law, see Fox "Constructive Trusts" 23ff. Sealy "Trustee" 83 note 3 submits that the suggestion that directors could be regarded as "constructive trustees" under this theoretical trust, should not be supported. The author indicates that none of the reported cases support this reasoning and that the fact that early corporations were competent to alienate without restriction as to "corporate purpose" places a further obstruction in the way of this theory. Burn *Trust and Trustees* 237 further indicates that the duty of a constructive trustee is, in many instances, less onerous than that of an ordinary trustee. The doctrine of constructive trusts is not recognised in South African law.
A further possible explanation is that the courts of equity generally applied the label of "trustee" to anyone in a fiduciary position. The terminology gradually became standard in cases where any fiduciary obligation was considered. Since the flexibility and range of the principles of fiduciary obligation had proved adequate to solve most of the problems arising from company law and all fiduciary problems had previously been connected to principles of trust, the liability of company directors was traditionally determined on these principles, and directors were often referred to as "trustees".

The influence of English principles of the law of trust and equity is apparent in early South African cases dealing with company directors. In both legal systems, directors are often simply referred to as trustees, without comparison or distinction between their respective legal positions.

Evaluation

A company director is evidently in a position of trust. He is responsible for the administration of the company's assets, similar to a trustee who administers trust assets. There are many other similarities between company directors and trustees. The most obvious resemblance is that both have control of a fund in which others are beneficially interested. A trustee must be honest and adhere strictly to the terms of his trust. The corresponding requirements in company law are that a director must be honest and act lawfully, within the terms of his own authority and the constitution of the company. There are, however, clear differences in function.

36 See, for example, Re German Mining Co, ex parte Chippendale (1853) 4 De Gm&G 19, where directors were afforded the rights of a trustee to be indemnified by the members as their beneficiaries.

37 See, for example, the authority referred to in African Claim and Land Co Ltd v Langermann 1905 TS 494 at 505. This case is referred to in Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168, which incorporated the principles developed by the English courts in South African law.

38 See, for example, McClean "Duty of Loyalty" 218, who, in his discussion of the theoretical basis of the trustee's duty of loyalty, refers to various cases which involved company directors. See also In re Wincham Shipbuilding, Boiler, and Salt Company; Poole, Jackson, and Whyte's Case (1878) 9 ChD 322 at 328; In re Forest of Dean Coal Mining Company (1879) 10 ChD 451 at 453; Re H Linney & Co Ltd [1925] NZLR 907 at 922; Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T) at 65C.

39 French Hairdressing Saloons, Ltd v National Employers Mutual General Insurance Association, Ltd 1931 AD 60 at 67 and 68.

40 Gore-Browne on Companies par 27.2.3; Sealy "Trustee" 86; Sealy "Problems" 168. The latter author contends that there is no reason why the law of directors' duties should stay within the conceptual straightjacket of the law of trust. Trust law does, however, offer some advantages - "By setting high standards of loyalty and integrity it acts as a salutary prophylactic, important wherever people have power over other people's property".

41 Sealy Cases 248.
between the office of a company director and that of a trustee. A trust is not created when directors are appointed and a director does not occupy the office of trustee. There is, furthermore, a marked difference in the purposes for which directors and trustees are appointed.

An important distinction between trustees and company directors concerns unanimity of acts undertaken by them. Trustees are often required to act unanimously. Although a trustee may be said not to be liable for the acts of a co-trustee, he is in practice invariably treated as being personally responsible for the due discharge of his trust, and is accountable for a misapplication whether or not he has been directly implicated. Under South African law, those persons who were trustees at the time of the breach of trust are, in the absence of a provision in the trust instrument to the contrary, jointly and severally liable. The trustees are co-principal debtors in solidum. It is no defence for a trustee that he did not take an active part in the affairs of the trust. Company constitutions, on the other hand, often determine that "control" of company property may be exercised by fewer than the total number of directors. The board may act by a quorum and the vote of a majority will, in normal circumstances, prevail. An individual director is not a necessary party to a transaction involving the property of the company. Should he dis-

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42 The statement by Vaughan Williams J in *In re Kingston Cotton Mill Company (No 2)* [1896] 1 Ch 331 that a director is in no sense a trustee (at 345), stresses this difference in the respective offices, and is qualified by a further statement (at 347) that there is a considerable bulk of authority which indicates that directors are trustees for the company of such funds as are committed to their control in such sense that they may be liable for a misapplication of funds. In *In re Exchange Banking Company, Fitchcroft's Case* (1882) 21 ChD 519 (AC) Bacon V-C held that directors were trustees and nothing else, when considering the legal problems involved. It is submitted that, in their contexts, both these statements are correct. They also serve as examples of the confusion caused by loose terminology. See also Palmer's *Company Law* 922; Sealy "Trustee" 86. In *Smith v Anderson* (1880) 15 ChD 247 (CA) James LJ pointed out (at 275) that the distinction between a director and a trustee is an essential distinction founded on the very nature of things. See also *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134, where it was emphatically stated that directors are not trustees, although they occupy a fiduciary position towards the company whose board they form.

43 Van Dorsten *Directors* 16. The provisions of the Trust Property Control Act 57 of 1988 do not apply to companies: s 1 of this Act. Directors also do not require the authority of the Master of the Supreme Court to act as trustees: Trust Property Control Act 57 of 1988, s 6.

44 Blackman *Fiduciary Doctrine* 279; *Selangor United Rubber Estates Ltd v Cradock and Others (No 3)* [1968] 1 WLR 1555, [1968] 2 All ER 1073.

45 The charitable trusts in English law are a regular exception to the requirement of unanimity: Sealy "Trustee" 87 note 22.

46 *Ex parte Blaikie* 1952 (3) SA 200 (N) at 203-204. In order to render a trustee accountable for due disposal of trust property under English law, it is necessary only to prove its receipt by, or the obligation to acquire it for, the trust: Sealy "Trustee" 87.

47 Honoré & Cameron *Honoré's Trusts* 308; *Adam and others v Dada and others* 1912 NPD 495 at 503; *Yorkshire Insurance Co, Ltd v Barclays Bank (Dominion, Colonial and Overseas)* 1928 WLD 199; *Minister of Internal Affairs v Albertson* 1941 SR 240; *Boyce NO v Bloem and others* 1960 (3) SA 855 (T) at 858G.
agree with co-directors, he is obliged to accept the decision of the majority. Only those directors who are active parties to any particular dealing with the company’s property ought therefore, *prima facie*, to be liable as fiduciaries for the propriety of their act.\(^{48}\)

A director is allowed a much higher degree of discretion and is able to take more risks with company property in the execution of his office than is a trustee in respect of trust property.\(^{49}\) Courts are not willing to intervene in the exercise of directors’ discretion as business men.\(^{50}\) Directors are, furthermore, subject to a more flexible, and generally lower, standard of skill and care than trustees.\(^{51}\) Finally, the beneficiary in the trust-analogy would in the case of directors, be the company as a separate legal entity, in which shares are held. The beneficiaries of a trust are persons, or is one person, and not a collective separate legal entity.\(^{52}\)

A further noteworthy aspect concerns the positions of the trustee under South African and English law in respect of the trust assets. Under English law the trustee merely holds the assets on behalf of the founder.\(^{53}\) It may therefore be more appropriate to regard his position as analogous to that of a company director. However, South-African law provides that the trustee is the owner of the trust assets as soon as they have been transferred to him in accordance with the trust docu-

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\(^{48}\) This was apparently not always recognised. The initially accepted view was that a director, by accepting his office, undertook to give the fullest intention, or even all of his time, to the company’s affairs. Non-feasant directors were commonly held collectively liable for the misappropriation of others: *Benson v Heathorn* (1842) 1 Y&CC 326, 63 ER 748; *Burt v British Nation Life Assurance Association* (1859) 4 DeG&J 158, 45 ER 62. As business practice changed, it came to be recognised that if the board could act by a quorum, a director’s absence was explicitly sanctioned. Companies often appointed directors who, because of their other interests and commitments, could not be deemed to have undertaken to fill more than a part-time or advisory position. The courts had to accept that an absent or dissenting director could not be held responsible for the acts of others: *Land Credit Company of Ireland v Lord Fermoy* (1870) LR 5 ChApp 763. It therefore became necessary to plead each alleged act of misfeasance specifically and to identify the particular directors who were responsible. See in general Sealy “Trustee” 88. It is interesting that the proposed statute for European companies provides that the directors will be collectively liable for damage sustained by a company as a consequence of any wrongdoing by a director. Any director wishing to escape liability will therefore have to prove that no fault was attributable to him personally (Proposal for a Council Regulation on the Statute for a European Company COM (89) 268 Final-SYN 218 and 219, art 77(2)). This requirement should ensure more active monitoring of directors by co-directors. On this proposed statute, see also chapter 8, par 2.3 below.

\(^{49}\) *Sheffield & South Yorkshire Permanent Building Society v Aizlewood* (1899) 44 ChD 412 at 454.

\(^{50}\) They are not concerned with the commercial or financial wisdom of the decisions taken by company directors: *Levin v Felt & Tweeds Ltd* 1951 (2) SA 401 (A) at 414-415; *Howard Smith Ltd v Arnpol Petroleum Ltd* [1974] AC 821, [1974] 2 WLR 689, [1974] 1 All ER 1126 (PC), [1974] 1 NSWLR 68.

\(^{51}\) *Gore-Browne on Companies* par 27.2.

\(^{52}\) *Hanbury and Maudsley Modern Equity* 568 note 96.

\(^{53}\) *Hayton and Marshall Trusts* 4; *Maudsley & Bum* 3ff; *Petit Trusts* 25, 85ff.
ment. In consequence, theft of trust assets by the trustee is not possible. But a director does not hold property on behalf of another. Therefore a company's property can be stolen by one or more of its own directors.

From the abovementioned it may be concluded that the designation of directors as trustees should be regarded as inappropriate in South African law. Fiduciary obligations are not imposed on directors because they are trustees or because they occupy a position similar to that of a trustee. The obligations are imposed because they are fiduciaries and because they are relied upon to manage property that, ultimately, belongs to others. To describe a mere fiduciary as a trustee is therefore at best a metaphor. It is submitted that it is in this metaphoric sense that the word "trustee" is sometimes used in respect of company directors. The application of strict rules pertaining to trustees to company directors might fetter their actions to an extent which might be disadvantageous to the companies they represent.

54 See in general Honoré and Cameron Honoré's Trusts 6, 222ff; Shrand Trusts 1; Lucas' Trustee v Ismail & Amod 1905 TS 239 at 242-243; The Princess Estate and Gold Mining Co, Ltd v The Registrar of Mining Titles 1911 TPD 1066 at 1078-1079; Plank NO v Otto 1912 AD 353; Estate Kemp v MacDonald's Trustee 1915 AD 491; Adam v Jhavry 1926 AD 147; Mohamed v Insolvent Estate Du Toit 1957 (3) SA 555 (A); CIR v Estate Merensky 1959 (2) SA 600 (A). In certain instances the ownership of the trust property vests in the beneficiary and not in the trustee, who merely has the control of that property: Honoré & Cameron Honoré's Trusts 5; Trust Property Control Act 57 of 1988, s 1.

55 Heydon Gummow & Austin Trustees 464.

56 Beuthin 'Theft' 480; Smukler Theft; R v Milne and Erleigh (5) 1950 (4) SA 604 (W); R v Herholdt and Others 1957 (3) SA 236 (A); S v De Jager and Another 1965 (2) 616 (A). In this regard, see also chapter 9 note 46 below. It could also be argued that a duty of care does not exist in respect of one's own property. However, the Trust Property Control Act 57 of 1988 provides that a trustee must in the performance of duties and the exercise of powers as a trustee act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another (s 9(1)). The duties of care and skill owed by a company director are similar.

57 Beuthin & Luiz Basic Company Law 218; Blackman Fiduciary Doctrine 275ff; Cilliers & Benade Corporate Law 112; Du Plessis Grondslae 83-86, 385; Fourie 'Perspektiewe' 350; Naudé Maatskap-pydirekteur 43-45. See also Du Plessis Grondslae 103, who states that there is no reason why principles of the English law of trust, which were developed for specific historic reasons, and about which there is little agreement in England, should continue to influence the South African company law.

58 Beck "Corporate Opportunity" 205.


60 For example by Goldstone J in Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T) at 65C. In this regard, see Havenga "Opportunities" 124.

61 In re Faure Electric Accumulator Company (1889) 40 ChD 141 at 151. See also Kaplan "Fiduciary Responsibility" 886, who states that 'presumably the term 'trustee' is narrower and more precise than the term 'fiduciary' and a trustee is only one form of fiduciary.'
3.2 The Director as Agent

A company, which exists as a separate legal entity, is not able to act of its own accord. It must necessarily participate in legal transactions through natural persons acting on its behalf. Directors represent the company in transactions with third parties. Their acts are the acts of the company. Their power to act on behalf of the company arises from and is limited by the authority conferred on them. When they contract on behalf of their company, they do not themselves incur any liability unless they act outside their powers or expressly assume liability. The relationship between the company and its directors is therefore in many respects regulated by the law of principal and agent. For this reason directors are frequently referred to as "agents" of their company. In some cases they are described as "trustees or

62 Cilliers & Benade Corporate Law 33ff; Farrar Company Law 33ff; Gower Company Law 85ff; Hahlo Cases 13ff; Naudé Maatskappydirekteur 45; Pennington Company Law 32.

63 Newbome v Sensolid (Great Britain) Ltd [1954] 1 QB 45 (CA), [1953] 1 All ER 708 (CA); Northern Counties Securities Ltd v Jackson & Steeple Ltd [1974] 1 WLR 1133, [1974] 2 All ER 625 (Ch).

64 Blackman Fiduciary Doctrine 281ff; Gore-Browne on Companies par 27.2.1; LAWSA Companies par 162; Pennington Company Law 572; Naudé "Mededinging" 198; Naudé "Toestemming" 217; Ferguson v Wilson [1866] 2 Ch 77 at 89; Cargill v Bower (1878) 10 ChD 502 at 513; Wilson v Bury (Lord) (1880) 5 QBD 518 (CA).

65 Naudé Maatskappydirekteur 45. Van Dorsten Directors 14 indicates that directors act as agents of the company when they derive their authority to act on the company's behalf from the articles, when they have been given a special or general mandate by the company and when the company ratifies unauthorised actions by the directors. See also Naudé Maatskappydirekteur 107 who suggests that in instances where puppet directors have been appointed the liability of the manipulator may be based on a deducted contract of mandate between himself and the company. In this regard see also chapter 9, par 2.1 below. The agency principle is also at the root of Naudé's distinction between directors who may compete with their company and those who may not: Naudé Maatskappydirekteur 135ff; Naudé "Mededinging" 193ff; Naudé "Toestemming" 217ff. See also chapter 9, par 4.6 below.

66 Naudé "Mededinging" 193; Naudé "Toestemming" 217; Palmer's Company Law 922. See also Ferguson v Wilson [1866] 2 Ch 77 at 89-90; Aberdeen Railway Co v Blaikie Bros (1854) 1 Macq 461 (HL); Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 216; Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606; Northern Counties Securities Ltd v Jackson & Steeple Ltd [1974] 1 WLR 1133 at 1144, [1974] 2 All ER 625 (Ch); Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T) at 198D; Dawson International plc v Coats Paton plc [1988] SLT 854, (1988) 4 BCC 305, [1988] PCC 362; Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1990] 3 All ER 404, [1990] BCLC 868 (PC). See further Anon "Liability" 220, where it is regarded as more helpful to look upon a director of a corporation as an agent of that corporation than as a trustee. In Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame [1906] 2 Ch 34 there was a difference of opinion in this regard. Collins MR held that there was no doubt that for some purposes directors are agents. Cozens-Hardy LJ thought it "not ... true to say that the directors are agents", but "more nearly true to say that they are in the position of managing partners appointed to fill that post by a mutual arrangement between all the shareholders" (at 45). In S v Berliner 1966 (4) SA 535 (W) at 536G-H Boshoff J held that it was the duty of all agents, including directors of companies, to conduct the affairs of their principals in the interests of the principals. See also Beuthin "Range of Interests" 155 and Guild "Company Directors" 642, who states that directors are "fiduciary agents".
agents.67

Evaluation

The notion of a director being an agent was especially popular until the beginning of the century. Before then, the directors were subject to the control of the general meeting of the company, because this body was regarded as the company.68 At the turn of the century, the principle emerged that if powers of management had been vested in the directors then they and they alone could exercise those powers. It became common to entrust the management of the company’s affairs to the directors.69 The general meeting retains the right to remove the directors at any time and to amend the articles. However, it may not direct or control the board in its management of the company’s affairs, nor overrule any decision which the board may have made in the conduct of the company’s affairs.70

However, since the company is itself incapable of acting and accordingly of conferring authority to act on its behalf, its directors cannot strictly be regarded as agents. Their authority as such derives ultimately from the articles, not from any appointment as agents by the company.71 Furthermore, each director does not individually have the power to bind the company, unless such power has been specifically delegated to him.72 But a director, as an individual, stands in a fiduciary posi-

67 In Great Eastern Railway Company v Turner (1872) LR 8 ChApp 149 (at 152), for example, Lord Selborne LC said "The directors are the mere trustees or agents of the company - trustees of the company's money and property - agents in the transactions which they enter into on behalf of the company." See also Boyle & Birds Company Law 589, 590; In re Cape Breton Company (1885) 24 ChD 795; Cohen NO v Segal 1970 (3) SA 706 (W).

68 Beuthin "Range of Interests" 156; Isle of Wight Railway Company v Tahourdin (1883) 25 ChD 320 (CA).

69 This is usually done by virtue of an article similar to art 59 of Table A and art 60 of Table B of the Companies Act 61 of 1973. See chapter 9 note 12 below.

70 Beuthin "Range of Interests" 156; Automatic Self-Cleansing Filter Syndicate Company, Limited v Cunninghame [1906] 2 Ch 34 (CA) at 38; The Gramophone and Typewriter, Limited v Stanley [1908] 2 KB 89 (CA) at 99 per Fletcher Moulton LJ; Scott v Scott [1943] 1 All ER 582 at 585. The indications to the contrary in Marshall's Valve Gear Company Limited v Manning, Wardle & Co Limited [1909] 1 Ch 267 at 274; Salmon v Quin & Axten, Limited [1909] 1 Ch 311 (CA); Quin & Axten, Limited and others v Salmon [1909] AC 442 (HL); John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113, [1935] All ER 456 pertain to specific instances where the articles subjected the directors' management powers to the approval of the shareholders. In limited circumstances the courts are prepared to hold that there is a residual power of management in the general meeting: Barron v Potter [1914] 1 Ch 895 at 903.

71 Henochsberg 394. In Newborne v Sensolid (Great Britain) Ltd [1954] 1 QB 45 (CA) at 51, [1953] 1 All ER 708 Goddard CJ rejected the agent-analogy: "The company makes the contract. No doubt the company must do its physical acts, and so forth, through the directors, but it is not the ordinary case of principal and agent. It is a case in which the company is contracting and the company's contract is authenticated by the signature of one of the directors."

72 Naude Maatskappydirekteur 19; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 217; Rosebank Television & Appliance Co (Pty) Ltd v Orbit Sales Corporation (Pty) Ltd (1969) 1 SA 300 (T) at 303A; Wolpert v Uitzigt Properties (Pty) Ltd 1961 (2) SA 257 (W) at 262.
tion in relation to the company. The powers of directors are, moreover, much wider than those usually accorded to agents and are often subject to little control by their principal. Unlike agents, directors sometimes incur criminal and civil liability for failing to comply with statutory requirements.

There are specific instances where directors may undertake to act as agents for certain people or for a certain class of people. In such cases they may also owe fiduciary duties, which extend beyond the usual scope of their duties, to their mandatories. This situation should be distinguished from instances where a company director merely acts as such, without any additional agreement between himself and the company or other parties.

It is therefore submitted that company directors are more than mere agents or trustees. There is no need to limit the fiduciary relationship to instances of agency.

3.3 The Director as Fiduciary 

The term "fiduciary" refers to a position of trust and confidence. It is applied to a large number of persons in diverse capacities who resemble each other in that each of them has duties to another, but each of those duties may vary and differ in many respects. Fiduciary duties may arise in many and varied circumstances. As

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73 Gower *Company Law* 551; Sealy *Cases* 247.

74 Van Dorsten *Directors* 15. Corkery *Directors* 54 and Gore-Browne on *Companies* par 27.2.1 indicate as the reason the fact that shareholders do not have much opportunity of knowing what the directors are doing, and that any action they may wish to take will be slow and greatly encumbered by dealing with large numbers of persons. See also *In re Faure Electric Accumulator Company* (1889) 40 ChD 141, where Kay J indicated (at 151): "Perhaps the nearest analogy ... [to the position of directors] would be that of the managing agent of a mercantile house to whom the control of its property and very large powers for the management of its business are confided; but there is no analogy that is absolutely perfect. Their position is peculiar because of the very great extent of their powers and the absence of control, except the action of the shareholders of the company."

75 Section 50(3)(b) of the Companies Act 61 of 1973, for example, provides that a director or officer who signs or authorises the signature on behalf of a company of any bill of exchange upon which the company's name is not correctly reflected incurs civil and criminal liability unless the bill of exchange is duly paid by the company.

76 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168. In *Allen v Hyatt* (1914) 30 TLR 444 (PC), for example, the court held that although in other circumstances it might be that the fiduciary duty of the directors was a duty to the company and not to individual shareholders, the facts of this case indicated that the directors had become the agents of the shareholders and that they therefore owed the shareholders a fiduciary duty in the conclusion of certain transactions.

77 Beuthin "Range of Interests" 156; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 180; *Sibex Constriuction (SA) (Pty) Ltd v Injectaseal CC and Others* 1988 (2) SA 54 (T) at 198D-F.

78 Mayson, French & Ryan *Company Law* 407.

79 Kaplan "Fiduciary Responsibility" 887. See also the discussion of the fiduciary principle under par 2 above.
the word fiduciary does not encompass a single class of relationships to which a fixed set of rules and principles apply,80 various fiduciary relationships are recognised by law.81 A fiduciary is a person who agrees, or undertakes, to act for, or on behalf of, another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense.82

In *Imperial Hydropathic Hotel Company, Blackpool v Hampson*83 Bowen LJ held:

> When persons who are directors of a company are from time to time spoken of ... as agents, trustees or managing partners of a company, it is essential to recollect that such expressions are used not as exhaustive of the powers or responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered .... It is not meant that they belong to the category, but that it is useful for the purpose of the moment to observe that they fall pro tanto within the principles which govern that particular class.

A further option is therefore to regard a company director, who is a creature of statute and who occupies a position which is peculiar to his office,84 as a specific type of fiduciary. This is the traditional view in South African law.85 It has, thus far, been accepted that the basis of a company director's liability for breach of trust is *sui generis*,86 and need not necessarily be based on fraud or delict.87 The basis for the

80 Blackman *Fiduciary Doctrine* 69ff; Naudé *Maatskappydirektur* 109; Scaly "Fiduciary Relationships" 73.


82 *Hospital Products Ltd v United States Surgical Corporation* (1984) 55 ALR 417 (HC Aust), (1984) 156 CLR 41. See also par 2 above.

83 (1882) 23 ChD 1 (CA) at 12, referred to with approval in *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706D-F.

84 *Farrar Company Law* 379; *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706A-C; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL) at 387, [1967] 2 AC 134 (HL) at 147.

85 See chapter 9 par 3 below.

86 This view appears to be largely based upon the judgments in *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168. At 199 Innes CJ agreed with the unanimous view of the trial court "that the action with which we have to do falls under none of the specified classes suggested." At 242 Solomon JA confirmed that "the action indeed is, as the Judges in the court below held, one *sui generis*." At 262 Juta JA also confirmed that the claim was not one for damages, nor an action on a contract, nor a *condictio indebiti*. See also Beuthin & Luiz *Basic Company Law* 218; Cilliers & Benade *Corporate Law* 136; Du Plessis *Grondslae* 101; Hahlo *Cases* 366; Naudé *Maatskappydirektur* 142-143; *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706G. In respect of the recently expressed opinion that the liability should in South African law be based on the *actio legis Aquiliae*, see chapter 9 par 3.1 below.

87 *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706G. See also Naudé *Maatskappydirektur* 143, who states "n Direkteur se aanspreeklikheid op grond van trouskending is onafhanklik van die bestaan van 'n kontraktuele verhouding, skuld is in beginsel geen vereiste daarvoor nie, en die verhaalsreg van die maatskappy is waar hy benadeel is nie vir *skade* nie. Die aanspreeklikheid is derhalwe nie te verklaar as
development of the concept of fiduciary relationships can be traced to the term "bona fides" in Roman law. Various such relationships were also recognised in Roman-Dutch law.

**Evaluation**

The law of fiduciaries has not developed as a separate area of the law, or even as an offshoot of one particular area of the law. Rather, it has existed for many years as a fundamental and often unstated assumption underlying certain aspects of the law.

Fiduciary duties have been ascribed to many legal relationships under South African law. It is suggested that company directors comprise one such a class.

The analogies between company directors and agents or trustees of the company often indicate useful points of view from which their position may for the particular purpose be considered. But they, and other legal terms used to describe directors, are equally inadequate to encompass all the legal relationships to which the directors may be parties. The importance of these analogies is that they indicate that directors, in the performance of their duties, stand in a fiduciary relationship to their company. The precise nature of the fiduciary duties is, however, not indicated. The exact scope of directors' fiduciary duties should therefore be determined according to their particular position. They are fiduciaries *sui generis* and, as such, legal principles and guidelines have been developed by the courts to regulate their unique position.

It is therefore submitted that it is preferable not to make use of potentially confusing terminology, by referring to directors as trustees, agents, managing part-

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88 Fourie "Vertrouenspligte" 123, who quotes Digesta 18.1.34.7: "Tutor rem pupill[i] emere non potest: idemque porrigendum est ad similia, id est curatores, procuratores et qui negotia aliena gerunt." See also chapter 9 par 3.1 below.

89 For a comprehensive discussion of the fiduciary relationship in Roman-Dutch law, see Blackman *Fiduciary Doctrine* 239ff.

90 Shepherd *Law of Fiduciaries* 123.

91 See Blackman *Fiduciary Doctrine* 239ff; Fourie "Vertrouenspligte" 123 and authorities cited for examples.

92 *Imperial Hydropathic Hotel Company, Blackpool v Hampson* (1882) 23 Ch 1 (CA) at 12.

93 Cilliers & Benade *Corporate Law* 112. Terms frequently encountered in this regard, include "quasi-trustee", "managing partner" and "paid servant". For other descriptive terms, see Fourie "Perspektiewe" 339-340.
Directors' Fiduciary Duties and Corporate Opportunities

ners but to regard them as fiduciaries sui generis. The action based on breach of trust should accordingly also be regarded as sui generis.

4 CONCLUSION

The existence of fiduciary relationships in commercial context has been recognised for many centuries. The law of fiduciaries developed in English courts of equity, with the trustee being recognised as the original fiduciary. In due course other fiduciary relationships which involved trust and confidence were recognised.

Many attempts have been made to define a fiduciary relationship. A universal definition does not seem possible, largely because the existence and extent of a fiduciary relationship requires a factual determination. But generally a fiduciary relationship will arise when a person has, or is assumed to have, access to the assets of a trusting party. The other person is vulnerable to the exercise of power in the discretion of the fiduciary. The nature and circumstances giving rise to the undertaking are such that loyalty and good faith are intrinsic elements of the consequent duty.

The fiduciary relationship is not definitive of a single class of relationships to which fixed rules and principles apply. To specify the content of the obligation in any particular case is therefore more difficult than to describe the relationship as fiduciary in nature.

It is generally recognised that a company director stands in a fiduciary relationship with his company. In order to determine the content of his obligation, his position is often compared to that of other fiduciaries. The most frequent analogies drawn are those between a director and a trustee and between a director and an agent. These analogies do little more than to prove the existence of a fiduciary

94 Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame [1906] 2 Ch 34 (CA) at 45.
95 Gore-Browne on Companies par 27.2.4. A director who performs no more than the tasks of a director will normally not be considered an employee of the company. If, however, he is appointed to some executive post such as managing director, or if he works full-time or part-time for the company so as to form a part of its 'labour-force', these activities may cause him to be considered an employee as well as a director. In this regard, see Rubin "Director as Employee" 328ff; Normandy v Ind, Coope & Co, Limited [1908] 1 Ch 84 at 104; Re Lee, Behrens and Company Limited [1932] 2 Ch 46 at 53; Boulting Limited and Another v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606 (CA) at 634 and 647; Griffiths v Secretary of State for Social Services [1974] QB 468.
96 Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168; Cohen NO v Segal 1970 (3) SA 702 (W). See also chapter 9 par 3.1 below.
97 Flannigan "Fiduciary Obligation" 322.
98 Gautreau "Fiduciary Principle" 7. See par 2 above.
99 See par 3.1 above.
100 See par 3.2 above.
Origin and Basis of Directors' Fiduciary Duties

...duty. Legally, directors are neither trustees, nor agents of the company. The fiduciary obligation that is common to the respective situations of directors, trustees and agents does not alter this fact. There will inevitably be similarities in the duties of various fiduciaries. But the relationship between a director and company remains separate. He is a fiduciary *sui generis*, and therefore legal principles and guidelines can and should be developed and applied by the courts to regulate his unique situation. Principles pertaining to other fiduciaries will obviously be of comparative value. It is further obvious that, although it is unnecessary to revert to English law to explain the existence of a fiduciary relationship between a company director and his company, the well-developed English law in this area will frequently be relied upon.

In *In re Forest of Dean Coal Mining Company* Jessel MR referred to company directors and indicated that

...it does not much matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and all the shareholders in it.

The view that the legal position of company directors is more important than how they are described, is endorsed. But if directors are described by terminology which implies specific meanings and consequences, it is too easy to assume that those consequences also apply to the directors. It is submitted that it is unnecessary to call directors by any other name. They are company directors, no more and no less. As such, they stand in a recognised fiduciary relationship towards their company. This duty arises from the director's position as a specific and unique type of fiduciary.

As is the case with trustees and agents, the director's position as fiduciary *sui generis* entails specific legal consequences. It is submitted that it is by these consequences, which have and can effectively be developed by courts of law, that the conduct of the director should be considered. Analogies with other fiduciaries may

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101 Naudé *Maatskappydirekteur* 43.

102 Cilliers & Benade *Corporate Law* 112; Naudé *Maatskappydirekteur* 142-143; Robinson *v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168. See also Fourie “Perspektiewe” 344, who indicates that merely to deduce that a director is not a trustee appears to be a futile exercise.

103 Naudé *Maatskappydirekteur* 109. The historical context of the development of these rules as well as the differences in law, especially with regard to the law of trusts should, of course, be considered. In this respect the warnings by Du Plessis *Grondslae* 103 and Fourie “Perspektiewe” 350 against indiscriminate following of English law should be heeded.

104 (1879) 10 ChD 451 at 452.

105 *Palmer's Company Law* 8088-8089 suggests that for most purposes it is sufficient to say that directors occupy a fiduciary position and all the powers entrusted to them are only exercisable in this fiduciary capacity.
be appropriate in certain circumstances, but do not alter the individual character of a company director's fiduciary office. It is therefore 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 that trust.\footnote{McLennan "Misapplication" 403. The statement was quoted with approval by Goldstone J in Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T) at 65G, albeit with reference to the wrong author.}
CHAPTER 3
THE BENEFICIARY OF DIRECTORS' FIDUCIARY OBLIGATIONS

1 INTRODUCTION

Once it has been determined that company directors owe fiduciary duties, it has to be established in favour of whom these duties ought to be exercised. Common law, and in some countries also legislation, require that the directors of a company should act in the best interests of the company. The entity to which the directors owe fiduciary duties is commonly described as "the company as a whole", a phrase described by Sealy as "of notoriously elusive meaning".

"The company as a whole" has been interpreted as the shareholders collectively, "all the shareholders, present and future", and the company as a separate legal entity respectively. The problem is compounded by the fact that despite the separate personality of the company, directors are not expected to act only on the basis of what is for the economic advantage of the corporate entity and to disregard

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1 See, for example, s 309 of the English Companies Act 1985 (c 6); s 229(5) of the Australian Companies Act 1981.

2 Calnan "Creditors' Rights" 93; Cilliers & Benade Corporate Law 156; Farrar Company Law 380; Fourie "Skuldeisers" 25-26 and authorities cited in note 12; Gower Company Law 553-556; Pennington Company Law 583; Palmer's Company Law 8104-8105; Van Rooyen Thesis 325 and 363ff; Worthington "Creditors' Rights" 121; S v De Jager and Another 1965 (2) 616 (A); S v Shaban 1965 (4) SA 646 (W); S v Ressel 1968 (4) SA 224 (A); S v Heller 1971 (2) SA 29 (A) at 44; Novick and Another v Comair Holdings Ltd and Others 1979 (2) SA 116 (W) at 130 and 151; Timmers and Another v Spansteel (Pty) Ltd 1979 (3) SA 242 (T) at 251; Fisheries Development Corporation of SA Ltd v Jorgensen 1980 (4) SA 156 (W) at 163E-G; Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwan (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T) at 65.


4 Sealy "Corporate Decisions" 269. The author contends that the attempt by modern commentators to make it mean all things to all men by adding gloss after gloss - shareholders present and future, employees and creditors - results in an emerging ill-focused conglomerate. See also Prentice "Creditor's Interests" 273, who indicates that the concept of "interests of the company" is often indeterminate and sometimes arguably incoherent.

5 Fourie "Skuldeisers" 26-27 and authorities cited. In Gaiman v National Association for Mental Health [1971] Ch 317 at 330, [1970] 2 All ER 374 Megarry J suggested that "[t]he interests of some particular section or sections of the company cannot be equated with those of the company, and I would accept the interests of both present and future members of the company, as a whole, as being a helpful expression of a human equivalent."
the interests of the members. In certain circumstances a duty owed directly to shareholders may arise on the facts of the particular case. Where appropriate, the short-term interests of present shareholders and long-term considerations, which also involve future shareholders, should be balanced. In some instances, attempting to do so may pose problems. If directors have been appointed by a particular class, for example of security holders, the obvious intention is that they should pay special attention to that class. But if the directors are also required to consider the interests of present and future shareholders they may not be able to do so. This places them in an untenable position. And where a company is to be taken over and the only issue concerns which of competing bids is to succeed, the interests of the company are regarded as the interests of only its current shareholders, and not those of the person who has made the bid as a prospective shareholder should the bid succeed. If a particular decision to be taken by the directors will affect classes of shareholders differently, the duty of the directors is to act fairly, with regard to the interests of all classes. It is therefore submitted that the duty is owed to the company as a legal

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6 Beuthin "Range of Interests" 157; Gower Company Law 554. If, as is normally the case, the directors are also shareholders, they are entitled to have some regard to their own interests as shareholders: Mills v Mills (1938) 60 CLR 150 at 164.

7 Sealy Cases 248. See, for example, Hutton v West Cork Railway Company (1883) 23 ChD 654 (CA); Parke v Daily News Ltd [1962] Ch 927, where the interests of the shareholders as a collective group were considered. These two cases were concerned with gratuitous payments, where the validity of a resolution of shareholders, as well as a decision of the directors were concerned. Boyle & Birds Company Law 593 note 27 and Birds "Making Directors do Duties" 70-72 suggest that the same meaning of "interests of the company" would probably apply when an issue is only one of the duties of directors. Contra Instone "Duty" at 226-227.

8 Boyle & Birds Company Law 593; Farrar Company Law 384; Fourie "Vertrouenspligte" 120; Gore-Browne on Companies par 27.4; Gower "Control" 1189; Hahlo Cases 393; Palmer's Company Law 8105; Pennington Company Law 591; Russell "Duty to Creditors" 417.

9 Gower Company Law 556. See also chapter 4 par 2.1 and chapter 9 par 2.1 below.

10 Gower Company Law 556. An attempt to resolve this problem is found in the Ghana Companies Code 1973 (Act 179). Section 203(3) provides: "In considering whether a particular transaction or course of action is in the best interests of the company as a whole, a director, when appointed by, or as a representative of, a particular class of members, employers or creditors, may give special, but not exclusive, consideration to the interests of that class." See also chapter 9 par 4.10 below.

11 Heron International Lid and Others v Lord Grade, Associated [1983] BCLC 244 (CA) at 264-265. This does not necessarily mean that the directors are under a positive duty to recommend the highest offer: Re a Company [1986] BCLC 382 Ch. In Dawson International plc v Coats Paton plc [1988] SLT 854, (1988) 4 BCC 305, [1988] PCC 362 (upheld on appeal (1989) 5 BCC 405) the court held that directors could still agree to recommend a particular bid or agree not to encourage or co-operate with another would-be bidder.

12 Boyle & Birds Company Law 593; Gore-Browne on Companies par 27.4; Mills and Others v Mills and Others (1938) 60 CLR 150. See also Fourie "Vertrouenspligte" 120, who indicates that although courts are reluctant to formulate a fiduciary duty to shareholders, they are, nonetheless, obliged to protect shareholders. Members of the same class must receive similar treatment and different classes have to be treated fairly.
Beneficiary of Directors' Fiduciary Obligations

entity.13

Modern management often takes the view that the interests to be taken into account by company directors should also encompass the interests of certain other interest groups and, at least in the case of large public companies, also those of the State and the general public.14 Various interest groups can be distinguished and are discussed below.15

2 INDIVIDUAL SHAREHOLDERS OF THE COMPANY

If shareholders have appointed directors specifically as their agents in any matter, the directors owe them the ordinary fiduciary duties which arise from the agency relationship.16 These duties should be distinguished from the fiduciary duties which arise by virtue of a company director's appointment to that office.

The most generally accepted view is that directors owe fiduciary duties to the company and not to individual shareholders.17 The leading authority is Percival v Wright.18 A group of shareholders approached the directors of a company with the request that the directors should purchase their shares. Some of the directors did so without disclosing that a purchase of the company's undertaking was imminent. It was held that the directors were not under any duty to the shareholders to disclose

13 Naudé Maatskappydirekteur 114; Sealy Cases 248. Although this entity comprises the shareholders collectively, the duty is not owed to them directly, since directors may in the exercise of their management powers take decisions against the wishes of the majority of shareholders: Instone "Duty" 226-227.

14 Gore-Browne on Companies par 27.4 regards this as an adequate practical guide for most decisions that a director has to take. Gower "Control" 1189 regards it as almost an accepted dogma that management owes duties to the four parties to industry: labour, capital, management and the community. Van Rooyen Thesis 337 questions "Slaan die begrip 'maatskappy' in hierdie verband op die maatskappy as regsentiteit of op die lede van die maatskappy? Welke rol speel die belange van die werknemers, skuldeisers, verbruikers en die gemeenskap wanneer 'n hof moet uitmaak of daar in belang van die maatskappy (of lede) opgetree is?" See also Beuthin "Range of Interests" 158 and pars 3.1 and 3.2 below.

15 In Germany, where a two-tier board is recognised (see chapter 7 below), it can be argued that the interest groups represented on the board should also be regarded as separate beneficiaries of the fiduciary obligation.

16 Palmer's Company Law 934; Pennington Personal Liability 154. These exceptional circumstances occurred in Allen v Hyatt (1914) 30 TLR 444 (PC) and Briess v Woolley [1954] AC 333. The duties then arise by virtue of the agency and not the directorship.

17 Du Plessis "Pligte" 378-379 and authorities cited in note 4; Farrar Company Law 380; Jacobs "Creditors" 310; Gower Company Law 551; Palmer's Company Law 934; Sappideen "Fiduciary Obligations" 386; Welling Corporate Law 387. There are, of course, statutory measures specifically aimed at the protection of shareholders, especially with regard to insider trading. On insider trading generally see s 440F of the Companies Act 61 of 1973; Cilliers & Benade Corporate Law 145ff; Du Plessis "Pligte" 381ff; Van Zyl "Binnekennistransaksies" 77; Du Plessis "Binnekennistransaksies" 46; Luiz "Transplant" 59; Luiz "Saga" 328.

18 [1902] 2 Ch 421.
this information, even though the price offered for the undertaking represented a substantial amount more per share than the directors were paying the shareholders for the purchase. The shareholders could accordingly not have the purchase set aside. The judgment stresses that there was no "unfair dealing" by the directors.\textsuperscript{19} It was also deemed significant that the initial approach had been made by the shareholders.\textsuperscript{20} The decision in \textit{Percival} has been widely criticised\textsuperscript{21} and may possibly be distinguished on its facts.\textsuperscript{22} Nevertheless, the basic principle remains: directors owe their duties to the company and not to individual shareholders.\textsuperscript{23}

\begin{flushleft}
\textsuperscript{19} At 426.
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\textsuperscript{20} At 427. The possibility that fiduciary duties would have arisen between the directors and the shareholders if the directors had instigated the purchase is thus not entirely ruled out.
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\textsuperscript{21} The rule was severely criticised by the Cohen Committee (Cmnd 6659 par 86 and par 87) and rejected by the Jenkins Committee (Cmnd 1749 par 89 and par 99(b)) in England. See also Farrar \textit{Company Law} 380; Gower \textit{Company Law} 551; Mackenzie "Employee" 688; Rider & Ffrench \textit{Insider Trading} 147; Rider "Percival" 471. Pennington \textit{Company Law} 607 note 20 submits that it seems unfair that directors should profit because of inside information which they have required as directors and which is not available to investors generally. This reasoning is also found in the recommendation by the Jenkins Committee that "a director who in any transaction relating to the securities of his company or any other company in the same group, makes improper use of a particular piece of confidential information which might be expected materially to affect the value of those securities, should be liable to compensate a person who suffers from his action in so doing, unless that information was known to that person" (Cmnd 1749 par 99(b)). In Coleman v Myers [1977] 2 NZLR 225 at 268 Mahon J referred to the criticism that \textit{Percival} was not only in conflict with commercial morality, but also inconsistent by analogy with the fiduciary duty of directors not to use the property or confidential information of the company for personal profit. Loss "Insiders" 40-41 regards the decision in \textit{Percival} as "a monument to the ability of lawyers to hypnotise themselves with their own creations."
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\textsuperscript{22} The directors had been approached by the shareholders and had named the price at which they wished to sell. The board may not have intended to accept the takeover offer in respect of which negotiations had ultimately proved abortive ([1902] 2 Ch 421 at 426). In Coleman v Myers [1977] 2 NZLR 225 at 274 the New Zealand court expressed the view that the decision in \textit{Percival} was incorrectly decided. Mahon J reached the unhesitating conclusion "that the decision in \textit{Percival} v Wright, directly opposed as it is to prevailing notions of correct commercial practice, and being in my view wrongly decided, ought no longer to be followed in an impeached transaction where a director dealt with identified shareholders" (at 280). The Court of Appeal dissented from this view and did not regard the decision as wrong on its own particular facts ([1977] 2 NZLR 297 at 329-330). See also Scally "Set-back" 247 and Dawson International plc v Coats Paton plc [1988] SLT 854, (1988) 4 BCC 305, [1988] PCC 362 where Lord Cullen saw no good reason to suppose that directors are under a fiduciary duty to current shareholders with respect to the disposal of their shares in the most advantageous way. In South Africa, the effect of \textit{Percival} has been somewhat tempered by the decision in Pretorius and Another v Natal South Sea Investment Trust Ltd (Under Judicial Management) 1965 (3) SA 410 (W), where the court held that directors were obliged to disclose material information concerning the affairs of the company to subscribers, because subscribers to shares "must perform rely on the directors to place before them all the available information material to their decision" (at 418C): Fourie "Vertrouenspligte" 134. But it must be noted that here the shareholders had been induced to enter into a direct contractual relationship.
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\textsuperscript{23} The authors of Cilliers & Benade \textit{Corporate Law} explain that "[i]t is a matter of impossibility for a director to maintain a fiduciary relationship towards both the company and the individual members. The interests of a member and of the company may diverge with the result that a director would be in an untenable position if he were to observe fiduciary duties towards both" (at 144).
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It is often difficult to maintain a rigid division between the corporate entity and its shareholders.\(^{24}\) It has thus been said that the directors are not expected to disregard members’ interests and to look only at the interests of the corporate entity.\(^{25}\) Some cases, many of which involved takeover bids, indicate that, in certain limited instances at least, directors may owe some duties directly to their shareholders.\(^{26}\) The New Zealand Court of Appeal\(^{27}\) has accepted that the directors of a company involved in a takeover can owe fiduciary duties to its shareholders. Woodhouse J held that it is not the law that anybody holding the office of director of a limited liability company is for that reason alone to be released from what otherwise would be regarded as a fiduciary responsibility owed to those in the position of shareholders of the same company.\(^{28}\)

\(^{24}\) Russell "Duty to Creditors" 417.

\(^{25}\) Fourie "Vertrouenspligte" 119ff. In Greenhalgh v Arpeme Cinemas LD and Others [1951] 1 Ch 286 (CA) Evershed MR held that it was plain that: "...bona fide for the company as a whole" means not two things but one thing. It means that the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase ... does not mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body" (at 291).

\(^{26}\) Palmer’s Company Law 935. In Gething v Kilner [1972] 1 WLR 337, [1972] 1 All ER 1166 the court accepted that where a takeover bid had been made, the directors of the offeree company were under a duty to their own shareholders which included a duty to be honest and a duty not to mislead. A minority could therefore complain if they were being wrongfully subjected to a compulsory purchase as a result of a breach of duty on the part of the offeree company. In Heron International Ltd and Others v Lord Grade, Associated Communications Corp plc and Others [1983] BCLC 244 (CA) the directors of the target company considered two competing bids. The board was empowered by the articles to choose the bidder to whom shares could be transferred. In the circumstances the court found that the directors owed a duty to the current shareholders to obtain for them the opportunity to accept or reject the best price that was reasonably obtainable. The duty to allot shares for a proper purpose has also been classified as a duty owed to shareholders directly (Re a Company [1987] BCLC 82). Cf Re a company [1986] BCLC 382 Ch where Hoffmann J considered that fairness could not require more of the directors than to give the shareholders sufficient information and advice to enable them to reach a properly informed decision and to refrain from giving misleading advice or exercising their fiduciary powers in a way which would prevent or inhibit shareholders from choosing to take the better price. It is submitted that the approach by Lord Cullen in Dawson International plc v Coats Paton plc (1988) 4 BCC 305, [1988] PCC 362 is sound, namely that directors owe no fiduciary duty directly to shareholders. If, however, they take it upon themselves to advise current shareholders, they have a duty to do so in good faith and not fraudulently, and not to mislead whether deliberately or carelessly. Breach of this duty may lead to liability arising out of their words or actions. This liability is based on ordinary principles of law.

\(^{27}\) See Coleman v Myers [1977] 2 NZLR 297 (CA). This case involved the takeover, at an undervalue, of a family company by a new company formed by one of the directors of the family company.

\(^{28}\) [1977] 2 NZLR 297 (CA) at 324.
assumed towards the shareholder should be scrutinised to determine whether the additionally required element was present.29

In the United States of America a "special facts rule" has been acknowledged for some time. This rule originated in Strong v Repide.30 The Supreme Court recognised that the ordinary relationship between directors and shareholders in a company does not impose any fiduciary duties on the directors. Nevertheless, it held that where special circumstances exist, a duty of disclosure must be held to arise. This principle was applied in later decisions of American state courts. Examples of "special facts" have been held to be a pending merger, a consolidation, a take-over, a pending sale of corporate assets and a pending liquidation.31 But in Coleman32 Mahon J distinguished the "special facts" doctrine on the basis that the liability arising from that doctrine is considered to be created by the existence of the special facts of the proposed transaction. The court's decision was based on the legal status and powers of a director being the originating cause of his liability.33 The American law presently places directors in a fiduciary relationship to virtually all those with whom they have dealings in their company securities.34

29 The court (at 325) mentioned a number of factors which could be relevant: the closely held nature of the company, the dependence of the shareholders upon the directors for information and advice, the existence of a relationship of confidence, the significance of the transaction for the parties and the extent of any positive action taken by or on behalf of the director or directors to promote it. The recognition of the special position of shareholders in small closely held companies and the intra-corporate relationship of confidence, which may contribute to a finding of a special relationship in equity are, according to Rider "Special Facts" 589, interesting elements in this decision. See also Gower Company Law 552, who indicates that this case illustrates that less than an agency relationship may suffice to establish a fiduciary duty between directors and shareholders. Some Australian dicta also indicate that directors may, in some circumstances, owe a duty to individual company shareholders. See, for example, Hooker Investments Pty Ltd v Email Ltd (1986) 10 ACLR 443, Palmer's Company Law 8104 suggests that the idea of a limited duty in favour of shareholders may be emerging in respect of the advice given and action taken by directors in relation to the shareholders' decision whether to dispose of their shares. The damages available to a shareholder in such circumstances would be limited to the loss suffered personally by the shareholder: Palmer's Company Law 8104; Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2) [1982] 1 Ch 204 (CA), [1982] 1 All ER 254 (CA).

30 Strong v Repide 213 US 419 (1909).

31 The California Corporations Code now specifically determines that directors owe duties not only to the corporation, but also to the shareholders: see ss 309 and 1203. In this regard, see Batenga & Willis "California Corporation Code" 1083ff.

32 Coleman v Myers [1977] 2 NZLR 225 at 278.

33 Ibid.

34 Rule 10b-5 of the Securities Exchange Act 1934 makes it unlawful for any person (whether an insider or not) to use or employ in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Securities Exchange Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. On trading in securities, see generally Loss Securities Regulation 1445-1474; Loss "Insiders" 34.
Evaluation

The interests of shareholders will certainly often have to be considered, but a formulation that the directors' fiduciary obligations should be towards the company's shareholders could be misleading. The division of powers within a company has the consequence that the directors, in the exercise of their management functions, may lawfully make decisions which are contrary to the interests of the majority of the shareholders. If the directors themselves are shareholders, they are entitled to have regard to their own interests in exercising their votes as members of general meetings. In certain instances, directors may, even outside the precise sphere of management, exercise their powers so as to frustrate the will of the majority of the shareholders. These factors indicate that the fiduciary duty cannot be widely stated to be exclusively in favour of the shareholders. Many cases therefore indicate that his fiduciary duty is owed to the company and not to the shareholders, even if the director should consider the interests of the shareholders.

35 In this regard, s 459 of the English Companies Act 1985, as amended by par 11 of Schedule 19 of the Companies Act 1989, provides that a member of a company may apply to the court by petition for an order on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial. Shareholders may also, in certain instances, be entitled to bring a derivative action. On shareholder remedies in England, see in general Farrar Company Law 442ff. See also chapter 4 par 3.3 below.


37 North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty (1887) 12 App Cas 589; Mills v Mills (1938) 60 CLR 150. There are certain limits to this proposition. A director may, for instance, sell his property to the company and use his vote as shareholder to ratify the sale. He may not, however, expropriate to himself property of the company and attempt to have the expropriation ratified by the general meeting: Cook v GC Deeks [1916] 1 AC 554 (PC). On ratification, see also chapter 9 par 4.8 below.

38 An example would be where the majority of shareholders are oppressing the minority. See The Australian Metropolitan Life Assurance Company Ltd v Ure (1923) 33 CLR 199 at 218, where the directors refused to consent to the registration of a transfer of shares against the wish of the majority of shareholders.

39 This would be the case even if the particular shareholder has a substantial shareholding in the company, as was the case in Bell v Lever Bros Ltd [1932] AC 161. See also Bath v Standard Land Company, Limited [1911] 1 Ch 618; Explanade Developments Ltd v Divine Holdings Pty Ltd (1980) 4 ACLR 826. In Scottish Co-operative Wholesale Society Ltd v Meyer and Another [1959] AC 324, [1958] 3 All ER 66 (HL) conduct by the nominee directors of a textile company, which was oppressive to the minority shareholders, was regarded as a breach of their fiduciary duty to the company. This approach is confirmed in s 309 of the English Companies Act 1985, which entitles directors to have regard to members' interests, whilst confirming that their duties are owed to the company. On this section see also par 3.2 below.
If directors take it upon themselves to give advice to current shareholders, they have a duty to advise in good faith and not fraudulently, and not to mislead, either deliberately or carelessly. The affected shareholders may have a remedy if the directors fail to comply with this duty. This does not, however, indicate an existing fiduciary duty owed to the shareholders, but a potential liability arising from their words or actions which can be based on ordinary principles of law.

3 OTHER PERSONS WHO HAVE RELATIONS WITH OR INTEREST IN THE COMPANY

In the case of a small private company, it is often difficult to distinguish the company and its members as two distinct entities. For instance, where all the shareholders agree to effect what amounts to an impermissible expropriation of the company's property for their own benefit, it may well be asked why they may not collectively agree to give themselves a return of capital. The justification for the refusal by the courts to allow such transactions has been the need to protect certain "outsider" interest groups. Some more modern formulations therefore imply that the fiduciary duty can also include the duty to act *bona fide* for the benefit of all who have relations with or interest in the company. This duty would then extend not only to shareholders of the company, but also to those persons who have derivative interests in its shares, together with the creditors, employees, suppliers and customers of the company. Thus in *Darvall v North Sydney Brick and Tile Company Ltd and Others* the opinion of Hodgson J was that

it is proper to have regard to the interests of the members of the company, as well as having regard to the interests of the company as a commercial entity. Indeed, it is proper also to have regard to the interests of the creditors of the company. I think it is proper to have regard to the interests of present and future members of the company, on the footing that it would be continued as a going concern.

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42 Russell "Duty to Creditors" 418.

43 Ibid.

3.1 The Creditors of the Company

The interests of company creditors are often protected by statute.\textsuperscript{45} Other rules sometimes have the need to ensure fairness towards creditors as sole or substantial justification. The various rules concerned with the maintenance of a company's capital, for example, are in theory based on the right of creditors to rely on the capital remaining undiminished by any expenditure outside the limits of the authorised objects, or by the return of any part of it to the shareholders.\textsuperscript{46} These

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\textsuperscript{45} See Russell "Duty to Creditors" 418 for provisions under the New Zealand Companies Act 1955 which are aimed, directly or indirectly, at the protection of the interests of company creditors. The author points out that the common feature of these statutory provisions, apart from that of protecting creditors, is that they come into operation upon liquidation. For provisions applicable in terms of the Insolvency legislation, see Souster "Directors' Responsibilities" 5. Specific mention may be made of ss 213 and 214 of the English Insolvency Act 1986 (c 45). Section 214 provides an extension of civil liability in the event of fraudulent trading, by the introduction of the concept of "wrongful" trading. On this section, see Oditah "Wrongful Trading" 20 and authorities cited in Fourie "Skuldeisers" 42 note 130. In South Africa, the most important provision is probably s 424 of the Companies Act 61 of 1973. It provides that where it appears, whether in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court may, on application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in such manner, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct. On this section, see in general Anon "Liability under S 424" 16; Benade 487; Brusser "Section 424" 11; Cassim "Section 424" 162; Cilliers & Benade Corporate Law 155; De Koker Aansprekelikheid 78ff; Du Piessis 'Pligte' 389ff; Fourie "Dorklerk" 328; Fourie "Skuldeisers" 48 and authorities cited in note 170; Fourie "Insolvent Trading" 148; Henochsberg 911-920; Hahlo Cases 739, 742-743; Hyman "Director's Liability" E1; Luiz "Extending Liability" 768; Hambidge & Luiz 'Personal Liability' 123; Luiz & Van der Linde "Trading in Insolvent Circumstances" 230; Williams "Reckless Trading" 684; Dorklerk Investments (Pty) Ltd v Bhayat 1980 (1) SA 443 (W); Fisheries Development Corporation of SA Ltd v Jorgensen 1980 (4) SA 156 (W); Gordon NO and Rennie NO v Standard Merchant Bank Ltd and Others 1984 (2) SA 515 (T); Cronjé NO v Stone en 'n Ander 1985 (3) SA 597 (T); Ex parte Lebowa Development Corporation Ltd (1989) 3 SA 71 (T); Howard v Herrigel and Another 1991 (2) SA 660 (A); Ex parte De Villiers NO; In re MSL Publications (Pty) Ltd (in liquidation) 1990 (4) SA 59 (W); Ozinsky NO v Lloyd & Others 1992 (3) SA 396 (C); Ex parte De Villiers & Another NNO: In Re Carbon Developments (Pty) Ltd (in liquidation) 1992 (2) SA 95 (W); Ex parte De Villiers & Another NNO: In Re Carbon Developments (Pty) Ltd (in liquidation) 1993 (1) SA 493 (A).

\textsuperscript{46} In re Dronfield Silkstone Coal Company (1881) 17 ChD 76; Trevor v Whitworth (1887) 12 App Cas 409. On the recent developments in England in this regard, see Gower Company Law 211ff.
common law rules are often backed by statute. Some rules, which exist at least partly for the benefit of creditors of a company, are not enforceable by them. It is therefore accepted that creditors' rights merit protection, but not so certain that the existing protection is, in fact, adequate.

The question arises whether the directors of a company owe anything in the nature of a general obligation to look after the interests of creditors. The courts were at first reluctant to acknowledge a general duty in this regard. It has always been thought that apart from statutory obligations to take into account the interests of creditors and the general obligation to maintain the capital of the company, directors are not obliged to take into account the interests of creditors in the exercise of their powers. The traditional view is that any duty owed by the directors is to the company and that only the company (or a liquidator) may enforce it. The basis of this proposition is that the company is a separate legal entity with its own rights and duties. The director therefore primarily stands in a fiduciary relationship towards the company. Creditors should protect their interests by bargaining with the company. It is further argued that in the event of winding-up of the company various statutory provisions are specifically aimed at the fair treatment of creditors. In In re Horsley & Weight Ltd the court held that it was a misapprehension to suppose

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47 In respect of the maintenance of capital, see for example s 38 of the Companies Act 61 of 1973.

48 Russell "Duty to Creditors" 419 points out the example of the ultra vires doctrine. In Lawrence v West Somerset Mineral Railway Company [1918] 2 Ch 250 it was held that a creditor has no standing to sue for a declaration to prevent the company from undertaking an ultra vires transaction.

49 Creditors have no independent remedy for breaches of directors' fiduciary duties, save ex post facto upon liquidation: Du Plessis Grondslae 126; Fourie "Skuldeisers" 42; Tomasic, Jackson & Woellner Corporation Law 342.

50 Cilliers & Benade Corporate Law 156; Fourie "Skuldeisers" 25. In In re Dronfield Silkstone Coal Company (1881) 17 ChD 76 James LJ was of the opinion that a creditor, as such, has no right except as against members. See also Parke v Daily News Ltd [1962] Ch 927 and In re W & M Roth Ltd (1967) 1 WLR 432 (discussed by Silberberg "Gratuitous Payments" 213), where the matter was decided on the basis that a pension payable to his wife in terms of a director's service agreement, was not bona fide for the benefit and to promote the prosperity of the company. In Nguril v McCann [1975] 2 NSWLR 425, (1953) 90 CLR 425 it was held that attention may be given to the interests of others, but only to the extent that promotion of those interests is incidental to a bona fide discharge of the duties owed to shareholders.

51 Salomon v A Salomon & Co Ltd [1897] AC 22; Dadoo v Krugersdorp Municipal Council 1920 AD 530 at 550; Gumede v Bandila Vukani Bakithi Ltd 1950 (4) SA 560 (N); RP Crees (Pty) Ltd v Woodpecker Industries (Pty) Ltd 1975 (2) SA 485 (R) at 489; Lategan v Boyes 1980 (4) SA 191 (T) at 200; J Louw and Co (Pty) Ltd v Richter 1987 (2) SA 237 (N) at 241B-C.

52 Sealy "Problems" 176; Wishart "Duties to Creditors" 335.

53 Cilliers & Benade Corporate Law 156.

that the directors of a company owe a duty to the company's creditors to keep the contributed capital of the company intact. Buckley LJ stated:

It may be somewhat loosely said that the directors owe an indirect duty to the creditors not to permit any unlawful reduction of capital to occur, but I would regard it as more accurate to say that the directors owe a duty to the company in this respect and that, if the company is put into liquidation when paid-up capital has been improperly repaid, the liquidator owes a duty to the creditors to enforce any right to repayment which is available to the company.55

However, a number of more recent cases suggest that directors should, in the exercise of their powers, also take into account the interests of the company's creditors.56 Especially when the company is insolvent, there is a growing body of authority for the proposition that "the company" to which the directors owe their duties, encompasses not just the shareholders but also the creditors of the company.57 This trend is most apparent from a series of Australian and New Zealand cases,58 which have a number of features in common.59 All the companies were closely controlled and the acts in question took place with the full knowledge of all the members. The companies were insolvent at the time proceedings were instituted, the plaintiffs suing as liquidators in the name of the companies. In each case the claim was for recovery of funds or property which had allegedly been diverted from the corporate estate in favour of one or more of the controllers or someone closely associated, for example another group company. In each instance there is an express reference by

55 At 442B-D. See also Fourie "Skuldeisers" 28ff; In Re Wincham Shipbuilding, Boiler, and Salt Company; Poole, Jackson, and Whyte's Case (1878) 9 ChD 322; Salomon v Salomon & Co Ltd [1897] AC 22; Attorney-General for Canada v Standard Trust Co of New York [1911] AC 498; In re H Linney & Co Ltd [1925] NZLR 907; In re JE Hurdley and Son Limited (in liquidation) [1941] NZLR 686. In Re Halt Garage (1964) Ltd [1982] 3 All ER 1016 Oliver J held that those who deal with a limited company do so on the basis that its affairs will be conducted in accordance with its constitution. Subject to that, they are entitled to have the capital kept intact. The real test, however, appeared to be whether the transaction in question (in this case the payment of remuneration to a director) was a genuine exercise of the particular power.

56 Wishart "Duties to Creditors" 323 states that "[I]n contrast to the conservative tone of most writers, the judiciary seems to view the extension of directors' duties with complacency, if not with clarity of vision."

57 Calnan "Creditors' Rights" 93 regards this proposition as so obvious that it is difficult to believe that it was not until recently that it was clearly expounded in case law. The author opines that consent to the transaction by the shareholders alone will therefore be ineffective to absolve the directors from liability. See further, generally, Grantham "Duties to Creditors" 1.


59 Sealy "Problems" 171.
the judge to the concept of a duty owed by the directors to the creditors of the company when the company is insolvent or nearly insolvent. In *Walker v Wimborne* Mason J indicated the possible existence of a general obligation to see to the interests of creditors.60 Barrett61 notes that it is significant that although the company was insolvent at the relevant time, it was not considered a factor in the decision that creditors' interests as well as those of the shareholders were relevant to the discharge of directors' duties to the company as a whole. The theoretical possibility of future insolvency was by itself considered sufficient to require directors to give continuing attention to creditors' interests.62 In *Ring v Sutton*63 the court permitted a liquidator, in the interests of creditors, to claim compensation in respect of loans made by a director to himself on non-commercial terms.64

In *Nicholson v Permakraft*65 the main issue was whether a certain transaction had been carried out in good faith and for the benefit of the company.66 In the High

60 The indication that the particular transactions offered no prospect of advantage to the company and "thereby prejudiced the unsecured creditors" (at 449) of the company, as well as his statement that "the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors" (at 449) has been interpreted in two ways in subsequent case law and commentary. It has been viewed by some as a suggestion that directors owe a duty to creditors independent of their duty to the company. In this regard, see Corkery *Directors* 69; Russell "Duty to Creditors" 420 and Trethowan "Personal Liability to Creditors" 44, who regard this interpretation as the possible basis for *dicta* by Cooke J in *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242, (1985) 3 ACLC 453 at 459. This interpretation is apparently also supported by the judgments in *Jeffree v National Companies & Securities Commission* (1989) 15 ACLR 217, 7 ACLC 556 and *Winkworth v Edward Baron Development Co Ltd* [1987] 1 All ER 114. The second interpretation is that the statement by Mason J is a comment on the necessity to consider the interests of creditors as part of their duty to the company in certain situations. This interpretation seems to be supported by most commentators. See Fourie "Skuldeisers" 30; Heydon "Directors' Duties" 126; Trethowan "Personal Liability to Creditors" 44; Worthington "Creditors' Rights" 134; *Kinsela v Russell Kinsela Pty Liq (in Liq)* (1986) 4 ACLR 215; *Grove v Flavel* (1986) 11 ACLR 161; *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd* (1990) 8 ACLC 980.

61 Barrett "Duties to Creditors" 229.

62 In *Hurley v BGH Nominees Pty Ltd* (1984) 2 ACLC 497 the matter was taken even further. Walters J held that the position of the beneficiaries of a trading trust company could be no lower than that of the creditors of a company. A duty to consider their interests could therefore also be identified. See Barrett "Interest" 46.

63 (1980) 5 ACLR 546.

64 See also *Re Day-Nite Carriers Ltd* [1975] 1 NZLR 172 where it was held that the payment of a working director in a small private company's salary constituted a misfeasance because the directors had failed to make provision for a debt. See further *Grove v Flavel* (1986) 11 ACLR 161, discussed by Herzberg "Voidable Preferences" 157. On misfeasance generally, see note 72 below.


66 The facts essentially concerned a restructuring of the company by the defendants, who were directors and shareholders of the company. Land and belongings of a company were substantially revalued, and as a result a capital dividend was paid to the shareholders. The shareholders subsequently purchased shares in a newly incorporated company and sold most of the shares of the first company to the newly incorporated company. As a result the latter company's capital had been severely depleted and
Court White J held that the defendants were liable to refund the moneys obtained from the transaction. His lordship referred to Re Avon Chambers Ltd in which a director had been held liable for having deliberately attempted to put funds beyond the reach of creditors and to benefit shareholders at a time when it was obvious that the company could not afford such a payment. The view of Mason J in Walker v Wimbome, that the interests of creditors had to be considered, since a failure to do so would have adverse consequences for the company as well as for them, was expressly adopted. The liability of the directors was based on their failure to have regard to the benefit of the company. In Nicholson, the Court of Appeal found that although the duties of directors are owed to the company, the facts of particular cases may require the directors to consider inter alia the interests of creditors. A payment made to the prejudice of current or continuing creditors when a likelihood of loss to them ought to have been known, was considered capable of constituting misfeasance by the directors.

money had passed to the defendants.

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67 The decision by White J is summarised by Cooke JA in the judgment by the Court of Appeal at 246-247.

68 (1978) NZCLC 98,358.


70 See page 36 above.

71 According to Cooke J the criterion could not be simply whether the step taken by the directors would leave a state of ultimate solvency according to the balance sheet: "Balance sheet solvency and the ability to pay a capital dividend are certainly important factors tending to justify proposed action. But as a matter of business ethics it is appropriate for directors to consider also whether they do will prejudice their company's practical ability to discharge promptly debts owed to current and likely continuing trade creditors." ([1985] 1 NZLR 242 at 249). See also Fourie "Skuldigers" 32. The author stresses that Nicholson is not authority for a general duty to consider the interests of creditors.

72 Under English law misfeasance proceedings are provided for in the Insolvency Act 1986. Section 212(1), (3) and (5) provide that in the winding up of a company an application may be made to the court by the official receiver, the liquidator, any creditor, or, with leave of the court, by any contributory for an order that any present or past officer of the company, any person who has acted as liquidator, administrator or administrative receiver of the company or any other person who has been concerned or has taken part in the promotion, formation or management of the company, and who in the case of any such officer has misapplied or retained or become accountable for any money or property of the company, or has been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company, shall repay with interest at such rate as the court orders, restore or account for the money or property or any part of it, or shall contribute such sum to the company's assets by way of compensation for the misfeasance or breach of duty as the court thinks fit. A contributory is a present or past member of the company (Insolvency Act 1986, s 74(1) and 79(1)). Misfeasance proceedings may only be brought when the company itself could have sued the respondent in an action commenced by writ. However, not all rights of action vested in a company may be enforced by misfeasance proceedings. Liability can arise as a result of the negligent mismanagement of the company's affairs as well as by deliberate wrongdoing. On misfeasance in general, see Farrar Company Law 718; Pennington Company Law 683-686; Pennington Personal Liability 206-207; and chapter 4 par 3.3.3 below.
Where an agreement had been reached by a family company and two of its directors that they would lease the freehold premises from which the company conducted its funeral business at a rental below the current market rental, and that the directors would have an option to purchase the premises at a price favourable to the two directors, the New South Wales Court of Appeal found that the lease was voidable and that the liquidator was entitled to have it set aside, despite the fact that the agreement had been approved by the general meeting. The court held that the lease did not exceed the capacity of the company. As it had, however, directly prejudiced the creditors of the company, it had been entered into by the directors in breach of the duty to the company (albeit with unanimous approval of all the shareholders). Street CJ held that where a company was insolvent, the interests of creditors would entitle them prospectively, through the mechanism of liquidation, to displace the power of the shareholders and the directors to deal with the company's assets. The court did not find it necessary, on the facts of the particular case, to consider the degree of financial instability that would be required for the duty to take account of the interests of the creditors to arise.

These cases suggest that when it is said that a board of directors must act bona fide for the benefit of the company, the directors should address their minds not only to what is for the economic well-being and financial advantage of the shareholders, but also to the effect that their decisions will have on the interests of the company viewed as a separate entity. This will require the interests of the creditors to be taken into account, at least when the company is insolvent or nearly insolvent.

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74 At (1986) 4 ACLC 233 the court held: "Once it is accepted, as in my view, it must be, that the directors' duty to a company as a whole extends to it in an insolvency context to not prejudicing the interests of creditors, ... the shareholders do not have the power or authority to absolve the directors from that breach."

75 Hill "Duties towards Creditors" 526. The author indicates (at 527) that an analysis of the duty to creditors as a fluctuating one will generate its own problems, particularly in view of the difficulty of defining its borders.


77 See Afterman & Baxt Cases on Corporations 540, who state that if the company is close to insolvency, the interests of the creditors clearly have to be taken into account. In a number of American states the accepted rule is that upon the insolvency of the ordinary private corporation a quasi trust relationship arises between its directors and creditors: Barrett "Duties to Creditors" 227 note 6. See also chapter 5 par 3.1 below. Hawke "Creditors' Interests" 60 submits that, as long as the company remains on the right side of "doubtful insolvency" any consideration for the interests of creditors need only be minimal. In South Africa, obiter recognition of creditors' interests in insolvent circumstances is found in Sammel v President Brand Gold Mining Co Ltd 1969 (3) SA 629 (A) at 662. See, however, Sappideen "Fiduciary Obligations" 387, who states that the view that duties to creditors are, or should be, dependent upon the solvency of the company, appears to be well under siege.
The most recent Australian authority, Jeffree v National Companies and Securities Commission, states unequivocally that a duty to creditors exists. The facts of the case are uncomplicated. Jeffree was a director of Wanup, a trustee company of the Jeffree Family Trust. The trust carried on a swimming pool business for the benefit of its beneficiaries. Arbitration proceedings were instituted by Leighton for defects in the construction of a swimming pool. Wanup, acting in accordance with legal advice and apparently with the unanimous consent of its shareholders, paid its creditors and sold its assets at full value to a new legal entity called Cassidy. Cassidy was incorporated with the same directors, shareholders and trustee establishment, and effectively took over the running of the business. When Leighton eventually obtained a judgment for the amount of the arbitration award, the only asset of Wanup was a debt representing the amount outstanding on the sale of the business. The court found that in authorising the transfer of Wanup's assets to Cassidy in order to defeat the arbitration claim, Jeffree had improperly used his position to gain an advantage for himself.

In its explanation of why the purpose of the transfer was considered improper, the court stated that the directors owed a duty to the company's creditors, present and future, to keep the company's property inviolate and available for the repayment of its debts. It is suggested that the finding of an improper purpose does not require also finding a positive duty to act in the interests of company creditors and that this finding did not affect the outcome of the case.

Until recently there has been no English case law directly on this point. In

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78 (1989) 15 ACLR 217, 7 ACLC 556 at 560 per Wallace J, 565 per Brinsden J and 566 per Pidgeon J. For discussions of this case, see Baxt "Creditors" 344; Baxt "Future Creditors" 404; Worthington "Creditors' Rights" 134-136.

79 Action was instituted in terms of s 229(4) of the Companies (Western Australia) Code, which provides: "An officer or employee of a corporation shall not make improper use of his position as such to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation." The court unanimously held that the directors had acted for the impermissible purpose of defeating the interests of contingent creditors.

80 (1989) 15 ACLR 217 at 221 per Wallace J and 227 per Brinsden J.

81 See also Worthington "Creditors' Rights" 136, who suggests that the court could have found that Jeffree had exercised his powers for the improper purpose of defeating a creditor or of obtaining a personal benefit, or that he had breached his fiduciary duty to the company either by not acting bona fide in its interests, or by misusing his position for personal gain or by allowing his personal interests to conflict with his duty, or possibly that he had acted fraudulently.

82 There are conflicting obiter dicta. In Lonrho Ltd and Another v Shell Petroleum Co Ltd and Another [1980] 1 WLR 627 Lord Diplock stated that when the board considers what is in the best interests of the company, the interests to be considered are not exclusively those of its shareholders but may include those of its creditors. However, in Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd and Others [1983] Ch 258, [1983] 3 WLR 492 (CA), [1983] 2 All ER 563 (CA) the Court of Appeal suggested that English courts would be reluctant to require creditors' interests to be considered by directors. The facts, briefly stated, were as follows: Three oil companies had entered into a joint venture to purchase, transport, store and sell liquified petroleum gas and liquified natural gas. This joint venture would be carried out through the medium of a company incorporated in Liberia ("Multinational"). For tax purposes, it was decided not to run the business from London, but to form a further company ("Services") to act as the agent of the first company. Services had offices in
Directors’ Fiduciary Duties and Corporate Opportunities

Winkworth v Edward Baron Development Co Ltd, however, Templeman LJ stated that:

[A] company owes a duty to its creditors, present and future. 

... 

A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors. 

Nourse LJ was also prepared to recognise the interests of creditors when considering the expression "interests of the company" in section 153(1)(b) of the Companies Act 1985. However, he confined his comments to the interpretation of the

London and advised its principal from there. Two years after the start of operations by Multinational, its board made policy changes and determined to acquire gas tankers for employment on the spot market. To do so the company had to undertake substantial liabilities. The market turned against Multinational and it went into liquidation owing approximately one hundred and thirteen million pounds. The creditors sought to force the three oil companies to stand by Multinational's speculation. The court held by a majority that although Multinational had a separate existence from its shareholders, it existed for their benefit. The shareholders, who owed no duty to third parties or future creditors, had approved of the directors' acts and by so doing had made those acts the acts of the company. Accordingly, the court found that the liquidator could not bring any claim against the directors. The majority emphatically restated the traditional view that when it is said that directors owe their duties to the company, what is meant is that they must have regard to the company's shareholders. In this regard, Dillon LJ said: "An individual trader who is solvent is free to make stupid, but honest commercial decisions in the conduct of his own business. He owes no duty of care to future creditors. The same applies to a partnership of individuals. A company ... likewise owes no duty of care to future creditors. The directors indeed stand in a fiduciary relationship to the company, as they are appointed to manage the affairs of the company and they owe fiduciary duties to the company though not to the creditors, present or future, or to individual shareholders. ... Indeed, so long as the company is solvent the shareholders are in substance the company." ([1983] 3 WLR 492 at 519).

83 [1987] 1 All ER 114, discussed by Prentice "Creditor's Interests" 265 at 273-274 and Jacobs "Creditors" 310.

84 [1987] 1 All ER 114 at 118. The statement that directors owe a duty to future as well as present creditors, is supported in Jeffree (see page 39 above). See, however, Jacobs "Creditors" 312, where it is indicated that Winkworth is "by no means compelling authority for the existence of a general duty to creditors", because the case was not a company law one which raised the issue directly. The author further contends that the decision is explicable in terms of existing duties and that references to a duty to creditors may be read as merely a compendious way of referring to the existing duties of directors which benefit creditors and to the rights of recovery of money on insolvency for the benefit of creditors. Riley "Interests of Creditors" 91, Faurie "Skuldeisers" 37 and Sealy "Gloss" 177 also opine that the statement by Templeman LJ is obiter.

85 Brady v Brady [1988] BCLC 20. At 40 he held: "... in a case where the assets are enormous and the debts minimal it is reasonable to suppose that the interests of the creditors ought not to count for very much. Conversely, where the company is insolvent, or even doubtfully solvent, the interests of the company are in reality the interests of existing creditors alone."
Beneficiary of Directors' Fiduciary Obligations

relevant statutory provision and indicated that the expression could have different meanings in different contexts.86

West Mercia Safetywear Ltd (in Liquidation) v Dodd87 is the first case to import the principle developed in Walker v Wimborne, Permakraft and Kinsela into the English law on directors' duties. West Mercia Safetywear Ltd ("West Mercia") was a wholly owned subsidiary of AJ Dodd & Co Ltd ("Dodd Co"). The common director of both companies was Dodd. The account of West Mercia at its bankers was in credit, whereas the account of Dodd Co at the same bankers was overdrawn. Dodd had guaranteed the liability of Dodd Co to the bank. A charge was also granted by Dodd Co to the bank over the book debts of Dodd Co. At the time the book debts included an inter-company debt from West-Mercia in the amount of thirty thousand pounds. Both companies encountered financial difficulties in 1984. An accountant, who subsequently became their liquidator, was called in to advise the directors. Hereafter Dodd instructed his bankers to transfer four thousand pounds from West Mercia's account to that of Dodd Co. This would reduce Dodd's contingent liability under his guarantee. The bank effected the transfer and immediately applied the transferred money to Dodd Co's overdraft. The liquidator subsequently brought proceedings against Dodd. Inter alia, he alleged that Dodd had breached his duty to consider the interests of creditors of West Mercia.

The Court of Appeal approved the comments in Kinsela and found in favour of the liquidator. Dillon LJ distinguished the decision in Multinational Gas88 on the ground that in that case the relevant company had not been insolvent.89 In West Mercia, his lordship held, the company was insolvent to the knowledge of the directors when the funds in question were transferred. Dodd was guilty of breach of duty as he had caused funds to be transferred for his own purposes in disregard of the interests of the general creditors of the insolvent company.90

86 The decision in Brady was overruled by the House of Lords, but the Court of Appeal acknowledged that the interests of creditors had to be taken into account: Brady v Brady [1989] 1 AC 755, [1988] 2 WLR 1308, [1988] 2 All ER 617.

87 [1988] BCLC 250 (CA), discussed by Finch "Creditors" 23 and Prentice "Creditor's Interests" 265 at 274.

88 See footnote 82 above. The judgment in Multinational Gas had also been given by his lordship.

89 The case does not, however, resolve whether it is possible to define in a satisfactory manner the point at which a prospect of insolvency becomes real enough to warrant the change of focus in the directors' attention: Finch "Creditors" 24.

90 See Sealy "Gloss" 175, who indicates that the same eventual result would have been reached in this case without specific reference to a duty owed to creditors. According to Jacobs "Creditors" 313 this case is even less compelling authority for a direct duty to creditors than Winkworth. The author opines that neither the wording nor the substance of the decision is inconsistent with the traditional means of incorporating the creditors' interests, namely through identifying their interests as those of the company or with the use of specific statutory provisions for recovery upon insolvency of money or other property disposed of by the company to the prejudice of its creditors.
On the other hand, it has been suggested\(^91\) that a director of an insolvent, and possibly a near insolvent, company owes a duty to the company not to prejudice or encumber the interests of present creditors to the company. This duty is only enforceable by the company or its liquidator. The duty should therefore not be regarded as owed directly to the creditors. It is a duty owed to the company, which, in the event of liquidation, can be enforced by the liquidator for the benefit of creditors.\(^92\) A breach of the duty may not be ratified by the shareholders.\(^93\) This viewpoint does not recognise a separate duty owed to creditors and seems to be endorsed in *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*,\(^94\) where the court confirmed as a general principle that a director does not by reason only of his position as director owe any duty to creditors or to trustees for creditors of a company.\(^95\)

### 3.2 Other Interest Groups

The extent to which directors may seek to promote interests other than financial interests,\(^96\) such as the public interest or the welfare of their employees, is often

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91 Petkovic "Creditors' Interests" 169.

92 *Gore-Browne on Companies* par 27.4. The benefit still belongs to the company and can therefore not be enforced by the creditors themselves. It is submitted that where the liquidator successfully enforces the duty on behalf of creditors, the courts should make an order as to which creditors should benefit. If this is not done, the benefit will accrue to the company for general distribution by the liquidator. See also Dabner "Directors' Duties" 113, who contends that it is naive to expect individual directors to operate corporations for the benefit of all, and that any duty to take the interests of creditors into account is a matter for the law of torts or specific legislation.

93 The parameters of the principle's application remain to be defined: Dabner "Directors' Duties" 123. The author acknowledges certain problems with ss 238 and 423 of the Insolvency Act 1986, which introduced the concept of transactions at an undervalue to English law; and questions the effectiveness of a widely drafted objects clause. See also Hawke "Creditors' Interests" 58, who is of the opinion that any disposal which falls within the test of *In Re Smith and Fawcett, Limited* [1942] 1 Ch 304 (CA), namely that directors should exercise their discretion *bona fide* in what they consider is in the interests of the company, and not for any collateral purpose, should be capable of ratification. See further Calnan "Creditors' Rights" 94. It would seem as if the acknowledgement of a general duty to creditors, albeit in limited circumstances, would cause its own problems in the areas of prior consent and ratification: Fourie "Skuldeisers" 42ff; Wishart "Duties to Creditors" 327; *Kinsela v Russell Kinsela Pty Liq (in Liq)* (1986) 4 NSWLR 722 (ratification by shareholders not considered possible); *Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd and Others* [1983] Ch 258 at 268-269, 280-282, 288ff, [1983] 3 WLR 492 (CA), [1983] 2 All ER 563 (CA) (company could not complain as the shareholders had unanimously approved the actions of the directors). On ratification generally, see chapter 9 par 4.8 below.


95 This general principle was qualified by the proviso that although directors are not liable as such to creditors of the company, a director may by agreement or representation assume a special duty to a creditor of the company.

96 Normally it would be the financial interests of the shareholders that are promoted, but in view of the authorities mentioned in par 3.1 above it may in certain instances also be the interests of the creditors. This is an aspect meriting separate investigation, and is not comprehensively discussed within the scope of this thesis.
questioned. The traditional view that directors must exercise their powers in the best interests of the company involves that, in the absence of any objects clause permitting other than financial objectives to be pursued, the directors are bound to exercise their powers to promote their shareholders' financial interests so that it is beyond the scope of the directors' powers to exercise their powers to promote the welfare of the employees of the company or for the general public interest.97

Many cases illustrate this philosophy. For example, a shareholder in a company whose memorandum did not empower it to make gifts to charitable causes obtained an injunction to prevent the company making a donation,98 investors prevented their companies granting ex gratia payments to employees on the termination of their employment on the ground that such payments could not be said to be enhancing the economic welfare of the company as the assets of each of the companies were about to be liquidated,99 and provisions for wives or widows of employees were held to be unenforceable on the ground that there was no evidence that these corporate gifts promoted the financial well-being of the company.100

97 See for example Parke v Daily News Ltd [1962] Ch 927, where Plowman J held that although the view may be widely held that directors, in having regard to the question what is in the best interests of their company, are entitled to take into account the interests of the employees, irrespective of any consequential benefit to the company, there was no authority to support that proposition as a proposition of law. Dabner "Directors' Duties" 114 states emphatically that there is no question of directors exercising their powers for the public good, and that to suggest that they are required to do so is to falsely present and extend the principles laid down in the recent cases beyond the scope envisaged by their authors.

98 Tomkinson v South-Eastern Railway Company (1887) 35 ChD 675. The contribution was held to be ultra vires.

99 Hutton v West Cork Railway Company (1883) 23 ChD 654; Parke v Daily News Ltd [1962] Ch 927, [1962] 2 All ER 929. In both instances, the court held that the proposed transactions had been ultra vires.

100 An early American example is found in Dodge v Ford Motor Co (1919) 204 Mich 459, 170 NW 668 (1919). The management of an extraordinarily successful American company thought that the shareholders had already received adequate dividends and wished to utilise the surplus funds to pursue a course of conduct which would benefit the general public. The idea was for the company to cut prices and thereby to make cars more easily available to the general public. The shareholders succeeded in forcing a dividend from the company, as the court considered it was not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others. This old authority remains worthy of consideration, because, as commented by Gower Company Law 4ed (1979) 578 note 46 "[n]o one, except perhaps the late Henry Ford at one time ... has yet suggested that the shareholders' interest should be totally subordinated to those of the employees, consumers and the public". See also Conard "Public Interest Directors", who regards it as still the leading case. In In Re Lee, Behrens and Company, Limited [1932] 2 Ch 46 at 51 Eve J tested the validity of a grant by the answers to three pertinent questions: (i) Is the transaction reasonably incidental to the carrying on of the company's business? (ii) Is it a bona fide transaction? (iii) Is it done for the benefit and to promote the prosperity of the company? (at 51). The court upheld the rejection of a claim for an annuity grant by the liquidator on the grounds that the contract to pay it was ultra vires and void and that the annuity was a mere gratuity which was ultra vires the company to pay otherwise than out of profits. In In re W & M Roith Ltd (1967) 1 WLR 432 the payment of a pension to a director's widow, in terms of his service agreement, was held on the facts to be ultra vires the company and not to have been entered into for the benefit of and to promote the prosperity of the company. On the distinguishing features between these two cases, see Silberberg "Gratuitous Payments" 213.
The traditional view of the company's interests therefore requires that interests of consumers or environmental factors may only be taken into account if they relate in some way to the financial interests of the company.101

The Savoy Hotel investigation102 which took place in 1953 is indicative of the approach in English law at that time to some factors directors should consider in the exercise of their fiduciary duties.103

The three tests104 posed by Eve J in Lee105 were analysed in Charterbridge Corporation Ltd v Lloyds Bank Ltd and Others.106 Pennycuick J held that to test whether the transaction was for the benefit and to promote the prosperity of the company was quite inappropriate to the scope of express powers. In this case, too, the deci-

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101 In Mercury Bay Co-operative Dairy Company, Limited v Lilley [1946] NZLR 766, [1947] NZLR 632 a resolution which passed a proposal to make an annual payment to the funds of a farmers' union was declared invalid. The court held that the company, as such, was incapable of having any interests but financial interests and the intended payment was found not to be related to these interests. In respect of political donations, see Ewing "Political Donations" 57; Garrett "Corporate Contributions" 365.


103 It also indicates the moral, social and economic arguments that ought to be heeded. In this regard, see Gower "Control" 1176ff, Hodes "Social Responsibility" 471-472. From the report, it appeared that the directors concerned with the management of certain hotel companies considered that the discontinuance of the Berkeley as a hotel and restaurant would be injurious to the interests of employees since it would involve a reduction of staff, and would be injurious to the national interest having regard to the dollar-earning powers of the Berkeley Hotel (par 14 (iii)). The investigator rejected the argument and maintained that these considerations, however meritorious, did not seem to form part of the true legal definition of the interests of the companies, except that indirectly a substantial reduction of staff might have unsettled the staff remaining at the other hotels and restaurants. Gower "Control" 1188 note 39 notes that this resembles the "outmoded argument" in Hutton v West Cork Railway Company (1883) 23 ChD 654 at 673 that "[T]here are to be no cakes and ale except such as are required for the benefit of the company." The author indicates that although lip service is still paid to this rule in England, it has been ignored in practice since Evans v Brunner, Mond and Company, Limited [1921] 1 Ch 359. In Evans it was found that the company had proved that the proposed expenditure of one hundred thousand pounds to universities or other scientific institutions for the furtherance of scientific education and research would not only be to the direct advantage of the company, but was also conducive to, and necessary for, its continued progress as chemical manufacturers. Hodes "Social Responsibility" 471 indicates that the Evans case accepts a remoter potential benefit as sufficient to justify a donation by a company and goes a long way from Tomkinson (see footnote 98 above), where a more immediate benefit was considered insufficient.


105 See footnote 100 above.

sion was based upon the issue of *ultra vires* transactions,\(^{107}\) rather than directors' duties.\(^{108}\) No problems as to capacity or power to make donations or to pay gratuities and pensions should ordinarily arise under South African law.\(^{109}\) The potential vulnerability of corporate gifts therefore lies not in the issue of capacity,\(^{110}\) but in the fact that directors authorising them may be in breach of their fiduciary duty.\(^{111}\)

In recent times there has been a strong indication that in carrying out their activities, directors of modern companies should be entitled, and perhaps even obliged, to take the wider public interest into account.\(^{112}\) It is said that in an increasingly complex society the aim of a board of directors can no longer be the simple one of immediate profitability, and that a board of directors ought to recon-

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\(^{107}\) See, for example, [1970] 1 Ch 62 at 74: "In my judgment, the state of mind of the directors of Cast­
leford and of the bank's officers is irrelevant upon this issue of *ultra vires*. The court also indicated that the question of good faith on the part of directors related to their fiduciary duty to the company and not to the question of *ultra vires*. See also Hodes "Social Responsibility" 470; page 43 above.

\(^{108}\) The court held that it would be contrary to the whole function of a memorandum if objects unequivocally set out in it should be subject to some implied limitation by reference to the state of mind of the parties concerned, and that the state of mind is irrelevant to the issue of *ultra vires*. In this regard, see also Gower *Company Law* 580-581: "[I]t probably makes for clarity to distinguish between an act *ultra vires* the directors because they have usurped a power which they never had, and an act which prima facie is within the powers delegated to them but which they have abused by exercising it for an improper purpose. The former hardly seems to be a breach of the fiduciary duty of good faith, the latter is."

\(^{109}\) Section 33 of the Companies Act 61 of 1973 provides that a company shall have the capacity determined by the main object stated in its memorandum and that there shall be included in its capac­ity unlimited objects ancillary to the said main object except such specific ancillary objects as are expressly excluded in its memorandum. Section 34 states that, subject to limitations imposed by the Act, every company shall have plenary powers, including the common powers stated in Schedule 2 to the Act, to enable it to realise its main and ancillary objects, except such specific powers as are expressly excluded or qualified in its memorandum. The common powers in Schedule 2 include the powers "(o) to make donations" and "(r) to pay gratuities and pensions and establish pension schemes, profit-sharing plans and other incentive schemes in respect of its directors, officers and employees."

\(^{110}\) The powers may, of course, be specifically excluded. Section 36 of the Companies Act 61 of 1973 provides that although an act of a company may be *ultra vires*, it is not void by reason only of that fact. The section therefore restricts the capacity to set aside such donations or charitable gifts that have already been made. The directors may, however, still incur personal liability for any loss or damage the company may suffer as a result of an *ultra vires* act: Blackman "Capacity" 39; Beuthin & Luiz Basic *Company Law* 89; Blackman "Authorised Purpose" 9; Cilliers & Benade *Corporate Law* 181; Du Plessis *Grondslae* 12; Fredman "Section 36" 286ff; Hahlo *Cases* 102-103; Henochsberg 64-68; Naudé "Section 36" 315.

\(^{111}\) Hodes "Social Responsibility" 476.

\(^{112}\) For the debate on the social responsibility of companies between professors Berle and Dodd in the United States of America, see Berle "Corporate Powers" 1049; Berle "Trustees" 1365; Berle *Capitalist Revolution* 169; Dodd "Trustees" 1145. For a brief summary of the debate, see Hodes "Social Responsibility" 486; Weiner "Berle-Dodd Dialogue" 1458ff. On the theories of social responsibility, see Hodes "Social Responsibility" 486ff. See further Carter "Corporate Social Responsibility" 519; Wedder­burn "Social Responsibility" 4.
cile several different interests of which profit is the main, but cannot be the only one. The common point of departure seems to indicate a deviation from identifying the interests of the company with the financial interests of its shareholders towards viewing the company as a separate entity in which many conflicting interests, such as those of its shareholders, creditors, employees, as well as environmental and consumer interests should be reconciled. In respect of employees, the general rule seems to be that directors may only have regard to their interests in so far as those interests may consequentially affect the interests of the company. In certain instances there is a prescribed obligation to take the interests of employees into account. In England, the idea that company directors also have to consider the interests of employees, has been entrenched in section 309 of the Companies Act...

113 Department of Trade and Industry, Company Law Reform 1973 Cmdn 5391 pars 55-59. See also the New Zealand Companies Act 1955, s 15A(1)(g) and 15A(2), which permit provision to be made for the welfare of the employees when a business ceases, whether or not it is in the best financial interests of the company. In the United States, too, the courts have held that boards of directors may take the national economic interest into account: Dawson 'Interests of the Company' 74-75 and authorities cited. Dawson observes that in the United States the courts have moved away from the view that charity has no place at the board room table and have held that boards of directors may take into account the national economic interest (The Sylvia Martin Foundation Inc v John E Swearingen 260 F Supp 231 (SDNY 1966), environmental interests (Shlensky v Wrigley 237 NE 2d 776 (Ill App 1968)), and educational interests (AP Smith Mfg Co v Barlow 98 A 2d 581 (NJ 1953); Theodora Holding Corporation v Henderson 257 A 2d 398 (Del 1969). Gower 'Contrasts' 1370 and Hodes 'Social Responsibility' 472 contend that this broader approach to the social responsibilities of companies by American courts may be partly explained by the differences in the historical development of English and American companies and the fact that the American system is based more on municipal and governmental corporations than on business corporations, this distinction resulting in the duty of good citizenship being more accentuated in the American corporation. See also Coleman 'Duties' 147; Conard 'Public Interest Directors' 941; Tarver 'Corporate Power' 155.

114 Beuthin "Range of Interests" 161; Parke v Daily News Ltd [1962] Ch 927. Although there is little judicial authority in South African law on the validity of donations made by companies, our courts will probably follow the principles enunciated in England: Hodes 'Social Responsibility' 475. In Amalgamated Society of Woodworkers of SA and Another v Die 1963 Ambagsaalvereniging 1967 (1) SA 586 (T), discussed by Hahlo "Benefactions" 261, De Vos J was of the opinion that the power of a corporate body to donate a major asset cannot be lightly inferred. The learned judge thought that donations should in any event, to the extent that the power to donate might be read into the empowering clause, be limited to such donations as are reasonably incidental to the carrying on of the activities of the donor or which are for the benefit of the donor (at 594 F-G). Beuthin "Annual Survey 1967" 216 points out that the two requirements limiting donations are placed in the alternative by De Vos J, whereas the usually accepted test in In re Lee, Behrens and Company, Limited [1932] 2 Ch 46 (see footnote 100 above) and Parke v Daily News insists not only that the payment should be made bona fide for the benefit of and to promote the prosperity of the company, but also that it should be reasonably incidental to the carrying on of the company's business.

115 See, for example, s 309 of the Companies Act 1985 (England); and the provisions of the Companies (Acquisition of Shares) Act 1980 and Codes, as well as clauses 5a of Part A and 5 of Part C of its Schedule (Australia). In the German company system, the day-to-day conduct of the business of the public company is the "Vorstand" or managing board. The company's "Aufsichtsrat" or supervisory board is composed of representatives of both shareholders and employees. It effects control over the managing board. See chapter 6 par 2 below. On the desirability for a company to take the interests of employees into account, see Hahlo Cases 9 and authorities cited; Hodes 'Social Responsibility' 478ff.
1985. Section 309(1) provides:

The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.

It is, however, stressed that the duty imposed by this section is owed by directors to the company. Consequently, it is only if a company's employees are also shareholders of the company, or if trustees of a fund held for the benefit of employees (such as a pension fund or a fund set up under a profit sharing scheme), hold shares in the company that they can, in their capacity as shareholders, enforce the director's obligation to have regard to the company's employees.

Section 309 requires directors to consider the interests of employees along with those of the members, but does not give guidance on how a balance should be struck between these two sets of interests should they conflict. The matter presumably rests within the business judgment of the directors.

A provision on the lines of section 309 was necessitated by the introduction of employee representatives on boards of directors, thereby adding a further class of representative directors to those which already exist when directors are appointed under the articles by a special class of shareholders or debentureholders. The practical effect of the duty imposed by the section is as yet uncertain. The duty appears to be that regard should be had to the interests of the company's employees.

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116 This section was based upon a recommendation of the Report (under chairmanship of Lord Bullock) of the Committee of Inquiry on Industrial Democracy (1977) Cmnd 6706 chapter 7 par 12 and chapter 9 par 38.

117 Subsection 309(2) specifically restates this: "Accordingly, the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors." For comments on s 46 of the Companies Act 1980, which has exactly the same wording, see Mackenzie "Employee" 690.

118 Pennington Personal Liability 66. Mackenzie "Employee" 690 contends that the duty should be owed to and enforceable by employees.

119 Palmer's Company Law 8106.

120 Palmer's Company Law 8106. The directors' business judgment was accepted in Re Welfab Engineers Ltd 1990 BCLC 833 (misfeasance proceedings) and Re a Company, ex parte Burr [1992] BCLC 724 at 731.

121 Gower Company Law 62-63, 73-74. Such a director should act in the interests of the persons who appointed him, and if he does not, he would probably lose his office. His position is, however, on the present law the same as that of any other nominee director (on nominee directors, see chapter 9 par 2.1 below).

122 Many rights are reserved for shareholders. See, for example Gower Company Law 579 where it is indicated that more use might be made of the right of inspection provided for in s 318 if it were to be extended from members to the employees to whose interests the directors are to have regard in terms of s 309.
in general. The directors will therefore have to make their own judgment as to what those interests are. Where there are different groups of employees with conflicting interests, they will have to decide what action by the company will promote the predominant interest of the employees and do the least harm to other employee interests in the particular situation.123

Although the directors will have to consider the expressed wishes of employees or groups of employees, they are not necessarily required to give effect to those wishes, but are entitled to reach their own conclusions.124 The directors would also be entitled to override the interests of company employees in the interests of shareholders as a whole.125

Evaluation

The question whether any of the abovementioned "wider" interests merits recognition and protection, should not be confused with the question whether the company directors owe fiduciary duties directly to the beneficiaries of such interest groups.126 The answer to the first question must be affirmative,127 to the second, it is

123 Pennington Personal Liability 66.

124 Pennington Personal Liability 66 opines that the directors' decision can be impeached only if there is evidence of bad faith on their part, or if their conclusion is so unreasonable that no sensible directors could have reached it in good faith.

125 Gore-Browne on Companies par 27.009; Pennington Personal Liability 67. See, however, Gower Company Law 556 who suggests that to deny a director who was openly appointed under the articles to appoint a particular class, the right to think primarily of the interests of that class, instead of exclusively of the members and creditors as a whole, may be to defeat the whole object of his appointment. The author contends that the customary formulation of the duties of directors fails to take the position of representative directors into account and suggests an amendment of the 1978 Bill (as it was at that time). It has been attempted to deal with these issues in the Ghana Companies Code (Act 179). Section 203(3) provides: "In considering whether a particular transaction or course of action is in the best interests of the company as a whole a director, when appointed by, or as a representative of, a special class of members, employees or creditors may give special, but not exclusive, consideration to the interests of that class". See also note 10 above; chapter 9 pars 3.2 and 4.10 below.

126 Sappideen "Fiduciary Obligations" 391 indicates that there is a clear distinction between saying that a director owes a fiduciary duty to a creditor, and stating that a director has a duty to consider the interests of creditors. See also Riley "Interests of Creditors" 87.

127 Existing statutory provisions do, in fact, to a certain extent, already provide for this need. Section 424 of the Companies Act 61 of 1973 (see footnote 45 above), for example, is regarded as an effective instrument in the hands of creditors: Cilliers & Benade Corporate Law 157; Du Plessis Gronslae 126; Fourie "Skuldeisers" 48-50. Du Plessis Gronslae 126 suggests that the ambit of s 424 could be extended to include not only "reckless", but also "unlawful" and "negligent" trade. The provisions in respect of the disqualification of directors could also be implemented to further the protection of creditors and other interest groups. The English Company Directors (Disqualification) Act 1986 (c 46) provides a good example in this regard. See in general Du Plessis Gronslae 129 and authorities referred to; Du Plessis "Ontwikkelinge" 435; Markgraaff Disqualification Act 1ff.
submitted, negative. Directors owe duties to the company, even though in fulfilling them it may be necessary to take into account the interests of other persons.\textsuperscript{128}

The increasing tendency to regard the fiduciary duties of directors to the company as widely as possible has the consequence that this area of company law becomes almost unmanageable.\textsuperscript{129} Warnings in respect of effective control have often been sounded.\textsuperscript{130}

An extension of the duty owed by directors to the company to a duty to advance the interests of shareholders, creditors, or any other interest group which may be identified in the particular circumstances would immediately place this group in a superior position to other possible interest groups, resulting in inequal treatment. It is submitted that the directors' conduct should always be evaluated according to the way in which the interests of the company were served. Obviously this evaluation cannot take place in isolation and various factors, depending on the circumstances of each case, will merit consideration. Amongst these may well be interests of other interest groups when this is indicated by the facts.

It is submitted that many of the cases in which it is attempted to identify a duty by the directors to a particular interest group, the same eventual result would have been achieved by application of established principles of company law.\textsuperscript{131} Recourse to traditional fiduciary duties or to restrictions on the exercise of limited powers for proper purposes would have sufficiently and effectively limited the powers of directors.\textsuperscript{132} The results in these cases have, mostly, been satisfactory. It is, however, important to realise that once "wider" duties are acknowledged, broader con-
sequences may result than those foreseen in the cases discussed. This could well lead to confusion and uncertainty about the effect of existing and established principles. Uncertainty may also arise as a result of insoluble problems in an attempt to reconcile the conflicting interests of various groups.

The authorities acknowledging a duty owed directly to other interest groups have not yet addressed the issue of enforcement of this duty. If the duty is owed to a specific interest group, it implies that a member of that group will be able to enforce it. If the duty is owed to the company, it is the company alone that may enforce it. It is also to be expected that acknowledgement of a duty to creditors would place important restrictions on shareholders' power to approve beforehand or to ratify a breach of directors' duties.

A further problem that would be encountered is when the company is "prospectively insolvent", for instance when at the time when the directors make a corporate gift it is solvent, but it enters into insolvent liquidation thereafter. Such a problem arose in the circumstances encountered in the English decision of Aveling Barford Limited v Perion Limited. Hoffmann J found that the shareholders' consent to

133 Sealy "Gloss" 175 indicates that "if these judicial utterances [referring to broader duties] are examined in their context, it will be seen that in most cases they are nothing more than extraneous words of censure directed at conduct which anyway comes within some well-established rule of law, such as the law imposing liability for misfeasance, the expropriation of corporate assets or fraudulent preference." He warns (at 176) that similar observations, if expressed in studiously cautious language, do no violation to the principles and policies of company law, but that there are also dangers lurking for the unwary. Amongst these is the danger that similar statements will be made in more extravagant terms, which will strike at the foundations of these principles. See also Trethowan "Personal Liability to Creditors" 52, who indicates that the decisions based on breach of duty leave a number of critical issues unresolved. This is explicable by the fact that the courts seem to be acting in a manner designed to reach the correct decision in the case before them, hampered by the conflicting conceptual and jurisdictional problems of this area of the law.

134 See Barrett "Interest" 231, who specifically refers to possible conflicts in interest of creditors and shareholders, and Russell "Duty to Creditors" 420.

135 Du Plessis Grondstae 126; Du Plessis "Pligte" 388-389; Worthington "Creditors' Rights" 151. In Australian Growth Resources Corporation Pty Ltd (Recs and Mgrs appid) v Van Reesema 13 ACLR 261 (SC)(SA) the court indicated that creditors would have no direct recourse against the defaulting director. Their only legal recourse would be through the company liquidator. See also Prentice "Creditor's Interests" 275-276; Sealy "Problems" 176 at 187-188; Trethowan "Personal Liability to Creditors" 59; Ex parte Lebowa Development Corporation Ltd (1989) 3 SA 71 (T) at 81 B-D and 109B-111B; Ex parte Clifford Homes Construction (Pty) Ltd 1989 (4) SA 610 (W).

136 Sappideen "Fiduciary Obligations" 391. See also Prentice "Creditor's Rights" 265 at 276. It is submitted that under South African law the problems with regard to double recovery would probably be resolved by the rules pertaining to locus standi. On locus standi, see in general Eckard Prosessreg 211.

137 See page 42 above and chapter 9 par 4.8 below.

138 1988 A No 5742; 17 April 1989, discussed by Calnan "Creditors' Rights" 94. A property owned by Aveling Barford had, to the knowledge of its directors and of Perion, been sold at a substantial undervalue to Perion. The shareholders of Aveling Barford had given their consent to this transaction. At the relevant time Aveling Barford had been solvent, but it had a substantial accumulated deficit on profit and loss account and was therefore unable to make any distributions to shareholders.
the particular transaction was ineffective because, even though the company was solvent at the time, the transaction was effectively a distribution of capital to an associate of the ultimate shareholder of the company and had been made at a time when the company was unable to make distributions to its members. Although the court referred to *ultra vires* transactions, Calnan\(^\text{139}\) indicates that the case should not be seen as one involving *ultra vires* or illegal distributions, but rather as a consideration of the extent of directors' obligations to consider the interests of creditors and consequently of the limits of shareholders' power to waive breaches of fiduciary duty by directors. He regards the case as a theoretical justification for extending the circumstances in which directors have an obligation to consider the interests of creditors.\(^\text{140}\)

It is probably easier to construe a duty to consider the interests of creditors where the circumstances at the time of the particular transaction indicate that there may be financial problems.\(^\text{141}\) Where there is no such indication, it is difficult to envisage why such a transaction may, with hindsight, later be set aside. This would be difficult to reconcile with the accepted principle that courts will not, and also should not, normally involve themselves in commercial decision-making. It is submitted that the same result would probably be reached in the circumstances of *Aveling Barford* by traditional consideration of the "interests of the company".

A further argument against a duty to creditors is that they charge interest for the services they render. Built into that fee is compensation for the risk that they bear. Creditors should not complain that insolvency has caused them loss because they have contracted to bear that risk, and have built compensation for bearing it into the cost of credit.\(^\text{142}\)

It is therefore submitted that a company director owes no independent duty to any specific interest group. The beneficiary of the fiduciary duty is the company, whatever that may mean. In the determination of whether the fiduciary duty has been properly exercised in favour of the beneficiary, circumstances may, however, require that the interests of specific groups be taken into account.\(^\text{143}\) This would, in

\(^{139}\) Calnan "Creditors' Rights" 95.

\(^{140}\) This decision should, however, only be seen as authority for a corporate gift being recoverable to the extent that the company did not have sufficient distributable profits to make a distribution of an equivalent amount: Calnan "Creditors' Rights" 96.

\(^{141}\) For example, the fact that in the *Aveling Barford-case*, distributions could not be made at that time.

\(^{142}\) Wishart "Duties to Creditors" 335. Risk assessment will, however, undoubtedly pose problems.

\(^{143}\) It is submitted that Gower (see LCB Gower *Final Report of the Commission of Enquiry into the Working and Administration of the present Company Law of Ghana* (1961)) followed this approach in formulating section 203(3) of the Company Code drafted for Ghana (Company Code 1962). See note 125 above. See also Baxt "Duties of Directors" 303. For a comparison with the position in Nigeria, see Bakibinga "Interest" 451ff. *Gore-Browne on Companies* par 27.4 submits that from the point of view of strict law, the "interests of the company" may now include the interests of the company's employees, and in certain situations the interests of creditors, but otherwise means the interests of the company as a commercial entity, to be judged in most cases by reference to the interests of present and future shareholders alone.
fact, normally be the case, for so long as the company remains a going concern the members' interests will be served by having regard to other interests.\textsuperscript{144} It is difficult to see what additional benefit the recognition of a duty owed to creditors\textsuperscript{145} or other interest groups would give to the interested parties. It also seems clear that any real changes to the present legal position cannot come from the courts, but should come from the legislature.\textsuperscript{146}

4 CONCLUSION

It was indicated above that modern management often takes the view that company directors should consider not only the interests of present and future shareholders, but also those of certain other interest groups and, possibly, those of the State and the general public.\textsuperscript{147} It is submitted that, nonetheless, directors' fiduciary duties remain owed to the company and that the existing principles of company law adequately address this issue.\textsuperscript{148} But directors' compliance with fiduciary obligations cannot be evaluated without taking cognisance of all surrounding circumstances. When indicated by the facts of a particular case, it is therefore logical to expect that the interests of certain definable groups, which include creditors and employees of the company, will in the specific circumstances merit careful scrutiny. Often this will imply a balancing of the interests of different groups.

The recognition and protection of other interest groups should not be regarded as the formulation of a fiduciary duty owed directly to them. Such a formulation would entail many difficulties and disadvantages. Perhaps the most impor-

\textsuperscript{144} Gower \textit{Company Law} 555 indicates that dissatisfied customers and an aggrieved public or government department are not conducive to the future prosperity of the company.

\textsuperscript{145} Jacobs "Creditors" 315.

\textsuperscript{146} Larkin "Duties" E-17. See also Sappideen "Fiduciary Obligations" 396, who opines that the best form of achieving the contemplated level of creditor protection is through a general statutory provision requiring directors to be evenhanded to both shareholder and creditor interests with respect to the corporation's financing, investment and dividend decisions. The author further submits that recognition of such an entitlement without a corresponding right of enforcement is of no use. Examples of statutory provisions are found in the Ghana Company Code 1962 (see note 143 above), s 309 of the English Companies Act 1985 (see page 47 above) and s 214 of the Insolvency Act 1986. Section 214 empowers the court to order a director to contribute to the assets of a company where the company has gone into "insolvent liquidation" and at some time before the winding up the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. Prentice "Creditor's Interests" 276 regards it as obvious that this section greatly diminishes the need for the common law doctrine as formulated in \textit{West Mercia}. Statutory protection does, to some extent, exist under South African law (see footnote 45 above). These provisions could be adapted to meet the increasing demand for protection of specific interest groups.

\textsuperscript{147} See page 27 above.

\textsuperscript{148} Wishart "Duties to Creditors" 353. This principle was reiterated by Lord Cullen in \textit{Dawson International plc v Coats Paton plc} [1988] SLT 854, (1988) 4 BCC 305, [1988] PCC 362 when he stated "Directors have but one master, the company."
tant of these, is the one already warned against many years ago, that recognition of a fiduciary duty owed to many various groups, who may even have conflicting interests or expectations, would cause the loss of all effective control. Not only will the protection of the wider groups it is sought to help be diminished, but the well-established principles which govern corporate decision-making, might be discarded. Furthermore, no means of effectively dealing with the problems of standing to sue and ratification have thus far been suggested.\(^{149}\)

It is therefore submitted that the beneficiary of the fiduciary duties owed by company directors remains the company and that authorities seeking to establish a separate duty to other beneficiaries only serve to confirm that these groups merit protection. It should be borne in mind that there are other means by which this protection may be arranged. Statutory provisions directly aimed at the protection of creditors reduce the need for a separate duty, relegating it to being a mere alternative procedure for reaching the same result.\(^{150}\) It seems unnecessary to create uncertainty by undue extension of directors' fiduciary duties. It is, in any event, debatable whether, in view of the existing authorities in favour of the company as beneficiary of directors' fiduciary duties, courts of law would be the proper forum for wider recognition. It is suggested that, in the interests of legal certainty, such wider recognition, if deemed desirable, should be provided for by legislature.

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\(^{149}\) Worthington "Creditors' Rights" 151. See also pages 42 and 50 above.

\(^{150}\) Jacobs "Creditors" 315; Wishart "Duties to Creditors" 332. Fourie "Skuldeisers" 27 suggests that existing measures under South African law also provide adequate protection and that there is no real need for the recognition of a general fiduciary duty in favour of creditors. See also page 32 and note 45 above.
CHAPTER 4
ENGLISH LAW

1 INTRODUCTION

English company law is primarily contained in the Companies Act 1985 (c 6), as supplemented by the Companies Act 1989 (c 40). However, this Act is not a complete codification of company law, but rather a consolidation of statutory provisions contained in the former principal Companies Act 1948 (11 & 12 Geo 6, c 38) and in four subsequent major Companies Acts, as well as in other legislation. Certain aspects of company law, including the fiduciary duties owed by company directors, remain largely the products of the courts of equity.

In this chapter, a company director under English law is identified. The *de facto*, "shadow" and nominee directors are briefly discussed, and a distinction is drawn between executive and non-executive directors. Various sub-rules pertaining to the fiduciary obligation which accompany a director's office are identified. One aspect of the general fiduciary obligation not to profit at the expense of the company, namely the appropriation of what is generally described as "corporate opportunities", is then discussed in more detail.

2 COMPANY DIRECTORS

A company can only act through agents. Usually the persons who act on its behalf and by whom its business is superintended are termed directors. They may also be called by other names, such as "managers", "council" or "managing committee". For the purposes of the Companies Act "director" includes any person who

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1 This vast Act originally consisted of 747 sections and was supplemented by the Business Names Act 1985 (c 7), Company Securities (Insider Dealing) Act 1985 (c 8), and Companies Consolidation (Consequential Provisions) Act 1985 (c 9). Sections hereafter mentioned refer to the Companies Act 1985, unless specifically stated otherwise.

2 For excellent accounts of the development of English company law, see Boyle & Birds *Company Law* 1-12; Farrar *Company Law* 15-24; Gower *Company Law* 19-54; Palmer's *Company Law* 1009-1034.

3 The Companies Acts of 1967 (c 81), 1976 (c 82), 1981 (c 62) and 1982.

4 Other enactments which directly affect company law include the Company Directors' (Disqualification) Act 1986 (c 46), the Financial Services Act 1986 (c 60), and the Criminal Justice Act 1993. The provisions relating to winding up and dissolution of companies as well as certain other measures which apply to company insolvency are contained in the Insolvency Act 1986 (c 45).

5 Palmer's *Company Law* 8101. Gower *Company Law* 8 confirms "behind it [company law] is a residual body of law and equity where some of the fundamental principles are still to be found."

6 Palmer's *Company Law* 8007.
occupies the position of director. All registered companies must have directors, who need not be members of the company. Their appointment is usually regulated in the articles of association. However appointed, a director may be removed from office by ordinary resolution in addition to any other means of removal provided for in the articles.

Alternate directors are in exactly the same position as any other director. The extent of their rights and powers depends upon the terms of the articles under which they were appointed.

2.1 *De Facto*, Shadow and Nominee Directors

A person is only a director in the eyes of the law if he has been duly appointed and if he has not ceased to meet the requirements of the company's articles for being a director by having become disqualified after his appointment. But in some cases legislation treats someone as a director when his appointment to this office by the company has not taken place, or has become defective. Such a person may be able to bind the company. He may be subject to liability as if he were a director because he has assumed that position. In addition, the Act provides for "shadow directors", who are described as persons "in accordance with whose directions or instructions the directors of the company are accustomed to act." Many of the modern statutory controls over directors have been applied also to shadow direc-

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7 Section 741(1).

8 Section 282. Private companies and companies registered before 1929 may have only one director. All other companies must have at least two directors.

9 Gower *Company Law* 142.

10 Gower *Company Law* 141; Palmer's *Company Law* 8007; Sealy *Cases* 236.

11 Section 303; Gower *Company Law* 141.

12 Gower *Company Law* 143; Palmer's *Company Law* 8014; Pennington *Company Law* 552-553.

13 Palmer's *Company Law* 8022.

14 Gower *Company Law* 143, 186-188.


16 Section 741(2). However, a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity: proviso to s 741(2). In respect of shadow directors' liability to third parties, see Cook "Shadow Directors" 131.
The definition of a shadow director presupposes that there is a board of directors who act in accordance with instructions from someone else. Outside the context of the Companies Act the concept of shadow director has no function. The fiduciary duties imposed on company directors therefore do not extend to them. Shadow directors are unknown in South African law.

A *de facto* director, on the other hand, incurs liability when he has openly acted as if he had been validly appointed, whether or not there are other, properly appointed, directors. A *de facto* director is as much in a fiduciary position as a *de iure* director, and liable accordingly.

Thus, where a statutory duty or liability is imposed on shadow directors as well as those appointed to the position of director by the company, it is not possible for a person to escape that duty or liability by declining formal appointment to the board, if that person in fact exercises the sort of control and influence over the company that is normally associated with appointment to the board.

Management of companies through nominees is an accepted practice. A nominee director can be described as a person who, independently of the method of

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17 These include the duty to have regard to the interests of employees (s 309) (see chapter 3 page 46 above), the requirement of shareholder approval of directors' contracts of employment for more than five years duration (s 319), the controls over substantial property transactions involving directors (ss 320-322), contracts with sole members who are directors (s 322B), the restrictions of loans to directors (ss 330-346), the duty of directors to disclose their interest in contracts with the company (s 317), the prohibition on directors dealing in share options (s 323), the duty of directors to disclose shareholdings in their companies (ss 324-329), liability for engaging in wrongful trading (Insolvency Act 1986, s 213) and the availability of disqualification orders in respect of unfit directors (Company Directors Disqualification Act 1986, ss 6-9 and 22(4)).


19 Pennington *Personal Liability* 29.

20 See chapter 9 par 2 below.

21 *Gower Company Law* 144; *Palmer's Company Law* 8022. Statutory provisions which specifically apply to *de facto* directors are s 42 (non-reliance upon any change in directors), s 13(5) (those named in the statement of particulars are deemed to be the first directors of the company upon its incorporation, even if there is some defect in their appointment) and s 285 which provides that the acts of a director shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification. See also *Dawson v African Consolidated Land and Trading Co* [1989] 1 Ch 6; *British Asbestos Co v Boyd* [1903] 2 Ch 439; *Mahoney v East Holyford Mining Co* (1875) LR 7 HL 869 in respect of the validity of acts performed by persons in circumstances resembling those foreseen by s 285. This section does not protect a person who is aware of the invalidity of the appointment: *Murray v Bush* (1873) LR 6 HL 37 at 77. Nor can a person take advantage of it if he knows of some probable defect or if he knows that the regularity of the appointment has been challenged and takes no steps to ascertain the facts: *Morris v Kanssen and Others* [1946] AC 459, [1946] 1 All ER 586.

22 *Palmer's Company Law* 8026; *In re Canadian Land Reclaiming and Colonizing Company, Coventry and Dixon's Case* (1880) 14 ChD 660 at 670.

23 *Palmer's Company Law* 8009.
his appointment, but in relation to his office, is expected to act in accordance with some understanding or arrangement which creates an obligation or mutual expectation of loyalty to some person, or persons other than the company as a whole. Nominees are de iure directors and occupy a fiduciary position in respect of their companies. They may not be excluded from deliberations for fear of disclosure of information to their nominators. It is no defense to possible liability that they were merely carrying out instructions.

2.2 Executive and Non-Executive Directors

The increasing practice of appointing non-executive directors, also described as part-time, outside or independent directors, has inevitably led to reconsideration of their position. In 1987 a Code of Recommended Practice of Non-Executive Directors was issued by Promotion of Non-Executive Directors (PRO NED), a project to increase the number and effectiveness of non-executive directors. The recent recommendations made by the Committee on the Financial Aspects of Cor-

24 On the position of nominee directors generally, see Boros "Nominee and Multiple Directors I" 211; Boros "Nominee and Multiple Directors II" 6; Redmond "Nominee Directors" 194; Thomson "Nominee and Multiple Directors" 162; Scottish Co-operative Wholesale Society Ltd v Meyer and Another [1959] AC 324, [1958] 3 All ER 66 (HL).

25 In Trounce and Wakefield v NCF Kaiapoi Limited & Ors (1986) 2 NZCLC 99,422 nominee directors of a company who initiated a take-over bid were successful in an application for an injunction that they should not be excluded from deliberations concerning the take-over. It was suggested that if they took part in the deliberations the company proposing the take-over would inevitably acquire confidential information. Heron J was not prepared to make that assumption as it presupposes possible breaches of a fiduciary duty, nor was he prepared to act on the basis that it is wise to protect experienced company directors from themselves (at 99,431). The court held further that it must have been contemplated when agreed that the directors would be nominees that they would participate in all matters relating to the future of the company (at 99,431).

26 Selangor United Rubber Estates Ltd v Cradock and Others (No 3) [1968] 1 WLR 1555, [1968] 2 All ER 1073; Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1991] 1 AC 187 at 222, [1990] 3 All ER 404, [1990] BCLC 868 (PC). In Boulting and Another v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606 (CA) Denning MR referred to the nominee's appointment and held: "There is nothing wrong in it ... . That is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves" (at 626). But see chapter 3 page 26 above where it is indicated that the nominee directors may sometimes find themselves in an untenable position. The ideal to retain an independent discretion may sometimes prove unattainable: Millard Director 7; Gower Company Law 556; Re Englefield Colliery Co (1878) 8 ChD 388 (CA).

27 Jacobs "Non-executive Directors" 269; Farrar Company Law 343; Palmer's Company Law 8042.

28 PRO NED was established in 1982 and has an impressive list of sponsors, including the Bank of England, the Confederation of British Industry, the Institutional Shareholders' Committee and the Stock Exchange. It has three specific functions: the promotion of the wider use of non-executive directors, the maintenance of a register of persons who are or who are considered suitable to be non-executive directors and the provision of names of suitable candidates to fill non-executive directorships to companies who seek advice. On the PRO NED Code generally, see Jacobs "Non-Executive Directors" 270-272.
porate Governance afford much greater recognition of the office of this type of
director and are of particular relevance in respect of their duties of care and skill.29

If a non-executive director qualifies as a director within the meaning of section
741(1) he has, in principle, the same obligations and is subject to the same liability
as any other director.30 This applies particularly to his fiduciary duty to the company
and to the possibility of disqualification under the statutory provisions or the arti­
cles.31 The duty of care, diligence and skill may vary in accordance with the position
of the particular director in the company. In this regard it is necessary to consider
some of the recommendations of the Cadbury Committee.

2.2.1 The Cadbury Report

The Cadbury Committee was set up in May 1991 by the Financial Reporting
Council, the London Stock Exchange and the accountancy profession to address the
financial aspects of corporate governance.32 Its aim was to review those aspects of
corporate governance specifically related to financial reporting and accountability.33
The proposals do, however, seek to contribute positively to the promotion of good
corporate governance as a whole.34 The Code of Best Practice drawn up by the
Committee is directed at the boards of directors of all listed companies in the
United Kingdom. Participation by as many other companies as possible is encour­
eged.35

The Report confirms that all directors are equally responsible in law for the
board's actions and decisions. Certain directors may have particular responsibilities,
as executive or non-executive directors, for which they are accountable to the board.
Regardless of the specific duties undertaken by individual directors, it remains the
task of the board collectively to ensure that it is meeting its obligations.36

Two important contributions by non-executive directors to the governance
process are identified by the Committee. The first is the reviewing of the perform-

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29 See the Report by the Committee on the Financial Aspects of Corporate Governance (1992), under chairmanship of Sir Adrian Cadbury. This report is hereafter referred to as the Cadbury Report. See par 2.2.1 below.

30 Palmer's Company Law 8042.

31 Ibid.

32 Cadbury Report 14, par 2.1.

33 Cadbury Report 11, par 1.2. On the Report generally, see Cadbury "Restoring Trust" 403; Dine "Governance" 73.

34 Ibid.


36 Cadbury Report 20, par 4.3.
ance of the board and of the executive. The second is in taking the lead where potential conflicts of interest arise.

In view of the importance of independent judgment on issues of strategy, performance and resources, including key appointments, the Committee recommends that all boards require a minimum of three non-executive directors, one of whom may also be the chairman of the company, provided he is not also its executive head. The appointment should be for specified terms and reappointment should not be automatic. It is further recommended that, apart from their directors' fees and shareholdings, the majority of non-executives should be independent of the company. They should therefore be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment. At least three non-executive directors should form an audit committee with written terms of reference which deal clearly with its authority and duties.

The Cadbury Committee thus envisages specific recognition of and a much more important role for non-executive directors. The independence of these directors is emphasised. Their duties are not specifically discussed. In respect of membership of an audit committee it is, however, recognised that this is a demanding task which requires commitment, training and skill. It is submitted that this indicates that the duty of care and skill may vary depending upon the role and function of the particular (non-executive) director in the company. If his general duties to keep himself informed about the business activities and financial status of his company, to attend board meetings fairly regularly, and to check on the activities of the full-time directors and leading executives are fulfilled conscientiously, courts may apply different standards to the non-executive director's duty to exercise skill, care and diligence than to the duty owed by an executive director. But the distinction

37 Cadbury Report 20-21, par 4.5.
38 Cadbury Report 21, par 4.6.
39 Cadbury Report 22, par 4.11.
40 Cadbury Report 59, par 2.3 of the Code of Best Practice.
41 Cadbury Report 22, par 4.12. See also page 101 below.
42 Cadbury Report 27ff, 59.
43 Cadbury Report 30, par 4.37. The Report indicates that "[t]he directors concerned need to have sufficient understanding of the issues to be dealt with by the committee to take an active part in its proceedings." See also page 24, par 4.19 where it is recommended that given the varying backgrounds, qualification and experience of directors, whether executive or non-executive, with no previous board experience, it is highly desirable that they should all undertake some form of internal or external training.
44 Palmer's Company Law 8042.
between executive and non-executive directors is less important in respect of their fiduciary duties.46

3 DIRECTORS' FIDUCIARY DUTIES

It is recognised generally under English company law that a director owes a fiduciary duty of loyalty and good faith to his company. Directors are also regarded as having some of the attributes of trustees, notably as regards assets of the company which are in their hands or under their control.46 This was confirmed by Ungoed-Thomas J in Selangor United Rubber Estates Ltd v Cradock and Others (No 3)47:

However much the company's purposes and the directors' duties, powers and functions may differ from the purposes of a strict settlement and the duties, powers and functions of its trustees, the directors and such trustees have this indisputably in common - that the property in their hands or under their control must be applied for the specified purposes of the company or the settlement.

The fiduciary duty is owed by each director individually and to the company alone.48 Except in so far as the duties are specifically restricted to directors by statute, they apply equally to any officers of the company who are authorised to act on its behalf,49 and, in particular, to those acting in a managerial capacity.50 The fiduciary obligation arises on the date when the director's appointment takes effect.51

The fiduciary duties are owed only to the company to which the director has been appointed. They are not owed to other companies or bodies corporate with

45 See page 59 above. See also chapter 9 par 2.3 below.

46 Gore-Browne on Companies par 27.2.3. See also chapter 2 par 3.1 and par 3.2.2 below.


48 Boyle & Birds Company Law 590; Farrar Company Law 325; Gower Company Law 551; Pennington Company Law 583; Scaly Cases 247; Stallworthy "Directors' Duties" 77. In respect of the interpretation of "the company" and of other possible beneficiaries of this duty, see chapter 3 above.

49 Gower Company Law 553.

50 Gower Company Law 553; Canadian Aero Service Ltd v O'Malley [1974] SCR 592; (1973) 40 DLR (3d) 371 at 381.

51 Boyle & Birds Company Law 591; Gore-Browne on Companies par 27.3. In Lindgren v L & P Estates Ltd [1968] Ch 572 (CA) the court emphatically rejected the argument that a director-elect is in a fiduciary relationship to the company: "The position of 'director-elect' seems to me to partake more of the atmosphere of comic opera than the sphere of serious legal argument" (per Danckwerts LJ at 596).
which the company is associated, for example its holding company, or subsidiary. In Charterbridge Corporation Ltd v Lloyds Bank Ltd and Another Pennycuick J stated obiter that a director should not be guided by the interests of the group as a whole if this might be detrimental to the interests of his own company, particularly if the company has separate creditors. If, however, the intended measure does not conflict with the interests of his company, it is not a breach of duty to his own company that he has taken into account the benefit of the group as a whole.

Directors' fiduciary obligations have been expressed in terms of various rules. Various categorisations and sub-categorisations of directors' fiduciary duties have been made. These categories are not exclusive and, to some extent, overlap. They all acknowledge two basic fiduciary duties, namely that directors should exercise their powers in good faith and that they should avoid a conflict of their own interests and the interests of the company. The appropriation of corporate

52 Bell and Another v Lever Brothers Limited and Others [1932] AC 161 (HL) at 195-196; Pergamon Press Ltd v Maxwell [1970] 1 WLR 1167; Lonrho Ltd and Another v Shell Petroleum Co Ltd and Another [1980] 2 WLR 367 (CA), [1980] 1 WLR 627 (HL). In Pergamon Pennycuick J refused to grant an injunction to a company which held seventy per cent of the shares of its subsidiary, to compel a director of the subsidiary to exercise a discretionary power in the way the parent company wished. In this case the principle that fiduciary duties are owed to the company and not to individual (even majority) shareholders prevailed: Palmer's Company Law 8107.

53 Gower Company Law 574; Lindgren v L & P Estates Ltd [1968] Ch 572 (CA) at 575. But see also Scottish Co-operative Wholesale Society Ltd v Meyer and Another [1959] AC 324, [1958] 3 All ER 66 (HL) where a holding company deliberately and successfully pursued the policy of "starving out" its partly owned subsidiary by not providing it with the business contracts upon which its existence depended. The minority members of the subsidiary company were successful in bringing a petition under s 210 of the Companies Act 1948 (now Part XVII of the Companies Act 1985). The House of Lords further indicated that the holding company's three nominee directors on the board of the subsidiary were in breach of their duty to the subsidiary as they had failed to ensure the protection of the subsidiary against the oppressive policy of the holding company. It should be noted that the directors in this case were also on the board of the subsidiary.


55 Gore-Browne on Companies par 27.3 states that "[t]he form in which a director's fiduciary duties are expressed is that of a number of general law and statutory rules, varying greatly in their range of application and at many points overlapping with each other. The lack of any precise and logical pattern makes orderly exposition of these rules difficult."

56 Gower Company Law 553 distinguishes four rules which have emerged from the application of the general equitable principle to company directors: Directors must act in good faith in what they believe to be the best interests of the company. They must not exercise the powers conferred upon them for purposes different from those for which they were conferred and may not fetter their discretion as to how they shall act. Lastly, they may not, without the informed consent of their company, place themselves in a position in which their personal interests or duties to other persons are liable to conflict with their duties to the company. Pennington Company Law 583 and 584 distinguishes two main duties, namely the duty not to exceed powers and the duty to act in the interests of members and employees. Farrar Company Law 383ff identifies directors' duties to act bona fide in the interests of the company and not to exercise their powers for any collateral purpose.

57 Farrar Company Law 380 note 12.
opportunities is treated as one aspect of the latter duty. Before focussing on this aspect, it is necessary to briefly identify the existing categorisations and rules pertaining thereto.

3.1 Exercise of Powers in Good Faith

The paramount duty of directors is to act *bona fide* in what they consider is in the interests of the company. In most instances compliance with this rule is tested on commonsense principles, the court asking itself whether it is proved that the directors have not done what they honestly believed to be right, and normally accepting that they have unless satisfied that they have not behaved as honest men of business might be expected to act.

The duty is therefore subjective in the sense that a court will not consider it broken only because, in its own opinion, the particular exercise of power was not in the company's interests. It is left to the directors in the exercise of their business judgment to decide how the interests of the company may best be promoted. The courts will interfere only if no reasonable director could have concluded that a particular course of action was in the interests of the company. But the duty is not simply to display subjective good faith, since directors may breach it when they have not acted with conscious dishonesty, but have failed to direct their minds to whether a transaction was in fact in the interests of the company.

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59 Gower *Company Law* 553.

60 Boyle & Birds *Company Law* 592; Farrar *Company Law* 391; Palmer's *Company Law* 8106. The court will not take it upon itself to order that a particular power vested in directors should be exercised in any particular way: *Pergamon Press Ltd v Maxwell* [1970] 1 WLR 1167. But, unless otherwise permitted by the articles, it must be the directors themselves who determine how the powers vested in them are used to serve the interests of the company: *In re County Palatine Loan and Discount Company, Cartnell's Case* (1874) 9 Ch App 691.


62 Palmer's *Company Law* 8107; *In re Lee, Behrens and Company, Limited* [1932] 2 Ch 46; *In re W & M Roith Ltd* (1967) 1 WLR 432 (service contract concluded with company in order to provide a pension for the director's wife without any consideration of whether the contract would be to the benefit of the company declared void). See also chapter 3 note 98 above.
3.1.1 Exercise of an Unfettered Discretion

A director should be able to manage the affairs of his company objectively. His discretion may, therefore, not be curtailed.63 A director’s contractual obligation with third parties to recommend a certain course of action to the company's shareholders is subject to an implied term, derived from the directors’ fiduciary duties, that, if circumstances change so that the director no longer thinks that particular course of action is in the best interests of the company, he may express that opinion, and may even recommend its rejection.64 It may, however, be necessary to distinguish the situation where the directors have in the bona fide exercise of their discretion entered into a contract which requires them for its effectuation to vote in a certain way at future board meetings.65

Directors may not delegate their powers,66 unless they have been given express or implied authority to do so. A general power to delegate may be provided for in the company’s articles.67

3.1.2 The Duty to Act for Proper Purposes

The powers of directors are limited in two ways by the company’s constitution. First, the objects clause in the company’s memorandum of association limits the capacity of the company. In respect of the duty of directors to their company, section 35(3) provides that it remains the duty of directors to observe any limitations on their powers flowing from the company's memorandum.68 Action by the directors beyond the company’s capacity may be ratified by the shareholders by special resolution. The directors may also, by separate special resolution, be relieved of liability to the company for causing it to act in an ultra vires manner.69

Second, other provisions of the company constitution may limit the authority of the directors to act on behalf of the company, although the particular transaction

63 Gower Company Law 558-559; Palmer’s Company Law 8128.


65 Thorby v Goldberg (1965) 112 CLR 597; Fulham Football Club Ltd v Cobra Estates plc [1992] BCC 863 (CA). See also chapter 9 par 3.2.2.1 below.

66 The maxim "delegatus non potest delegare" applies to directors: Palmer's Company Law 8129; Cobb v Becke (1845) 6 QB 930 at 936.

67 Re Taurine Co (1883) 25 ChD 118; Leeds Estate Co v Shepherd (1887) 36 ChD 787.

68 In this sense, the ultra vires doctrine is still operative, although it has been effectively abolished in respect of third parties: Palmer's Company Law 8108.

69 Section 35(3) inserted by the Companies Act 1989, s 108.
may fall within the company's capacity. It remains the duty of the directors to observe this limitation. Directors may be relieved of this duty by ordinary resolution of the shareholders in general meeting.

If directors exercise their powers for purposes other than those for which they were conferred, they have also exceeded their authority and are liable accordingly. Powers exercised for an improper purpose may be set aside. If the improper purpose is financial gain for the directors, or the preservation of their control, it also amounts to a breach of the duty to act honestly for the benefit of the company as a whole. But even if the directors have acted honestly, they may be liable if the exercise of their powers was for a purpose other than that for which they were conferred. The obligation to exercise their powers for proper purposes is sometimes seen as a variant of directors' duty to act bona fide and at other times as distinct from this duty. The "proper purpose doctrine" thus examines objectively the directors' purpose while giving due credit to their business judgment.

The proper purpose doctrine has been applied in several cases in connection with directors' powers to issue shares and it has been held that

directors are not entitled to use their power of issuing shares merely for the purpose of maintaining their control or the control of themselves and their friends over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders.

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70 Section 35A protects third parties who deal in good faith with directors who exceed their powers under the company’s constitution. But s 35A(5) provides that this shall not affect any liability incurred by the directors by reason of their exceeding their powers. That liability exists at common law: Palmer's Company Law 8108; Re Oxford Benefit Building and Investment Society (1886) 35 ChD 502; Cullerne v London Suburban General Permanent Building Society (1890) 25 QBD 485; Rolled Steel Products (Holdings) Ltd v British Steel Corporation [1986] 1 Ch 246 at 297-298.

71 Palmer's Company Law 8108; Grant v United Kingdom Switchback Railways Company (1888) 40 ChD 135 (CA).

72 Gore-Browne on Companies par 27.4; Gower Company Law 556; Palmer's Company Law 8110.

73 Farrar Company Law 391; Gower Company Law 556.

74 Gower Company Law 556. See par 3.1 above.


76 Sealy Cases 247.

77 Farrar Company Law 391. The authors point out (in note 10) that it is sometimes argued that there should be no other test than the genuineness of the directors' motives.

78 Piercy v S Mills & Co [1920] 1 Ch 77 at 84. See also Punt v Symons & Co Ltd [1903] 2 Ch 506.
In *Hogg v Cramphorn Ltd and Others,* the directors of a company facing a take-over bid issued preference shares to a trust newly established for the benefit of the company’s employees. The trustees were provided by the company with an interest-free loan in order to be able to subscribe to the shares. The votes attached to the shares coupled with those of the directors and their friends were sufficient to constitute a majority of the general meeting, and the bid was defeated. The allotment was challenged by one of the shareholders. Buckley J distinguished between the duty to act for a proper purpose and the duty to act *bona fide.* The view that the requirement of proper purpose is distinct from that of *bona fides* has been rejected in certain Commonwealth jurisdictions.

A similar situation arose in *Howard Smith Ltd v Ampol Petroleum Ltd and Others.* Although the court found that the allotment had not been made by the directors for any reason of self-interest, it rejected the contention that the allotment was valid simply because the directors had acted *bona fide.* It ordered the allotment to be set aside as resulting from the exercise by the directors of their powers under the articles for an improper purpose. In his judgment, Lord Wilberforce stated

> [I]t must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers.

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80 At 266-268. In particular, whereas the *bona fides* test was satisfied if the directors had acted in what they considered, subjectively, was in the best interests of the company, the improper purpose test involved applying an objective standard of assessment to their conduct: *Palmer's Company Law* 8110.

81 *Teck Corp Ltd v Millar* (1973) 33 DLR (3d) 288.

82 [1974] AC 821, [1974] 2 WLR 689, [1974] 1 All ER 1126 (PC), [1974] 1 NSWLR 68. The directors of a company issued shares to the appellant company, which was intending to make a take-over bid for the company, in order to defeat the existing majority position in the company held by the respondent company and another. The latter parties had rejected the appellant's offer and themselves intended to bid for the company.

83 The articles conferred broad powers upon the directors and permitted them to issue authorised but unissued shares to such persons on such terms and conditions and with such rights or restrictions and either at a premium or otherwise at such times as the directors might deem fit. It therefore appears that even broadly worded articles conferring powers upon the directors must be construed in the context of the articles as a whole in order to establish whether any limitation should be read into an apparently unlimited power: *Palmer's Company Law* 8112.

84 [1974] AC 821 at 837. If the directors' purpose is unlawful or contrary to public policy their decision will be ineffective for that reason: *Palmer's Company Law* 8112 note 50; *Pharmaceutical Society v Dickson* [1970] AC 403.
In Great Britain this aspect may in future arise less frequently in relation to the issue of shares because of certain statutory measures. The object of the court in construing the articles is to determine whether the particular purpose for which the power was exercised in the case before it was proper. Since a power may be exercised legitimately for a variety of reasons it would be incorrect to attempt to define a proper purpose and thereby to conclude that all other purposes are improper.

Where directors have acted for various purposes, some of which are proper and some not, the power will be considered to be validly exercised if its primary purpose was proper.

3.1.2.1 Approval by the General Meeting

In Hogg v Cramphorn the judge stood the action over for a specified period to enable the directors, if they so wished, to convene a general meeting which could be asked whether it wished to ratify the directors' allotment of shares. The directors' transaction were in fact ratified and no order was made.

In Bamford v Bamford the Court of Appeal held that an issue of shares made by the directors for an improper purpose could be ratified by the general meeting by ordinary resolution. The directors' act was not considered an act outside the articles.

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85 For example, s 80 (authority of company required for allotment of certain securities by directors) and s 89 (pre-emption rights).

86 It was applied in Lee Panavision Ltd v Lee Lighting Ltd [1992] BCLC 22 (CA) in respect of interference by directors with shareholders' powers to appoint and remove directors.

87 This was found to be the case in, for example, Gaiman v National Association for Mental Health [1971] Ch 317, [1970] 2 All ER 374 and In re Smith and Fawcett, Limited [1942] 1 Ch 304, [1942] 1 All ER 542 (CA).


89 This was decided in other Commonwealth jurisdictions: Mills and Others v Mills and Others (1938) 60 CLR 150; Hartlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co (1968) 42 ALJR 123, (1968) 121 CLR 483. In Howard Smith Ltd v Ampol Petroleum Ltd and Others [1974] AC 821 at 835, [1974] 2 WLR 689, [1974] 1 All ER 1126 (PC), [1974] 1 NSWLR 68 the court held that if a particular exercise of power was challenged, it would have to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not. See also Mcanie (London) Ltd v Cook & Watts Ltd (1967) CLY 482 where it was held that if the primary purpose for which the power was exercised was improper, then a subsidiary proper purpose would not save the directors' decision.

90 See page 66 above.


but in breach of the directors' fiduciary duties. Their act was therefore, as is the case with other breaches of fiduciary duty, ratifiable by ordinary resolution.\textsuperscript{93}

From the abovementioned cases it can be concluded that, although the process of establishing whether there are any restrictions upon the purposes for which the powers of directors may be exercised involves construing the articles of the company, actions by the directors for an improper purpose do not constitute a breach of the articles, but rather an abuse by the directors of their powers under the articles.\textsuperscript{94}

### 3.2 Avoidance of Conflicts of Interest and Duty

Directors are required not to put themselves in a position where there is, or may be, a conflict between their personal interests and their duties to the company.\textsuperscript{95} A possibility of conflicting interests will be found where the reasonable man considering the relevant facts and circumstances of the particular case would think that there is a real possibility of conflict.\textsuperscript{96}

This principle may be applied in a number of situations.\textsuperscript{97} These include nominee directorships,\textsuperscript{98} the conclusion of a contract with the director's own company,\textsuperscript{99} holding directorships in competing companies,\textsuperscript{100} and the acquisition of profit or gain in instances of insider-trading.\textsuperscript{101} There are also a number of statutory restrictions imposed on directors.\textsuperscript{102}

\textsuperscript{93} See also \textit{Winthrop Investments Ltd and Another v Winns Ltd and Others} [1975] 2 NSWLR 666.

\textsuperscript{94} \textit{Palmer's Company Law} 8114.

\textsuperscript{95} \textit{Palmer's Company Law} 8114; \textit{Aberdeen Rail Co v Blaikie Bros} (1854) 1 Macq 461, (1854) 2 Eq Rep 1281 (HL); \textit{Bray v Ford} [1896] AC 44 at 51; \textit{Transvaal Lands Co v New Belgium Land and Development Co} [1914] 2 Ch 485; \textit{Boardman and Another v Phipps} [1967] 2 AC 46 (HL).

\textsuperscript{96} \textit{Boardman and Another v Phipps} [1967] 2 AC 46 (HL) at 124; \textit{Industrial Development Consultants Ltd v Cooley} [1972] 1 WLR 443, [1972] 2 All ER 162 at 172. See also chapter 9 par 3.2.4 below.

\textsuperscript{97} \textit{Palmer's Company Law} 8114.

\textsuperscript{98} See par 2.1 above.


\textsuperscript{100} See par 4.7.1 and chapter 9 par 4.6 below.

\textsuperscript{101} This entails the use by an "insider" of price-sensitive information (known to him, but not generally, which he has acquired by virtue of his position) to trade to his advantage in the securities of a company. \textit{Farrar Company Law} 364. See, in general, Boyle & Birds \textit{Company Law} 229ff.

\textsuperscript{102} \textit{Palmer's Company Law} 8120ff.
3.2.1 Secret Profits

The principle that a director may not make a secret profit for himself has now attained the status of a separate rule.¹⁰³

A director's use of corporate assets in order to make a secret profit for himself is clearly a breach of his fiduciary duties.¹⁰⁴ The origins of this rule can be traced back to the early eighteenth century case of Keech v Sandford.¹⁰⁵ In that case a lease of the profits of a market had been given by will on trust for an infant. The trustee applied for a renewal of the lease, which was refused because the landlord was dissatisfied with the legal security for the rent. The trustee then took a lease for his own benefit. The court held that it was subject to the trusts of the will. The general principle deriving from Keech was summarised as follows in Keith Henry & Co Pty v Stuart Walker & Co Pty:¹⁰⁶

The doctrine ... is shortly stated by saying that a Trustee must not use his position as trustee to make a gain for himself: any property acquired, or profit made, by him in breach of this rule is held in trust for his cestui que trust. The rule is not confined to cases of express trusts. It applies to all cases in which one person stands in a fiduciary relation to another ...

The most famous application of the principle in company law is that of the House of Lords in Regal (Hastings) Ltd v Gulliver.¹⁰⁷ From the facts of the case, it appeared that a company owned a cinema. The directors decided to acquire two further cinemas with the purpose of disposing of the whole undertaking as a going concern. With this object in mind, another company was formed to take a lease on the two cinemas. But the lessor insisted on a personal guarantee from the directors unless the paid-up capital of the second company exceeded a certain amount. The company was unable to subscribe this amount and the directors were unwilling to furnish personal guarantees. The initial plan was then amended. The first company did not subscribe for all the shares in the second company, but only took up a limited number. The remaining shares were taken by the directors and their friends. Subsequently, instead of selling the undertaking, the shares in both companies were sold. The new controllers of the first mentioned company then caused the company to institute an action against the former directors to recover the profit that had been made from the sale of the shares in the second company.

The claim in Regal was clearly unmeritorious. Recovery by the company would have benefited only the purchasers, who would recover an undeserved windfall

¹⁰³ Palmer's Company Law 8129.
¹⁰⁴ Menier v Hooper's Telegraph Works (1874) LR 9 Ch App 350.
¹⁰⁵ (1726) SelCas Ch 61, 2 Eq Cas Abr, 25 ER 223. For a discussion of the case, see Cretney "Keech v Sandford" 161ff.
¹⁰⁷ [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL).
resulting in a reduction in the price which they had voluntarily agreed to pay.\textsuperscript{108} However, only one of their lordships appeared perturbed about this aspect.\textsuperscript{109} Furthermore, since the directors had apparently held a majority of the shares in the company, they should have been able to obtain ratification of their action by the company in general meeting.\textsuperscript{110} It was also apparent that the directors had not deprived the company of any of its property,\textsuperscript{111} or deprived it of an opportunity which it might have exercised for its own advantage.\textsuperscript{112}

The court of first instance and a unanimous Court of Appeal\textsuperscript{113} dismissed the action. However, the House of Lords reversed the decision unanimously. It was held that the directors were liable to account if it was established that what they did was so related to the affairs of the company that it could properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors, and that this had also resulted in a profit to themselves.\textsuperscript{114}

It was accepted that the directors had acted in good faith and in order to facilitate a transaction for the company which the company was unable to finance from

\textsuperscript{108} Gower \textit{Company Law} 565. See also Jones "Unjust Enrichment" 496; Lowry "Fiduciary Duties" 9.

\textsuperscript{109} See the judgment by Lord Porter [1942] 1 All ER 378 at 395, [1967] 2 AC 134 at 157 where his lordship stated: "This ... may be an unexpected windfall, but whether it be so or not, the principle that a person occupying a fiduciary relationship shall not make a profit by reason thereof is of such vital importance that the possible consequence in the present case is in fact as it is in law an immaterial consideration."

\textsuperscript{110} It was conceded that they had acted in good faith and in full belief in the legality and propriety of their actions. They had therefore not formally sought ratification. It should be noted that in the editorial note to the All ER Report it is stated: "As their Lordships point out, no question as to the right to retain this profit could have arisen if the respondents had taken the precaution of obtaining the approval of the appellant company in general meeting, and this would have been a mere matter of form, since they doubtless controlled the voting". See, however, the comment by Vincclott J in \textit{Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)} [1981] Ch 257, [1980] 2 All ER 841 at 862 that "nothing in the report ... indicates that the defendant directors controlled the voting and, as I understand this passage in the speech of Lord Russell of Killowen, he contemplated that the defendant directors might have protected themselves by a resolution in general meeting precisely because they had not control of the majority of votes." See also Sealy \textit{Cases} 269.

\textsuperscript{111} Unless information is regarded as property: Gower \textit{Company Law} 565. On this issue, see par 4.6 below.

\textsuperscript{112} The shares in the second company had never been property of the company, and, on the facts, the company could not have availed itself of the opportunity to acquire them. On the effect of inability of a company to pursue a particular opportunity, see par 4.5 below.

\textsuperscript{113} The decision of the Court of Appeal is not reported. Portions of it were cited before the House of Lords and have been referred to in subsequent case law.

\textsuperscript{114} Per Lord MacMillan [1942] 1 All ER 378 (HL) at 391-392, [1967] 2 AC 134 (HL) at 153 and Lord Porter [1942] 1 All ER 378 (HL) at 395, [1967] 2 AC 134 (HL) at 158.
its own sources. But their lordships applied strict fiduciary standards and held that the liability of the directors did not depend upon whether the profit would or should otherwise have gone to the company, whether they acted as they did for the benefit of the company, or whether the company was damaged or benefited by the action. The test for accountability as stated by Lord Porter was that

\[ \text{On occupying a position of trust must not make a profit which he can acquire only by use of his fiduciary position, or, if he does, he must account for the profits so made.} \]

According to this formulation a director will be liable for any benefit acquired by virtue of his office, whether or not the advantage was acquired in the exercise of that office. On the other hand, Lord MacMillan described directors as accountable if

(i) what the directors did was so related to the affairs of the company that it can properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors, and
(ii) what they did resulted in a profit for themselves.

Lord Russell of Killowen agreed, and based liability upon the fact that the shares had been acquired by the directors

by reason, and only by reason of the fact that they were directors of Regal, and in the course of their execution of that office.

Liability according to this test only arises if the benefit was acquired by virtue of the director's office as well as in the exercise of that office. At first glance, the decision in Regal appears inequitable, since it favours the

115 At 391 Lord Macmillan described their conduct as having been done "lawfully, in good faith and indeed avowedly in the interests of the company."

116 [1967] 2 AC 134 at 144 per Lord Russell of Killowen.

117 [1942] 1 All ER 378 (HL) at 395.

118 Naudé Maatskappydirekteur 118.

119 [1967] 2 AC 134 at 153. See also Palmer's Company Law 8131.

120 [1967] 2 AC 134 at 147.

121 Naudé Maatskappydirekteur 118. See also Parker v McKenna (1874) 10 Ch App 96 where Lord Cairns LC held that a director would be liable if the benefit was acquired "without the knowledge of his principal, in the course and execution of his agency."
wrong people and does not effect recovery from the right people. This result should be ascribed to the particular facts of the case. Had the change of ownership not taken place, it might well have been equitable to order restoration to the company, on the basis that the rule that directors should not be able to derive secret benefits from their position of trust should apply whether or not any actual loss is suffered by the company, and irrespective of whether the company has been deprived of an opportunity of benefiting itself.

Irrespective of which one of the tests formulated in Regal is applied, the profit must have been made by virtue of the fiduciary position of the director to be recoverable as a "secret profit". All profits acquired by a director during the course and execution of his office or by use of his office are recoverable.

The defendants in Boardman and Another v Phipps were not company directors. They were a trustee and the solicitor to the trust who had acted as agents of the trustees in relation to a company in which the trust had a substantial albeit minority shareholding. This was not proving to be a satisfactory investment. The defendants decided to try to obtain control of the company by making a take-over bid for the other shares and, if that was successful, to make a capital distribution.

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122 Gore-Browne on Companies par 27.031; Gower Company Law 566. On the particular facts, the chairman, who was apparently also the dominant member of the board, had not himself subscribed to shares, but had found subscribers for a certain amount. These shares had been taken up by a personal friend and by two private companies of which he was a member. It was accepted that these parties had subscribed beneficially and not as his nominees. The chairman was therefore held not to be under any liability to account for the profit which they had made. The company's solicitor also escaped liability. Although he had subscribed for shares and profited personally, he could retain the profit because he had acted with the knowledge and consent of the company exercised through the board of directors. The two men most responsible for the scheme thus escaped liability.

123 This would have had the effect of causing the directors' profits to be shared among all the members. Gower Company Law 566 note 96 points out that English law does not have any procedure for "pro rata recovery" by those shareholders who have not profited, such as is recognised by certain American jurisdictions.

124 Gower Company Law 566-567 suggests that it is generally salutary to insist that directors shall not derive secret benefits from their trust. The author further submits that it is probably as well that this should apply whether or not any actual loss is suffered by the company, and whether or not it is deprived of an opportunity of benefiting itself. To allow directors to decide that the company shall not accept the opportunity and then to accept the opportunity themselves may impose too great a strain on their impartiality; Gower Company Law 567. Bastin "Secret Profits" 527 regards it as apparent from this case that the honest director who makes a profit out of his position is to be treated in the same way as the dishonest director. See, however, Jones "Unjust Enrichment" 497, who states that, although the relevant policy considerations in this case were delicately balanced, they were never properly weighed against each other.

125 In this regard, see chapter 9 par 3.2.4.1 below.

126 Parker v McKenna (1874) 10 Ch App 96 at 118; Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 39; Boardman and Another v Phipps [1967] 2 AC 46; [1966] 3 All ER 721; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378, [1967] 2 AC 134.

Since there were inherent problems in using the trust fund in bidding, they sought to obtain the informal consent of all the trustees and beneficiaries to bid on their own behalf and at their own expense. The shares were eventually obtained from the other shareholders and the distribution made. The trust benefited from the scheme, and the defendants made a profit of over seventy five thousand pounds. The court held that the plaintiff, a beneficiary of the trust, was entitled to his fraction of the beneficial interest in that profit, since the defendants had not adequately explained their proposed course of action to him. The importance of the decision lies in the fact that the defendants were considered to be entitled to liberal remuneration for their work and skill, without which the profit would not have been made. Such an equitable allowance will probably only be allowed in exceptional circumstances.128

The secret profit rule applies to, *inter alia*, any secret commission or "bribe" received by a director in the course of negotiating business transactions on the company's behalf,129 any secret benefit acquired by a director in the course of any takeover bid for the company's shares or any reconstruction or amalgamation involving the company,130 and profit derived through the use of confidential information which comes to the director's knowledge through his position on the board.131 Courts have also been especially strict in making directors account for money and shares given to

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128 Gower *Company Law* 569. In *Guinness PLC v Saunders* [1990] 2 AC 663 (HL), [1990] 2 WLR (HL) the court rejected the defendant's plea that he should be entitled to some equitable allowance for his undoubtedly valuable and skilful work. For the various reasons for the refusal by the different courts in which this matter was heard (see *Guinness PLC v Saunders & Ward* [1987] PCC 413 (Ch); *Guinness PLC v Saunders & Another* [1988] 1 WLR 863 (CA; *Guinness PLC v Saunders* [1990] 2 AC 663 (HL), [1990] 2 WLR (HL)), see Gower *Company Law* 569 note 11. The rules pertaining to equitable allowance have not been accepted in South African law. A director would, in similar circumstances, only be able to retain an amount in respect of his services and skill if he could, under one of the recognised enrichment actions, prove that the company has been unjustly enriched to his detriment: Havenga "Profit" 106-107.

129 Boyle & Birds *Company Law* 615; Pennington *Company Law* 586. In *Imperial Mercantile Credit Association v Coleman* (1873) LR 6 HL 189 a director who agreed to place the shares of a railway company with customers of his own company was held accountable to his company for the commission he received from the railway company, because his power to induce the customers to subscribe arose from the business connection he had established with them on his own company's behalf. Similarly, in *Boston Deep Sea Fishing and Ice Co v Ansell* (1888) 39 ChD 339 the court ordered a director to account for commission paid to him by persons with whom he placed orders for goods or services on the company's behalf. The company could not qualify for the commission itself, since it was only paid to a limited class of persons.

130 Boyle & Birds *Company Law* 615. Certain provisions of the Companies Act reinforce this position: Companies Act ss 313-316. Where two companies amalgamated, a director of one of them was held accountable for a share of the remuneration paid to the person who negotiated the amalgamation and which he had given to the director as a present: *General Exchange Bank v Homer* (1870) LR 9 Eq 480.

131 See par 4.6 below.
them by the company's promoters or the vendors of the property or business which the company was formed to acquire.\textsuperscript{132}

Some English commentators have argued that the secret profit rule is applied too strictly.\textsuperscript{133} In respect of corporate opportunities, it has been argued that the courts should move away from the strict accountability of the director who benefits secretly from his position towards the notion of whether he took advantage of a genuine corporate opportunity.\textsuperscript{134} The argument to the contrary is that there is merit in the strict rule at least in respect of directors of large companies and of companies with widely dispersed shareholders. Such directors are generally well-paid fiduciaries.\textsuperscript{135} A strict rule can have the positive effect of encouraging them to do their best for their companies. Since the prohibition is, in any event, only against secret profits, the director is relieved of any possibility of a breach of duty if disclosure is made to and approval obtained of the company in general meeting.\textsuperscript{136}

3.2.2 Trusteeship of the Company's Assets

It was pointed out above that directors are regarded as trustees of company property which is in their hands or under their control.\textsuperscript{137} The primary consequence of this principle of trusteeship is that a director is answerable as a trustee for any misapplication of the company's property in which he participated and which he knew or ought to have known to be a misapplication.\textsuperscript{138} A "misapplication" in this context is a wide concept:

\textsuperscript{132} Pennington Company Law 586-587 and authorities cited.

\textsuperscript{133} Boyle & Birds Company Law 616. The major criticisms are that it penalises the honest and leads to absurd results, especially since the company may receive a windfall. See Jones "Unjust Enrichment" 472ff, who bases his criticisms on the failure by the courts to require a genuine conflict of duty and interest.

\textsuperscript{134} See par 4.3 below.

\textsuperscript{135} As opposed to, for example, the solicitor in Boardman v Phipps (see page 72 above). Boyle & Birds Company Law 617 note 188 indicate that, even if they are not, the court can allow them such remuneration, in effect allowing them to retain part of their profits, as in Boardman v Phipps and in O'Sullivan v Management Agency and Music Ltd [1985] 3 WLR 448 (CA).

\textsuperscript{136} Boyle & Birds Company Law 617. Furthermore, the articles may lessen or exclude the obligation of disclosure (see par 3.4.1 below) and the director can also seek relief under s 727 if he has acted honestly and reasonably (see par 3.4.3 below).

\textsuperscript{137} See chapter 2 par 3.1 and par 3 above.

\textsuperscript{138} Boyle & Birds Company Law 597; Gore-Browne on Companies par 27.6; Selangor United Rubber Estates Ltd v Cradock and Others (No 3) [1968] 1 WLR 1555, [1968] 2 All ER 1073; Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2) [1980] 1 All ER 393 at 405 approved in Rolled Steel Products (Holdings) Ltd v British Steel Corporation and others [1986] 1 Ch 246 at 297-298, [1985] 3 All ER 52.
A misapplication in this context means any disposition of the company's property which by virtue of any provision of the company's constitution or any statutory provision or any rule of general law the company or the board is forbidden or incompetent or unauthorised to make, or which is carried out by the directors otherwise than in accordance with their duty to act bona fide in the interests of the company and for the proper purposes.\textsuperscript{139}

The scope of a director's trusteeship is, moreover, widened by the fact that property which can be misapplied can include property which is not yet vested in the company or in any person on its behalf, but which comes to the directors in circumstances where they are in duty bound, for example through some express or implied mandate, to acquire and hold it for the company's benefit.\textsuperscript{140} Furthermore, the term "property" in this context may cover confidential information of a special and valuable nature (such as secret manufacturing processes and patents, but not mere "know-how"),\textsuperscript{141} and also business advantages such as the opportunity to enter into a favourable contract within the company's existing line of business.\textsuperscript{142} The term "constructive trust" has only fairly recently become part of the usual judicial terminology in this type of company case:

\begin{quote}
[F]rom whatever cause of action the obligation may arise, there can be no doubt that the duty to hold, for the company's account, funds (other than agreed emoluments of his appointment) which a director has acquired as a consequence, direct or indirect, or [sic] being a director, should now be classified as arising from a constructive trust.\textsuperscript{143}
\end{quote}

A fairly recent application of the law of constructive trusts in company law context occurred in \textit{Rolled Steel Products (Holdings) Ltd v British Steel Corporation and Others}.
\textsuperscript{144} The Court of Appeal dismissed, subject to variations to the judge's order, an appeal against the judgment of Vinelott J which had declared invalid a guarantee given by the plaintiff company in favour of another company and had ordered repayment with interest of funds transferred to that company pursuant to the guarantee. From the judgments in this case it is clear that a constructive trust in favour of a company is capable of arising (a) if the company's property has been transferred to another party in a transaction which exceeds the company's corporate

\begin{footnotes}
\item[139] Boyle & Birds Company Law 597; Gore-Browne on Companies par 27.6.
\item[140] Gore-Browne on Companies par 27.6.1; Benson v Heathorn (1842) 1 Y&CCC 326, 63 ER 748; Burland and Others v Earle and Others [1902] AC 83 (PC) at 98-99; Cook v GC Deeks and Others [1916] 1 AC 554 (PC).
\item[141] In respect of confidential information, see par 4.6 below.
\item[142] Burland and Others v Earle and Others [1902] AC 83 (PC); Cook v GC Deeks and Others [1916] 1 AC 554 (PC). On corporate opportunities, see par 4 below.
\item[143] Fox "Constructive Trusts" 26-27.
\item[144] [1986] 1 Ch 246, [1985] 3 All ER 52.
\end{footnotes}
capacity,145 and (b) if its property has been transferred in a transaction which is within the company's corporate capacity but, nevertheless, in abuse of its powers, or has been transferred contrary to procedures prescribed in its articles, or if the transfer has been effected by a director in breach of his fiduciary powers.146 In situations covered by (a) above, a constructive trust will arise irrespective of any notice on the part of the transferee.147 But in the situations covered by (b) above, a constructive trust will only arise in favour of the transferor company if it can show that the recipient had notice, actual or constructive, of the impropriety of the transfer. In the Rolled Steel Products case the recipients of the plaintiff company's property were found to hold it as constructive trustee for that company since the requirements of (b) above were found to have been fulfilled.

3.3 Enforcement of Directors' Duties

The relief sought for breach of duty depends upon the nature of the directors' duties which they are alleged to have broken. The company is usually the plaintiff or applicant to court.148 It sues to enforce a right or a cause of action which is vested in it.149 Since fiduciary duties are equitable in character,150 the relief which should be sought for breaches of these duties are equitable remedies, and will be adapted to the circumstances of the case. Those remedies are injunctions, mandatory injunctions, an order that the defendant shall account to the company for money or assets which belong to it, or which he holds on its behalf, and the award of compensation for loss suffered by the company as a result of the defendants' breaches of fiduciary duties.151 The amount recoverable in an action against directors who have been

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145 See, for example, Precision Dippings Ltd v Precision Dippings Marketing Ltd and Others [1985] 3 WLR 812, for a decision by the Appeal Court in which the recipient of an ultra vires dividend was regarded as a constructive trustee in respect of what had been so received.

146 Fox "Constructive Trustees" 32; Rolled Steel Products (Holdings) Ltd v British Steel Corporation and Others [1986] 1 Ch 246 at 297ff and 304-305, [1985] 3 All ER 52.

147 Rolled Steel Products (Holdings) Ltd v British Steel Corporation and Others [1986] 1 Ch 246 at 302-307 per Browne-Wilkinson LJ, [1985] 3 All ER 52.

148 See par 3.3.1 below.

149 Generally, the form of the litigation initiated by the company is an action commenced by writ. See, in general, Pennington Personal Liability 199.

150 See chapter 2 par 2 above.

151 Pennington Personal Liability 199.
guilty of a breach of fiduciary duty will be either the loss they have caused the company or the profit they have obtained by the breach, whichever is greater.\(^\text{152}\)

Irrespective of the identity of the plaintiff, the estate of an insolvent or deceased director remains liable for any breach of duty he may have committed.\(^\text{153}\) If two or more directors are implicated in the same breach of duty, they are jointly and severally liable.\(^\text{154}\)

### 3.3.1 Enforcement by the Company

It was accepted above\(^\text{155}\) that directors owe their fiduciary duties to the company. If such a duty is breached then the wrong is done to the company, which is a separate legal person from its shareholders and its creditors. The company is therefore the proper person to sue in respect of the breach.\(^\text{156}\) In this regard, the rule in  

\(^{152}\) Pennington Company Law 605. Compensation for material loss appears to be identical with the award of damages at common law and its amount is assessed by the same standards: Pennington Personal Liability 199. The author indicates that, nominally, a claim for damages does not lie for breaches of purely equitable obligations, although, in terms of the Supreme Court Act 1981, s 50 the court has a statutory power to award damages in addition to, or instead of, issuing an injunction in any situation where an injunction would be an appropriate remedy. In fact, the court has always had power in equity to award pecuniary compensation for loss suffered as a result of breaches of equitable obligations. For examples where such awards have been made, see Selangor United Rubber Estates Ltd v Cradock and Others (No 2) [1968] 1 WLR 1555, [1968] 2 All ER 1073; Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2) [1980] 1 All ER 393. But the company does not necessarily have to suffer damages as a result of the conduct of the director: Pennington Company Law 588. An example of this type of situation is where a director obtains a profit by concluding a contract which the company is legally incapable of concluding or which it is prohibited from entering into, such as dealing in its own shares. Parker v McKenna (1874) 10 Ch App 96 at 118 and 124 per Cairns and James LJJ. Pennington Company Law 588 suggests, with reference to Boardman and Another v Philips [1967] 2 AC 46 (HL), that a further example would probably be where the company would not have entered into the transaction because of the opposition of the majority of its board. If directors improperly use the property of the company for their own purposes, they are liable not only for the value of the property, but also for compound interest thereon at such rate as the court deems fit from the date of the misapplication until the date judgment is entered against them. See, for example, Wallersteiner v Moir (No 2) [1975] QB 373 at 388, [1975] 1 All ER 849 (CA).

\(^{153}\) Boyle & Birds Company Law 629; Gore-Browne on Companies par 27.22; Ranskill v Edwards (1885) 31 ChD 100 at 112; Concha v Murietta (1889) 40 ChD 543 (CA) at 553; In re Sharpe [1892] 1 Ch 154 (CA). A discharge in bankruptcy does not release a director from liability for a fraudulent breach of duty (Insolvency Act 1986, section 281(3)) or a claim for a refund of secret profits, for the retention thereof amounts to a breach of trust: Emma Silver Mining Company v Grant (1881) 17 ChD 122 at 128-130.

\(^{154}\) In re Carriage Co-Operative Supply Association (1884) 27 ChD 322 at 331. See also Pennington Company Law 605-606.

\(^{155}\) See chapter 3 above.

\(^{156}\) Templeman "Company Law" 10. See also Pennington Personal Liability 210, where it is indicated that English law does not recognise the right of a third person to enforce obligations or liabilities incurred by a defendant to someone other than himself, even though he is interested in the obligation or liability being fulfilled.
Directors' Fiduciary Duties and Corporate Opportunities

_Foss v Harbottle_ determines that the majority has the right to bar an action by the minority whenever they may lawfully ratify alleged misconduct, and, secondly, that it is normally the exclusive right of the company to sue upon a corporate right of action.

### 3.3.2 Enforcement by Minority Shareholders

Despite the fact that a director's fiduciary duties are generally owed only to the company itself, a minority shareholder may, in certain circumstances, also be entitled to institute proceedings. Since the directors could possibly command a majority in general meeting, the company will often resolve not to institute proceedings against them. To counteract this, English courts have developed a number of exceptions to the rule in _Foss v Harbottle_, whereby shareholders may proceed

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157 This rule derives its name from the case in which it was first clearly established, _Foss v Harbottle_ (1843) 2 Hare 461. It has since "spawned an immense volume of case law and legal literature" (Gower _Company Law_ 643). See, in general, Boyle "Minority Shareholder" 317ff; Farrar _Company Law_ 443ff; _Gore-Browne on Companies_ par 28.2; Gower _Company Law_ 643-662; Wedderburn "Shareholders" 194ff. For a comprehensive list of literature on the rule, which "is notorious among students of company law for the difficulties which lie underneath this simple surface" (Wedderburn "Shareholders" 194), as well as its applications in South African law, see Hahlo _Cases_ 510-511. For justifications of the policy behind the rule by the courts, see _Gray v Lewis_ (1873) 8 Ch App 1035 at 1051; _MacDougall v Gardiner_ (1875) 1 Ch 13 at 25, discussed by Baxter "Role of Judge" 101-105.

158 See _Foss v Harbottle_ (1843) 2 Hare 461 at 491-492 and 494-495. See also _Burland and Others v Earle and Others_ [1902] AC 83 (PC) at 93; _Pavlidis v Jensen_ [1956] 1 Ch 565 at 575. See further the judgment of Jenkins LJ in _Edwards v Halliwell_ [1950] 2 All ER 1064 (CA) at 1066-1069 for the "classic definition of the rule" in _Foss v Harbottle_, which was summarised in _Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2)_ [1982] 1 Ch 204 (CA) at 210-211, [1982] 1 All ER 254 (CA) as follows: "1. The proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is prima facie the corporation. 2. Where the alleged wrong is a transaction which might be made binding on the corporation and on all its members by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of the matter because, if the majority confirms the transaction, cadit quaestio: or, if the majority challenges the transaction, there is no valid reason why the company should not sue. 3. There is also no room for the operation of the rule if the alleged wrong is ultra vires the corporation because the majority of members cannot confirm the transaction. 4. There is also no room for the operation of the rule if the transaction complained of could be validly done or sanctioned only by a special resolution or the like, because a simple majority cannot confirm a transaction which requires the concurrence of a greater majority. 5. There is an exception to this rule where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance would never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue." For criticisms levelled at these propositions, see Gower _Company Law_ 644-664.

159 If the company is in liquidation, it is generally the liquidator who will conduct the action in the name of the company. Enforcement of directors' duties may also, depending upon the circumstances, be conducted by the official receiver, or any creditor or contributory. If the breach of duty falls within the ambit of s 212 of the Insolvency Act 1986, the liquidator, or the official receiver, or any creditor or contributory may be able to invoke the simpler procedure of a summons in the liquidation. On s 212, see chapter 3 note 72 above and par 3.3.3 below.
against the wrongdoers on behalf of the company. However, any shareholder who decides to pursue an action against alleged wrongdoers, whether on his own behalf or on behalf of the company, will find his path fraught with obstacles.\(^{160}\) Even should the shareholder elect to proceed, the judiciary's traditional reluctance to interfere with directors' business judgment or in the company's internal management must be considered.\(^{161}\)

The principal minority shareholder remedies are shareholders' actions by exception to the rule in *Foss v Harbottle*, petitions on the ground of oppression of the minority under sections 459 to 461 of the Companies Act and the powers of the Department of Trade and Industry to investigate companies and to bring proceedings.\(^{162}\) It should, however, be noted that the best option for dissatisfied shareholders is often not litigation, but simply to withdraw their investment from the company by selling their shares.\(^{163}\)

In respect of shareholders' actions, it is clear that a member *qua* member has two distinct types of action.\(^{164}\) He may institute a personal action against the com-

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\(^{160}\) For a comprehensive account of the difficulties faced by minority shareholder litigants, see Sealy "Corporate Litigation" 1ff. See also Farrar *Company Law* 442; Prentice "Peso" 450; Schreiner 'Derivative Action' 214-215, Xuereb *Shareholders* 163; Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2) [1982] 1 Ch 204 (CA), [1982] 1 All ER 254 (CA) (see page 80 below). Previously, one of the largest obstacles to shareholder litigation was posed by the enormous expense which it entailed. This problem has been greatly reduced by the decision in *Wallersteiner v Moir (No 2)* [1975] QB 373 at 403-404, [1975] 1 All ER 849 (CA) at 868-869, that where a shareholder has, in good faith and on reasonable grounds, sued as plaintiff in a minority shareholder's action, the benefit of which if successful will accrue to the company and only indirectly to the plaintiff as a member of the company and which it would be reasonable for an independent board of directors to bring in the name of the company, then the court may order the company to pay the plaintiff's costs. The test to be applied by the court in deciding whether to indemnify the minority shareholders, is whether an independent board of directors, exercising the standard of care which prudent businessmen would exercise in their own affairs, would consider that the shareholders ought to bring their action. In this respect, see also Xuereb *Shareholders* 178.

\(^{161}\) Farrar *Company Law* 442; Sealy "Section 75" 26; Tunc "Judge and Businessman" 554; *Burland and Others v Earle and Others* [1902] AC 83 (PC) at 93; *Hogg v Cramphorn Ltd and Others* [1967] Ch 254 at 268, [1966] 3 All ER 420 at 428; *Howard Smith Ltd v Ampol Petroleum Ltd and Others* [1974] AC 821, [1974] 2 WLR 689, [1974] 1 All ER 1126 (PC) at 1131, [1974] 1 NSWLR 68. By contrast, this reluctance is not observed in French courts: see chapter 6 pars 3.2.1 and 3.2.2 below.

\(^{162}\) The right of a contributory to petition for the winding-up of a company because it is "just and equitable" under s 122(1)(g) of the Insolvency Act 1986, is not included in the discussion. Neither is the right of dissenting shareholders to object to the exercise of statutory powers to alter class rights, to reduce capital or to merge or reconstruct a company.

\(^{163}\) Farrar *Company Law* 442-443.

\(^{164}\) For detailed expositions and critiques of personal and derivative actions, see Boyle & Birds *Company Law* 631ff; Farrar *Company Law* 442ff; *Gore-Browne on Companies* par 28ff; *Gower Company Law* 646ff; Pennington *Company Law* 650ff. See also Drury "Shareholder's Right" 245, who suggests that the position under German and French law, which, in certain circumstances, allows a specified minority to bring an action on behalf of the company, should be followed. In this regard, see chapter 6 page 215 and chapter 7 note 124 below.
pany in respect of a breach of the duties which the company owes to him. Where the same personal right of a number of shareholders has been infringed, a representative action may be brought on behalf of the group. The second type of action is a derivative action, which allows the shareholder pursuit of a cause of action derived from, and exercised on behalf of, the company where the alleged wrongdoers control the company, thereby preventing the appropriate organ from causing the company itself to pursue it.

The difficulties encountered in this area of English company law are apparent from, but not resolved in, the Newman Industries litigation, where the central issue was whether a derivative action can be brought against defendants who do not have voting control of the company on whose behalf the derivative claim is brought and, if it can, in precisely what circumstances such a claim will be allowed to proceed.

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165 It should be noted that in such an instance, where the member has personal rights that have been invaded, the rule in Foss v Harbottle has no application, so that both it and its exceptions are irrelevant: Gower Company Law 660; Smith "Minority Shareholders" 160. See also Heron International Ltd and Others v Lord Grade, Associated Communications Corp plc and Others [1983] BCLC 244 (CA) at 263 where it is stated that "Foss v Harbottle has nothing whatever to do with a shareholder's right of action for a direct loss caused to his own pocket as distinct from a loss caused to the coffers of a company in which he holds shares." Only limited personal rights are, however, recognised by the courts.

166 Farrar Company Law 443.

167 Whether de facto control will be recognised or whether absolute numerical control must be established, is uncertain. See, in general, Farrar Company Law 443; Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257, [1980] 2 All ER 841 (discussed by Sealy "Setback" 247) at 875; Wedderburn "Shareholders 2" 94-95. See also Smith and Others v Croft and Others (No 2) [1988] Ch 114, [1987] 3 All ER 909, where Knox J found it appropriate to consider the views of the remaining, independent shareholders, who made up the majority of the minority shareholders, and who for disinterested reasons did not wish proceedings to continue. According to Xuereb Shareholders 169 "control" usually indicates majority voting control.

168 Farrar Company Law 443; Gower Company Law 647; Pennington Company Law 651ff.

169 See, for example, Gower Company Law 647, where it is indicated that "the fact that there are two possible types of action can cause doubts and difficulties about which is appropriate in the relevant circumstances and whether both can be combined in a single action; and that successful pursuit of the derivative type [of action] is particularly fraught with difficulty ... ."

170 Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 1) [1981] Ch 229; Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2) [1982] 1 Ch 204 (CA), [1982] 1 All ER 254 (CA); Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257, [1980] 2 All ER 841. The litigation arose from a transaction between two associated companies (Newman and TPG), each of which was directly or indirectly a substantial minority shareholder of the other. Bartlett (the chairman and chief executive of Newman, as well as director and non-executive vice-chairman of TPG) and Laughton (the chief executive of TPG and vice-chairman and non-executive director of Newman) wholly-owned a private company holding thirty five per cent of the shares of TPG, which in fact owned twenty five comma six per cent of the shares of Newman. Bartlett and Laughton were therefore likely to face conflicts between their personal interests and their fiduciary duties to each of the two companies in any transaction between Newman and TPG. Since TPG was in financial difficulties, Bartlett and Laughton devised a proposed rescue plan whereby Newman would purchase substantially the whole of TPG's assets (other than its shares in Newman) and take over some of its liabilities. Under the Stock Exchange regulations such a transaction in which the directors were personally interested,
The confusion caused by the decision in *Prudential* caused a leading commentator to comment as follows:

Has company law really been brought to this level of absurdity? What advantage is there to anyone in pretending that the real issues do not matter, and requiring the judge to speculate, on the sketchiest of evidence, about where "control" lies, which shareholders can be supposed "independent", and how such shareholders might be likely to vote at a hypothetical meeting which might itself have to reach decisions on no better evidence?

... The message to minority shareholders is fairly clear: the exceptions to *Foss v Harbottle* are now being drawn far more restrictively than we have customarily assumed, and the cost of finding any path through the legal jungle that surrounds the shareholder's derivative action will be so great as to deter all but the most foolhardy.

Despite the problems encountered when derivative actions are instituted, it is clear that a minority shareholder may institute such an action on behalf of the company against wrongdoers who have been guilty of a breach of their fiduciary duties to the company, if the wrongdoers are able to prevent the company from suing them in its own name because they control a majority of the votes at a general meeting, or because they are otherwise able to prevent a general meeting from resolving that the company shall sue them. A derivative action may therefore also be brought when a corporate opportunity has been usurped.

had to be conditional on approval by the general meeting of both *Newman* and *TPG*. Notices and circulars were sent out accordingly. One of the minority shareholders, *Prudential*, was unhappy about the scheme and the valuation of *TPG's* assets. At *Prudential's* insistence, the meeting was adjourned in order to obtain a bank report from an independent merchant bank. The report was not ready by the adjourned date. The meeting went ahead and the resolution was passed by a small majority. The shares owned directly by *TPG*, Bartlett and Laughton were not voted. In a personal and non-representative action, *Prudential* then claimed that the transaction had not been duly approved at a valid general meeting, because the circular had been complex and misleading. By the time the case reached the courts, *Prudential* probably realised that the claimed declaratory relief would be pointless because it was too late to rescind the transaction. It therefore joined Bartlett and Laughton as defendants and claimed declarations that they had, fraudulently and in breach of their fiduciary duties, conspired to injure *Newman* and its members and were liable to pay damages or equitable compensation. The claim was made in four capacities, namely in a personal action on behalf of *Prudential* alone, in a personal action in a representative capacity on behalf of all the other members of *Newman*, in a personal action against all members (other than Bartlett and Laughton) at the date of the alleged conspiracy, and in a derivative action on behalf of *Newman*. The procedural problems were dealt with by Vinelott J in *Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 1)* [1981] Ch 229. The subsequent trial was reported as *Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2)*.

In the lower court Vinelott J attempted to clarify some of the doubts and confusions encountered in this area of the law. However, as is indicated by Gower *Company Law* 647, the Court of Appeal left his efforts in some disarray.

171 See Sealy "Bleak News" 400.


173 See, for example, *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC), where a derivative action was permitted against directors for profits made by appropriating for themselves a business opportunity...
A breach of the fiduciary duties owed by directors to their company can be ratified, or authorised in advance, by the passing of an ordinary resolution after proper disclosure of the relevant facts.\textsuperscript{174} In the absence of fraud, the ratification or prior authorisation validates what would otherwise have been an unlawful act or transaction. That act or transaction is therefore incapable of being the subject of a minority shareholder's action.\textsuperscript{175} It also appears that, although directors who control shareholders cannot absolve themselves from liability for breaches of duties owed to the company by using their votes as shareholders,\textsuperscript{176} the other shareholders may ratify or authorise the act in question by a resolution on which the directors who are alleged to have breached their fiduciary duties do not vote.\textsuperscript{177} However, if directors exercise their powers \textit{mala fide} or for an improper purpose, this not only constitutes a breach of duty to the company, but is a matter of which the minority is entitled to complain,\textsuperscript{178} since a \textit{mala fide} exercise of directors' powers is not ratifiable.\textsuperscript{179}

The second remedy available to oppressed minority shareholders is that of a petition under sections 459 to 461 of the Companies Act 1985. Section 459 provides that a member of a company may apply to the court by petition for an order on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members,\textsuperscript{180} or that any actual or proposed act or omission of the company, including an act or omission which the company would otherwise have enjoyed. See also par 4 below.

\textsuperscript{174} Pennington \textit{Company Law} 661; Smart "Confidential Information" 467; \textit{Lagunas Nitrate Co v Lagunas Syndicate Ltd} [1899] 2 Ch 392; \textit{Regal (Hastings) Ltd v Gulliver} [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) (see page 69 above); \textit{Bamford v Bamford} [1970] Ch 242 (CA) at 241, [1969] 2 WLR 1107. It should also be remembered that under English law, "a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a particular interest in the subject-matter of the vote": \textit{Burland and Others v Earle and Others} [1902] AC 83 (PC) at 94.

\textsuperscript{175} Gore-Browne on Companies par 28.2; Pennington \textit{Company Law} 661; \textit{Burland and Others v Earle and Others} [1902] AC 83 (PC); \textit{Dominion Cotton Mills Company Limited and Others v George E Amyott and Others} [1912] AC 546 (PC) at 552; \textit{Pavilides v Jensen} [1956] 1 Ch 565; \textit{Heyting v Dupont and Another} [1964] 1 WLR 843, [1964] 2 All ER 273 (CA); \textit{Bentley-Stevens v Jones and Others} [1974] 1 WLR 638 at 640-641, [1974] 2 All ER 653, discussed by Baxter "Irregular Meetings" 326.

\textsuperscript{176} \textit{Attwool v Merryweather} (1867) LR 5 Eq 464n; \textit{Cook v GC Deeks and Others} [1916] 1 AC 554 (PC) at 564.

\textsuperscript{177} Pennington \textit{Company Law} 661.

\textsuperscript{178} \textit{Alexander v Automatic Telephone Company} [1900] 2 Ch 56 (CA); \textit{In re Smith and Fawcett, Limited} [1942] 1 Ch 304 (CA).

\textsuperscript{179} \textit{Cook v GC Deeks and Others} [1916] 1 AC 554 (PC). See also par 4.8 below.

\textsuperscript{180} The applicant must, at least, be included in this group.
on its behalf, is or would be so prejudicial.\(^{181}\) This section replaced section 210 of the Companies Act 1948, which was considered to operate too restrictively.\(^{182}\) The precise meaning of the reference to "unfair prejudice" in section 459 is still somewhat uncertain, but it is clear that the petitioner does not have to establish the infringement of a shareholder’s right given by some other aspect of company law.\(^{183}\)

Breaches of directors’ fiduciary duties may establish unfair prejudice to minority shareholders, at least in a private company and in a small public company.\(^{184}\) The misappropriation of corporate assets clearly falls within the ambit of the section.\(^{185}\)

If the court is satisfied that a petition in terms of section 459 is well founded; it may make such order as it thinks fit for giving relief in respect of the matters complained of.\(^{186}\) In particular, the court may regulate the conduct of the company’s affairs in the future, or require the company to refrain from doing or continuing an act complained of by the petitioner, or to commit an act which the petitioner has complained it has omitted to do.\(^{187}\)

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\(^{181}\) Section 459(1). The provisions pertaining to unfairly prejudicial conduct also apply to non-members to whom shares in the company have been transferred or transmitted by operation of law: s 459(2).

\(^{182}\) Report of the Company Law Committee (Jenkins-Report) 1962, Cmnd 1749 76 par 206. Under s 210 a court could grant relief if the affairs of the company were being conducted in a manner oppressive to some part of the members. In earlier decisions oppressive conduct was defined in fairly general terms. See, for example, George Young Elder and Others v Elder & Watson Limited (1952) SC 49; Re Harmer Ltd [1959] 1 WLR 62 at 78. In later cases, s 210 was interpreted somewhat restrictively. See, for example, Scottish Co-operative Wholesale Society Ltd v Meyer and Another [1959] AC 324, [1958] 3 All ER 66 (HL); In re Jernyn Street Turkish Baths Ltd [1971] 1 WLR 1042 (CA). Even the commission of a serious breach of fiduciary duty by a director would not amount to oppression: Gore-Browne on Companies par 28.12. On s 210 generally, see Bastin “Minority Protection” 230; Brown “Corporate Governance” 945; Prentice “Protection of Minority Shareholders” 124; Rajak “Managing Director” 156. For a comprehensive discussion of s 459, see Boyle & Birds Company Law 649-658; Gore-Browne on Companies par 28.12-28.20; Farrar Company Law 462ff; Gower Company Law 662-665; Pennington Company Law 666-679. See also Boyle “Part XVII Companies Act 1985” 23ff.

\(^{183}\) Gore-Browne on Companies par 28.13. See also Oosthuizen “Statutère Minderheidsbeskerming” 223ff; Van Rooyen “Minderheidsbelange” 268ff for a comparison with the equivalent s 252 of the South African Companies Act.


\(^{185}\) In re London School of Electronics Ltd [1986] Ch 211, [1985] BCLC 273.

\(^{186}\) Section 461(1).

\(^{187}\) Section 461(2)(a) and (b).
A further option available to minority shareholders is to apply for the investigation of the affairs of a company by the Department of Trade and Industry.\(^{188}\) As a result of these inquiries, or of a report published by the inspectors, the Department has the power to bring proceedings on behalf of the company or to petition for a winding-up order.

The grounds upon which the affairs of a company may be investigated include that the company's business is being conducted with intent to defraud its creditors or the creditors of any other person, or otherwise for a fraudulent or unlawful purpose or in a manner which is unfairly prejudicial to some part of its members, or that any actual or proposed act or omission of the company (including any act or omission on its behalf) is or would be so prejudicial,\(^{189}\) that persons concerned with its formation or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards it or towards its members,\(^{190}\) or that the company's members have not been given all the information with respect to its affairs which they might reasonably expect.\(^{191}\)

3.3.3 Misfeasance Proceedings

A company director may be made liable for a breach of fiduciary duty by misfeasance proceedings in the company's winding up. In the winding up an application may be made to the court\(^{192}\) by the official receiver, the liquidator or by any creditor or, with leave of the court, by any contributory\(^{193}\) for an order that, \textit{inter alia}, any present or past officer of the company or any other person who has taken part in the management of the company, and who has misapplied or retained or become accountable for any money or property of the company, or has been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company, shall repay with interest at the rate ordered by the court, restore or account for the money or property or any part of it, or shall contribute such sum to the company's

\(^{188}\) Companies Act 1985, s 431ff as amended by the Companies Act 1989. The Department possesses comprehensive powers to appoint inspectors or to conduct its own investigations by more informal inquiries. For a comprehensive discussion of the powers of the Secretary of Trade and Industry in this regard, see \textit{Gore-Browne on Companies} pars 28.21-28.32; Pennington \textit{Company Law} 686ff.

\(^{189}\) Section 432(2)(a) and (b).

\(^{190}\) Section 432(2)(c).

\(^{191}\) Section 432(2)(d).

\(^{192}\) The court is the court which has jurisdiction to wind up the company: Companies Act 1985, s 744.

\(^{193}\) Any present or past member of the company is a contributory: Insolvency Act 1986, s 74(1) and s 79(1).
assets by way of compensation for the misfeasance or breach of duty as the court thinks just.\textsuperscript{194}

Misfeasance proceedings may be brought with leave of the court by a member even though he could not bring a derivative action.\textsuperscript{195} But the proceedings may only be instituted when the company itself could have sued the respondent in an action commenced by writ.\textsuperscript{196} A member can therefore not enforce a right which vests in him personally by this means.\textsuperscript{197} Furthermore, even if an action could be brought by the company itself, it does not always follow that misfeasance proceedings may be resorted to, since not all rights of action vested in a company may be enforced by misfeasance proceedings.\textsuperscript{198}

In misfeasance proceedings a court may only order the return of property to the company, or the payment of compensation for damages for losses wrongfully inflicted on it.\textsuperscript{199} Such proceedings may therefore be brought to recover a secret profit from a director, even though the company has not suffered any loss, because the profit belongs to the company, and the director is accountable for it.\textsuperscript{200}

Should a respondent in misfeasance proceedings be found guilty of a breach of duty to the company which has caused it loss, the court has a discretion in the determination of the amount of compensation which he is ordered to pay to the company. It need not require the respondent to make good the whole of the resulting loss.\textsuperscript{201}

A member will only be permitted to bring misfeasance proceedings by the court if he has an interest in the property or in compensation claimed being returned or paid to the company. Such an interest will only exist if the company is solvent.\textsuperscript{202}

\textsuperscript{194} Insolvency Act 1986, s 212(1), (3) and (5). See, in general, Farrar \textit{Company Law} 718; Pennington \textit{Company Law} 683-686; Pennington \textit{Personal Liability} 206-207.

\textsuperscript{195} For example, because there has been no fraud or oppression by the majority shareholders, or because the respondents are not in control of the company.

\textsuperscript{196} \textit{In re Canadian Land Reclaiming and Colonizing Company, Coventry and Dixon's Case} (1880) 14 ChD 660.

\textsuperscript{197} Pennington \textit{Company Law} 684; \textit{In re Hill's Waterfall Estate and Gold Mining Company} [1896] 1 Ch 947 at 953.

\textsuperscript{198} \textit{In re Etic Limited} [1928] Ch 861. The claims enforceable in this way are limited to those which satisfy certain conditions in respect of their nature and the persons against whom they are made.

\textsuperscript{199} Insolvency Act 1986, s 212(3).

\textsuperscript{200} Pennington \textit{Company Law} 684; \textit{In re North Australian Territory Company, Archer's Case} [1892] 1 Ch 322 at 339 per Lindley LJ.

\textsuperscript{201} Pennington \textit{Company Law} 685.

\textsuperscript{202} Pennington \textit{Company Law} 686.
If a right of action vested in a company in liquidation cannot be enforced by misfeasance proceedings, it must be enforced by an action brought in the company's name by the liquidator. It cannot be enforced by a derivative action brought by a member after the commencement of the liquidation without the liquidator's authorisation. Should the liquidator decline to sue in the company's name, a creditor or present or past member of the company may apply to the court for an order that he shall do so.

Misfeasance proceedings will therefore be an option available to the company in instances where corporate opportunities have been usurped, either because the opportunity is regarded as "property" of the company, or under the general provision of section 212(1) that any fiduciary duty owing to the company was breached.

3.4 Exemption from or Indemnification against Breaches of Duty

A director who is prima facie liable for a breach of his duties may be relieved from liability in a number of ways. They are consent of the shareholders, ratification, provisions in the articles, discretionary relief from liability by the court and limitation of actions. Consent by the shareholders and ratification are discussed below. Provisions in the articles of association, discretionary relief from liability by the court and limitation of actions are briefly discussed in this paragraph.

3.4.1 Provisions in the Articles

Prior to the 1948 Act it was generally accepted that provisions in articles might effectively exempt officers of the company from liability to it, provided that they were not guilty of fraud or wilful default. But section 310 of the Companies Act 1985, which is the successor to section 205 of the Companies Act 1948, provides that any provision which purports to exempt a director against any liability which would otherwise attach to him in respect of any negligence, default or breach of duty or breach of trust of which he may be guilty in relation to the company, is void.

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203 Insolvency Act 1986, s 165(3) and s 167(1).
204 *Fargro Ltd v Godfroy and Others* [1986] 3 All ER 279 at 282-283.
205 Insolvency Act 1986, s 112(1) and s 167(3).
206 See par 4.2 below.
207 See par 4.8 below.
208 *In re City Equitable Fire Insurance Company Limited* (1925) Ch 407 at 430-431 and 474.
209 Section 310 provides: "(1) This section applies to any provision, whether contained in a company's articles or in any contract with the company or any person (whether an officer or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of 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. (2) Except as provided for by the following subsection, any such provision is void." It is arguable that the reference to a provision contained "or otherwise" in subsection (1) is apt to cover aspects of the
Exceptions are allowed in respect of indemnification of an officer who is a successful defendant in civil or criminal proceedings, or who successfully applies for relief under section 144, or section 727. Apparently the exempting provision is only invalid if it is to operate in the future.

Precisely which provisions in articles are covered by section 310 has been the subject of considerable discussion. The problem with the application of the section arose because Table A, which is the model form of articles of association, contains provisions which appear to modify and even partly to exclude the duties of directors. These articles have statutory authority and must therefore be valid. The question then arose whether, and if so to what extent, articles adopted by companies which do not exactly follow the Table A articles, are valid.

This problem was considered in Movitex Ltd v Bulfield. It was held that the increasingly common professional negligence insurance policies taken out by companies on behalf of their directors, and thus technically renders them void: Asif "Section 310" 209ff; Boyle & Birds Company Law 626 note 245. The argument that "otherwise" includes shareholder resolutions which ratify breaches of duty is regarded as less convincing by the authors. On the interpretation of s 310, see also Gower Company Law 572 note 29. On the Companies Act 1948, s 205, see Gregory "Section 205" 413. See further chapter 9 par 3.3 below in respect of the corresponding s 247 of the South African Companies Act 61 of 1973.

Section 310(3), inserted by s 137 of the Companies Act 1989.

Subsections 144(3) and 144(4) provide for relief from liability for the acquisition of a company's shares for the nominee, and a subscriber or director respectively.

See page below.

Pennington Company Law 603.

Sealy "Exempting Articles" 217. On the similar problem in respect of Companies Act 1948, s 205, see Baker 'Disclosure of Interests' 186; Birds "Articles Excluding Duties" 394; Gregory "Section 205" 413; Parkinson "Modification" 335.

In both the 1948 and the 1985 Companies Acts.

Boyle & Birds Company Law 626 and Gore-Browne on Companies par 27.21.2 cite articles 78 and 84 of the 1948 version and articles 85 and 94 in the 1985 Table A as examples. See also Gower Company Law 574; Sealy "Exempting Articles" 217-219.

Boyle & Birds Company Law 626; Gore-Browne on Companies par 27.21.2. Their validity has been assumed in authoritative decisions such as Hely-Hutchinson v Brayhead Ltd and Another [1967] 3 All ER 98 and Guinness PLC v Saunders [1990] 2 AC 663 (HL), [1990] 2 WLR (HL), but this aspect was not discussed in Movitex Ltd v Bulfield (1986) 2 BCC 99,403, which is discussed below.

(1986) 2 BCC 99,403. The company had articles which were similar, although a little more comprehensive, than article 84 of the 1948 Table A. They permitted a director to have interests in and profit from transactions in which the company was interested, provided that he disclosed his interest to his fellow directors and, in most instances, did not vote on the matter. If he did vote, his presence was not to be counted in the quorum. In certain circumstances, a director could vote and be so counted. The difference between these articles and article 84 of the 1948 Table A and article 94 of the 1985 Table A is that the number of circumstances where voting was permitted, was greater.
articles were valid and did not infringe section 205 of the 1948 Act.\textsuperscript{219} The court recognised that there was a difficult point of construction to be resolved in reconciling the articles with the section. The argument that articles could rewrite the content of directors' duties as long as they did not purport to exempt directors from liability for breaches of duty not ratifiable by the general meeting or from breaches of duties which arose from a mandatory rule of statute, was rejected. Vinelott J distinguished between the general equitable principle which forbids directors to put themselves in a position where their duty to the company might conflict with their own interest and which obliges them to promote the interests of the company, and when those interests conflict with his own to prefer the interests of the company. The court held that the equitable principle referred to above was not a duty in the strict sense of the word, but merely a disability.\textsuperscript{220} It therefore did not fall within the ambit of section 310. The company could thus exclude the general principle in its articles, in effect providing that specified situations did not give rise to a conflict of duty and interest, provided that it did not exclude the duties of directors properly so-called.\textsuperscript{221}

From this decision, it would seem that the non-excludable duties of directors are those obligations which seek to prevent a director from damaging the interests of the company.\textsuperscript{222} The duty not to misappropriate company property is probably included.\textsuperscript{223} The general rule imposing accountability for secret profits,\textsuperscript{224} as well as that avoiding a transaction which involves a conflict of duty and interest, would, however, be excludable, as long as the director acts in good faith.\textsuperscript{225}

The conclusions of Vinelott J in \textit{Movitex} indicate that section 310 and exclusions by articles such as article 85 of Table A cannot be reconciled without producing undesirable results. One suggested solution is to insert sections with provisions similar to article 85 into the Companies Act and to amend s 310 so as to exclude from its ambit any transactions permitted under those sections.\textsuperscript{226}

\textsuperscript{219} Now s 310.

\textsuperscript{220} The court referred to \textit{dicta} in \textit{Tito and Others v Waddell and Others} (No 2) [1977] Ch 106, [1977] 3 All ER 129.

\textsuperscript{221} See also Boyle & Birds \textit{Company Law} 627; Gore-Browne on \textit{Companies} par 27.21.3; Gower \textit{Company Law} 573.

\textsuperscript{222} Gore-Browne on \textit{Companies} par 27.21.3.

\textsuperscript{223} Boyle & Birds \textit{Company Law} 627; Gore-Browne on \textit{Companies} par 27.21.3.

\textsuperscript{224} See, however, Boyle & Birds \textit{Company Law} 627 note 256 where it is pointed out that Vinelott J erroneously assumed in \textit{Movitex} that liability for secret profits is imposed only when there is a conflict of duty and interest.

\textsuperscript{225} Boyle & Birds \textit{Company Law} 627. In note 257 the authors indicate that this corresponds with the intentions of the Greene Committee (Cmnd 2627, 1925) as reflected in paragraphs 46 and 47 of its report.

\textsuperscript{226} Gower \textit{Company Law} 574.
3.4.2 Release by Agreement

Before the introduction of section 310, the court found that a director could be released from liability for a particular breach of duty by an appropriately worded agreement with the company. It had to be apparent that the company was fully aware of the nature and extent of the breach. A release of this nature is akin to a settlement or compromise of an action and would presumably not fall within the terms of section 310. The agreement would therefore be valid.

3.4.3 Discretionary Relief from Liability by the Court

A court which has found a director or other officer liable for negligence, default, breach of duty or breach of trust is permitted to relieve him from liability, wholly or in part on such terms as the court deems fit. Three requirements have to be satisfied. The court must be satisfied that he has acted honestly, reasonably and that he ought, in the particular circumstances, fairly to be excused. Whether he

227 See par 3.4.1 above.

228 *Re Joint Stock Trust and Finance Corporation Ltd* (1912) 56 SJ 272. However, in *Boulting and Another v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606 (CA) at 626 Denning MR thought that "no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties or to act inconsistently with them."

229 *Gore-Browne on Companies* par 27.21.4.

230 In *New Zealand Netherlands Society 'Oranje' Incorporated v Kuys and Another* [1973] 1 WLR 1127 (PC), [1973] 2 All ER 1222 at 1225 (see also page 97 below), it was admitted that Kuys was a fiduciary of a Dutch residents' society, and that he had obtained ownership of a certain newspaper while he held this position and by virtue of it. In the appeal from the judgment of the Court of Appeal of New Zealand, Lord Wilberforce held that it would be possible for the society to release him from accountability and to allow him to keep the ownership of the newspaper for himself. This could only be done by an arrangement freely arrived at and with full disclosure of all relevant matters.

231 Section 727(1) states: If in any proceedings for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by a company as auditor (whether or not he is an officer of the company) it appears to the court hearing the case that that officer or person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as it thinks fit. On the corresponding s 248 of the South African Companies Act 61 of 1973, see chapter 9 par 3.3 below. See also the Trustee Act 1925 (15 & 16 Geo 5 c 19), s 61 from which this section is borrowed. On this section, see *Halsbury's Laws of England* Vol 48 221ff. For general applications of s 727 and its predecessors (Companies (Consolidation) Act 1908, s 279, Companies Act 1929 (c 23), Companies Act 1948, s 448) see *In re Claridge's Patent Asphalte Co Ltd* [1921] 1 Ch 543; *In re Duomatic Ltd* [1969] 2 Ch 365; *Re J Franklin & Son Ltd* [1937] 4 All ER 43 at 46; *Selangor United Rubber Estates Ltd v Cradock and Others (No 3)* [1968] 1 WLR 1555, [1968] 2 All ER 1073. See also *Palmer's Company Law* 8144-8146.
ought "fairly to be excused" is a matter for the court’s discretion in each case.\textsuperscript{232} A
director may apply to the court for relief under this section,\textsuperscript{233} which is applicable
only in respect of his liability to his company or duties imposed under the Com­
panies Act.\textsuperscript{234} However, a director cannot claim relief under the section where he is
in possession of the company’s property as constructive trustee,\textsuperscript{235} nor can the sec­
tion be pleaded as a defence to a claim of wrongful trading under section 214 of the
Insolvency Act 1986.\textsuperscript{236}

### 3.4.4 Limitation of Actions

Proceedings against a director for breach of duty are barred after the lapse of
six years,\textsuperscript{237} unless the claim is founded upon any fraud or fraudulent breach of
trust,\textsuperscript{238} or is to recover trust property or the proceeds thereof still retained by the
director,\textsuperscript{239} or previously received by him and converted to his own use.\textsuperscript{240} A claim in
respect of appropriation of corporate opportunities would therefore not be barred
under this Act.

## 4 CORPORATE OPPORTUNITIES

### 4.1 Introduction

The fiduciary obligation owed by a director to his company obliges him to act
in its best interests.\textsuperscript{241} Consequently, a director must not, without the informed con-

\textsuperscript{232} \textit{Re J Franklin & Son Ltd} [1937] 4 All ER 43 at 46.

\textsuperscript{233} Section 727(2).

\textsuperscript{234} It cannot be used to seek relief from liability for default imposed on a company director by other
2 All ER 697 (CA) at 702.

\textsuperscript{235} \textit{Guinness PLC v Saunders} [1990] 2 AC 663 (HL), [1990] 2 WLR (HL). Boyle & Birds \textit{Company
Law} 628 note 260 consider it surprising that the equivalent s 61 of the Trustee Act 1925 was not at least
pleaded in \textit{Regal} (see page above). See also Birds “Articles Excluding Duties” 397.

\textsuperscript{236} \textit{Re Produce Marketing Consortium Ltd} (1989) 5 BCC 399. In respect of s 214, see chapter 3 note 45
above.

\textsuperscript{237} Limitation Act 1980 (c 58), s 21.

\textsuperscript{238} In such a case there is no limit on the time within which the director may be sued: Limitation Act
1980, s 8(1).


\textsuperscript{240} Limitation Act 1980, ss 21 and 23; \textit{In re Lands Allotment Company} [1894] 1 Ch 617 (CA).

\textsuperscript{241} See par 3.1 above.
sent of the company, use for his own profit the company's assets, opportunities or information. The director is thus sometimes under an obligation to acquire economic opportunities for his company if he acquires them at all. If he obtains these opportunities for himself it is said that he acquired a "corporate opportunity".

Abuse of corporate assets normally does not pose any particular problems. The only problem that may arise, is to establish what is regarded as an "asset", and to what extent this concept overlaps with a corporate "opportunity" or "corporate information". The latter two concepts are likely to overlap and have proved to be problematic areas of company law. No separate body of rules dealing with the problem of directors usurping their company's business opportunities exists in English company law. However, it is recognised under the general law pertaining to fiduciaries that, if a director appropriates for his personal profit a business opportunity which the company would otherwise have obtained, he is accountable for that profit. Such conduct is regarded as a contravention of the broad principle that no-one who is subject to a fiduciary duty "shall be allowed to enter into engagements in which he has, or can have a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect".

242 Gower *Company Law* 564. Every director usually realises that he should not use the property of the company as if it were his own. In this regard, see *Guinness PLC v Saunders* [1990] 2 AC 663 (HL), [1990] 2 WLR (HL), discussed by Havenga "Profit" 95ff and RMM "Editorial" 178.


244 Afterman *Company Directors and Controllers* 82.

245 *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC); *Fine Industrial Commodities Limited v Powling* (1954) LXXI RPC 253 at 262; *Thomas Marshall (Exporters) Ltd v Guinle* [1979] Ch 227 at 245, [1978] 3 All ER 193. See further the statement of Vice-Chancellor Malins in *Imperial Mercantile Credit Association v Coleman* (1873) LR 6 Ch 558 at 563 that "It is of the highest importance that it should be distinctly understood that it is the duty of directors of companies to use their best exertions for the benefit of those whose interests are committed to their charge, and that they are bound to disregard their own private interests whenever a regard to them conflicts with the proper discharge of such duty", which was quoted with approval in *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL) at 388, [1967] 2 AC 134 (HL) at 149 and *Fine Industrial Commodities Limited v Powling* (1954) LXXI RPC 253 at 262.

246 *Aberdeen Rail Co v Blaikie Bros* (1854) 1 Macq 461 at 471-472, (1854) 2 Eq Rep 1281 (HL). See also Bastin "Secret Profits" 527; *North-West Transportation Company, Limited and James Hughes Beauty v Henry Beauty* (1887) 12 App Cas 589 at 593; *George Bray v John Rawlinson Ford* (1896) AC 44 (HL) at 51-52; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL) at 381, [1967] 2 AC 134 (HL) at 137; *Boulting and Another v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606 (CA) at 635; *New Zealand Netherlands Society 'Oranje' Incorporated v Kays and Another* [1973] 1 WLR 1127 (PC) at 1129, [1973] 2 All ER 1222 at 1225; *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399 (PC) at 400.
The secret profit rule is sometimes treated as the Commonwealth’s version of the corporate opportunity doctrine recognised in the United States of America. In the first instance, it extends to all kinds of fiduciary relationships, including non-commercial relationships, whereas the corporate opportunity doctrine applies only to commercial fiduciary relationships. Furthermore, the secret profit rule extends to all kinds of collateral profits, whereas the corporate opportunity doctrine deals only with the exploitation of business opportunities. A further distinction lies in the fact that a director does not always gain knowledge of a corporate opportunity by virtue of his directorship. Secret profits, on the other hand, are gained at least by virtue of the director's position as such.

Before reviewing the English case law on this issue, the concept "corporate opportunity" must be defined.

4.2 Definition of a Corporate Opportunity

Although English authorities refer widely to the concept of a "corporate opportunity", the term is less frequently defined. Farrar describes a corporate opportunity as a corporate asset which the directors cannot therefore appropriate to their own use. But Sealy warns against too readily accepting the concept of an "opportunity" as property. Gower merely indicates that corporate information and corporate opportunities are likely to overlap.

It appears that any business opportunity which the company would otherwise have obtained and which is acquired by a director for his own private profit, is

247 See par 3.2.1 above.
248 Austin "Accountability" 149. In respect of the corporate opportunity doctrine, see chapter 5 par 6 below.
249 Austin "Accountability" 149.
250 The solicitor-client relationship in Boardman and Another v Phipps [1967] 2 AC 46 (HL) (see page 72 above) is an example of such a non-commercial relationship.
251 See chapter 5 par 6 below.
252 See par 4.2 below.
253 See pages 72 above and 94 below.
254 Farrar Company Law 422.
255 Sealy Cases 269. See also Bean "Corporate Opportunities" 272.
256 Gower Company Law 565.
regarded as a "corporate opportunity" and renders the director accountable for the profit he makes from it. The opportunity can pertain to material or immaterial property. Thus, in Cranleigh Precision Engineering Ltd v Bryant and Another a director who had developed an invention on the company's behalf, but had discovered the existence of a patent which might prevent his company from exploiting the development, was held accountable to his company when he resigned his directorship, obtained an exclusive licence under the patent from the patentee, and formed a new company to manufacture the patented product with the development added to it. Similarly, a director will be liable if he solicits orders from his company's customers for the benefit of a competing company in which he is interested, or obtains supplies for the competing company from the first company's regular suppliers over whom he has acquired influence as a result of his directorship.

An "opportunity" denotes a chance, occasion, happening or suitable circumstance. The concept of appropriation of a corporate opportunity is therefore presumably wider than the acquisition of a particular asset, for example where a director has a specific mandate to acquire a particular asset. Should the director acquire such an asset for himself rather than for the company, his accountability arises under the secret profit rule.

4.3 Case Law

Court decisions clearly illustrate the questions and problems which arise in this area of law.

In Cook v GC Deeks and Others three directors of a private company who held a majority shareholding between them, appropriated an opportunity to enter into a lucrative business contract. It was evident that the opportunity had only pre-

257 Pennington Company Law 587.
258 See page 91 and authorities cited in notes 245 and 246 above.
260 See also Fine Industrial Commodities Limited v Powling (1954) LXXI RPC 253. Here the company was unable to continue the manufacture of a product, but its plant was suitable for manufacturing an alternative product. It was held that a director who devised an invention which would enable the transformation to be carried out and patented it personally, had thereby made himself a trustee of the patent for the company. The specific opportunity was not mentioned in the objects of the company.
262 Collins New World Thesaurus 424; Webster Encyclopedic Dictionary of the English Language 664.
263 See par 3.2.1 above. See also Beck "O'Malley" 787 where it is indicated that the Canadian corporate opportunity doctrine is not circumscribed by any notion of "commission or mandate to purchase". In respect of the Canadian law, see chapter 8 par 3.4 below.
264 [1916] 1 AC 554 (PC).
sented itself to them because of their position. The directors then purported to ratify their breach of duty. The court held them liable to account to the company for the profits derived from the contract on the ground that the contract "belonged in equity to the company and ought to have been dealt with as an asset of the company".\textsuperscript{265} Moreover, since there was bad faith on the part of the directors, the breach was considered non-ratifiable.\textsuperscript{266} The court found that the directors were guilty of a distinct breach of duty in the course they took to secure the contract, and that they should therefore be regarded as holding it on behalf of the company.\textsuperscript{267} It made it clear that it regarded the benefit of the contract as property which in equity belonged to the company. Buckmaster LC confirmed the importance of avoiding the establishment of rules as to directors' duties which would impose upon them burdens so heavy and responsibilities so great that men of good position would hesitate to accept the office. But, warned his lordship:\textsuperscript{268}

Men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.

Circumstances such as those encountered in \textit{Regal}\textsuperscript{269} and \textit{Cook v Deeks} did not require a separately developed doctrine of corporate opportunity. The secret profit rule, which is applied strictly by English courts,\textsuperscript{270} sufficed. But there are circumstances where a corporate opportunity doctrine, or a variant of it, is needed, for example where a company director benefits from the exploitation of an opportunity which falls within the general line of business of the company, but where knowledge of such opportunity was acquired in a capacity other than that of director.\textsuperscript{271} This was the situation in \textit{Industrial Development Consultants Ltd v Cooley},\textsuperscript{272} where action was brought against a director, who had retired from his company with the specific aim of concluding contracts for which he had been negotiating on behalf of the com-

\textsuperscript{265} At 563.

\textsuperscript{266} On ratification generally, see par 4.8 below.

\textsuperscript{267} At 563.

\textsuperscript{268} \textit{Ibid}.

\textsuperscript{269} See page 69ff above.

\textsuperscript{270} See par 3.2.1 above.

\textsuperscript{271} Prentice "Doctrine" 465.

\textsuperscript{272} [1972] 1 WLR 443, [1972] 2 All ER 162. This case is comprehensively discussed by Prentice "Cooley" 623ff. For other comments on the decision, see Collier "Duties" 222; Rajak "Managing Director" 655; Yoran "Director's Liability" 187.
pany.273 The court held that the director was accountable to the company for the whole of his benefits under the contract or, alternatively, liable in damages for breach of his service contract.274 Roskill J referred to the *dictum* of Lord Blanesburgh in *Bell and Another v Lever Brothers Limited and Others*275 that:

> The liability of a director in respect of profits made by him from a contract in which his company also is concerned is one thing; his liability, if any there be, in respect of his profits from a contract in which the company has no interest at all is quite another. ... In the second case, the company has no concern in his profit and cannot make him accountable for it unless it appears - this is the essential qualification - that in earning that profit he has made use either of the property of the company or of some confidential information which has come to him as a director of the company.

Liability in this case was based on misuse of information rather than loss of opportunity.276 This is presumably so because the chance that the company could successfully have pursued the opportunity itself was so remote.277 It was considered irrelevant that the approach had been made to the director and that his services were specifically required as an individual consultant free from any association with the company. Roskill J opined that

> [information which came to him while he was managing director and which was of concern to the plaintiffs and relevant for the plaintiffs to know, was information which it was his duty to pass on to the plaintiffs.]278

It follows that, even if the defendant had not used the information himself he could have been liable in damages for his failure to disclose.279 Although the plaintiffs in

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273 Briefly stated, the facts are as follows: Cooley, an architect, was the managing director of the plaintiff company, which was in business as building and development consultants. As the representative of the company, he negotiated with the Eastern Gas Board, attempting to secure contracts for the company to build four large depots. The negotiations were unsuccessful, because the Board would not engage a firm of consultants. A short time afterwards, they offered the work to Cooley in his private capacity. Cooley falsely represented ill health, obtained a release from his company, and subsequently concluded the contract with the Gas Board on his own behalf.

274 The latter amount would have been relatively small, because the likelihood that the company would have been able to secure the contract for itself was so remote.


276 On the difference between these two concepts, see par 4.2 above. On confidential information, see also par 4.6 below.

277 Gower *Company Law* 567. Roskill J assessed it at no more than ten per cent ([1972] 1 WLR 443 at 454, [1972] 2 All ER 162 at 176).


279 Gower *Company Law* 567. This raises the question what his liability would have been, had he been a director of two companies to each of which the information was relevant. On multiple directorships, see par 4.7.1 below.
this case received a benefit which they would in all probability not have obtained if
the director had fulfilled his duty to them, this was considered preferable to the
alternative outcome, that the defendant would have made a large profit as a result
of having put himself into a position in which his duty to the company and his own
interests conflicted.280

Most commentators regard the outcome of the decision in Cooley as correct.281
The circumstances would clearly have satisfied the narrower of the American prin­
ciples, namely the expectancy test, as the plaintiff company had developed an interest
in the specific opportunity which the directors had appropriated.282 The decision
reflects an application of the inflexible equitable rule that a fiduciary cannot benefit
from his position without, at least, full disclosure having been made to and approval
having been obtained from his principals.283 But it can also be argued that the deci­
sion goes further, and that the defendant was liable because of his failure to trans­
mit to the plaintiffs information which was of commercial value to them.284 This
argument not only has inherent shortcomings, but would also have far-reaching
effects. A major problem with the argument is the lack of certainty about the
measure of recovery. There would be no benefit accruing to the director, although
in many instances loss may be suffered by the company. It would, in such circum­
stances, be patently unfair to hold a director accountable for all potential profits
which might have accrued to the company on the supposition that the company
would have been able to exploit the economic opportunity in question.285 It has been
indicated in South African law that a delictual claim for an omission which caused


281 They indicate that there can hardly be much argument as to the propriety of the application of the
equitable fiduciary rules in similar circumstances. See, for example, Boyle & Birds Company Law 617
note 184; Collier "Duties" 222. See, however, Rajak "Managing Director" 661, who contends that the
decision in Cooley is correct, but would find more rational expression within the doctrine of unjust
enrichment. The author also submits that it is arguable that the relationship between Cooley and the
plaintiff company was akin more to that of employer and employee than to that of director and com­
pany.

282 Prentice "Doctrine" 466. On the American corporate opportunity doctrine and its applications, see
chapter 5 par 6 below.

283 Prentice "Cooley" 625 points out that such an inference could be made if one accepts that Cooley's
liability to account only arose because he personally benefited and that the mere failure to transmit the
information about the approach to him, without the element of improper profit making, would not, by
itself, have constituted a breach of duty. Support for this point of view can be found in the statement by
Roskill J that the defendant "was putting himself into the position in which the duty to his employers,
the plaintiffs and his own private interests conflicted and conflicted grievously" ([1972] 1 WLR 443 at
452-453, [1972] 2 All ER 162 at 175).

284 Prentice "Cooley" 626, who indicates that this interpretation would make the case a dramatic con­
tribution to extending the scope of directors' fiduciary duties in that it would recognise an affirmative
duty on directors to promote actively the interests of their companies. The author opines that there are
dicta in the judgment by Roskill J which amply justify this broader interpretation.

285 Prentice "Cooley" 626.
pure economic loss could succeed after dissolution of the company.\(^{286}\) Even if loss could be shown and quantified, it would probably not resort under a restitutionary claim for breach of fiduciary duty. The claim should thus rather be for damages and not for an accounting of profits. The effect of the broader interpretation would, furthermore, eliminate the accepted corporate practice of a person holding more than one directorship, at least where the companies are in the same line of business. It would also preclude a director from carrying on a business in competition with his company.\(^{287}\)

Even the "narrower" interpretation of *Cooley* represents a considerable development in English law on the reach of fiduciary duties imposed on company directors. In previous cases there was always a strong connection between the position of director and the opportunity to make an improper profit. *Cooley* holds the director accountable for profits arising from the exploitation of a business opportunity which fell within the general line of business of the company in which he served as a director, but where the holding of the office of director in no way contributed to the making of the profit.\(^{288}\) This approach has been recommended, since it would often be difficult to determine exactly in what capacity a director received information which is of potential use to the company.\(^{289}\) Permitting such a distinction also presents a director with obvious temptations. The result of *Cooley* is that "the English law on corporate opportunity could now be formulated in a manner similar to its American counterpart."\(^{290}\)

The decision in *New Zealand Netherlands Society 'Oranje' Incorporated v Kuys and Another*\(^{291}\) indicates that a director may secure a release or immunity from potential accountability by proper negotiation with a competent organ of the company.\(^{292}\) Kuys had been the secretary of a Dutch residents' society and the editor of its newsletter for several years. When the newsletter ceased publication because of financial problems, it was decided to form a new society of which Kuys was to be the

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\(^{286}\) *McLelland v Hulett* (1992) 1 SA 456 (D). See also chapter 9 page 335 below.

\(^{287}\) As is indicated by Prentice "Cooley" 627, this might not be such a bad thing. On multiple directorships and confidential information see pars 4.6 and 4.7 below.

\(^{288}\) Prentice "Cooley" 629.

\(^{289}\) Prentice "Cooley" 629 note 28 points out a prior, unsuccessful, attempt by Roskill J to distinguish between a situation where a director entering into a contract with his company acted in his private capacity and not as director. In *Hely-Hutchinson v Brayhead Ltd* [1967] 2 All ER 14, affirmed in *Hely-Hutchinson v Brayhead Ltd* [1967] 3 All ER 98 the attempted distinction was not pursued on appeal.

\(^{290}\) Prentice "Cooley" 629. The author (at 632) also indicates that the decision will make it well nigh impossible for a director to carry on a competitive business with the company of which he is a director. The position under American law is discussed in chapter 5 par 6 below.


\(^{292}\) Sealy *Cases* 271. The officer in question was the secretary of an incorporated, non-profitmaking society.
secretary and one of the committee members. It was also agreed that a newspaper would be produced. The newspaper would be Kuys' property. For the first six months the society would support the paper by taking a certain amount of copies for its members. Subsequently Kuys left the society, which then decided to publish a rival newspaper under the same name. Kuys was granted an injunction restraining the society from this action. The court held that, notwithstanding any fiduciary position in which he might stand towards the society, Kuys had effectively been given a dispensation from any duty in regard to the newspaper venture by the terms of the agreement. He was therefore not under any obligation to hold the newspaper or its title on trust for the society.

The director in Island Export Finance Ltd v Umunna and Another was allowed to keep the profit which he had derived from contracts that he had obtained for himself after he had resigned as the managing director of his company. The contracts, to supply postal boxes to the Cameroons postal authorities, were of the same nature and made with the same party, as an earlier contract which the director had secured for the company while working as it managing director. But Hutchinson J accepted evidence that the company was not actively seeking further orders either when the director resigned or when he later obtained the contracts and that his resignation had been for unrelated reasons. He had also not made use of any confidential information.

In Balston Limited and Another v Headline Filters Limited and Another an employee and director of a company gave notice terminating his employment and resigned his directorship. He had already agreed to lease premises where he intended to set up his own business, but had, according to the evidence, not yet decided what that business would be. Shortly afterwards one of the company's customers telephoned the director after having been notified by the company that it would continue to supply him with a particular kind of filter tube for only a limited further period. As a result of the call, the ex-director commenced business making the particular kind of filter tube and supplied them to the customer. Falconer J held that it was not a breach of duty for a director to form the intention to set up business in competition with his company after his directorship had ceased. There had also not been any maturing business opportunity which the director had improperly diverted to himself.

The cases discussed above indicate various problematic areas in the law relating to corporate opportunities. The effect of the director's resignation, rejection of the opportunity or the inability to pursue it, and the relationship between corporate opportunities and misuse of confidential information merit further investigation. Other aspects which pose problems are to what extent ratification absolves the director from liability and to what extent the law on competition between a director and his company is affected by the law on corporate opportunities. These aspects are investigated below.

293 [1986] BCLC 460.
294 (1990) 17 FSR 385.
4.4 Corporate Opportunities and Former Directors

A director's fiduciary duties attach from the date when his appointment takes effect. There have been indications that they do not necessarily terminate when the appointment ends. In *Island Export Finance Ltd v Umunna and Another,* Hutchinson J warned that, if this were not the case, a director might with impunity conceive the idea of resigning to exploit some opportunity of the employees and, having resigned, proceed to exploit it for himself.

The contrary view is that the director's fiduciary duties do come to an end on the termination of his directorship, otherwise than as a result of the director's breach of his service contract. It is submitted that this is correct. Former directors are not fiduciaries, since they no longer hold the position from which they derive their fiduciary duties. A former director who obtains a profit by reason of his past association with the company, is therefore not guilty of any breach of duty to the company and is not accountable to it. But if the director is guilty of a breach of duty while an officer of the company, and completes the transaction by which he makes a profit after resigning by doing further acts which would amount to breaches of fiduciary duties if he were still a director, the company may recover the whole profit from him. Therefore, if a director's resignation is influenced by a desire to acquire an opportunity for himself, or where his position with the company, rather

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296 [1986] BCLC 460 at 480. See page 98 above.

297 See also *Balston Limited and Another v Headline Filters Limited and Another* (1990) 17 FSR 385 at 410-411. For the facts of the case, see page 98 above. The court confirmed that mere investigation of the possibility of setting up a business in competition with one's employer is not a breach of fiduciary duty (at 404). In *casu* there had been no maturing business opportunity which had caused the director to resign (at 411). The director had therefore not breached his fiduciary duty to the company.


300 See chapter 2 above on the basis of the fiduciary position.

301 Pennington *Company Law* 589.

302 Pennington *Company Law* 589-590. It is suggested that this led to the decisions in *Cranleigh Precision Engineering Ltd v Bryant and Another* [1965] 1 WLR 1293, [1964] 3 All ER 289; *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.
than an independent initiative, led him to the opportunity, he remains precluded from taking that opportunity.

4.5 Rejection of the Opportunity or Inability to Pursue It

The question arises whether directors and officers are prohibited from taking all opportunities which come their way, or whether a more limited restriction applies.303 In Regal304 the question posed, but left unanswered, was whether a director who pursues an opportunity with his own financial resources after the directors have bona fide decided not to invest their company's funds in it, is accountable to the company for any profits which he may make.305 The decision in that case seems to suggest that he may be liable.306 It was indicated that the director would be liable if the profit or opportunity was acquired by reason of his position as director and in the course of his fiduciary relationship.307 A strict application of the fiduciary principles applied in this decision would deny a director any opportunity which came to him because of his position as director.308 This approach concentrates on the capacity of the profiteer, rather on an examination of the nature of the particular opportunity.309

303 Farrar Company Law 361. Mayson, French & Ryan Company Law 441 suggest that there would be different limits where a company director pursues one of its corporate opportunities while remaining a director than would be the case where a former director of a company pursues one of the company's corporate opportunities after leaving the company. In this regard see also par 4.4 above.

304 Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 391, [1967] 2 AC 134 (HL) at 152 per Lord Russell of Killowen. See page 69ff above.

305 On the particular facts it was unnecessary to consider this question, since it had been the original intention of the directors that the company should acquire all the shares in the subsidiary itself.

306 Farrar Company Law 362; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 386, [1967] 2 AC 134 (HL) at 144. Lord Russell of Killowen confirmed that "[T]he rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends upon a fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff." See also the dicta by Lord MacMillan and Lord Porter referred to on page 71 above. In Peso-Silver Mines Ltd v Cropper (1966) 58 DLR (2d) 1, discussed in chapter 8 par 3.4.2 below, the Canadian Supreme Court decided otherwise. The directors of a company who had decided not to pursue the opportunity because of strained finances and other reasons, were found not liable to the company for having acquired the opportunity for themselves. See also Queensland Mines Ltd v Hudson (1978) 52 ALJR 399, discussed in chapter 8 par 3.4.6 below, where the court indicated that it had to be shown that the director had acted in a way which demonstrated that there was a real possibility of conflict between his interests and those of the company.

307 See page 71 above for the different formulations by their lordships. It should, however, be noted that the decision in Regal is an application of the secret profit rule, rather than one on corporate opportunities.

308 Afterman Company Directors and Controllers 82.

309 Farrar Company Law 361.
Similarly, one of the defences raised in *Cooley*\(^{310}\) was that the defendant should not be held accountable since the Eastern Gas Board would not have entered into any contractual relationship with the plaintiff company.\(^{311}\) This defence was rejected, even though the rejection had the effect of conferring on the plaintiffs a benefit which it is unlikely they would have got for themselves had the defendant complied with his duty to them.\(^{312}\)

A more flexible approach was followed by Hutchinson J in *Island Export Finance Ltd v Umumma and Another*.\(^{313}\) The court found no breach of fiduciary duty in the particular circumstances. Both the "opportunity" and the "capacity" approaches were considered in this decision.\(^{314}\) The former, more flexible, approach was specifically endorsed.\(^{315}\) It has been suggested that this will lead to the development of a more flexible doctrine which, in keeping with other jurisdictions, will go beyond the capacity of the individual concerned to examine the nature of the opportunity in question.\(^{316}\)

Commentators have indicated that, from the point of view of policy, there is much to be said in favour of a more flexible approach. They argue that it could be unwise to place the honest and diligent director in the same category as the dis-

\(^{310}\) See page 94 above. Roskill J held that Cooley had only one capacity at the particular time and that was as the managing director of the plaintiff company. Information which came to him during this time and which was of concern to the plaintiff and relevant to the company to know was information which he had to pass on to the company because of his fiduciary position.

\(^{311}\) 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 ([1972] 1 WLR 443 at 484, [1972] 2 All ER 162 at 176).

\(^{312}\) 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" ([1972] 1 WLR 443 at 483, [1972] 2 All ER 162 at 175). Prentice "Cooley" 630 submits that there are sound policy reasons why this defence in Cooley was rejected, for 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.

\(^{313}\) [1986] BCLC 460. See also page 98 above. Hutchinson J applied the reasoning of Laskin J in the Canadian Supreme Court in *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371, discussed in chapter 8 par 3.4.2 below.

\(^{314}\) The court considered the defendant's capacity as the former managing director of the company, as well as the nature of the opportunity. Hutchinson J found that although the director may on resignation have contemplated generally that the Cameroon authorities might be a source of business for his own company, the exploitation of that opportunity had not been his primary, nor an important motive for his resignation. He had also not actively been pursuing business with the Cameroon authorities at the time when the contracts came his way. There had therefore not been any "maturing business opportunity" ([1986] BCLC 460 at 482).

\(^{315}\) At 483.

\(^{316}\) Bastin "Secret Profits" 527-528; Farrar *Company Law* 362; Weinrib "Fiduciary Obligation" 7.
honest one.\textsuperscript{317} Other arguments have, nevertheless, also had to be considered. Courts are reluctant to become involved in issues where principles of business are involved.\textsuperscript{318} Directors may, furthermore, be subjected to a temptation to refrain from exerting their strongest efforts on behalf of the company.\textsuperscript{319} To allow directors to retain profits made in these situations also seems to strike at the foundation of the role which they should play within the company.\textsuperscript{320} A fourth consideration is that, even though the board may have rejected an opportunity, a director who subsequently takes personal advantage of it, will still be in a position in which his personal interests and duty conflict. The reason is that, in most instances, a possibility remains that, notwithstanding the initial rejection, the opportunity could again be offered to the board and that the company may then be in a position to reconsider its earlier rejection of it. It has also been argued that, where a subsequent approach is made to a director in his personal capacity, he is, at least where he has been seeking to obtain the opportunity for his company, under a duty to disclose the information to his company, since it is of concern to the company and is relevant for the company to know.\textsuperscript{321} Other solutions to the problem have been suggested. One recommendation is that different rules should apply depending upon whether the company is a public company or a small private company.\textsuperscript{322} It has also been suggested that in fact no rules are required at all. This viewpoint 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 of executives who deflect corpo-

\footnotesize{317 Bastin "Secret Profits" 528. See also \textit{Cook v GC Deeks and Others} [1916] 1 AC 554 (PC) (see page 93 above) at 563, and \textit{Bames 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."

318 Bastin "Secret Profits" 528.

319 Bastin "Secret Profits" 528 warns that this could open the way to fraud and weaken the confidence which ordinary men should have in dealing with registered companies.

320 Bastin "Secret Profits" 528. In \textit{Imperial Mercantile Credit Association v Coleman} (1871) 6 Ch App 558 at 567-568 Lord Hatherley confirmed that "[t]he company have a right to the services of their directors, whom they remunerate by considerable payments; they have a right to their entire services, they have a right to the voice of every director .... And the general rule that no trustee can derive any benefit from dealing with those funds of which he is a trustee applies with still greater force to the state of things in which the interest of the trustee deprives the company of the benefit of his advice and assistance."


322 Farrar \textit{Company Law} 363 suggests that public companies should be covered by a categorical rule in view of, \textit{inter alia}, their widely dispersed shareholdings and the adequate managerial compensation schemes in those companies. The authors opine that private companies, on the other hand, 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 \textit{Company Law} 617; Brudney & Clark "Corporate Opportunities" 997.
rate assets to themselves by shareholders.323

4.6 Corporate Opportunities and Confidential Information

It was seen above that the secret profit rule extends to profit derived through the use of confidential information which comes to the director's knowledge through his position on the board.324 It was also pointed out that confidential information of a special and valuable nature may be regarded as "property" over which the director exercises trusteeship in favour of the company.325 Examples of this type of confidential information are secret manufacturing processes and patents, but not mere "know-how".326

In Boardman and Another v Phipps327 the House of Lords did not draw a clear distinction between a constructive trust and a duty to account as a result of the misuse of confidential information. Lord Guest stated:

... I have no hesitation in coming to the conclusion that the appellants hold the Lester and Harris shares as constructive trustees and are liable to account to the respondent.328

But their lordships differed on whether information should be regarded as property. Lord Cohen held:329

Information is, of course, not property in the strict sense of the word and ... it does not necessarily follow that because an agent acquired information and property while acting in a fiduciary capacity he is accountable to his principals for any profit that comes his way as a result of the use he makes of that information and opportunity.

323 Farrar Company Law 364. In respect of the American law, see also Wolfson "Critique" 980-982 and chapter 5 par 8 below.

324 See par 3.2.1 above.

325 See par 3.2.2 above.

326 Saltman Engineering Co Ltd v Campbell Engineering Co Ltd (1984) [1983] 3 All ER 413n, 65 RPC 203 (the information was in connection with drawings of tools for the manufacture of leather products); Heyting v Dupont and Another [1964] 1 WLR 843, [1964] 2 All ER 273 (CA); Cranleigh Precision Engineering Ltd v Bryant and Another [1965] 1 WLR 1293, [1964] 3 All ER 289; Boardman and Another v Phipps [1967] 2 AC 46; [1966] 3 All ER 721 (HL). It is interesting to note that in the Regal-case (see page 69 above) no argument on confidential information as company property was heard. But, as is indicated by Smart "Confidential Information" 466, by 1942 the very idea that confidential information could be property had not yet been accepted.

327 [1967] 2 AC 46 (HL). See also page 72 above.

328 At 117. See also Carrian Investment Ltd (in liquidation) v Wong Chong-po [1986] HKLR 945, referred to by Smart "Confidential Information" 465-466, where Boardman was specifically relied on to prove a constructive trust where confidential information had been misused.

329 At 102-103.
In relation to such "property", the positions of directors, ordinary employees and other fiduciary agents are virtually the same. But in Baker v Gibbons the court stated that the duty not to misuse confidential information applies with particular force as between a director and his company. A director, after having been dismissed from the board, attempted to persuade four of the company's selling agents to leave the company and join his own competing business. The court held that he was not in breach of duty, because the names and addresses of the agents, which he had simply memorised, did not constitute confidential information.

In Thomas Marshall (Exports) Ltd v Guinle a company involved in manufacturing and marketing clothing was granted an interlocutory injunction restraining its former managing director from disclosing confidential information. The information included details of the company's manufacturers and customers, prices paid by the company, the company's new ranges, current negotiations, and samples. Megarry VC considered what constitutes confidential information. Acknowledging that it is difficult to make a general statement in this regard, the learned judge discerned four elements which may be of assistance in identifying confidential information or trade secrets in an industrial or trade setting:

First ... the information must be information the release of which the owner believes would be injurious to him or of advantage to his rivals or others. Second, I think the owner must believe that the information is confidential or secret, ie that it is not already in the public domain. It may be that some or all of his rivals already have the information: but as long as the owner believes it to be confidential I think he is entitled to try and protect it. Third, I think that the owner's belief under the two previous heads must be reasonable. Fourth, I think that the information must be judged in the light of the usages and practices of the particular industry or trade concerned.

A company which finds itself in the same situation as Regal would therefore have two possible claims. It could claim that the directors were accountable having placed themselves in a position of conflict of duty and interest. Alterna-

330 Gore-Browne on Companies par 27.6.1.
331 [1972] 1 WLR 693 at 700.
333 See also Balston Limited and Another v Headline Filters Limited and Another (1990) 17 FSR 385 (see page 98 above for the facts of the case) where the court held that a former director who during his seventeen years of service with the company had inevitably become very knowledgeable about the process of making fibre tubes had not misused confidential information in his subsequent manufacture of similar tubes.
334 At 248.
335 See page 69ff above.
336 Smart "Confidential Information" 466.
337 This is what happened in Regal.
tively, it could claim that the directors, having used company property in the form of confidential information, became constructive trustees of any profit made thereby. This latter claim has the disadvantage that the confidential nature of the information would have to be established.\textsuperscript{338}

If profits derived from confidential information are regarded as belonging in equity to the company, ratification of the act by which the profits were derived would amount to giving away the company's assets.\textsuperscript{339} It seems, however, that misuse of confidential information is capable of ratification by the company in general meeting. In \textit{Boardman v Phipps}\textsuperscript{340} it was accepted that profits gained from confidential information might with the appropriate approval be retained by the fiduciary:

In the present case the knowledge and information obtained by Boardman was obtained in the course of the fiduciary position in which he placed himself. The only defence available to a person in such a fiduciary position is that he made the profit with the knowledge and assent of the trustees.\textsuperscript{341}

Only a use of confidential information, which is both \textit{bona fide} and not at the company's expense, does not give rise to a minority shareholder action.\textsuperscript{342}

\subsection*{4.7 Corporate Opportunities and Competition}

The acquisition of personal profit by a director frequently stems from a patent abuse of his powers for his own benefit.\textsuperscript{343} It is less easy to determine his accountability for profits earned by carrying on a business of his own in competition with the company. \textit{Prima facie} he is not accountable, unless the terms of his service contract preclude him from competing, because competing with his company does not of itself amount to a breach of duty by a director.\textsuperscript{344} But he is accountable if he uses the

\textsuperscript{338} Smart "Confidential Information" 466 mentions the additional disadvantage that the complexities arising out of \textit{Boardman v Phipps} would inevitably increase the cost of any litigation.

\textsuperscript{339} Smart "Confidential Information" 467.

\textsuperscript{340} [1967] 2 AC 46 at 117; [1966] 3 All ER 721 (HL).

\textsuperscript{341} In \textit{Queensland Mines Ltd v Hudson and Others} (1978) 52 ALJR 399 (PC) this was confirmed by the Privy Council. A managing director was permitted to retain profits made from the exploitation of a certain mining licence, even though the relevant information and opportunity had initially arisen from his position as managing director. See also chapter 8 page 283 below.

\textsuperscript{342} On ratification, see par 4.8 below. See also \textit{Daniels v Daniels} [1978] Ch 406 at 414, [1978] 2 All ER 89 where Templeman J held that a minority shareholder who has no other remedy may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company.

\textsuperscript{343} Pennington \textit{Company Law} 587.

\textsuperscript{344} Farrar \textit{Company Law} 420; Pennington \textit{Company Law} 587; \textit{London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd} [1891] WN 165, approved in \textit{Bell and Another v Lever Brothers Limited and Others} [1932] AC 161 (HL) at 195.
company's property or trade secrets, or his knowledge of the company's customers,345 or, possibly, any special skill acquired by him while engaged in the company's business346 in order to carry on his own rival concern.347 When he ceases to be a director of the company, his duty not to use any special skill or knowledge of the company's affairs comes to an end.348

It was noted above that the Cadbury Committee recommended that the majority of non-executive directors of a company should be free from any business or other relationship which could materially interfere with the exercise of their independent judgment.349 Such a director would therefore not be able to compete with his company or to be a director of a rival company.

4.7.1 Multiple Directorships

Whether the no-conflict rule prohibits a person from being a director of competing companies is unclear.350 In London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd351 Chitty J refused to restrain a director who had never acted as a director or attended a board meeting of the plaintiff company from acting as director of the competing defendant company. Lord Blanesburgh LC considered this case as authority for a general statement that a director is normally free to be a director of a competing company in Bell and Another v Lever Brothers Limited and Others352 But in Scottish Co-operative Wholesale Society Ltd v Meyer and Another353 Lord Denning considered directors of a textile company to be in breach of their duty by continuing their association with a co-operative society when that society set up its own rayon department.354

345 Measures Bros Ltd v Measures [1910] 2 Ch 248.

346 Hivac Limited v Park Royal Scientific Instruments Limited and Others [1946] Ch 169, [1946] 1 All ER 350. In this case the competition was entered into by an ordinary employee of the company.

347 See also Balston Limited and Another v Headline Filters Limited and Another (1990) 17 FSR 385 discussed on page 98 and note 333 above.


349 See par 2.2.1 above.

350 Palmer's Company Law 8128.

351 [1891] WN 165

352 [1932] AC 161 (HL) at 195.


354 Palmer's Company Law 8129 submits that this view is more in line with the principle applied to employees and trustees proper.
It does not constitute a breach of fiduciary duty by a director if he, while a
director, forms the intention of entering into business in competition with his com­
pany and takes the preliminary steps towards implementing that intention.355 His
action may not, however, involve the exploitation of any opportunity which belongs
in equity to the company, nor may he misuse confidential information.356

4.8 Corporate Opportunities and Ratification

It was seen above that a breach of the fiduciary duties that directors owe to
their company can be ratified or, apparently, authorised in advance, by the passing
of an ordinary resolution after proper disclosure of the relevant facts.357 In the
absence of fraud, the ratification or authorisation then validates what would other­
wise have been an unlawful act or transaction.358 This may be so although the trans­
action relates to the ordinary management of the company and is therefore
primarily a matter for the board of directors.359 Consequently, the activities of gen­
eral meetings may indirectly extend over the whole sphere of the company's opera­
tions, and ultimate control may revert to shareholders who are free from duties of
good faith to which the directors are subject.

355 Palmer's Company Law 8129. See also Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty)
Ltd and Others 1981 (2) SA 173 (T), discussed in chapter 9 par 4.3 below.

356 Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162; Balston
Limited and Another v Headline Filters Limited and Another (1990) 17 FSR 385. But see also the
remarks pertaining to the recommendations of the Cadbury Committee in par 4.7 above.

357 See page 81 above. Bax "Ratification" 16 indicates that the doctrine of ratification is not only
recognised by the courts, but is also a necessity in the context of modern commercial life.

358 Boyle & Birds Company Law 623; Gore-Browne on Companies par 27.21.1; Gower Company Law
592; Parkinson "Modification" 337.

359 Gower Company Law 592; William Irvine v The Union Bank of Australia (1877) 2 App Cas 366
(PC) at 375; Grant v United Kingdom Switchback Railways Company (1888) 40 ChD 135 (CA) at 138­
139; Hogg v Cramphom Ltd [1967] Ch 254 at 269-270, [1966] 3 All ER 420; Bamford v Bamford [1970]
Ch 212 (CA) at 238. See also the obiter comment in Rolled Steel Products (Holdings) Ltd v British Steel
Corporation [1986] 1 Ch 246 at 296 that: "First, if an act is beyond the corporate capacity of a company
it is clear that it cannot be ratified ... However, the clear general principle is that any act that falls
within the corporate capacity of a company will bind it if it is done with the unanimous assent of all the
shareholders or is subsequently ratified by such consent." Slade LJ held that this principle is not
unqualified. In particular, it will not enable the shareholders of a company to bind the company itself to
a transaction which constitutes a fraud on its creditors ((1986) 1 Ch 246 at 296). This view is supported
ChD, discussed by Burke "Ratification" 240ff. Hoffmann J confirmed (at [1989] PCC 376) that a breach
of duty on the part of the directors would be binding upon the company if it is approved or sub­
sequently ratified by the shareholders, subject to the exceptions created by the general law. The return
of a company's capital to its shareholders without the leave of the court or the adoption of a special
procedure constituted one such exception, and amounted to a fraud on the creditors (at 378). See also
Re Halt Garage (1964) Ltd [1982] 3 All ER 1016 at 1023.
Ratification of directors' conduct should be distinguished from the exercise of a power by the general meeting, where the meeting validly performs the relevant act itself, as opposed to approving its prior performance by the board. The ratification takes place by an ordinary resolution taken by shareholders. The notice summoning a meeting for this purpose should make it clear that the purpose or one of the purposes of the meeting is to sanction the relevant conduct of the director. Should such disclosure not be made, the notice may be held insufficient and the resolution ineffective. The director may, generally, vote upon any shares that he holds in favour of his conduct being sanctioned, provided that this does not constitute "fraud" or "oppression". Consequently, directors who have de facto con-

360 The general meeting is regarded as having power to act in the place of the board if for any reason the board cannot function. For instance, if a proper quorum cannot be obtained at a directors' meeting or there is a deadlock on the board, the general meeting may act instead: Barron v Potter [1914] 1 Ch 895 at 903; Foster v Foster [1916] 1 Ch 532; Alexander Ward & Co Ltd and Another v Samyang Navigation Co Ltd [1975] 1 WLR 673 (HL) at 683.

361 In this instance, the ratification applies to the consequences of the breach of duty. According to Boyle & Birds Company Law 623 note 227 the locus standi of a minority shareholder to challenge the validity of the resolution may well turn upon the distinction. See also Bamford v Bamford [1970] Ch 242 (see page 67 above) and Xuereb Shareholders 75, where it is indicated that the action by the general meeting in Bamford amounts to ex post facto approval given by virtue of the meeting's inherent power to ratify a voidable act performed in excess of authority, and not the exercise by the meeting of any residual power to allot shares.

362 In Peters' American Delicacy Company Limited v Heath and Others (1939) 61 CLR 457 at 503-504 the High Court of Australia described the position of a shareholder as follows: "Primarily a share in a company is a piece of property conferring rights in relation to distributions of income and of capital. In many respects the proprietary rights are defined by the articles of association, and it is easy to see that a power of alteration might be used for the aggrandisement of a majority at the expense of a minority. ... The shareholders are not trustees for one another, and, unlike directors they occupy no fiduciary position and are under no fiduciary duties. They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage. No doubt the exercise of the right affects the interests of others too ...."

363 Kaye v Croydon Tramways Company [1898] 1 Ch 358 (CA) at 369-370.

364 Beck "Corporate Opportunity" 233; Boyle & Birds Company Law 624; North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty (1887) 12 App Cas 589 (PC) at 601; Burland and Others v Earle and Others [1902] AC 83 (PC) at 94; Hogg v Cramphom Ltd [1967] Ch 254, [1966] 3 All ER 420. In Northern Counties Securities Ltd v Jackson & Steeple Ltd [1974] 1 WLR 1133 at 1146, [1974] 2 All ER 625 (Ch) the court held that although, in order to comply with an undertaking given by the company to the court, the directors were bound to advise the shareholders to vote for a resolution, they, as shareholders, could vote against it if they chose to do so. See, however, the views of Vinelott J in Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257, [1980] 2 All ER 841 at 862-863. See further Beck "Corporate Opportunity" 238 where it is suggested that there is no reason why the rule in Beatty should apply to cases where the taking of a corporate opportunity is being sanctioned: "The courts should insist that the directors' acts be approved by a majority of disinterested shareholders. 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. The denial of his shareholder vote to a director would be no more than the application to corporate affairs of the commandment that no man should be seen to be a judge in his own cause."
trol can sometimes disregard their fiduciary duties, provided that they openly disclosure what they propose to do, and force a confirming resolution by the exercise of their own votes supplemented, if necessary, by their control of the proxy voting machinery.365

If all the shareholders are present at a meeting and unanimously give their assent to a proposal, it does not matter that no formal proposal was put to the vote.366 It would also appear that, if all the shareholders have given their consent to a proposal, it is also not necessary that they should have held a meeting.367 A breach of duty by directors which is ratifiable by ordinary resolution is therefore equally ratifiable by the informal approval of every member who would have the right to vote on such a resolution.368

Certain dicta in recent cases indicate that the principle of unanimous approval goes further than this and that, given before or subsequent to the breach, it would be effective to relieve a director from liability for any breach of duty, provided only that the breach is not ultra vires the company369 and does not involve a fraud on its

365 Gower Company Law 592-593; Xuereb Shareholders 176.
366 Boyle & Birds Company Law 457; Re Express Engineering Works [1920] 1 Ch 466 (CA).
367 Boyle & Birds Company Law 457. See Parker and Cooper v Reading [1926] Ch 975 and In re Duomatic Ltd [1969] 2 Ch 365 at 373 for instances where the members of a company were held to have informally ratified acts by directors although no shareholders’ meetings had been held. In these cases, the acts had been beyond the powers of the directors. The Duomatic decision establishes that all that is required is the unanimous assent of the shareholders with the right to vote (see [1969] 2 Ch 365 at 373 where Buckley J states: “I proceed upon the basis that where it can be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to some matter which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be.”). Boyle & Birds Company Law 457 point out that it is, of course, only in small private companies that the informal agreement of all the shareholders is likely to occur. In The Attorney-General for the Dominion of Canada v The Standard Trust Company of New York [1911] AC 498 (PC) at 504-505 and In re Innes & Co, Limited [1903] 2 Ch 254 (CA) it was suggested that the rule as to the effect of unanimous consent should be confined to such companies as a matter of legal principle.
369 In respect of breaches of duty which are beyond the capacity of the company, s 35, as inserted by s 108 of the Companies Act 1989, should be noted. This section effectively abolishes the doctrine of ultra vires in as far as third parties are concerned. However, the directors’ duty to observe any limitations on their powers flowing from the company’s memorandum, is expressly preserved. A resolution which ratifies action by the directors which would, but for this section, be beyond the company’s capacity may only be ratified by the company by special resolution. In respect of s 35, see Farrar Company Law 95-100; Gore-Browne on Companies par 27.21.2; Gower Company Law 175-182; Pennington Company Law 97ff. See also page 69 above.
creditors.\textsuperscript{370} Ratification in this context probably merely indicates that the company waives its right to sue a director.\textsuperscript{371}

Clearly some restraint should operate in respect of the power of those able to command a majority vote, and, in some instances, the courts will in fact intervene to annul the resulting resolution.\textsuperscript{372} Not all breaches of duty are ratifiable. If the wrong is ratifiable, the minority is precluded from bringing a derivative suit.\textsuperscript{373} The distinction between ratifiable and non-ratifiable wrongs is, however, not always very clear,\textsuperscript{374} nor is it governed by any very consistent principle.\textsuperscript{375} Some types of breach have been expressly established as ratifiable. They include failing to disclose an

\textsuperscript{370} In re Horsley and Weight Ltd [1982] Ch 442 (CA) at 454, [1983] 3 WLR 431 at 442 per Buckley LJ; Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd and Others [1983] Ch 258 at 269 and 289-290, [1983] 3 WLR 492 (CA) at 519, [1983] 2 All ER 563 (CA) (the \textit{dicta} of Cumming Bruce and Templeman LJ in \textit{Horsley} at 455 and 456, which appear to be to the contrary effect, were disapproved in this case); Rolled Steel Products (Holdings) Ltd v British Steel Corporation [1986] 1 Ch 246. Boyle & Birds \textit{Company Law} 625 and Gore-Browne on Companies par 27.21.2 indicate that a fraud on the creditors, for example the taking of excessive remuneration by directors as occurred in Re Halt Garage (1964) Ltd [1982] 3 All ER 1016, seems likely to arise only when a company is in danger of going out of business in an insolvent state. Following the decision in Rolled Steel Products (Holdings) Ltd v British Steel Corporation [1986] 1 Ch 246, the requirement that the breach be \textit{intra vires} is unlikely to be of much importance: Boyle & Birds \textit{Company Law} 81ff and 625. In that case the Appeal Court drew a distinction between transactions which were \textit{ultra vires} in the sense of being beyond the capacity of the company and those which were in excess of, or were an abuse of, the powers of directors. In the latter case a transaction was capable of binding the company on the basis that a company holds out its directors as having ostensible authority to enter into any transaction falling within the powers expressly or impliedly conferred on it by its memorandum (at 295ff).

\textsuperscript{371} Boyle & Birds \textit{Company Law} 625 submit that, if this is the case, the principle seems acceptable in theory. It is perfectly proper for a company which has been fully informed to take such a decision in respect of any breach of duty, subject to the qualifications mentioned. See also Gower \textit{Company Law} 596, where it is shown that ratification or prior approval by the general meeting can only absolve directors from liability in respect of a transaction which is obviously in their interest, but which they are not satisfied is necessarily in the interests of the company, if all material facts are disclosed in the notice of the meeting or in a circular accompanying the notice.

\textsuperscript{372} A resolution which is only impeachable as a fraud on the minority is merely voidable and will be valid until successfully attacked: Gower \textit{Company Law} 593, but compare Borland's Trustee \textit{v} Steel Brothers and Co Ltd [1901] 1 Ch 279 at 292 and Brown \textit{v} British Abrasive Wheel Company Limited [1919] 1 Ch 290 at 292, where Farrell J held that "an agreement like this ... ought to be set aside on the suggestion that it might result in an unfair price."

\textsuperscript{373} Beck "Corporate Opportunity" 233; \textit{Foss v Harbottle} (1843) 2 Hare 461. On derivative actions generally, see par 3.3.2 above.

\textsuperscript{374} Beck "Corporate Opportunity" 233; Boyle & Birds \textit{Company Law} 624; Partridge "Ratification" 122; Smith "Minority Shareholders" 155. It should also be noted that ratifying one's own wrongdoing may also be grounds for a petition under s 459, alleging unfairly prejudicial conduct. In this regard, see page 86 above. See also Van Rooyen \textit{Thesis} and chapter 9 par 4.8 below in respect of the South African law.

\textsuperscript{375} Boyle "Minority Shareholder" 327.
interest in a contract to which the company is a party,\textsuperscript{376} obtaining a secret profit not involving a misapplication or misappropriation of company property,\textsuperscript{377} negligence,\textsuperscript{378} and using a power to suit personal interests or for an improper purpose.\textsuperscript{379} The overriding qualification in all these instances is that the director must have acted \textit{bona fide} in the interests of the company.\textsuperscript{380}

Breaches which are not capable of ratification by the general meeting include breaches involving a lack of \textit{bona fides} on the part of the director,\textsuperscript{381} breaches resulting in the performance by the company of an illegal or \textit{ultra vires} act,\textsuperscript{382} and breaches resulting in the performance by the company of an act which, although it is lawful and \textit{intra vires}, cannot be done under the articles without compliance with some special procedure such as a special resolution.\textsuperscript{383} Also included are breaches which bear directly upon the personal rights of an individual shareholder as defined in the articles,\textsuperscript{384} and breaches involving a "fraud on the minority".

The expression "fraud on the minority" has been described as an action whereby a majority of the shareholders or the directors succeed in expropriating at the expense of the minority the money, property or advantages of the company.\textsuperscript{385} The appropriation of corporate opportunities could therefore constitute such a fraud. However, the exact meaning of the phrase is not easy to determine, since both

\textsuperscript{376} Parkinson "Modification" 337; North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty (1887) 12 App Cas 589 (PC) at 594; Joseph Harris v A Harris Limited and Others 1936 SC 183 at 198 per Lord Hunter.

\textsuperscript{377} Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL). See, however, the comments made in footnote 110 above.

\textsuperscript{378} Pavlides v Jensen [1956] Ch 565.

\textsuperscript{379} Alexander v Automatic Telephone Company [1900] 2 Ch 56 (CA) at 67; Hogg v Cramphon Ltd [1967] Ch 254, [1966] 3 All ER 420; Bamford v Bamford [1970] Ch 212 (CA). The impropriety in the latter two cases consisted of an improper allotment of shares. It was confirmed that the votes on the improperly allotted shares should not be used on the resolution. See par 3.1.2.1 above.

\textsuperscript{380} Parkinson "Modification" 337.

\textsuperscript{381} Attwool v Merryweather (1867) LR 5 Eq 464n at 467n; Mason v Harris (1879) 11 ChD 97 (CA) at 107.

\textsuperscript{382} In re Exchange Banking Co, Flitcroft's Case (1882) 21 ChD 519 (CA) at 536. It should be noted that the doctrine of \textit{ultra vires} is now largely abolished. In this regard, see note 68 above.

\textsuperscript{383} Gore-Browne on Companies par 27.21.1.

\textsuperscript{384} For example, refusal to register a transfer of shares for an improper purpose: Boyle & Birds Company Law 624 note 239.

\textsuperscript{385} Burland and Others v Earle and Others [1902] AC 83 (PC) at 93.
"fraud" and "minority" are used somewhat loosely. There need not be any actual deceit. "Fraud" in this sense indicates "an abuse of power analogous to its meaning in a court of equity to describe a misuse of a fiduciary position." Nor is it necessary that the injured parties should be a minority. In instances where corporate opportunities are usurped, the injured party is usually the company itself.

The cases involving the issue of ratification or confirmation where there has been an expropriation of corporate assets appear to fall into two groups. The first group entails circumstances in which the directors have either fraudulently or oppressively diverted to themselves property which in law or in equity belonged to the company. In such instances the minority shareholders have remedies at common law. The other group involves situations in which directors take up an opportunity which the corporation either cannot or will not pursue itself. It is in this group that much of the difficulty pertaining to the issue of ratification arises.

An early example of a resolution permitting the expropriation of company property is found in *Menier v Hooper's Telegraph Works*. From the facts it appeared that the European South American Telegraph Company was formed to lay a transatlantic line. A licence was required, but one of the company's directors obtained it in his own name and organised a second company to exploit it. He received payment for this service. The company brought an action against the director. The court held that the diversion of the licence and side payment amounted to a sale of corporate assets for the benefit of the defendant and that the subsequent abandonment of the action by the company was unfair. The decision was followed in *Cook v GC Deeks and Others*.

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386 Gower *Company Law* 593. The author also indicates that the concept of fraud on the minority has been greatly reduced by the remedy available to members under s 459, which applies not only to oppressive conduct, but also to conduct which is, or will be, unfairly prejudicial to members generally, or to some part of the members. On this section, see page 82ff above. Nevertheless, if all a member wants is to bar a particular resolution, it is apparently still the normal practice to apply for an injunction or declaration rather than to invoke s 459.

387 Actual deceit would give rise to a common law remedy against the wilful deceiver.

388 Gower *Company Law* 593. Fraud in this context includes not just fraud at common law, but also fraud in the wider equitable sense of an abuse or misuse of power: Farrar *Company Law* 386; *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2 at 12, [1982] 1 All ER 437 at 445.

389 Gower *Company Law* 593. The injured party will normally be the company itself. Sometimes the sufferers will be a class or section of members, not necessarily a numerical minority, who are outvoted by the controllers.

390 Baxt "Ratification" 44.

391 See, for example, *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC), discussed on page 93 above.

392 In this regard see also par 4.5 above.

393 (1874) LR 9 Ch App 350. See also page 115 below.

394 [1916] 1 AC 554 (PC). For the facts of the case, see page 93 above.
tracts which they should have taken up on behalf of the company, had secured the passing of a resolution in general meeting which ratified and approved what they had done. The court held that they should be regarded as holding the benefits of the contracts on trust for the company and that directors holding a majority of votes would not be permitted to make a present to themselves.395

It is difficult to reconcile the decision in *Cook* with the many cases in which directors have been held not liable as a result of ratification by the general meeting, notwithstanding their use of their own votes.396 In *Hogg v Cramphorn Ltd*397 and *Bamford v Bamford*398 it was indicated that exercise of directors' powers for a collateral purpose is ratifiable.399 The question thus arises whether an independent majority can ratify any "fraud on the minority", or at least decide not to sue whatever the wrong that has been committed. One suggested solution is that a distinction should be drawn between misappropriation of the company's property and merely making

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395 See page 94 above. Gower *Company Law* 594 indicates that the same may apply when the present is to someone other than themselves.

396 Barak "Bamford" 249ff; Smart "Confidential Information" 464ff; McPherson "Duties" 464. See, for example, *North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty* (1887) 12 App Cas 589 (PC); *Burland v Earle* [1902] AC 83 (PC). See also *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL), where it was suggested that the directors would not have been liable to account for their profits had the transaction been ratified (see, however, the comment made in note 110 above).

397 [1967] Ch 254, [1966] 3 All ER 42, discussed by Mason "Ratification" 161 and Wedderburn "Shareholders' Control" 77. See also page 66 above. In this case the court held that it constituted an improper use of shares, even if it was done in good faith or for the benefit of the company, where such shares are issued to trustees for the benefit of the company's employees as part of an elaborate scheme to defeat a take-over bid. Although a minority shareholder was entitled to sue despite the rule in *Foss v Harbottle*, the court stood over the action until it could be seen whether a general meeting would ratify the transaction. It directed a meeting to be held at which the defendants undertook that the wrongly issued votes would not be used. The success of the minority's action was therefore dependant upon whether or not the director's misconduct would in fact be ratified in general meeting. According to Sealy *Cases* 281, *Hogg* introduced a new approach in which good faith on the part of the directors was expressly found, or conceded, but their "purpose" was nevertheless declared "improper" and their decision struck down.

398 [1970] Ch 242 (CA), [1969] 2 WLR 1107. See page 67 above. Here the Court of Appeal followed a similar approach to the one pursued in *Hogg* where the majority had ratified an improper issue of shares shortly after proceedings commenced.

399 According to Gore-Browne on *Companies* par 28.6 the natural inference to be drawn from these decisions is that the use of directors' powers for an improper or collateral purpose may be the subject of a minority shareholder's suit even though such conduct is open to ratification. Furthermore, a minority action will be defeated if such ratification takes place. The authors opine that both these propositions appear to be contrary to the established principles on which the rule in *Foss v Harbottle* and its exceptions rest, although it is acknowledged that it is possible to regard the reasoning in *Hogg v Cramphorn* as primarily directed to the issue before the court, namely the improper issue of shares. Beck "Corporate Opportunity" 237, submits that the ratification rule of *Hogg* and *Bamford* is not applicable to corporate opportunity cases.
an incidental profit for which the directors are liable to account to the company.\footnote{Gower \textit{Company Law} 595, who argues that \textit{Cook} resorts under the first aspect since it was the duty of the directors to acquire the contracts on behalf of the company. Accordingly, when they themselves acquired the contracts, they did so as constructive trustees of the company. By contrast, in \textit{Regal} the directors did not misappropriate any property of the company. Instead, they had profited from information acquired as directors of the company and made use of an opportunity of which the company might have availed itself. See also Farrar \textit{Company Law} 359-360.} This approach has been criticised on the ground that in both cases the directors in the course of acting as such took for themselves opportunities with respect to which they had a duty to use their best efforts to acquire for the company.\footnote{Beck \textit{"Peso Mines"} 116 and \textit{"Corporate Opportunity"} 235 submits that the similarity between \textit{Regal} and \textit{Cook} lies in this fact, and not in the fact that the information which came to the directors is company property. The author submits that an \textquote{information as property} analysis of the corporate opportunity cases can only further confuse an already troubled area of the law. See also Bakibinga \textit{"Ratification"} 123, who suggests that a distinction should be drawn between a breach of duty \textit{per se} and a breach of duty resulting in harm to the company, which is, in effect, a breach of trust. Baxt \textit{"Ratification"} 48 also finds the approach narrow and suggests that it requires the courts to engage in a gymnastic analysis where a strict rule should be the rule with a few exceptions.} In \textit{Daniels v Daniels} Templeman J held that a minority shareholder could sue where directors use their powers intentionally or unintentionally, fraudulently or negligently in a manner which benefits them at the expense of the company.\footnote{[1978] Ch 406 at 414, [1978] 2 All ER 89 at 96.} The net result of this case seems to be that the rule in \textit{Foss v Harbottle} is confined to a very narrow compass to situations where a director's breach of duty does not result in personal gain.\footnote{It follows that breaches of duty by directors constituting self-serving negligence are not ratifiable. A minority shareholder can therefore sue in respect of such breaches. Bakibinga \textit{"Ratification"} 126 attempts to distinguish \textit{Regal} and \textit{Daniels} on the basis that it was not alleged, nor proved, that the directors' conduct in \textit{Regal} harmed the company as was done in \textit{Daniels}.} Another view is that ratifiability depends on whether the company suffered damages.\footnote{See Parkinson \textit{"Modification"} 340, where it is stated that it is because the no-conflict duty may be breached without damage resulting to the company that breaches of it are normally ratifiable. On the same page, the author states that it is reasonably easy to see why, at least in principle, breaches of duty which damage the company should not be capable of ratification by a majority in general meeting.} However, the most accurate opinion seems that in \textit{Cook} the court did not decide that a company may never give its property to directors, but rather that the directors' action allowed a minority shareholder to proceed, since the directors were not at liberty to direct in their own favour business which should properly belong to the company they represent.\footnote{Smart \textit{"Confidential Information"} 467-468. This is substantiated by the fact that Lord Buckmaster stated (\textit{Cook v GC Deeks and Others} [1916] 1 AC 554 (PC) at 565): \textquote{If their lordships took the view that, in the circumstances of this case, the directors had exercised a discretion or decided on a matter of policy (the view which appears to have been taken in the Supreme Court) different results would ensue ... } If it were never permitted that a company could by ratification allow directors to keep property belonging to the company, then, whatever the policy decisions, no different result could have ensued: Smart \textit{"Confidential Information"} 468. A different conclusion could have been drawn only if the directors had properly decided that the company would not take up the contracts and the company in general meeting had permitted the directors to do so. This is also confirmed by Street CJ in \textit{Kinsela v Russell Kinsela Pty Liq (in Liq)} (1986) 4 ACLC 215, (1986) 10 ACLR 395 at 404 (see chapter 8 par 3.3.}
In cases involving misappropriation of corporate property and opportunities, the majority shareholders have sometimes been prepared to compromise litigation commenced by the company on terms which are advantageous to themselves, but which are often detrimental to the company and the minority shareholders. The court refused to permit such conduct in *Menier v Hooper's Telegraph Works*. Similarly, the court held that a decision of a company to discontinue proceedings for breach of contract amounted to a fraud on the minority.

4.8.1 Prior Approval

A director will not be liable where the company has duly authorised his act. Where only one, or some, of the directors wish to take advantage of the opportunity, the question arises whether approval by the board of directors may be relied upon. The general principle is that the company has the right to the unbiased advice of every director. Therefore disclosure to and approval by the board of directors is ineffective even if the director in question refrains from voting and is not counted in the quorum. However, it has been suggested that the decision may be taken by an independent board. It may be that, even for directors, a *bona fide* decision by the board after full disclosure that the company should not avail itself of a particular opportunity would mean that the opportunity is no longer a corporate one and that a director's subsequent exploitation of the opportunity personally would not be a...

below): “It is, to my mind, legally and logically acceptable to recognise that, where directors are involved in a breach of their duty to the company affecting the interests of shareholders, then shareholders can either authorise that breach in prospect or ratify it in retrospect.”

406 Farrar *Company Law* 387.

407 *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350. The defendants, a rival concern, had allegedly exercised their controlling interest in a company to compromise a pending action to their own advantage. They had then put the company into liquidation, leaving them in possession of the assets of the company to the exclusion of the minority. The court held that the transaction could be vetoed at the suit of the minority. See also page 112 above.

408 *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2, [1982] 1 All ER 437 (Ch). Megarry V-C felt “little doubt that the council had used its voting power not in order to promote the best interests of the company but in order to bring advantage to itself and disadvantage to the minority” ([1982] 1 WLR 2 at 15, [1982] 1 All ER 437 at 447).

409 Gower *Company Law* 569; Mayson, French & Ryan *Company Law* 443. The board of directors cannot effectively authorise the directors. Authorisation must be by the general meeting of shareholders, or by agreement of all the members who are entitled to vote. However, the board may effectively authorise an officer of the company who is not also a director: *Palmer's Company Law* 8133. In *New Zealand Netherlands Society 'Oranje' Incorporated v Keys and Another* [1973] 1 WLR 1127 (PC), [1973] 2 All ER 1222 the secretary of a company acquired, as a result of his position, the opportunity to publish a newspaper. The society had full knowledge of the relevant facts and agreed that the newspaper should be published by the secretary beneficially and at his own risk.

410 Farrar *Company Law* 363; Palmer's *Company Law* 8133.
breach of duty. The interested director should declare his interest at the meeting and absent himself from any discussion of the matter. If this has not been done, the board's decision to consent should be submitted for ratification by a general meeting, or by all the members who are entitled to attend and vote. The circumstances should also clearly indicate that the decision by the board to reject the opportunity was taken bona fide in the interests of the company rather than in that of the director. It is this aspect which forms the major criticism of the Canadian approach in Peso, since it is uncertain to what extent courts will satisfactorily be able to determine whether a board's rejection of a particular opportunity was bona fide or not.

A director who develops an interest in pursuing an opportunity subsequent to the board's decision not to pursue it on behalf of the company, should disclose all material facts. If he is still a member of the board, he should not play any part in its deliberations on the matter.

4.9 Codification of Directors' Duties

A last aspect which merits attention is the attempts that have been made in the past to reduce the fiduciary duties of company directors to a statutory form.

4.9.1 The Companies Bill 1973

The proposals made by the Jenkins Committee did not amount to a code in the strict sense. Rather, they stated the obligations of company directors in very

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411 Palmer's Company Law 8133. The Privy Council held in favour of this view in Queensland Mines Ltd v Hudson and Others (1978) 52 ALJR 399 (PC) (see also chapter 8 par 3.4.6 below). See also Sullivan "Queensland Mines" 715. Contra Parsons "Director's Duty" 411 note 72 who suggests that consent of the company given by the board would not be sufficient even if the director took no part in the board's decision.

412 Gower Company Law 570.

413 Gower Company Law 570 note 19 warns that a court "is likely to take a deal of persuading" in this respect. See also Farrar Company Law 363.

414 See note above and the discussion of Peso in chapter 8 par 3.4.6 below.

415 Bastin "Secret Profits" 528; Bishop & Prentice "Fiduciary Remuneration" 303; Farrar Company Law 363; Prentice "Regal" 451ff; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 392, [1967] 2 AC 134 (HL) at 154. The problem is augmented by the fact that the evidence which would establish the financial ability or inability of the company to pursue the opportunity is solely within the control of the people who will personally benefit should the company decide to reject it.

416 These may differ from the facts as they existed at the time of the company's decision to renounce.

417 Gower Company Law 570-571.

general terms. The recommendations were contained in clause 52 of the Companies Bill 1973. Clause 52(1) provided:

A director of a company shall observe the utmost good faith towards the company in any transaction with it or on its behalf and shall act honestly in the exercise of the powers and the discharge of the duties of his office.

It is apparent from the proposal that the obligation is in favour of the company, although it is not explained what "the company" is. The statement was criticised on the basis that it failed to recognise the proper purpose doctrine.

Profit-making by a director was also addressed. In this regard clause 52(2) provided:

A director of a company shall not make use of any property of the company, or of any information acquired by him by virtue of his position as a director or other officer of the company, to gain directly or indirectly an improper advantage for himself at the expense of the company.

It was further recommended that a director who commits a breach of the above-mentioned provisions should be liable to the company for any profit made by him and for any damage suffered by the company as a result of the breach. The intention was broadly to codify the rules which forbid directors making a profit for themselves or disclosing confidential information. In the corresponding common law it is not required that the advantage should be gained by the director "at the expense of the company". Many decisions on "secret profits" have concerned situations where, strictly speaking, the company lost nothing. Furthermore, where corporate opportunities are concerned, it is not a requirement for liability that the director must have learnt of the opportunity by virtue of his office.

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419 See Cmd 1749 (1962).
420 Birds "Making Directors do Duties" 67.
422 Birds "Code of Duties" 1163. See also Goode "Codification" 137, who opines that any codification should, at least, be as comprehensive as the existing case-law. On the proper purpose doctrine, see par 3.1.2 above.
424 Cmd 1749 (1962) par 99(iii) and (iv).
425 Birds "Code of Duties" 1163; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL), discussed on page 69ff above. See also Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162 (discussed on page 94 above) where the company was financially unable to use the opportunity from which the directors eventually made their profit. On the secret profit rule, see par 3.2.1 above.
426 See page 92 above.
Clause 52(3) of the Companies Bill 1973 made it clear that the section was without prejudice to any other provision of the Companies Acts and to any rule of law with respect to the duties or liabilities of directors.427 This was necessary in view of the fact that some of the clauses were narrower than the existing common law. The recommendations did not clearly indicate how issues such as ratification and minority shareholders' actions would be addressed in a code. Neither was the position of directors who are appointed by specific interest groups considered. It is submitted that an effective statutory code would have to provide for these matters.

The Companies Bill 1973 proposed by the Conservative Government would have implemented many of the proposals of the Jenkins Committee. The Bill lapsed with the defeat of the Government in the general election of 1974. Gower regards this as regrettable, since:

... had it been enacted and followed by a reconsolidation, our company law would have been more intelligible both to us and to our Continental partners in the European Communities to which we have belatedly secured admission.

The contrary view is put forward by Birds,428 who suggests that, even if it is accepted that the purpose of a code such as the one proposed in the Bill, is to educate rather than codify, there is a danger of misleading directors if wider duties exist than those laid down by statute.

4.9.2 The Companies Bill 1978

The English Companies Bill 1978 contained a comprehensive clause, intended to codify the law of directors' fiduciary duties, in addition to clauses on the interest of employees and the duties of care and skill.429 Specific clauses on aspects of directors' fiduciary duties were also included.430 The Bill was, however, never enacted. But it is important to take note of, because of its comparative value for any proposed codification of company law in South African law.

The Bill provided for consideration of employees' interests.431 In respect of directors' duties, the relevant provisions of the proposed Bill are as follows.432

427 Cmd 1479 (1962) par 99(4).
428 Birds "Code of Duties" 1166.
429 Clause 44(8) of the Bill made it clear that the Bill intended entirely to replace the present law.
430 Birds "Making Directors do Duties" 67 regards this attempt by the Labour Government as much more comprehensive, and in many respects a more accurate reflection of the case law, than the one contained in the Companies Bill 1973 (see par 4.9.1 above). Gower Company Law 4ed 595 also regards the proposed codification as a reasonably accurate distillation of the principles derived from cases.
431 Clause 46. Similar provision is now made under the Companies Act 1985, s 309. In this regard, see chapter 3 page 47 above.
432 See clause 44.
(1) A director of a company shall observe the utmost good faith towards the company in any transaction with it or on its behalf and owes a duty to the company to act honestly in the exercise of the powers and the discharge of the duties of his office.

(2) A director of a company shall not do anything or omit to do anything if the doing of that thing or the omission to do it, as the case may be, gives rise to a conflict or might reasonably be expected to give rise to a conflict, between the duties of his office and his private interests or, without prejudice to the foregoing, between those duties and any duties he owes to any other person.

(3) Without prejudice to subsections (1) and (2) above, a director of a company or a person who has been a director of a company shall not, for the purpose of gaining, whether directly or indirectly, an advantage for himself -

(a) make use of any money or other property of the company; or
(b) make use of any relevant information or of a relevant opportunity -

(i) if he does so while a director of the company in circumstances which give rise or might reasonably be expected to give rise to such a conflict; or
(ii) if while a director of the company he had that use in contemplation in circumstances which gave rise or might reasonably have been expected to give rise to such a conflict.

(4) In this section -

"relevant information" in relation to a director of a company, means any information which he obtained while a director or other officer of the company and which it is reasonable to expect him to disclose to the company or not to disclose to persons unconnected with the company;

"relevant opportunity" in relation to a director of a company, means an opportunity which he had while a director or other officer of the company and which he had-

(a) by virtue of his position as a director or other officer of the company; or
(b) in circumstances in which it was reasonable to expect him to disclose the fact that he had that opportunity to the company.

In South African law, the concept of "utmost good faith" would arguably not be recognised. It is, furthermore, not clear whether this concept would also preclude acting on the board of a competitor or running a competing business, at least without disclosing the fact. This is not inevitably a breach of duty at common law.

The provision in clause 44(2) which renders a director accountable only if he profited in circumstances which could reasonably be expected to give rise to a conflict of duty and interest is narrower than the present law. This serves as a warning

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433 In Mutual and Federal Insurance Co Ltd v Oudtshoom Municipality 1985 (1) SA 419 (A) the Appeal Court considered the term uberrima fides used in the English Marine Insurance Act 1906. Joubert JA rejected the idea that there could be degrees of good faith. The distinction, held the court, is between good faith and bad faith: "It is entirely inconceivable that there could be a little, more or most (utmost) good faith" (at 433C).

434 Birds "Making Directors do Duties" 68.

435 In this regard, see par 4.7 above.

436 Birds "Making Directors do Duties" 68. See also Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162, discussed on page 94ff above, where it was decided that proof that the company could not have benefited from the opportunity did not absolve the director who had appropriated it for his own benefit.
that any statutory statement of directors' duties should preferably not be exclusive.\textsuperscript{437}

Other criticisms levelled at the Bill, were that it did not adequately deal with the issue of ratification and that the relationship between it and section 205 of the Companies Act 1948 was not considered.\textsuperscript{438}

It is apparent from the discussion above that codification presents problems of its own.\textsuperscript{439} In respect of codification of directors' duties the following view is endorsed:\textsuperscript{440}

... If we are to have a code of directors' duties, that code should be comprehensive enough not to be misleading, while still leaving room for the development of common law principles. In particular, it is more important to lay down by statute a modern standard of care and skill for the company director than to codify fiduciary duties which are already well established and clear. Finally, if codification is to serve any purpose, it must be accompanied by an effective attack on the present stringent requirements for a minority shareholder's derivative action.

5 CONCLUSIONS

In the preceding discussion it was seen that under English law all registered companies must have directors. The word "director" includes any person who occupies the position of director.\textsuperscript{441} Specific provision is made for "shadow directors". However, the fiduciary duties owed by company directors do not extend to them and this type of director is not recognised in South African law.\textsuperscript{442} Alternate,\textsuperscript{443} de facto,\textsuperscript{444} and nominee directors, on the other hand, occupy fiduciary positions in relation to their company.\textsuperscript{445} But especially in the case of nominee directors, the ideal of an independent discretion may sometimes prove unattainable.\textsuperscript{446}

\textsuperscript{437} Birds "Making Directors do Duties" 68.
\textsuperscript{438} Birds "Making Directors do Duties" 69. On s 205 (now s 310 of the Companies Act 1985), see par 3.4.1 above.
\textsuperscript{439} In this regard, see chapter 9 par 4.10 below.
\textsuperscript{440} Birds "Code of Duties" 1163.
\textsuperscript{441} See par 2 above.
\textsuperscript{442} See par 2.1 above.
\textsuperscript{443} See par 2 above.
\textsuperscript{444} See par 2.1 above.
\textsuperscript{445} See par 2.1 above.
\textsuperscript{446} See pars 2.1 and 3.1.1 above.
The recommendations by the Cadbury Committee in respect of non-executive directors were reviewed. The Committee proposed specific recognition of and a much more important role for non-executive directors. The independence of these directors was emphasised. It appeared that the distinction between executive and non-executive directors was more important in respect of their duties of care and skill than with regard to their fiduciary obligations.

It was further seen that a fiduciary duty of loyalty and good faith is generally recognised between a director and his company. Directors are also regarded as having some of the attributes of trustees, notably as regards assets of the company which are in their hands or under their control. The primary consequence of this principle of trusteeship is that a director is answerable as a trustee for any misapplication of the company's property in which he participated and which he knew or ought to have known to be a misapplication. From the decision in Rolled Steel Products it is apparent that a constructive trust will arise if a company's property has been transferred in a transaction which is within the company's corporate capacity but where the transfer has been effected by a director in breach of his fiduciary powers. It is therefore important to define the parameters of the concepts of "assets" and "property" in English law.

The fiduciary obligation arises on the date upon which the director's obligation takes effect. It is owed by each director individually and to the company alone. Except in so far as the duties are specifically restricted to directors by statute, they apply equally to any officers of the company who are authorised to act on its behalf and, in particular, to those acting in a managerial capacity.

Various categorisations and sub-categorisations of directors' fiduciary duties have been made. These categories are not exclusive and, to some extent, overlap. Generally stated, it is acknowledged that directors should exercise their powers in good faith and that they should avoid conflicts between their own interests and the interests of the beneficiary of their duty, namely the company. These duties encompass an obligation to act for an unfettered discretion, to act for proper purposes, and not to make any "secret profits".

447 See par 2.2.1 above.
448 See par 3 above.
449 See par 3.2.2 above.
450 More so than in South African law, where constructive trusts are not recognised. See chapter 2 note 35 above.
451 See pars 3.1 and 3.2 above.
452 See par 3.1.1 above.
453 See par 3.1.2 above.
454 See par 3.2.1 above.
The enforcement of directors’ duties was briefly discussed.\textsuperscript{455} Enforcement is either at the instance of the company\textsuperscript{456} or of the minority shareholders.\textsuperscript{457} Alternatively, misfeasance proceedings may be instituted.\textsuperscript{458}

A director who is \textit{prima facie} liable for a breach of his duties may be relieved from liability by exempting provisions in the articles,\textsuperscript{459} by agreement,\textsuperscript{460} by means of discretionary relief by the court,\textsuperscript{461} or as a result of the limitation of actions.\textsuperscript{462}

The discussion then focussed on the acquisition of economic opportunities for a director’s personal gain in circumstances when he is regarded as being under an obligation to acquire them for his company. This is generally known as the acquisition of "corporate opportunities".\textsuperscript{463} A corporate opportunity can be defined as any business opportunity which the company would otherwise have obtained and which is acquired for the director’s own private profit. The opportunity can pertain to material or immaterial property.\textsuperscript{464} Some commentators accept that such an opportunity constitutes a corporate asset.\textsuperscript{465} Others are more hesitant.\textsuperscript{466} But it is clear that English company law does not recognise any separate doctrine to deal with this situation. Consequently, the general fiduciary principles that a director may not make secret profits from his office, nor place himself in a conflict of interest with the company, and that he has a duty to act \textit{bona fide} in the interest of the company are applied.

The problems which arise in this area of company law were apparent from the overview of case law.\textsuperscript{467} It appeared that in many instances, the application of general principles suffice to resolve problems which arise when corporate opportunities have been wrongfully appropriated. Earlier cases relied heavily upon the position of

\textsuperscript{455} See par 3.3 above.
\textsuperscript{456} See par 3.3.1 above.
\textsuperscript{457} See par 3.3.2 above.
\textsuperscript{458} See par 3.3.3 above.
\textsuperscript{459} See par 3.4.1 above.
\textsuperscript{460} See par 3.4.2 above.
\textsuperscript{461} See par 3.4.3 above.
\textsuperscript{462} See par 3.4.4 above.
\textsuperscript{463} See par 4 above.
\textsuperscript{464} See par 4.2 above.
\textsuperscript{465} \textit{Farrar Company Law} 422.
\textsuperscript{466} \textit{Sealy Cases} 269.
\textsuperscript{467} See par 4.3 above.
the director and the opportunity to make an improper profit. The decision in Cooley\(^{468}\) indicates that a director may be accountable for profits arising from the exploitation of a business opportunity which fell within the general line of business of the company, but where his tenure of the office of director in no way contributed to the making of the profit. The nature of the opportunity is also regarded as an important factor in the determination of liability.

A number of problems were identified. The effect of a director's resignation from office\(^{469}\) and rejection of a particular opportunity by the company or its inability to pursue that opportunity\(^{470}\) were considered. It was concluded that directors' fiduciary duties come to an end when the directorship terminates. But, if a director's resignation is influenced by a desire to acquire an opportunity for himself, or where his position with the company, rather than an independent initiative, led him to the opportunity, he remains precluded from taking it. The decision in Umunna indicates that courts are likely to adopt a flexible approach which will go beyond the capacity of the individual concerned to examine the nature of the opportunity in question.\(^{471}\) Inability by the company to pursue a particular opportunity, or a decision to reject that opportunity might therefore, in the circumstances of a particular case, enable the director to pursue it.

It was seen that corporate opportunities and misuse of confidential information are likely to overlap.\(^{472}\) Confidential information may be regarded as property over which the director exercises trusteeship in favour of the company. Where confidential information has been misused, a company would have two possible courses of action. It could claim that the directors were accountable having placed themselves in a position of conflict of duty and interest. Alternatively, it could claim that the directors, having used company property in the form of confidential information, became constructive trustees of any profit made thereby. This latter claim has the disadvantage that the confidential nature of the information would have to be established.\(^{473}\)

It was accepted that profits gained from confidential information might with the appropriate approval be retained by the fiduciary. Only a use of confidential information, which is both _bona fide_ and not at the company's expense, does not give rise to a minority shareholder action. If corporate opportunities were consistently to be regarded as corporate assets it is submitted that the effect in respect of ratifica-

\(^{468}\) See page 94 above.

\(^{469}\) See par 4.4 above.

\(^{470}\) See par 4.5 above.

\(^{471}\) See page 101 above.

\(^{472}\) See par 4.6 above.

\(^{473}\) See page 105 above.
tion would be similar. This could lay to rest the controversy surrounding the ratifiability of appropriation of corporate opportunities.474

It was shown that a director would not incur liability solely because he conducted a business in competition with that of his company.475 But he is accountable if he uses the company's property or trade secrets, or his knowledge of the company's customers, or, possibly, any special skill acquired by him while engaged in the company's business in order to carry on his own rival concern. Similarly, the holding of multiple directorships is not a breach of fiduciary duty, even where the companies are in competition. The possibility of a conflict of interests does not amount to a breach of fiduciary duty. It is only when the director actually acts in conflict with the company's interests that he may incur liability. This may place the director who holds a directorship in a rival company in a difficult position.476

In the last instance, previous efforts to codify directors' duties and the law pertaining to corporate opportunities were reviewed.477 They were never implemented, and at present no codification of directors' duties exists in England. However, certain provisions in the Companies Act 1985 entrench some aspects of the fiduciary duty, notably section 309 in respect of employees' interests.478

In conclusion, English company law is a good example of a system where specific problems arising from the fiduciary obligation imposed on company directors, are resolved by means of the application of established general principles. No specific doctrine of corporate opportunities has been developed. It is submitted that in that system existing rules, such as the secret profit rule479 and the proper purposes480 rule used in conjunction with the doctrine of constructive trusts adequately resolve problems arising in that area of the law.

474 See par 4.8 above.
475 See par 4.7 above.
476 See par 4.7.1 above.
477 See par 4.9 above.
478 See also chapter 3 page 47 above.
479 See par 3.2.1 above.
480 See par 3.1.2 above.
CHAPTER 5
AMERICAN LAW

1 INTRODUCTION

The American business corporation is historically closely connected to the company as recognised in English and South African law. The corporation is the dominant type of business organisation, mainly because of its characteristics of limited liability for investors, free transferability of investor interests, legal personality and centralised management.

Any survey of American corporation law is complicated by the fact that a different Corporations Act exists for each state. Federal legislation may also be applicable. Since the law regarding business corporations is largely based on state statutes, the choice of the state of incorporation is very important. The states of Delaware, California and New York are the most significant. A general survey of American corporation law is further complicated by the fact that perusal of case law reveals different interpretations of basically the same statutory provisions in many states. However, an attempt will be made to state the legal rules which apply

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1 Du Plessis Grondslae 480ff; Naudé Maatskappydirekteur 240. For an exposition of the historical relationship between English and American corporation law, see Gower "Contrasts" 1369ff; Naudé Maatskappydirekteur 240. Both systems are based upon the same general principles of law and equity derived from a common heritage. There are sufficient basic similarities to make a comparison between the two systems possible, but also sufficient differences to make comparison fruitful: Gower "Contrasts" 1370. Other possible forms of American business enterprise are the sole proprietorship, partnership, joint stock association, business trust and professional corporation: Henn & Alexander Laws of Corporations 50ff; Kempin, Wiesen & Bagby Management Process 26ff.

2 Clark Corporate Law 2ff.

3 Du Plessis Grondslae 480; Naudé Maatskappydirekteur 241. In recent years a growing body of "federal corporation law", has emerged, especially under the Securities Exchange Act 1934. See Henn & Alexander Laws of Corporations 7 and 36-39 for examples of the more relevant federal constitutional provisions.

4 On the selection of jurisdiction of incorporation generally, see Cary & Eisenberg Cases 97; Choper, Coffee & Morris Corporations 123; Henn & Alexander 176-201.

5 Since the beginning of the century, Delaware has been the most popular jurisdiction of incorporation for multi-state corporations. No other jurisdictions are as fully accommodating to corporations as the Delaware General Corporation Law, as revised in 1967, especially in the area of corporate management. According to Henn & Alexander Laws of Corporations 185 and Herzel & Richman "Delaware's Preeminence" lix, two-fifths of the corporations listed on the New York Stock Exchange were incorporated in Delaware by 1983 (for example, Chrysler Corporation, Ford Motor Company and Warner Bros Pictures Inc). On the history of Delaware corporation law, see Arsh "History" 1ff.

6 Du Plessis Grondslae 480.
generally and, where relevant, to indicate which states deviate substantially therefrom. Reference can also be made to the Revised Model Business Corporation Act of the American Bar Association, which is followed (with modifications) by many state jurisdictions, thus enabling the deduction of general principles. The proposals by the American Law Institute are also important, because they not only restate existing law but also point out the problems encountered in specific areas.

In this chapter the director of a corporation is identified and his fiduciary obligation reviewed, with specific reference to the beneficiaries and content of this obligation. Enforcement of the fiduciary obligation and exemption from or indemnification against it are then considered. The corporate opportunity doctrine, which has been developed as a specific sub-rule pertaining to the fiduciary obligation, is then discussed. In view of its possible application in South African

7 In American law there is an abundance of decided cases dealing with the topic of directors' fiduciary duties. An attempt is made only to state current American law. References are, therefore, mainly to the more recent decisions. Citations of these decisions refer to the National Reporter System and, as parallel citations were not available, an indication is provided throughout of the state in which the decision was given. Older cases will be referred to only in those instances where they are relevant or where no recent authority could be traced.

8 The Model Business Corporation Act ("MBCA") was drafted to balance the interests of the public, corporations, shareholders and management. Its purpose was to serve as a guide to state legislatures revising their own corporation statutes. The revisions of more recent years have tended to be more management-oriented. The Revised Model Business Corporation Act 1984 (hereafter "RMBCA") was used as a model in the recodification of corporation statutes in a number of states between 1984 and 1989. It is likely to maintain a strong influence on state statutes: D'Ambrosio "Duty" 663ff; Hamilton Corporations 4; Henn & Alexander Laws of Corporations 199.

9 Campbell Liability of Corporate Directors 677.

10 The American Law Institute's proposed Principles of Corporate Governance consists of several tentative drafts and one discussion draft. At a late stage of writing it came to my attention that a final draft was published in 1993. This draft has been unavailable to me and further references are therefore to the tentative drafts. The original intention was to restate the law of corporate governance without departing from the primary goal stated in the Institute's charter, namely to promote the clarification and simplification of the law and its better adaptation to social needs. The proposals in fact go further than mere restatements and have proposed reforms in addition to codifying the common law: Fine "ALI Proposals" 693-695.

11 See par 2 below.
12 See par 3 below.
13 See par 3.1 below.
14 See par 3.2 below.
15 See par 4 below.
16 See par 5 below.
17 See par 6 below.
law, criticisms against this doctrine are reviewed.18 From the foregoing, certain conclusions are drawn.19

2 CORPORATE DIRECTORS

All corporations must, from necessity, act through the aid and by means of individuals. Every corporation must have at least one or more directors, who, as a board, manages the corporation.20 The authority of the board does not extend beyond the management of ordinary corporate affairs,21 nor does their discretionary power extend beyond the limits of their authority.22

Although the directors are elected and removable by the shareholders, they are not the agents of the shareholders.23 Neither are they considered trustees.24 It is generally accepted that their position is *sui generis.*25

The board of directors determines policy matters and appoints (and removes) directors to execute the policy and to administer corporate affairs.26 Traditionally the directors, who are sometimes called trustees, managers or governors,27 could

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18 See par 8 below.
19 See par 9 below.
20 RMBCA, par 8.01; Choper, Coffee & Morris *Corporations* 195; Clark *Corporate Law* 105; Feuer *Liabilities* 3; Ford "Director" 467; Henn & Alexander *Laws of Corporations* 129, 550; Kempin Wiesen & Bagby *Management Process* 372ff. The number of directors required is usually stated in the articles of incorporation, or in the bylaws of the corporation. The bylaws of a corporation are the equivalent of the articles of association of a South African company. They have been described as rules resulting from an agreement or contract between the corporation and its members to conduct the corporate business in a particular way: *Schraft v Leis* 686 P2d 865 (Kan 1984) at 868.

21 *Moore v Los Lugos Gold Mines* 21 P2d 253 (Wash 1933) at 260.
22 *Leggett v Missouri State Life Insurance Company* 342 SW2d 833 (Mo 1961) at 851.
24 Henn & Alexander *Laws of Corporations* 563; *Guth v Lof, Inc* 5 A2d 503 (Del 1939) at 510; *Berger v Amana Society* 111 NW2d 753 (Iowa 1962) at 756-757; *Paddock v Siemoneit* 218 SW2d 428 (Texas 1949) at 431.
25 Anon "Duty Not to Compete" 1191; Fuller "Restrictions" 189; Henn & Alexander *Laws of Corporations* 563; *New York Dock Co v McCollum* 16 NYS2d 844 (Sup Ct 1939) at 847.
26 Henn & Alexander *Laws of Corporations* 129.
only act as a board. Almost all the state statutes now expressly provide that directors may act without a meeting if they unanimously consent in writing.28

2.1 De Facto Directors

Persons who exercise the functions of directors despite the lack of proper qualifications, election, other requirements necessary to constitute them de iure directors, or despite even their removal, may nevertheless bind the corporation under the so-called de facto doctrine.29 Thus in Morse v Fall River Line Pier, Inc,30 directors who had been elected by directors, instead of by shareholders as required, were considered de facto directors. A contract concluded between them and the pier manager, who did not know of the defect, was held to be valid and binding.31

De facto directors have the same fiduciary duties as de iure ones, for a de facto director may not exercise the prerogatives of a corporate position and yet avoid its attendant fiduciary duties and liabilities.32

2.2 Inside and Outside Directors

The distinction between "inside" and "outside" directors has been described as a "judicial invention".33 Generally, an inside director is employed by the corporation, usually as an officer. An outside director, on the other hand, is neither an officer, nor a corporate employee.34 The definition does not, however, include legal counsel,

28 Henn & Alexander Laws of Corporations 565; Kempin Wiesen & Bagby Management Process 379. Typical of such a provision is RMBCA, par 44 which provides: "Unless the articles of incorporation or by-laws provide otherwise, action required or permitted by this Act to be taken at a board of directors' meeting may be taken without a meeting if the action is taken by all members of the board. The action must be evidenced by one or more written consents describing the action taken, signed by each director, and included in the minutes or filed with the corporate records reflecting the action taken." Only North Dakota does not allow such action by unanimous consent: North Dakota Business Corporation Act par 10-19-41.

29 Henn & Alexander Laws of Corporations 562. Since the de facto doctrine is aimed at the protection of innocent persons, it may not be invoked by a person who has wrongfully assumed to act as director: Henn & Alexander Laws of Corporations 562.

30 189 NE2d 512 (1963 Mass) at 514-515.

31 See also Prickett v American Steel and Pump Corporation 253 A2d 86 (Del Ch 1969) at 88, where directors elected under an invalid bylaw were held to be de facto directors who were replaceable at a valid election.

32 Kempin Wiesen & Bagby Management Process 376; South Seas Corporation v Sablan 691 F2d 508 (N Mariana Islands 1981) at 1038 (self-elected directors are not properly elected de iure directors, but are de facto directors with the same duties as the former).

33 Campbell Liability of Corporate Directors 678.

34 Rowen v Le Mars Mutual Insurance Company of Iowa 282 NW2d 639 (Iowa 1979) at 652. On outside directors generally, see Soderquist "Outside Directors" 1341ff.
the corporation's banker, retired executives of the corporation and representatives of major corporate suppliers or customers.35

Inside directors are required to exercise a higher standard of care in the exercise of their duties than outside directors, since they have the advantage of greater knowledge of the actual business operations of the corporation.36 Outside directors are scarcely in a position to make decisions based on direct knowledge of business operations, but if they are competent and understanding, and properly informed, the judgments they make should be impartial and sound. A balanced board, consisting of both inside and outside directors, is, in most circumstances, desirable.37

2.3 Directors and Officers

Directors and officers share responsibility for management of the corporation. Their functions are, however, not the same and the activities of the officers are under the board's technical control.38

Corporate officers are elected or appointed by the board of directors and are mandated to carry out the policies established by the board.39 They are normally highly paid, full-time employees, whereas directors generally receive smaller stipends and lend only a portion of their time to any one corporation.40

The duties of officers and directors are similar.41 There are indications that a heavier duty of care and skill is imposed upon some officers than on directors, since they are expected to be heavily involved in day-to-day corporate management.42 But the same principles apply to both groups in respect of their fiduciary obligations.43

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35 Rowen v Le Mars Mutual Insurance Company of Iowa 282 NW2d 639 (Iowa 1979) at 652.

36 Campbell Liability of Corporate Directors 678; Feuer Liabilities 11; Moran v Household International, Inc 490 A2d 1059 (Del 1985).

37 Feuer Liabilities 11.

38 Ibid.

39 Campbell Liability of Corporate Directors 680.

40 Anon "Corporate Opportunity" 769. On directors' compensation, see also par 2.4 below.

41 Campbell Liability of Corporate Directors 680.

42 Usually the standard of care for officers with discretionary authority is statutorily similar to that imposed on directors: Campbell Liability of Corporate Directors 680.

43 Feuer Liabilities 11; Henn & Alexander Laws of Corporations 587.
2.4 Directors' Compensation

Traditionally, directors were regarded as representative shareholders whose shareholdings and dividends therefrom justified special attention to corporate affairs without further compensation. With the increasing prevalence of directors with little or no share ownership, attitudes in favour of compensating directors developed. Increasingly, such compensation was provided for in articles of association, bylaws adopted by shareholders, and resolutions of shareholders.

Some modern statutes expressly provide that the board of directors shall have the authority to determine the compensation of directors unless otherwise provided in the articles of incorporation or, sometimes, the bylaws. Many corporations still do not compensate their directors as such, or only provide for a nominal honorarium. But a growing number of American corporations provide for substantial compensation to directors. There is, however, no general obligation to compensate corporate directors. Directors may also not vote to themselves excessive or unreasonable compensation, or compensation which is out of proportion to the value of the services rendered by them.

3 DIRECTORS' FIDUCIARY DUTIES

The office of director of a corporation carries with it certain duties. Corporate officers and directors owe three basic duties to their corporations. Broadly stated, the duties of management include the duty to act \textit{intra vires} and within their respective authority, to exercise due care, and to observe the applicable fiduciary duties.


45 Feuer \textit{Liabilities} 50; Henn & Alexander \textit{Laws of Corporations} 665; RMBCA par 8 (articles). The statutes of Delaware and New York are amongst these.

46 Clark \textit{Corporate Law} 191; Henn & Alexander \textit{Laws of Corporations} 665.

47 Choper, Coffee & Morris \textit{Corporations} 292; Feuer \textit{Liabilities} 51; Henn & Alexander \textit{Laws of Corporations} 668; Adams \textit{v Smith} 153 So 2d 221 (Ala 1963) at 225.

48 Henn & Alexander \textit{Laws of Corporations} 611ff; Feuer \textit{Liabilities} 11; Knepper & Bailey \textit{Liability} 9.

49 Knepper & Bailey \textit{Liability} 9.

50 Daniel "Developments" 631; Henn & Alexander \textit{Laws of Corporations} 611, 620-625. RMBCA par 8.01 provides that a director shall perform his duties as a director, including duties as a member of any committee of the board upon which he may serve, in good faith, in a manner one reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a similar position would use under similar circumstances.
As persons in control of property belonging to others, directors are fiduciaries. The fiduciary relationship to the corporation and its stockholders is well established. The fiduciary obligations also apply to dummy directors, who are mere figureheads. Directors may not lawfully divest themselves of their fiduciary duty in a contract.

It is important to note that breaches of fiduciary duty owed to the corporation precludes application of the business judgment rule. This rule, which developed concurrently with the duty of care, provides that officers or directors are excused from liability if they exercised reasonable business judgment in discretionary decisions, even if these decisions ultimately cause damage to the corporation. In order to qualify for protection under the rule, the conduct by the director must be intra vires, within his authority and in good faith.

51 See chapter 2 par 2 above, where it is shown that the characteristics of a fiduciary relationship are that the fiduciary should have scope for the exercise of some discretion or power, and that he should be able to unilaterally exercise that power so as to affect the beneficiary's interests. Control over the property of others thus seems to be a universal element of a fiduciary relationship. See, for example, Scott "Fiduciary Principle" 540, who states that "[a] fiduciary is a person who undertakes to act in the interest of another person. It is immaterial whether the undertaking is in the form of a contract. It is immaterial that the undertaking is gratuitous." Wolfson "Critique" 974 regards the duty of loyalty as the most fundamental responsibility of directors.

52 In this regard, see also par 3.1 below.

53 Representative of the numerous cases supporting this principle are the following: Guth v Loft, Inc 5 A2d 503 (Del 1939); Arneman v Arneman 264 P2d 256 (Wash 1955) at 263; Poweroil Manufacturing Company v Carstensen 419 P2d 793 (Wash 1966) at 796; Hol-Rest, Inc v Trelor 217 NW2d 517 (Iowa 1974) at 525; Atlantic Acoustical & Insulation Co v Moreira 348 A2d 263 (Me 1975) at 267; Parsons Mobile Products, Inc v Remmert 531 P2d 428 (Kans 1975) at 432; Schwartz v Marien 335 NE2d 334 (NY 1975) at 337-338; Epperly v E & P Brake Bonding, Inc 348 NE2d 75 (Ind 1976) at 81; Wolff v Arctic Bowl, Inc 560 P2d 758 (Alaska 1977) at 770; Smith v Great Basin Grain Co 561 P2d 1299 (Idaho 1977) at 1311; Dannen v Scafieldi 393 NE2d 1246 (Ill 1979) at 1250; Unicure, Inc v Thurman 599 P2d 925 (Colo 1979) at 927; Salvadore v Connor 276 NW2d 458 (Mich Ct App 1979) at 463; Richardson v Arizona Fuels Corporation 614 P2d 636 (Utah 1980) at 639; Master Records, Inc v Backman 652 P2d 1017 (Ariz 1982) at 1020; Nicholson v Evans 642 P2d 727 (Utah 1982) at 730; Westgor v Grimm 318 NW2d 56 (Minn 1982) at 58; Wisconsin Avenue Associates, Inc v 2720 Wisconsin Avenue Cooperative Association, Inc 441 A2d 956 (De App 1982) at 962; Taylor v Terry 649 SW2d 392 (Ark 1983) at 393; Pacelli Brothers Transportation, Inc v Pacelli 456 A2d 325 (Conn 1983) at 329; Gearhart Industries, Inc v Smith International, Inc 741 F2d 707 (5th Cir 1984) at 721; Schraft v Leis 686 P2d 865 (Kan 1984); Aronson v Lewis 473 A2d 805 (Del 1984) at 811; Smith v Van Gorkom 488 A2d 858 (Del 1985).

54 Burton v Exxon Corp 583 FSupp at 405 (NY 1984) at 414.

55 Great Western Producers Co-Operative v Great Western United Corporation 613 P2d 873 (Colo 1980) at 878; Jewel Companies, Inc v Pay Less Drug Stores Northwest, Inc 741 F2d 1555 (9th Cir 1984) at 1563.

56 Henn & Alexander Laws of Corporations 628; Veasy "Duty of Loyalty" 2065.

Liability for breach of the fiduciary duty may be found even in the absence of bad faith or dishonesty, or of injury, or, if there is bad faith, even if the act complained of otherwise falls within the directors' authority.

3.1 Beneficiaries of Fiduciary Duties

Directors' duties of loyalty are owed primarily to the corporation. American law has, however, gone further than many other jurisdictions in recognising the claims of other interest groups. It is increasingly accepted that a fiduciary duty may be owed to shareholders directly. This duty to shareholders is said to arise from the fact that shareholders are owners of the corporation and that they expect to share in the profits. When a director or officer benefits at the expense of the corporation, he therefore breaches his duty to the shareholders by preventing them from realizing their expectation to share fairly in the corporate fortunes. Any fiduciary relationship to shareholders is to the latter collectively. Directors do not have a fiduciary duty to individual shareholders, except in special circumstances where advantage is taken of inside information by a corporate insider who deliberately

58 Robinson v Watts Detective Agency, Inc 685 F2d 729 (1st Cir 1982) at 736.
59 Walton v Morgan Stanley & Co, Incorporated 623 F2d 796 (2nd Cir 1980) at 798. See also par 3.2.3.1 below.
60 O'Leary v Board of Directors, Howard Young Medical Center, Inc 278 NW2d 217 (CA Wis 1979) at 221-222.
61 Clark Corporate Law 141; D'Ambrosio "Duty" 681; Henn & Alexander Laws of Corporations 562-563. See also the authorities referred to in note 53 above, and RMBCA, par 8.01 referred to in note 50 above.
62 Willett "Conflict" 484. On the possible recognition of other beneficiaries than the company elsewhere, see chapter 3 above.
63 Campbell Liability of Corporate Directors 679; Scott "Fiduciary Principle" 541. In Remillard Brick Co v Remillard-Dandini Co 241 P2d 66 (Cal 1952) the defendants were officers and directors of separate manufacturing companies. At a directors' meeting of the two companies, they proposed to separate the sales units of both companies and to transfer them to a company in which they were to be the sole owners and operators (at 69). Both defendants voted in favour of the proposal. Subsequently, acting in their capacities as officers, they obtained sales contracts between the two manufacturing companies and their company. The court indicated that the defendants had used their power for their own ends, which created a conflict of interest between their needs and the superseding needs of the corporation and its shareholders (at 76). The court affirmed the decision by the trial court to set aside the sales contracts. It confirmed that the directors stood in a fiduciary relationship to the corporation and its shareholders, which required them to act in good faith (at 74). See also Guth v Loft, Inc 5 A2d 503 (Del 1939); Hanson Trust PLC v ML SCM Acquisition, Inc 781 F2d 264 (2nd Cir 1986) at 273. See also chapter 3 par 2 above in respect of shareholders as direct beneficiaries of directors' fiduciary obligations.
64 Am Jur vol 18B par 1689.
65 Richardson v Arizona Fuels Corporation 614 P2d 636 (Utah 1980) at 639; Hendricks v Mill Engineering & Supply Co 413 P2d 811 (Wash 1966) at 813-814.
misleads an ignorant shareholder, or where some individual right of a shareholder is being impaired by the improper acts of a director.\textsuperscript{66} Even if a particular statute expressly recognises the fiduciary duty of directors not only to the corporation but also to its shareholders, the latter have a right only to bring a derivative suit, and not a direct suit for violation of the duty.\textsuperscript{67} But most statutes do not name the beneficiaries of directors' and officers' fiduciary obligations.\textsuperscript{68}

Under American law, directors' duties may also extend to the creditors of an insolvent corporation.\textsuperscript{69} Generally, when a corporation becomes insolvent or the directors know insolvency is imminent, the creditors of the corporation become beneficiaries of the fiduciary obligation.\textsuperscript{70} In this regard, the "trust fund doctrine", where strictly applied, provides that upon insolvency directors no longer owe a duty to stockholders who no longer have any viable economic interest in the entity. Instead, directors owe their duty to corporate creditors.\textsuperscript{71}

The extent to which directors of an insolvent corporation, or a corporation on the verge of insolvency, owe fiduciary duties to creditors is as yet uncertain. In Delaware, the duty is fairly wide. In a recent case the Delaware Chancery Court held that a contract creditor could bring a direct action against a director of an insolvent corporation for breach of fiduciary duty.\textsuperscript{72} In another case before the

\textsuperscript{66} Rose v Schantz 201 NW2d 593 (Wis 1972) at 597-598.

\textsuperscript{67} Beyer v F & R Oilfield Contractors, Inc 407 So 2d 15 (La 1982) at 16. The sole issue in this case was whether shareholders could directly recover damages from directors for alleged illegal and \textit{ultra vires} acts (payment of excessive salaries, denial of access to books, failure to insure corporate property). The court held that although the Louisiana Statute (LSA-RS 12:91) extends the fiduciary duty of directors to shareholders, this does not allow a direct right of action by shareholders against directors. California and North Carolina are examples of other states recognising a duty to shareholders: Henn & Alexander \textit{Laws of Corporations} 613. On ss 309 and 1203 of the Californian Corporations Code, see Batenga & Willis "California Corporations Code" 1083ff. On derivative action, see par 4.3.1 below.

\textsuperscript{68} Henn & Alexander \textit{Laws of Corporations} 613.

\textsuperscript{69} An officer or director of an insolvent corporation is bound to act with absolute fidelity to creditors and shareholders. Liabilities of corporate managers to creditors usually arise after the corporation has become insolvent. Corporate officers and directors are liable to creditors for damages caused by their fraud or deceit: Choper, Coffee & Morris \textit{Corporations} 226; Clark \textit{Corporate Law} 35ff, 141; Knepper & Bailey \textit{Liability} 162-176; Dannen v Scafidi 393 NE2d 1246 (Ill 1979) at 1250; Winger v Chicago City Bank & Trust Co 67 NE2d 265 (Ill 1946) at 277.

\textsuperscript{70} In effect, the directors become the trustees of corporate property and the creditors are the beneficiaries of this trusteeship: Campbell \textit{Liability of Corporate Directors} 705; Varallo & Finkelstein "Financially Troubled Company" 243-244. This means that the directors are obliged to protect the trust by obtaining full value upon any sale of corporate assets and are liable to the creditors if they fail to do so.

\textsuperscript{71} Varallo & Finkelstein "Financially Troubled Company" 244ff; Bovay v HM Bylesby & Co 38 A2d 808 (Del 1944) at 813; \textit{New York Credit Men's Adjustment Bureau v Weiss} 110 NE2d 397 (NY 1953) at 398-400.

\textsuperscript{72} Geyer v Ingersoll Publications Co 621 A2d 784 (Del 1992) at 790-791.
Directors' Fiduciary Duties and Corporate Opportunities

Delaware Chancery Court, it was stated that the directors of a solvent corporation "in the vicinity of insolvency" should realise that they have a duty to the corporation which includes creditors. But as a general rule, creditors are not able to sue directors for causing harm to a corporation which led it to become insolvent and unable to pay its bills. In these instances, however, a bankruptcy trustee may be able to assume the place of and the claims of the bankrupt corporation and to sue the directors for breach of duty or violations of federal securities laws in order to recover money for the benefit of the creditors.

A general fiduciary duty to creditors is, however, not recognised. Creditors have been allowed to enforce liability indirectly for the breach of a director's fiduciary duties to the corporation by means of statutory provisions, the appointment of a receiver or trustee in bankruptcy and through enforcement of the corporation's cause of action by a judgment creditor. But the general opinion still favours the approach that recognition of a general fiduciary duty to creditors would allow inappropriate interference in corporate management by creditors. Another consequence would be that of conflicting duties to stockholders and creditors.

3.2 Content of the Fiduciary Obligation

Generally stated, the fiduciary obligation requires that a corporate director shall act with undivided loyalty to his corporation and imposes fundamental limitations on the extent to which a director may benefit from dealings with the corporation he serves.

73 Crédit Lyonnais Bank Nederland, NV v Pathe Communications Corp Civ Act No 12150, 1991 WL 277613 at 34 note 55 (Del Ch Dec 30, 1991). Since this case has not been available to me, I have had to rely on the comments of Beveridge "Duty to Creditors" 591, 620 and Varallo & Finkelstein "Financially Troubled Company" 240-243.

74 Campbell Liability of Corporate Directors 705.

75 The bankruptcy trustee is the equivalent of the liquidator of an insolvent South African company.

76 In Brown v Presbyterian Ministers Fund 484 F2d 998 (3rd Cir 1973) at 1005 the court confirmed that the fiduciary obligation is normally enforceable directly by the corporation, or by means of a stockholders' derivative action. In the event of bankruptcy of a corporation, it is enforceable by the trustee. Where the opportunity to purchase debts of the corporation at a discount was taken up by a director personally on the morning of institution of bankruptcy proceedings, the approval by directors and shareholders was found to be invalid because the transaction was unfair to creditors.

77 Beveridge "Duty to Creditors" 590.

78 Beveridge "Duty to Creditors" 621.

79 Ibid.

80 Anon "Corporate Opportunity" 765; Feuer Liabilities 32; Hamilton Corporations 770; Kempin, Wiesen & Bagby Management Process 416; Ruder "Duty of Loyalty" 1386; Tovey "Corporate Opportunity" 102; Wimberly "Recovery of Profits" 228; Guth v Loft, Inc 5 A2d 503 (Del 1939) at 510; Litwin (Rosemarin) v Allen 25 NYS2d 667 (1940); Marciano v Nakash 535 A2d 400 (Del 1987) at 403.
In *Meinhard v Salmon*,\(^1\) this strict obligation was thus motivated:

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behaviour. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. ... Only thus has the level of conduct for fiduciaries been kept at a higher level than that trodden by the crowd.\(^2\)

Many state statutes confirm the fiduciary relationship in general terms.\(^3\) The purpose of the statutory provision is to emphasise the duty and implied obligation of fidelity owed to the corporation.\(^4\) The Model Business Corporation Act and the corporation statutes of most states do not refer to specific fiduciary responsibilities of directors.\(^5\) The concept of a "duty of loyalty" is therefore flexible. As is the case in English law,\(^6\) various categorisations and sub-categorisations of directors' fiduciary duties can be made. These categories are not exclusive, and, to some extent, overlap.\(^7\)

\(^1\) 164 NE 545 (1928).

\(^2\) At 546. In *Litwin (Rosemarin) v Allen* 25 NYS2d 667 (1940) the court commented on the rule of undivided loyalty and confirmed (at 685) that while there is a lofty moral ideal implicit in this rule, it actually accomplishes a practical beneficial purpose, by recognising the frailty of human nature and realising that where man's immediate fortunes are concerned he may sometimes be subject to a blindness often intuitive and compulsive.

\(^3\) See McMurray "Historical Perspective" 625 note 122 for a comprehensive list of the states which had codified the duty of loyalty by 1987. On the Delaware General Corporation Law par 102(b)(7), see Veasy, Finkelstein & Bigler "Delaware Directors" 402ff. See also note 50 above in respect of RMBCA par 8.01.

\(^4\) Clark *Corporate Law* 141 opines that the recognition of a general fiduciary duty permits a continuous evolution in corporate law. At the same time, courts and legislatures have developed more specific rules, or particular fiduciary duties, to deal with the many recurring situations which involve a conflict of interest.

\(^5\) Knepper & Bailey *Liability* 11.

\(^6\) See chapter 4 par 3 above.

\(^7\) Henn & Alexander *Laws of Corporations* 625 classify the cases which involve fiduciary duties into those involving competing with the corporation, usurpation of corporate opportunity, having some interest which conflicts with the interest of the corporation, insider trading, oppression of minority shareholders and purchase or sale of control. Clark *Corporate Law* 142 distinguishes between instances involving basic self-dealing, executive compensation, the taking of corporate or shareholder property and corporate action with mixed motives.
Case law has also confirmed the fiduciary status of directors in most states. Again, the duty is stated broadly, which has the result that its exact ambit is not always apparent. From the authorities, certain guidelines can, however, be deduced.

3.2.1 Unfettered Discretion

Directors possess a large amount of discretionary power within the limits of their legal authority and in the exercise of business judgment in the performance of their duties. Accordingly, in addition to the exercise of express powers, the generally recognised rule is that the management of a corporation has, in the absence of express restrictions, discretionary authority to enter into all contracts and transactions that may be deemed reasonably incidental to its business purposes.

Directors may not bind themselves in their capacity as directors if they thereby unduly deprive themselves of their discretion in managing the corporation according to its best interests. They may not abrogate their independent judgment. Any contract purporting to do so is against public policy and void. Furthermore, directors may not agree to exercise their official duties for the benefit of anyone other than the corporation itself.

88 Under Delaware law this duty requires scrupulous observation of a duty to protect the interests of the corporation and to refrain from doing anything to injure it: Knepper & Bailey Liability 81; Guth v Loft, Inc 5 A2d 503 (Del 1939); Sterling v Mayflower Hotel Corporation 93 A2d 107 (Del 1952) at 110; Bastion v Bourns, Inc 256 A2d 680 (Del 1969) at 69, affirmed 278 A2d 467 (Del 1970); David J Greene & Co v Dunhill International, Inc 249 A2d 427 (Del 1968) at 431; William B Weinberger v UOP, Inc 457 A2d 701 (Del 1983) at 710; Smith v Van Gorkom 488 A2d 858 (Del 1985) at 872. New York requires a "high fiduciary duty of honesty and fair dealing" from corporate directors: Chris-Craft Industries Inc v Piper Aircraft Corporation 480 F2d 341 (2d Cir 1973). What exactly this means, depends on the circumstances of each case. See also the authorities cited in note 53 above.

89 See, for example, Veasy "Duty of Loyalty" 2067, where it is emphasised that "there is no bright line definition. While the general concept underlying the duty of loyalty - that a director refrain from self-dealing - is simple, application of the loyalty principle can be difficult and highly fact-intensive."

90 Herald Company v Seawell 472 F2d 1081 (10th Cir 1972) at 1094.

91 Marsili v Pacific Gas and Electric Company 79 ALR3d 477 (Cal 1975) at 485.


93 EK Buck Retail Stores v Harkert 62 NW2d 288 (Neb 1954) at 299.

94 Ray v Homewood Hospital, Inc 27 NW2d (Minn 1947) at 411; Milton Frank Allen Publications, Inc v Georgia Association of Petroleum Retailers, Inc 162 SE2d 724 (Georgia 1968) at 730.

95 Ray v Homewood Hospital, Inc 27 NW2d (Minn 1947) at 411.
3.2.2 *Manipulation of "Corporate Machinery"*

In the second place, it is said that directors may not manipulate the internal corporate machinery for the primary purpose of entrenching themselves in office.\(^96\) Thus the board of directors may not use the corporate machinery for the purpose of obstructing legitimate efforts of dissident shareholders to contest management.\(^97\) When self-dealing or bad faith has been proved, the director must prove that the transaction in question was fair and reasonable to the corporation.\(^98\)

3.2.3 *Avoidance of Conflicts of Interest*

The *Corporate Director's Guidebook*\(^99\) characterises the duty of loyalty as one in which the director pledges his allegiance to the enterprise and acknowledges that the best interests of the corporation and its shareholders must prevail over any individual interest of his own.\(^100\) Four specific components of the duty to avoid a conflict of interests are described.\(^101\) First, whenever a director has a material personal interest in dealings with the corporation he should disclose the existence of the interest before the board takes action and abstain from acting on the matter himself. In the second instance, he should attempt to resolve conflicting corporate interests fairly, with concern for the treatment of any minority shareholder who might be adversely affected. Thirdly, whenever a business opportunity comes to the director's attention as a result of his relationship to the corporation, he should present it to the corporation before pursuing the opportunity on his own account. Only after informed evaluation and a determination by disinterested peers that the corporation should not pursue such an opportunity, should the corporate director pursue the matter for

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\(^{96}\) Knepper & Bailey *Liability* 87; *Condec Corp v Lunkenheimer Co* 230 A2d 769 (Del 1967) at 775 (sale of stock); *Moran v Household International, Inc* 490 A2d 1059 (Del 1985) at 1071, affirmed in *Moran v Household International, Inc* 500 A2d 1346 (Del 1985); *Hanson Trust PLC, HSCM Industries Inc v ML SCM Acquisition, Inc* 781 F2d 264 (2nd Cir 1986). In *Hanson*, agreements concluded in order to forestall a proposed take-over were held invalid.

\(^{97}\) *Schnell v ChrisCraft Industries, Inc* 285 A2d 437 (Del 1971) at 439; *Norlin Corporation v Rooney, Pace, Inc* 744 F2d 255 (2d Cir 1984) at 258. In *Schnell* attempts to advance the date of the annual stockholders' meeting were prevented by injunction. The purpose of the advancement was to limit the amount of time available to plaintiffs to wage a proxy battle in order to elect new management.

\(^{98}\) *Norlin Corporation v Rooney, Pace, Inc* 744 F2d 255 (2d Cir 1984) at 265.

\(^{99}\) Committee on Corporate Laws, Section of Corporation, Banking and Business Law, American Bar Association, *Corporate Director's Guidebook* (rev ed 1978), reprinted in (1978) 33 *Business Lawyer* 1595. This guidebook is the product of a group comprising mostly corporation attorneys, many of whom often represent corporate management. It was prepared in order to assist the corporate director in the performance of his duties (preface at 1595). The guidebook is therefore influential: Hamilton *Corporations* 616.

\(^{100}\) At 1599.

\(^{101}\) At 1599-1600.
his own account or for the benefit of others. Finally, the director should deal confidentially with corporate matters until public disclosure has been effected.

Courts scrutinise alleged conflict of interest transactions very carefully. The party alleging a breach of the duty of loyalty initially bears the burden of proving that a conflict of interests existed. When the duty of loyalty line is transgressed, the burden of proof shifts to the director, who must prove that the transaction was intrinsically fair to the corporation. Most jurisdictions will uphold a transaction involving a conflict of interest if the transaction was approved by a majority of disinterested directors or was ratified by a majority of the stockholders.

3.2.3.1 Secret Profits

Profitmaking by a fiduciary in a corporate transaction is not always precluded. But a cardinal principle which arises from the fiduciary relationship existing between the director and his corporation, is the fact that he is not permitted to make a "private" or "secret" profit from his official position. Any benefit or advantage so acquired must be given to the corporation. English law also requires that secret profits should not be derived from the director's fiduciary position.

The concept of a secret profit is misleading, since the profit need not really be secret. The concept generally refers to any benefit gained by virtue of the fiduciary's position. For example, a corporate director may not use the corporate assets to

102 McMurray "Historical Perspective" 627.
103 Arsh "Business Judgment Rule" 116; McMurray "Historical Perspective" 627.
104 Campbell Liability of Corporate Directors 679; McMurray "Historical Perspective" 627; Backus v Finklestein 23 F2d 531 (Minn 1924) at 535; Popperman v Rest Haven Cemetery, Inc 345 SW2d 715 (Tex 1961) at 717.
105 McMurray "Historical Perspective" 627.
106 Feuer Liabilities 71.
107 Representative of the numerous cases supportive of this principle are the following: Chounis v Lang 23 SE2d 628 (W Virg 1942) at 636; Ameman v Ameman 264 P2d 256 (Wash 1953) at 263; Tovrea Land and Cattle Company v Linsenmeyer 412 P2d 47 (Ariz 1966) at 59; Wilshire Oil Company of Texas v Riffe 381 F2d 646 (10th Cir 1967) at 651; Ramacciotti v Joe Simpkins, Inc 427 SW2d 425 (Miss 1968) at 432; Hawaiian International Finances, Inc v Pablo 488 P2d 1172 (Hawaii 1971) at 1174; Simpson v Spellman 522 SW2d 615 (Miss 1975) at 620; Brecher v Gregg 392 NYS2d 776 (1975) at 780.
108 Various tests are applied: see chapter 4 page 75 above. In Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162, however, it was regarded as immaterial that an opportunity had come to the knowledge of the director in his personal or individual capacity. See chapter 4 page 94 above.
109 Such profits are generally referred to as "secret", because they are often made furtively. However, whether they are "secret" or open in the sense that the other directors know about the profits, is not material: Feuer Liabilities 71-72; Blum v Fleischhacker 21 FSupp 527 (Cal 1937) at 533; Penn-Texas Corporation v Sarle 181 NYS2d 750 (1958) at 752.
advance his own interests or for his personal benefit. Neither may he keep any commission or compensation paid by a third person in connection with loans made by that person to or from the corporation. It has, however, been held that where a corporation is insolvent and to all purposes incapable of exercising the function of carrying out the purposes for which it was organised, its officers and directors do not owe it the duty of turning over to it the profits realised by the exercise of their skill and judgment, unless they were acting for the corporate interest.

A director who makes private or secret profits must therefore account for them. It makes no difference if the transaction from which the profits are derived is advantageous to, or is not harmful to, the corporation. Liability may be incurred for breach of fiduciary duty even in the absence of bad faith or dishonesty, or of injury.

3.2.3.2 Competing with the Corporation

The rule of undivided loyalty inter alia restricts the director, as fiduciary, from competing with the corporation. But it is recognised that directors also have personal interests to advance, and that too strict an application of the rule of undivided loyalty would tend to restrict freedom of enterprise and to discourage competent persons from serving in corporate directorships.

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110 Central Ry Signal Co v Longden 194 F2d 310 (7th Cir 1952) at 316. Here the defendant director had made use of services and time of the corporation's employees in order to develop his own business.

111 Blackburn's Adm'x v Union Bank & Trust Co 108 SW2d 806 (Ky 1937) at 809; Fleischhacker v Blum 109 F2d 543 (9th Cir 1940) at 545-546; Sullivan v Mountain 160 P2d 477 (Mont 1945) at 479; Broadway Federal Savings and Loan Association of Los Angeles v Howard 285 P2d 61 (Cal 1955) at 69; Security National Bank of Long Island v Heaney 194 NYS2d 828 (1959) at 829.

112 Jasper v Appalachian Gas Co 153 SW 50.

113 Thomas v Robin Industries, Inc 520 F2d 1393 (3rd Cir 1975) at 1397; Adelman v Conotti Corporation 213 SE2d 774 (Virg 1975) at 779; Boyd v Cooper 410 A2d 860 (Penn 1979) at 861.

114 Sullivan v Mountain 160 P2d 477 (Mont 1945) at 479; Heit v Bixby 276 FSupp 217 (Miss 1967) at 226; Hawaiian International Finances, Inc v Pablo 488 P2d 1172 (Hawaii 1971) at 1175; Thomas v Robin Industries, Inc 520 F2d 1393 (3rd Cir 1975) at 1397.

115 Blum v Fleischhacker 21 F Supp 527 (Cal 1937); Walton v Morgan Stanley & Co, Incorporated 623 F2d 796 (1980) at 798. In Guth v Loft, Inc 5 A2d 503 (Del 1939) the court confirmed (at 510) that the rule requiring a corporate officer or director to account for a private profit or advantage which arises from a violation of his duty, is not based upon the narrow ground of injury or damage to the corporation, but upon a broader foundation of public policy, which, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation.


117 Especially since, as was noted above (see par 2.4), directorships often involve no or only nominal compensation under American law.
The general rule is, therefore, that directors may engage in independent business, but if such business competes with that of the corporation, equitable limitations apply.\footnote{118} Thus, in \textit{H Vincent Allen & Associates, Inc v Weis},\footnote{119} a director was ordered to pay damages in the amount of thirty thousand dollars for soliciting accounts and employees of the corporation while still employed by it. The basic requirements are that the director should act in good faith and not interfere with the business of the corporation.\footnote{120} The director may, furthermore, not organise another corporation to engage in a competing business.\footnote{121}

The fiduciary may not use his corporate position to prevent the corporation from competing with him.\footnote{122} Neither may he use corporate personnel, facilities, or funds for his own business,\footnote{123} use or disclose to others the corporation's trade secrets or confidential information,\footnote{124} lure away corporate business,\footnote{125} or personnel.\footnote{126} The prohibition on the disclosure of confidential information applies not only to those communications which are stated as confidential, but also to information which the fiduciary should know that the corporation would not wish to have revealed or used in competition with it.\footnote{127} It does not apply to matters of common knowledge in the community nor to special skill which an employee has acquired because of his employment.\footnote{128}
A fiduciary may, furthermore, not receive, unknown to the corporation, a commission on a corporate transaction.129

Where a fiduciary competes with the corporation in breach of his fiduciary obligation, the corporation is entitled to damages to itself or profits realised by the fiduciary and may be able to attach a constructive trust to any property acquired by the fiduciary.130

Agreements not to compete will be enforced if they are reasonable as to time,131 area and scope.132 Several corporate state statutes provide that covenants not to compete are invalid restraints of trade. Sale of goodwill or corporate shares are usually exceptions to the general rule.133

Theoretically, therefore, a director may compete with his company, subject to certain limitations.134 However, any director who competes with his corporation runs the risk of breaching his fiduciary duty of loyalty.135 The duty is not breached merely by competing. The competition must be in bad faith.136 Full disclosure by the (outside) director is therefore critical for avoiding liability when that director is alleged to be competing with the corporation. A director is not liable if the corporation consents to him competing with the company.137

A subsidiary issue of a director’s liability for competing with his corporation arises when the director is a party to a corporate transaction. Directors may deal

129 Wilshire Oil Co v Riffe 381 F2d 646 (10th Cir 1967) at 651. See also par 2.4 above.

130 Bancroft-Whitney Co v Glen 411 P2d 921 (Cal 1966) at 941. In that case damages were awarded against a former president who joined a competing publishing company and solicited more than twenty officers, directors and employees from the plaintiff company. On constructive trusts, see par 4.1 below.

131 In Marine Contractors Co, Inc v Hurley 310 NE2d 915 (Mass 1974) a five year limitation was upheld (at 919).

132 Henn & Alexander Laws of Corporations 630. Where covenants operate too restrictively, courts have sometimes narrowed them to reasonable scope. At other times they have been treated as entirely invalid: H & R Block, Inc v McCaslin 541 F2d 1089 (5th Cir 1976).

133 Henn & Alexander Laws of Corporations 631.

134 According to Ford "Director" 474 the director’s duty not to compete is regarded in some jurisdictions as being no wider than a duty not to divert corporate opportunities (in this regard, see par 6 below).

135 An outside director should pay careful attention to this risk, whereas it is all but impossible for an inside director to compete without incurring liability: Campbell Liability of Corporate Directors 695.

136 Campbell Liability of Corporate Directors 695. In Elzey v Fyr-Pruf, Inc 376 So 2d 1328 (Miss 1979) the court warned that it would be difficult for a director to enter into a competing business without doing so in bad faith (at 1334).

137 Smith v Pacific Pools, Inc 530 F2d 658 (Wash 1975) at 662. A director had given his consent for his co-director to compete in the swimming pool construction business. He was willing for the competition to continue, if the co-director would resign. The latter never resigned, but no steps were taken to have him removed. The court held that the required consent had been given to the competition.
with their corporation. But, in William B Weinberger v UOP, Inc the court confirmed that directors of a corporation who are on both sides of a transaction must prove the utmost good faith and the most scrupulous inherent fairness of the bargain. A director who is interested in a transaction bears the burden of establishing its fairness, which includes both fair dealing and fair price. This test of fairness is strict. The transaction will be carefully scrutinised by the court, even if the corporate charter or bylaws expressly permit the interested directors to negotiate contracts with the corporation. The court concluded that a director of two corporations owes the same duty of loyalty to both corporations.

Some statutes regulating these transactions provide that a transaction with interested directors is not voidable merely because interested directors are involved or participate in a vote to authorise the transaction. In Delaware, the transaction is not void or voidable if the director discloses his relationship to the contract or transaction to the other directors, or it is known by them and the board authorises the transaction by a majority vote of disinterested directors. It is not relevant that the disinterested directors may by themselves form less than a quorum. Another way to validate transactions of this nature, is to obtain shareholder approval or ratification. The transaction will not be void or voidable if the shareholders are informed by the director of the material facts of his relationship with or interest in the contract or transaction, or the facts are known to them, and they approve it in good faith by shareholder vote. But the transaction must be fair to the corporation at the

138 Popperman v Rest Haven Cemetery, Inc 345 SW2d 715 (Tex 1961) at 717.
139 457 A2d 701 (Del 1983), discussed by Daniel "Developments" 648ff. In Marciano v Nakash 535 A2d 400 (Del 1987), discussed by Hamilton Corporations 769ff, a corporation which was a joint venture for the marketing of designer jeans and sportswear was placed in custodial status by reason of a deadlock among its board of directors. The intrinsic fairness test was applied to validate a claim in respect of loans by some of the directors to the corporation, notwithstanding their origin in self-dealing transactions (the defendants had, as officers, executed documents which supported loans to the corporation extended through their wholly owned subsidiaries).
140 William Weinberger at 710.
141 At 710. It is submitted that this could put him in an untenable position, and, in fact, precludes directorships in competing corporations: Daniel "Developments" 648ff.
142 RMBCA par 8.31 establishes typical procedures for approval of conflict-of-interest transactions between the corporation and an "interested" director. It provides that a conflict-of-interest transaction is not voidable by the corporation solely because of the director's interest in the transaction if any one of the following is true: (1) the material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors and the board or committee authorised, approved or ratified the transaction, (2) the material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorised, approved or ratified the transaction, or (3) the transaction is fair to the corporation. Most courts follow this approach by requiring a determination of the transaction's fairness: Kempin Wiesen & Bagby Management Process 417.
143 Delaware General Corporation Law, par 144.
time it is authorised, approved or ratified by the board or the shareholders.\textsuperscript{144} If a majority vote of the disinterested directors is not obtained in such an instance, the interested directors will bear the burden of proving the transaction's fairness.\textsuperscript{145} If creditors' rights are compromised and the particular transaction would render the corporation insolvent, the shareholder ratification is ineffective.\textsuperscript{146}

The corporation is entitled to rescind transactions with interested directors when the abovementioned standards are not complied with. In addition, the corporation may recover damages from the director if unfair profits have been made. For example, if a director gains an inflated value in assets sold to the corporation, the corporation may obtain damages equal to the inflated value.\textsuperscript{147} In some instances, the original cost of assets sold to the corporation may be used to compute the damages, even though such a computation could totally deprive the director of any appreciation profit. Rescission is the only remedy if an interested director acts in good faith or fails to make a personal profit.\textsuperscript{148}

3.2.3.3 Multiple Directorships

The same person may hold directorships in two or more corporations.\textsuperscript{149} This is generally considered desirable because of the diminishing pool of adequate director talent. It is considered impossible for large corporate boards to be completely exclusive without having some members who also serve on the boards of other corporations.\textsuperscript{150} But in some cases this may have the unfortunate effect of confronting the director with a conflict of loyalties. The same requirements therefore apply as mentioned under paragraph 3.2.3.2 above. As long as a fully informed consent is given by the two boards or shareholders, transactions between corporations with interlocking directorates are valid.\textsuperscript{151}

\textsuperscript{144} Ibid.

\textsuperscript{145} Campbell Liability of Corporate Directors 696.

\textsuperscript{146} Kempin Wiesen & Bagby Management Process 417. See also par 3.1 above, where it was indicated that in circumstances of insolvency, the fiduciary obligation may also extend to creditors of the company.

\textsuperscript{147} Kempin Wiesen & Bagby Management Process 417.

\textsuperscript{148} Kempin Wiesen & Bagby Management Process 417. However, it was shown above (see par 3.2.3.1 above) that bad faith is not a requirement for an accounting of secret profits. This seems anomalous.

\textsuperscript{149} The facts in Johnston v Greene 121 A2d 919 (Del 1956) illustrate the variety of offices which may be held by one man.

\textsuperscript{150} Feuer Liabilities 42; Kempin Wiesen & Bagby Management Process 420.

\textsuperscript{151} Feuer Liabilities 42; Henn & Alexander Laws of Corporations 638; Kempin Wiesen & Bagby Management Process 420.
The problem of interlocking directorates often arises between corporations that are part of a group. Some jurisdictions place the burden of proving that a particular transaction is fair on the parent (holding) corporation.\textsuperscript{152}

The provisions of the United States Annotated Code ("USCA") 15 paragraph 19 are also relevant in respect of interlocking directorates.\textsuperscript{153} This paragraph provides that no person shall, at the same time, serve as a director or officer in any two corporations (other than banks, banking associations and trust companies) that are engaged in whole or in part in commerce and are competitors, if each of the corporations has capital, surplus and undivided profits aggregating more than ten million dollars.\textsuperscript{154} The paragraph does not apply where the allegedly interlocking corporations are operated as a single economic entity and not as competitors.\textsuperscript{155}

3.3 Duration of the Fiduciary Obligation

It is not possible to limit the fiduciary duty of a director to the time when he is acting as director of the corporation under any special delegation of power or is in attendance at meetings of the board. Fiduciary duties continue as long as the directorship continues.\textsuperscript{156}

After there has been a severance of the official relationship, either because of resignation or removal, a director generally occupies no relation of trust or confidence to the corporation.\textsuperscript{157} The fact that a person was formerly a director of a corporation does not prevent him from engaging in a similar business.\textsuperscript{158}

\begin{footnotes}
\item[152] This is the position in Delaware: Kemppin Wiesen & Bagby Management Process 420; Getty Oil Company v Skelly Oil Company 267 A2d 883 (Del 1970).
\item[153] This paragraph is the same as the previous par 8 of the Clayton Act (38 Stat 730, Ch 323), which was adopted in 1914 to supplement other antitrust legislation. The only difference is in the required value of the corporation’s capital.
\item[154] Paragraph 8 of the Clayton Act was applied in United States v Sears, Roebuck & Co 111 FSupp 614 (NY 1953) to prevent a director from acting on the boards of two corporations who were competitors in the sale of home appliances, hardware and automotive supplies.
\item[155] Las Vegas Sun, Inc v Summa Corporation 610 F2d 614 (9th Cir 1979) at 618. “Competitors” in the context of USCA par 19 means companies that vie for the business of the same prospective purchasers, even if the products they offer, unless modified, are sufficiently dissimilar to preclude a single purchaser from having a choice of suitable products from each of them: TRW, Inc v Federal Trade Commission 647 F2d 942 (9th Cir 1981) at 946-947.
\item[156] Bentz v Vardaman Manufacturing Company 210 So 2d 35 (Miss 1968) at 40.
\item[157] Renpak, Inc v Oppenheimer 104 So 2d 642 (Fla 1958) at 644.
\item[158] Witmer v Arkansas Dailies, Inc 151 SW2d 971 (Ark 1941) at 973; American Window Cleaning Company of Springfield v Cohen 178 NE2d 5 (Mass 1961) at 8-9; Aero Drapery of Kentucky, Inc v Engdahl 507 SW2d 166 (Ky 1974) at 169; Epperly v E & P Brake Bonding, Inc 348 NE2d 75 (Ind 1976) at 83; Southeast Consultants, Inc v McCrary Engineering Corp 273 SE2d 112 (Ga 1980) at 116 (in this case it was also confirmed that although a former director may compete with his former employer he may not appropriate a business opportunity existing at the time of his resignation); United Seal & Rubber Company, Inc 285 SE2d 721 (Ga 1982) at 722.
\end{footnotes}
indicated that it is a common occurrence for corporate fiduciaries to resign and form a competing enterprise, and that unless restricted by contract this may be done freely, because freedom of employment and encouragement of competition dictate that such persons can leave their organisation at any time and enter into a competing business.159 Directors may utilise the experience and knowledge acquired while working for their former corporation.160 In the absence of any contrary contractual provision,161 the customers of their former corporation may be solicited, unless the customer list is in itself of a confidential nature.162 However, confidential information acquired while in a strategic position of trust may not be utilised for the profit of the directors and to the detriment of the company.163 Neither may they take with them key personnel of the corporation for the purpose of operating their own competitive enterprise.164

A director may, however, not divert to himself business opportunities in which the corporation has an interest or expectancy.165 A director who resigns in order to acquire such an opportunity will therefore still be liable for breach of his fiduciary obligation. The breach lies in the fact that his duty of loyalty is transgressed during his office. It does not mean that the fiduciary obligation extends beyond the duration of the directorship.

159 Kempin Wiesen & Bagby Management Process 429; Raines v Toney 313 SW2d 802 (Ark 1958) at 809; Epperly v E & P Brake Bonding, Inc 348 NE2d 75 (Ind 1976) at 83; Maryland Metals, Inc v Metzner 382 A2d 564 (Md 1978) at 568.

160 Raines v Toney 313 SW2d 802 (Ark 1958) at 809; Epperly v E & P Brake Bonding, Inc 348 NE2d 75 (Ind 1976) at 83.

161 On the requirements for such provisions to be enforceable, see par 3.2.3.2 above.

162 Raines v Toney 313 SW2d 802 (Ark 1958) at 809; Epperly v E & P Brake Bonding, Inc 348 NE2d 75 (Ind 1976) at 83. In Raines the court also held that the directors could, while still employed by the corporation, notify their corporation's customers of their intention to resign and subsequently go into business for themselves. If business should be offered to them by the clients, they could accept it (at 809).

163 Opie Brush Company v Bland 409 SW2d 752 (Mo 1966) at 758; Maryland Metals Inc v Metzner 382 A2d 564 (Md 1978) at 569; Haynes v CRC Information Systems, Inc 415 NYS2d 25 (AD 1979) at 26. In Duane Jones Co v Burke 306 NY 172 (1954) the defendants were held in breach of their fiduciary duties because they had conspired to take over their corporation's customer accounts while they were still in the employ of the corporation. In addition, they had used corporate assets and facilities to plan their move to a competing advertising agency and had actively solicited the corporation's key employees to join them in the new venture.

164 Twin Falls Farm & City Distributing, Inc v D&B Supply Co, Inc 528 P2d 1286 (Idaho 1974) at 1293; Aero Drapery of Kentucky, Inc v Engdahl 507 SW2d 166 (Ky 1974) at 169.

165 See par 6 below.
4 ENFORCEMENT OF DIRECTORS' FIDUCIARY DUTIES

4.1 Introduction - Equitable Relief and Legal Action

A breach of fiduciary duty is a ground for the exercise of equity jurisdiction in the absence of an adequate and complete remedy at law. Where, however, the remedy at law is complete and adequate and there is no need for invoking the aid of a court in equity, either because of the issues involved or to avoid a multiplicity of actions, it has been held that the proper action would be one in law for damages.

The general rule is that an equitable suit may be instituted by or on behalf of the corporation where the director, by making use of his official position, obtained an undue advantage or profit for himself in a transaction, or in a similar manner committed a breach of his fiduciary obligations towards the corporation so that it sustains an injury or loss.

The primary remedies in equity are injunctive relief and the imposition of a constructive trust. The constructive trust has been described as a remedial device by which the holder of legal title to property is deemed to be a trustee of that property for the benefit of another who in good conscience is entitled to it. A constructive trust arises when equity so demands. It has frequently been imposed for the abuse of a fiduciary relationship.

The difference between equitable relief and legal action is clearly illustrated by the decision in Poling Transportation Corporation v A&P Tanker Corporation. A vessel had been purchased personally by a corporate officer for twenty thousand dollars. It was alleged that a vessel of that size and type was not ordinarily con-

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166 Historically, relief in equity is given where the plaintiff could get no relief, or only inadequate relief, in a court of common law: Penfield v Murray Hill Holding Corp 117 NYS2d 589 (1952) at 590. The distinctions between actions at law and suits in equity have been generally abolished. Usually the trial in an American action in equity is by the court without a jury. An action at law is tried before a jury. There are, however, certain states whose statutes provide for the trial of issues of fact by a jury in certain actions in equity.

167 Kocan v Cordeiro 200 A2d 708 (Rhode Island 1964) at 710.

168 Am Jur volume 18B par 1776.

169 On constructive trusts in English law, see chapter 4 par 3.2.2 above. This remedy may be invoked at law and in equity: Jacobson v Yaschik 155 SE2d 601 (S Car 1967) at 607.

170 Namow Corporation v Egger 668 P2d 265 (Nev 1983) at 267. It is a fiction of equity: Russell v Douglas 138 So 2d 730 (Miss 1962) at 734; Duran v Komyaite 490 NE2d 388 (Ind 1986) at 392.

171 Hall v Superior Federal Bank 794 SW2d 611 (Ark 1990) at 615.

172 Austin "Constructive Trusts" 196ff; Winger v Chicago City Bank & Trust Co 67 NE2d 265 (Ill 1946) at 276; Mile-O-Mo Fishing Club, Inc v Noble 210 NE2d 12 (Ill 1965) at 15; Thomas v Fales 577 A2d 1181 (Me 1990) at 1183.

structed at that time and could not be obtained in the secondhand market. If a competitor were to acquire such a used vessel the corporation would suffer competitive disadvantage. Legal action for damages against the defendant would be impractical and inefficient as compared to equitable action. Use of the preliminary injunction was considered to be suitable for this type of action and permitted the use of the constructive trust. The court thus held that injunctive relief was appropriate.\textsuperscript{174}

Wrongdoers are jointly and severally liable in respect of breach of fiduciary duties.\textsuperscript{175}

Minority shareholders have also been permitted to sue in tort for fraudulent breaches of fiduciary duty by a corporation officer and majority shareholder.\textsuperscript{176}

\section*{4.2 Enforcement by the Corporation}

Wrongs which affect the corporation itself, or the shareholders generally, give rise to causes of action on behalf of the corporation.\textsuperscript{177} Actions to enforce corporate rights or to redress injuries against the corporation must therefore be brought in the name of the corporation.\textsuperscript{178} In the absence of any independent duty owed specifically to a shareholder,\textsuperscript{179} any wrong suffered by such shareholder is deemed to be the same as a wrong suffered by the corporation.\textsuperscript{180}

Primarily the corporation, or if it is insolvent, its receiver,\textsuperscript{181} is therefore the proper party to sue for wrongs to itself through the mismanagement of its affairs.

\begin{itemize}
\item \textsuperscript{174} At 897.
\item \textsuperscript{175} Henn & Alexander \textit{Laws of Corporations} 628; Knepper & Bailey \textit{Liability} 159; Irving Trust Co \textit{v} Deutch 73 F2d 121 (2d Cir 1934).
\item \textsuperscript{176} Knepper & Bailey \textit{Liability} 14. In \textit{Jacobson v Yaschik} 155 SE2d 601 (S Car 1967) this was allowed when directors failed to disclose special facts which enhanced the value of stock which they were purchasing.
\item \textsuperscript{177} \textit{Fried v Easton} 293 So 2d 87 (Fla 1974) at 88.
\item \textsuperscript{178} \textit{Green v Victor Talking Mach Co} 24 F2d 378; \textit{James Talcott, Inc v McDowell} 148 So 2d 36; \textit{Caldwell v Eubanks} 30 SW2d 976; \textit{Buck Retail Stores v Harkert} 62 NW2d 288; \textit{Bank of New Mexico v Rice} 429 P2d 368; \textit{Goodwin v Castleston} 144 P2d 725.
\item \textsuperscript{179} \textit{Sacks v American Fletcher National Bank and Trust Company} 279 NE2d 807 (Ind 1972) at 811; \textit{Pecora v Szabo} 418 NE2d 431 (Ill 1981) at 439.
\item \textsuperscript{180} \textit{Fifty States Management Corporation v Niagara Permanent Savings and Loan Association} 396 NYS2d 925 (AD 1977) at 927-928 (stockholder had given a personal guarantee for a corporate loan).
\item \textsuperscript{181} A receiver, or sequestrator, of a corporation may be appointed by court if the corporation is insolvent or nearly insolvent. State statutes generally provide that the application may be brought by stockholders or creditors: Henn & Alexander \textit{Laws of Corporations} 1162.
\end{itemize}
official misconduct, or waste of its assets by its directors or officers.\textsuperscript{182} This is so, even though the wrongdoers continue to be shareholders who will, as such, benefit from the proceeds of the recovery. Any right of recovery for misappropriation of a corporate opportunity therefore resides in the corporation, and not in its individual shareholders.\textsuperscript{183} A former shareholder who has sold his stock has no remedy for breach of fiduciary duty by a director.\textsuperscript{184} In the event of the bankruptcy of the corporation, the fiduciary obligation is enforceable by the trustee.\textsuperscript{185}

A bill or complaint in equity which alleges misfeasance by corporate directors must disclose the facts upon which the charge is based.\textsuperscript{186}

4.3 Shareholders’ Remedies

Liability of corporate officers and directors are enforced by class actions, direct actions and derivative actions.\textsuperscript{187} Each of these actions performs a particular function.

A representative or class action arises by necessity if the parties are too numerous to be joined.\textsuperscript{188} One party is, or a few are, then permitted to sue on behalf of all the parties. An action may thus be said to be representative when it is based on a primary or personal right which belongs to the plaintiff shareholder and those of his class. Sometimes a derivative action is referred to as representative, in the

\textsuperscript{182} Platt Corporation \textit{v} Platt 256 NYS2d 256 (CA 1965) at 335; Pickett \textit{v} Paine 199 SE2d 223 (Ga 1973) at 227; Richardson \textit{v} Arizona Fuels Corporation 614 P2d 636 (Utah 1980) at 638; Thrift \textit{v} Maxwell 290 SE2d 301 (Ga 1982) at 304; Moity \textit{v} Acadian Woodworks, Inc 435 So 2d 597 (La 1983) at 599; Fitzpatrick \textit{v} Shay 461 A2d 243 (Pa 1983) at 246.

\textsuperscript{183} The remedies accrue to the corporation and not to the shareholders. The same result could therefore occur as in \textit{Regal (Hastings) Ltd \textit{v} Gulliver} (see chapter 4 page 69 above), where the order to disgorge benefited the new owners of the corporation rather than those who were shareholders when the breach of duty occurred: Ford “Directors” 474. On corporate opportunities, see par 6 below.

\textsuperscript{184} In \textit{Davis \textit{v} Hamm} 387 SE2d 676 (S Car 1989), discussed by Hogue “Former Shareholder” 11, the South Carolina Court of Appeals held that a former shareholder cannot bring a direct action against a corporate director for misappropriation of corporate assets and breach of fiduciary duty.

\textsuperscript{185} \textit{Brown \textit{v} Presbyterian Ministers Fund} 484 F2d 998 (1973). See par 3.1 above, where it is indicated that a director of an insolvent corporation owes fiduciary duties to creditors of the corporation, as well as to the shareholders.

\textsuperscript{186} In Am Jur volume 18B par 1776 the commentators suggest that since the corporate opportunity doctrine is narrower in scope than actions based on the general duties owed by a director to his corporation, an action for breach of fiduciary duty should be brought in addition to the action for breach of corporate opportunity. See also par 6 below.

\textsuperscript{187} Clark \textit{Corporate Law} 639ff; Feuer \textit{Liabilities} 194ff; Henn & Alexander \textit{Laws of Corporations} 1035ff; Kempin Wiesen & Bagby \textit{Management Process} 350; Knepper & Bailey \textit{Liability} 569. The court is not bound by the designation employed by the plaintiff: \textit{Moran \textit{v} Household International, Inc} 500 A2d 1346 (Del 1985) at 1069.

\textsuperscript{188} Brill \textit{v} Blakeley 120 NYS2d 713 (AD 1953).
sense that the shareholder sues on behalf of or as a representative of the corporation.\footnote{189}

A shareholder may institute an individual or direct right of action against a corporation when he has sustained a loss which is distinct from that of other shareholders generally,\footnote{190} for instance where a contractual or statutory duty is owed to the shareholder directly.\footnote{191} Examples of such claims are management's refusal of inspection of the corporate books by the particular shareholders or an insider's failure to disclose material information when purchasing shareholders' shares.\footnote{192} Although a shareholder may not bring an individual suit when the whole body of stockholders is injured,\footnote{193} the wrong necessary to support an individual cause of action need not be unique to the shareholder. The same injury may affect a substantial number of stockholders. But if it is not incidental to an injury to the corporation an individual cause of action exists. For example, a wrong may affect all minority shareholders, but may still support an individual cause of action.\footnote{194} When an injury affects numerous shareholders, the direct action may be brought as a class action.\footnote{195} For example, if management denied all preferred shareholders the payment of a mandatory dividend, all the preferent shareholders would have the right to sue. To avoid the multiplicity of numerous separate and costly suits, a class action may be maintained in either federal or state court by a single preferent shareholder representing all other preferent shareholders.\footnote{196} Any damages awarded in individual or class actions is for the direct benefit of the plaintiffs, and is not awarded to their corporation.\footnote{197}

Where the claim is that management's wrongdoing has directly injured the corporation and has thereby prejudiced the shareholders only indirectly, the shareholders' injury (dimunution in the value of their shares) derives from the fact that

\footnote{189} On derivative actions, see par 4.3.1 below.

\footnote{190} Clark Corporate Law 640; Choper, Coffee & Morris Corporations 785. This type of action was instituted where a pre-incorporation contract which provided for the plaintiff's employment as general manager was breached: Henderson v Joplin 217 NW2d 920 (Neb 1974) at 925.

\footnote{191} Moran v Household International, Inc 500 A2d 1346 (Del 1985) at 1070.

\footnote{192} Choper, Coffee & Morris Corporations 785; Kempin Wiesen & Bagby Management Process 351.

\footnote{193} Southeast Chrysler-Plymouth, Inc v Pieroni 465 NYS2d 499 (AD 1983).

\footnote{194} Jones v HF Ahmanson & Company 460 P2d 464 (Cal 1969) at 470-471. The majority stockholders created a scheme whereby they profited from the subscription in stock of another corporation, which they had been instrumental in forming. The minority stockholders were not given the opportunity to participate in the subscription. The plaintiff, who owned twenty five shares, was permitted to bring a class action on behalf of all minority shareholders.

\footnote{195} Knepper & Bailey Liability 571.

\footnote{196} Kempin Wiesen & Bagby Management Process 351.

\footnote{197} Clark Corporate Law 640.
the alleged misconduct has reduced the value of the corporation's assets. An individual shareholder has no right to bring an action in his own name in respect of a wrong committed solely against the corporation. However, equity allows the shareholder to maintain a derivative action on behalf of the corporation if the directors refuse to sue or if a demand upon them to sue would be futile, either because of self-interest or neglect.

In ambiguous cases, where it is not clear whether the wrong is directed primarily at a particular shareholder, at a class of shareholders, or at the corporation, the court must identify the alleged harm in order to identify the suit. For example, in Richardson v Arizona Fuels Corporation the court confirmed that mismanagement of a corporation which resulted in damage to the stockholders by depreciation of the corporation's stock, gave rise to a derivative action on behalf of the corporation, and not to a class action.

4.3.1 The Derivative Action

The derivative suit is an action in equity and often involves equitable issues of breaches of fiduciary duty. Because it is an equitable action, the use of a jury is prevented. Equitable relief is flexible, and in the case of a derivative suit includes an accounting; appointment of a receiver; dissolution of the corporation; an injunction prohibiting certain activities or requiring certain acts; a money judgment; disgorgement of corporate assets; the removal of corporate directors or officers; rescission, cancellation or specific performance of contracts; or the creation of a trust.

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198 For example, directors may have breached their fiduciary duties by taking excessive salaries or appropriating corporate opportunities, or management may have improperly declined to enforce a corporate cause of action against outsiders: Choper, Coffee & Morris Corporations 785-786.

199 Fried v Easton 293 So 2d 87 (Fla 1974) at 88.

200 Branson "Standard of Loyalty" 475ff; Choper, Coffee & Morris Corporations 785ff; Henn & Alexander Laws of Corporations 1037; Kempin, Wiesen & Bagby Management Process 353; Pennington Personal Liability 225. The derivative action is discussed in par 4.3.1 below.

201 614 P2d 636 (Utah 1980).

202 Chittur "Derivative Suits" 104; Clark Corporate Law 639ff; Feuer Liabilities 203. Where a large number of shareholders might suffer from a director's breach of duty, his removal from office may provide an inadequate remedy. Therefore equity developed the derivative action: Kempin Wiesen & Bagby Management Process 353.

203 Kempin Wiesen & Bagby Management Process 354. See also 4.1 above.

204 Kempin Wiesen & Bagby Management Process 354.
Since the wrong of a director is primarily committed against the corporation, it creates a cause of action on the part of the corporation.\textsuperscript{205} Judgment is, accordingly, in favour of the corporation. Until it is shown that the corporation is incapable of enforcing the right of action or that it improperly or collusively refuses to do so, individual shareholders may not attempt to redress the wrong.\textsuperscript{206} The value of the derivative remedy lies in the fact that it allows a single action to be brought by a shareholder for complete relief to the corporation as a whole. Thus creditors and shareholders are protected according to their respective interests.\textsuperscript{207}

In the absence of any independent duty owing to a stockholder from a wrongdoer,\textsuperscript{208} any wrong suffered by a shareholder is deemed to be the same as a wrong suffered by the corporation. There is no stockholder right of action separate from the corporate right of action in such instances.\textsuperscript{209}

Since a derivative action enforces a corporate rather than an individual right, recovery is usually for the full corporate loss or injury.\textsuperscript{210} In limited instances, courts have allowed individual shareholders to recover in derivative actions.\textsuperscript{211} In such cases the shareholder receives a \textit{pro rata} share of what the corporation normally

\footnotesize{\textsuperscript{205} Chittur "Derivative Suits" 104; Choper, Coffee & Morris \textit{Corporations} 786; Clark \textit{Corporate Law} 639; Henn & Alexander \textit{Laws of Corporations} 1037; Knepper & Bailey \textit{Liability} 570; Veasy "Duty of Loyalty" 2073; \textit{Caldwell v Eubanks} 30 SW2d 976 (Mo 1930) at 978; \textit{Goodwin v Castleston} 144 P2d 725 (Wash 1944) at 731; \textit{EK Buck Retail Stores v Harkert} 62 NW2d 288 (Neb 1954) at 305; \textit{James Talcott, Inc v McDowell} 148 So 2d 36 (Fla 1962) at 37; \textit{Bank of New Mexico v Rice} 429 P2d 368 (New Mexico 1967) at 374; \textit{Fried v Easton} 293 So 2d 87 (Fla 1974) at 88.

\textsuperscript{206} \textit{Caldwell v Eubanks} 30 SW2d 976 (Mo 1930) at 978. In \textit{Alario v Miller} 354 So 2d 925 (Fla 1978) stockholders brought action against a corporation and its president, who was also chairman of the board and chief executive officer. They alleged negligence, breach of fiduciary duty, corporate mismanagement and misappropriation of corporate assets, all of which proximately caused corporate insolvency. The court confirmed that the action amounted to a stockholder's derivative action and not to an individual action, since the injuries complained of were indirect, rather than to the plaintiffs' individual interests as stockholders (at 927).

\textsuperscript{207} Henn & Alexander \textit{Laws of Corporations} 1037.

\textsuperscript{208} See page 147 and authorities cited in notes 179-180 above.

\textsuperscript{209} \textit{Fifty States Management Corporation v Niagara Permanent Savings & Loan Association} 396 NYS2d 925 (AD 1977) at 927. However, in \textit{Von Brimer v Whirlpool Corporation} 536 F2d 838 (9th Cir 1976), the court confirmed that where a corporation is closely held by a small number of shareholders who operate more as partners than in strict compliance with the corporate form, it may be proper for the shareholders to bring an individual action even though, technically, the cause of action may rest with the corporation (at 846-847).

\textsuperscript{210} The interests of both shareholders and creditors in the unimpaired financial condition of the corporation are thereby protected: Henn & Alexander \textit{Laws of Corporations} 1096; \textit{Keenan v Estheman} 2 A2d 904 (Del 1938) at 912.

\textsuperscript{211} Anon "Individual Recovery" 1314 and Henn & Alexander \textit{Laws of Corporations} 1097 emphasise that this type of recovery is entirely different from that awarded in an individual or direct action brought by a shareholder.
would have received. Thus a shareholder who owns twenty per cent of the outstanding shares would be awarded twenty per cent of what the corporation would have been awarded, had an individual recovery not been allowed. One such instance has been where the derivative action is against insiders who have misappropriated corporate assets. In *Backus v Finkelstein*, for example, the misappropriation of corporate assets consisted of the payment of salaries to directors, payments made in respect of expenses not really incurred and excessive charges for films shown at one of the theatres controlled by directors of the corporation (a theatre company). In this instance a *pro rata* recovery prevents the funds from reverting to the control of the wrongdoers. Generally, a *pro rata* recovery by shareholders is not allowed when the rights of creditors are involved.

The ordinary principle is that each party to a lawsuit pays his own litigation expenses. In the context of a derivative suit, this would require the plaintiff shareholder to pay his attorney the substantial fees involved in bringing the suit even though any recovery from the defendants generally goes to the corporation and not to the plaintiff. The deterring influence that this could have on derivative action is lessened by the "common fund doctrine". This doctrine determines that if the litigation brought by the plaintiff produces a fund or recovery that benefits an entire class of persons, or an entity in which he and others have an interest, the reasonable litigation expenses of the plaintiff may be taken out of the recovery. The plaintiff in a derivative action usually has a contingency fee agreement with his lawyer. Derivative actions are therefore subject to all the abuses attributable to the contingency fee system, including "strike suits", whereby small

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213 Henn & Alexander *Laws of Corporations* 1097; *Backus v Finklestein* 23 F2d 531 (Minn 1924).


215 Clark *Corporate Law* 659. When fees are awarded, the amount must be determined or approved by court. Surveys of fees awarded in stockholders' derivative actions show that they amount to approximately twenty per cent (of the amount recovered, or value of the asset, depending upon the particular court order): Clark *Corporate Law* 663.

216 Clark *Corporate Law* 660.

217 Clark *Corporate Law* 660. Thus the doctrine promotes efficiency by eliminating a problem that would deter the bringing of meritorious suits, and also satisfies the intuitive notion of fairness. On the position in English law, as determined by the decision in *Wallersteiner v Moir (No 2)* [1975] QB 373, [1975] 1 All ER 849 (CA), see chapter 4 note 160 above.

218 A contingent fee agreement is an express contract specifying the percentage of recovery an attorney is to receive in a suit. Compensation therefore depends upon the success of the suit: *Perline v Pennroad Corporation* 51 A2d 327 (Del 1947); *Brady v Pennroad Corporation* 64 A2d 412 (Del 1948) at 414.

219 Chittur "Derivative Suits" 100.
shareholders bring actions primarily to enrich themselves. The law has therefore developed some procedural requirements for shareholders who wish to sue derivatively.

A plaintiff in a derivative suit must allege that he was a shareholder at the time of the transaction of which he complains, or that his shares thereafter devolved upon him by operation of law. If the alleged misconduct can be construed as having continued until the plaintiff acquired his shares, the plaintiff can still bring an action. The plaintiff should continue holding the shares during the course of the litigation. This requirement is aimed at preventing investors from purchasing stock merely in order to attack a transaction which occurred prior to the purchase by means of a derivative action. If the plaintiff sells his shares during the litigation, the action is dismissed. However, another shareholder may intervene as plaintiff.

220 A "strike suit" is described as an action brought wholly or in part for its nuisance value. Its primary objective is not the welfare of stockholders. Originally the purpose was to obtain a settlement for the sole benefit of the complaining stockholder. Nowadays, with general acceptance of the principle that any recovery, including the proceeds of any settlement, must go to the corporation, the motivation of a strike suit is more likely to be the expectation of the plaintiff's lawyer, who hopes that the court will award him a generous fee out of any moneys awarded or out of the corporation's assets if the benefit resulting to the corporation takes some form other than a-cash recovery: Henn & Alexander Laws of Corporations 1039 note 22; Kempin Wiesen & Bagby Management Process 354. See also Joy v North 692 F2d 880 (2d Cir 1982) at 887 where the court warned that "[d]erivative actions may be brought for their nuisance value, the threat of protracted discovery and litigation forcing settlement and the payment of fees even where the underlying suit has modest merit." The problem of strike suits has not occurred in England, because of the general English rule that the loser pays the costs, including the winner's advocate's fees, and because it is unprofessional for a lawyer to take a case on a contingent fee basis: Gower "Contrasts" 1385.

221 Chittur "Derivative Suits" 105; Kempin Wiesen & Bagby Management Process 354; Pennington Personal Liability 226.

222 Federal Rules of Civil Procedure Rule 23.1; Chittur "Derivative Suits" 106; Frey v Frankel 443 F2d 1240 (10th Cir 1971) at 1244.

223 For example, because the prior owner died and he inherited the shares. This rule, known as the contemporaneous ownership rule, is recognised in most American jurisdictions, either by statute, court rule or judicial decision: Henn & Alexander Laws of Corporations 1058ff; Clark Corporate Law 651; Schreiner 'Derivative Action' 223ff.

224 This exception is known as the continuing-wrong doctrine: Clark Corporate Law 651.

225 Bernstein v Polo Fashions Inc 389 NYS2d 368 (1976) at 370.

226 Newkirk v WJ Rainey, Inc 76 A2d 121 (Del 1950) at 123.

227 Hutchison v Bernhard 220 A2d 782 (Del 1961).

228 The intervenor must also meet the requirements of the original plaintiff: Chittur "Derivative Suits" 107.
Some states have security for expense statutes as a further measure to restrict
derivative actions. These usually require minimum holdings before a stockholder
can sue derivatively, or before a preliminary judicial review on merits. If the plaintiff
does not meet either criterion, the corporation is entitled to demand security for its
expenses of the suit. The plaintiff may be entitled to reimbursement of litigation
expenses by the corporation if he is victorious and the suit provides a substantial
benefit to the corporation. Directors may be entitled to indemnification out of cor­
porate funds for expenses incurred in the defense of derivative suits. When the
defendant loses or settles, the states differ on the issue of indemnification. In some
states, a losing defendant is prohibited from receiving indemnification. Delaware
and California allow indemnification if approved by court. Many states permit
insurance coverage for payment of officers' or directors' litigation expenses. Such
insurance is generally known as "D & O Liability Insurance".

4.3.1.1 The Requirement of Demand

The general rule in virtually all United States jurisdictions is that before
bringing a derivative suit, a shareholder must first make a demand on the corpo­
rations's board of directors to act so as to remedy the situation about which the
shareholder complains. It bars a stockholder's suit if the action complained of is one
which could be effectively remedied by a vote of a simple majority at a general
meeting. By contrast, no such requirement is recognised in English law. But the
rule in Foss v Harbottle from which the American practice seems to be derived, still
exists in England.

229 For example, New York Business Corporation Law par 627; California Corporations Code par
800(c)-800(f). By contrast, Delaware never adopted a security for expenses statute.

230 Chittur "Derivative Suits" 108; Clark Corporate Law 652ff; Feuer Liabilities 208ff; Henn &


233 Federal law provides no remedy for breach of fiduciary duty since it is a matter which is tradi­
tionally left to state corporation law. According to Kempin, Wiesen & Bagby Management Process 355
the federal courts will also not interfere with the development of state prerequisites for derivative suits.
On the institution of derivative action in case of breach of fiduciary duties generally, see Zapata Corp v
Maldonado 430 A3d 779 (Del 1981).

234 On demand in derivative actions generally, see Anon "Individual Recovery" 1314; Chittur "Deriva­
tive Suits" 109; Clark Corporate Law 640ff; DeMott "Demand" 415ff; Feuer Liabilities 195ff; Henn &

235 Boyle "Minority Shareholder" 320; Gower "Contrasts" 1385; Pennington Personal Liability 224-227.
On the rule in Foss v Harbottle, see chapter 4 par 3.3.2 above.
Demand is excused when it would be futile, which is typically the case where the alleged wrongdoers comprise or control a majority of the directors.236

If the demand made on the board of directors is ineffective, a demand must, generally, be made at a general meeting of shareholders that it shall resolve to bring an action in the company's name.237 This is the case irrespective of whether the directors have rejected the initial demand made upon them, or whether such a demand need not be made. Generally, the authority to call shareholders' meetings rests with the board of directors.238

A demand need not be addressed to a general meeting if a shareholder or shareholders controlling a majority of the votes which could be cast at such a meeting have expressly refused to bring an action in the name of the company, or have stated their intention to vote against a resolution that the company shall sue. A demand need also not be made at a general meeting if the directors accused of a breach of duty themselves control a majority of the votes which are likely to be cast.239 Some statutes do not require a demand first to be made upon the corporation.240

236 Clark Corporate Law 641; Kempin Wiesen & Bagby Management Process 354. The futility of demand must be determined at the time the derivative action is commenced, not afterwards with the benefit of hindsight: Cramer v General Telephone & Electronics Corporation 582 F2d 259 (3rd Cir 1978) at 276; Grossman v Johnson 674 F2d 115 (1st Cir 1982) at 123. The position is not changed by any change in the composition of the board thereafter: Chittur "Derivative Suits" 112. In respect of futile demand generally, see also Knutsen v Frushour 436 P2d 521 (Idaho 1968) at 525; Barr v Wackman 329 NE2d 180 (NY 1975) at 186; Aronson v Lewis 473 A2d 805 (Del 1984); Joy v North 692 F2d 880 (2d Cir 1982) at 887-888.

237 Henn & Alexander Laws of Corporations 1070; Pennington Personal Liability 225. This requirement is not universal: Clark Corporate Law 649. In some important jurisdictions, such as New York (New York Business Corporation Law par 626(c)), and California (California Corporations Code s 800(b)(2)), there is no requirement for demand on shareholders. There are three reasons for not imposing the requirement of a demand on shareholders. First, with a publicly held corporation, making such a demand would be quite expensive and burdensome and would unduly deter the bringing of derivative lawsuits. In the second instance, the shareholders in a publicly held corporation are an inappropriate body for making a complicated judgment about the merits, costs, and likelihood of success of suit and therefore about whether suing or not suing is in the corporation's best interest. Thirdly, a majority of shareholders should not be allowed to ratify a fraud over the objection of the minority: Clark Corporate Law 649.

238 In this regard RMBCA par 7.02(a) and the statutes of a number of other jurisdictions provide that special meetings of the shareholders may be called by the board of directors, or such other persons as may be authorised in the articles of incorporation or the bylaws, as well as by the holders of not less than one-tenth of all the shareholders entitled to vote at the meeting. In Freeman v King Pontiac Company 114 SE2d 478 (So Car 1960) the statute authorised the president or owners of one-fifth of the capital stock to call a meeting if an annual meeting was not held. If the shareholders do not have the right to call a meeting, they must resort to the appropriate court action: Young v Jonas 103 A2d 299 (Del 1954) at 304.

239 Thus demand would be excused where it is alleged that a majority of the directors have usurped a corporate opportunity. No one would expect the defendant directors to give adequate consideration to a shareholder demand for corrective action: Clark Corporate Law 641-642.

240 Petition of Bloch 70 NYS2d 530 (AD 1947) at 534.
As was stated above, the determination of when derivative actions may be brought is basically procedural, and is not concerned with the nature of the alleged breach of duty. However, the nature and the seriousness of the alleged breach of duty are relevant in two instances. The first is that a derivative action may not be brought if an independent committee or a general meeting of the board of directors decides in good faith that for sound business reasons the company should not sue. The board or the committee must have investigated the circumstances of the alleged breach of duty impartially before taking the decision not to sue in the company's name. If the decision is taken by the board, it must be the decision of a majority of the directors who are not involved in the alleged breach of duty. The decision must, therefore, be taken by disinterested directors. In the second instance, no demand for the company to sue need be made on either the board of directors or a general meeting if the alleged act or transaction by the directors is one which a general meeting of shareholders cannot confirm or ratify. Non-ratifiable acts include those which are tainted by fraud on the part of the prospective defendants, those which involve breaches of directors' fiduciary duties and duties of care and skill, and those which involve ultra vires or illegal acts.

4.3.1.2 Special Litigation Committees

Special Litigation Committees have come to play a vital role in more recent derivative actions. The establishment of these committees started with cases in which managers were alleged to have been guilty of waste of corporate assets. The committees are set up by corporate managements in order to ward off derivative suits. They are composed of directors who are not named as defendants in a particular suit, including outside directors. On appointment the committee hires its own counsel to review all circumstances surrounding the derivative litigation. Almost invariably, the investigation leads to the conclusion that it is in the best

241 See page 153 above.

242 \textit{Gall v Exxon Corporation} 418 FSupp 508 (NY 1976) (use of corporate funds to make allegedly illegal political payments confirmed by disinterested directors); \textit{Gaines v Haughton} 645 F2d 761 (9th Cir 1981) at 772ff.

243 See par 5.1 below.

244 \textit{Michelson v Duncan} 407 A2d 211 (Del 1979) at 219. See also par 5.1 below.

245 On these committees generally, see Chittur "Derivative Suits" 113ff; Clark \textit{Corporate Law} 645; Cox "Derivative Suit Litigation" 287ff; Henn & Alexander \textit{Laws of Corporations} 1073ff; Kempin Wiesen & Bagby \textit{Management Process} 355-359.

246 The board of directors derives its authority to delegate some or most of its functions to working committees from modern corporation statutes: Clark \textit{Corporate Law} 645.

247 Outside directors are sometimes specifically recruited for this purpose: \textit{Zapata Corp v Maldonado} 430 A3d 779 (Del 1981).
interests of the corporation not to proceed with the lawsuit.248 The corporation then brings a motion to dismiss the suit.249

Courts faced with motions to dismiss have had to decide whether these committees had the power to dismiss or to request a dismissal. Most courts answered this question in the affirmative.250 A second question which courts have had to determine concerned the scope of judicial review of the special committee’s recommendation. New York allows only minimal review of the findings by the committee.251 After the special committee has recommended dismissal of an action, the plaintiff may try to prove that the committee members were not truly independent or disinterested, that they did not act in good faith, or that their investigations and deliberations were not really diligent. If the plaintiff can establish any of these factors, the motion to dismiss will be denied. If not, the substantive merits of the committee’s recommendations will not be scrutinised by the court.252 In Delaware moderate scrutiny of the committee’s recommendation is allowed.253

A further suggested solution is that the court should have the discretion to, upon request from the board of directors in a derivative suit, appoint a special committee of independent and knowledgeable persons to determine whether con-

248 Clark Corporate Law 645.

249 The satellite litigation brought about by special litigation committees (stay of plaintiff’s discovery by the committee, extent of discovery by plaintiff on its report and its motion to dismiss) sidetracks derivative litigation for about two years and imposes substantial additional burdens on the trial court: Chittur “Derivative Suits” 122.

250 However, in Abella v Universal Leaf Tobacco Co 495 FSupp 713 (Va 1980), the federal court, applying Virginia law, indicated that a derivative suit could routinely proceed despite the recommendations by such a committee. In Miller v Register & Tribune Syndicate, Inc 336 NW2d 709 (Iowa 1983) the court held that directors who are parties to a derivative suit cannot delegate the power to bind the corporation as to the conduct of the litigation to a special committee.

251 Auerbach v Bennett 393 NE2d 994 (1979) at 1002ff.

252 The decision by the committee is regarded as being protected by the business judgment rule. On this rule, see page 131 above.

253 In Zapata Corp v Maldonado 430 A3d 779 (Del 1981) a two-step test was suggested and applied by the Delaware Supreme Court. First, an inquiry should be made into the independence, good faith and bases supporting the committee’s conclusions. If the court is satisfied on all these procedural grounds, it may, in its discretion, proceed with a determination of whether the motion (to dismiss plaintiff’s action) should be granted. In this determination, the court should apply its own business judgment. The approach in Zapata was followed in the federal decision in Joy v North 692 F2d 880 (2d Cir 1982), which applied Connecticut law. The court noted the reality that special litigation committees are appointed by the defendants to the litigation and was of the opinion that it was not cynical to expect that such committees will tend to view derivative actions against the other directors with scepticism. The court further rejected the argument that courts are not competent to make the relevant business decision whether to continue the litigation, since courts do have a special aptitude for analysing the termination of lawsuits (at 888-889).
tinuance of the lawsuit would be in the corporation’s best interest. The committee’s decision would be reviewed as in *Auerbach*, thus relieving the court from the necessity to decide about business matters. The advantage of such a committee would be that it would be less likely to be biased in favour of the defendant.

In conclusion, there is no doubt that, under American law, the shareholders’ derivative suit can be an important and effective agent in controlling directorial conduct.

5 EXEMPTION FROM OR INDEMNIFICATION AGAINST BREACHES OF FIDUCIARY DUTY

A director who is *prima facie* liable for a breach of his fiduciary duties may be relieved from liability. The most important means of effecting release from liability is by ratification. In certain instances, the fiduciary may also be protected by limitation of actions or laches.

5.1 Ratification

A corporation may ratify the originally unauthorised acts and contracts of its officers, if such acts fall within its authorised powers. In order to have an effective ratification of an unauthorised act or contract, the corporate body or officer pur-

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254 Clark *Corporate Law* 648-649. On the appropriate standard of review generally, see also Cox “Derivative Suit Litigation” 295ff.

255 *Auerbach v Bennett* 393 NE2d 994 (1979). See note 251 above.

256 Clark *Corporate Law* 649.

257 Beck “Derivative Suit” 163; Chittur “Derivative Suits” 101. See also Pennington *Personal Liability* 226ff, where derivative actions under English and American law are compared (on the English derivative action, see chapter 4 par 3.3.2 above). The author concludes that “[t]he American rule is more flexible than the British one and is also fairer, and despite the litigious propensities of the Americans, the American rule does not appear to have overloaded the courts with the burden of trying derivative actions which turn out to be baseless” (at 227).

258 See par 5.1 below.

259 See par 5.2 below.

porting to ratify must have been able to authorise the particular act in the first instance.\textsuperscript{261}

Shareholders or directors will, therefore, generally be able to ratify any transaction that they could originally have authorised. But the ratification is effective only within certain limits. "Fraud",\textsuperscript{262} "overreaching"\textsuperscript{263} and a "waste or gift of corporate assets"\textsuperscript{264} may not be ratified by the shareholders, except by a unanimous vote.\textsuperscript{265} The ratifiers must, furthermore, have been supplied with full knowledge of the transaction.\textsuperscript{266} Ratification by shareholders may be effected after action has been instituted, provided that it is voted by \textit{bona fide} shareholders.\textsuperscript{267}

Thus directors of a corporation may ratify any unauthorised act not done or entered into by themselves that they could have originally authorised.\textsuperscript{268} But a corporate officer has no power to ratify his own unauthorised act.\textsuperscript{269} Directors may not, for example, authorise or ratify the taking of a secret profit.\textsuperscript{270} The ratification must

\textsuperscript{261} Boyce v Chemical Plastics, Inc 175 F2d 839 (8th Cir 1949) at 842. An \textit{ultra vires} act is therefore unratifiable: Keenan v Eschelman 2 A2d 904 (Del 1938) at 912. Ratification by stockholders will not validate \textit{ultra vires} acts exceeding the express or implied powers of a corporation where estoppel is not applicable: Komanetsky v Missouri State Medical Association 516 SW2d 545 (Mo 1975) at 554; Bowers Steel, Inc v DeBrooke 557 SW2d 369 (Tex 1977) at 372.

\textsuperscript{262} See page 161 below.

\textsuperscript{263} Chambers v Beaver-Advance Corporation 140 A2d 808 (Pa 1958) at 812. In this case the overreaching consisted of additional payments made to management.

\textsuperscript{264} Schreiber v Bryan 396 A2d 512 (Del 1978) at 518; Eliasberg v Standard Oil Co 92 A2d 862 (NJ 1952) at 872.

\textsuperscript{265} Carrad "Corporate Opportunity Doctrine" 23; Keenan v Eschelman 2 A2d 904 (Del 1938) at 912; Kerbs v California Eastern Airways Inc 90 A2d 652 (Del 1952) at 656; Mayer v Adams 141 A2d 458 (Del 1958) at 460; Saxe v Brady 184 A2d 602 (Del 1962) at 605; Michelson v Duncan 407 A2d 211 (Del 1979) at 219. See, however, Clark \textit{Corporate Law} 178 where it is indicated that the difference between "fraud", "overreaching", or a "waste of corporate assets" and ordinary unfairness is often just a matter of degree. The author submits that, in practice, courts have a great deal of latitude in deciding what the effect of shareholder ratification will be in a particular case.

\textsuperscript{266} Henn & Alexander \textit{Laws of Corporations} 515; Knepper & Bailey \textit{Liability} 112; Chambers v Beaver-Advance Corporation 140 A2d 808 (Pa 1958) at 812-814; Komanetsky v Missouri State Medical Association 516 SW2d 545 (Mo 1975) at 555; Bowers Steel, Inc v DeBrooke 557 SW2d 369 (Tex 1977) at 372-373; Michelson v Duncan 407 A2d 211 (Del 1979) at 220.

\textsuperscript{267} In Michelson v Duncan 407 A2d 211 (Del 1979) the court held that ratification of a stock option plan for key executives, which had been authorised by interested directors, by the majority of shareholders at a special meeting, cured any voidable defect in the act by the board of directors.

\textsuperscript{268} Tovey "Corporate Opportunity" 111-112.

\textsuperscript{269} Angelus Securities Corporation v Ball 67 P2d 152 (Cal 1937) at 156; Re Sterling Navigation Co, Ltd 444 FSupp 1043 (NY 1977) at 1049.

\textsuperscript{270} Feuer \textit{Liabilities} 75; Fleishhacker v Blum 109 F2d 543 (9th Cir 1940) at 547. On secret profits, see par 3.2.3.1 above.
be by the shareholders who act on behalf of the corporation. Since the taking of a private profit violates the principle of undivided loyalty and is deemed fraudulent, it would also appear that the shareholders’ ratification must be unanimous. A majority resolution does not suffice. However, a corporation which is entitled to repudiate a transaction made by directors for their own benefit must act promptly on knowledge of the facts, otherwise it may be deemed to ratify the action.

Acts done in the interest of the corporation that are voidable only, and not fraudulent or ultra vires, may be ratified by a majority of the shareholders. The ratification does not validate the contract, since it always was valid, unless avoided or repudiated by the corporation. For example, although a director should not vote on matters in which he has a personal financial interest, if he does, the action by the board is only voidable and may be ratified by the shareholders.

Ratification has been found invalid in other instances, for example, where the ratifying directors were all co-defendants; the act was prohibited by law or opposed to public policy; the defendant-director’s vote constituted the necessary majority, or he dominated the board of directors, thus depriving it of the required freedom of choice.

Wrongful acts of directors of a corporation cannot be ratified by a majority of the shareholders, if they were guilty of participation in such wrongful acts. An interested director who is also a shareholder is entitled to vote his shares to ratify his challenged act.

271 Feuer Liabilities 76.
272 Ibid.
273 Knepper & Bailey Liability 112; Michelson v Duncan 407 A2d 211 (Del 1979) at 220; Keenan v Eshleman 2 A2d 904 (Del 1938) at 912.
274 Knepper & Bailey Liability 112.
275 Poweroil Manufacturing Company v Carstensen 419 P2d 793 (Wash 1966) at 796.
276 Irving Trust Co v Deutch 73 F2d 121 (2d Cir 1934).
277 Knepper & Bailey Liability 111; Flight Equipment & Engineering Corporation v Shelton 103 So 2d 615 (Fla 1958) at 621; Emerson v Labor Investment Corporation 284 F2d 946 (10th Cir 1960) at 950; Continental Assurance Company v Supreme Construction Corporation 375 F2d 378 (5th Cir 1967) at 383; General Finance Corporation v Fidelity & Casualty Company of New York 439 F2d 981 (8th Cir 1971) at 986; Lowe v April Industries, Inc 531 P2d 1297 (Utah 1974) at 1298; Komanetsky v Missouri State Medical Association 516 SW2d 545 (Mo 1975) at 554.
278 Poweroil Manufacturing Company v Carstensen 419 P2d 793 (Wash 1966) at 796.
279 Am Jur volume 18B par 1638.
There is authority that fraudulent acts cannot be ratified. Thus, a fraudulent misappropriation or misapplication of corporate funds is not capable of ratification by the majority stockholders. There is, however, also authority that a disinterested majority of the shareholders of a corporation have the power to ratify fraudulent acts of directors or officers, provided that there was no actual fraud in either inducing or effecting the ratification.

A corporation cannot ratify a breach of fiduciary duties unless the fiduciary makes full and complete disclosure of all facts and circumstances and the corporation intentionally relinquishes its rights. Accordingly, rules governing fiduciary conduct of corporate directors do not prevent a corporation from ratifying and affirming transactions where, with full knowledge of the facts, it appears advantageous to the corporation to do so.

As a general rule, ratification by a corporation need not be manifested by any vote or formal resolution by the shareholders or board of directors. No higher degree of evidence is required to establish ratification on the part of a corporation than is required for proof of a prior authorisation. Since shareholders and directors cannot bind the corporation individually, ratification can also not be effected by individual shareholders or directors. The ratification may be express or implied. Implied ratification will be found where the ratification arises under circumstances of acquiescence or where a duty to disaffirm is not promptly exercised.

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281 Mayer v Adams 141 A2d 458 (Del 1958) at 465; General Finance Corporation v Fidelity & Casualty Company of New York 439 F2d 981 (8th Cir 1971) at 986; Keenan v Eshleman 2 A2d 904 (Del 1938) at 912.

282 Keenan v Eshleman 2 A2d 904 (Del 1938) at 912. The majority stockholders cannot effectively ratify a gift of corporate property or assets to a director or officer where there is minority objection: Rosenthal v Burry Biscuit Corporation 60 A2d 106 (Del 1948) at 110.

283 Claman v Robertson 128 NE2d 429 (Ohio 1955) at 436.

284 Knepper & Bailey Liability 112; Hayes Oyster Company v Keypoint Oyster Company 391 P2d 979 (Wash 1964) at 984.

285 Poweroil Manufacturing Company v Carstensen 419 P2d 793 (Wash 1966) at 796.

286 Boyce v Chemical Plastics, Inc 175 P2d 839 (8th Cir 1949) at 842; Johnson v Community Development Corporation of Wahpeton 222 NW2d 847 (No Dak 1974) at 849-850; AA Martin Transportation Co, Inc v Almonte 468 A2d 268 (RI 1983) at 271. In Almonte, the court found that evidence of a corporation's ratification of a contract made prior to its incorporation could be demonstrated by the corporation's initiation of a suit for specific performance.

287 Tuttle v Junior Bldg Corporation 46 SE2d 313 (No Car 1948) at 316.

288 See-Tee Mining Corp v National Sales, Inc 417 P2d 810 (New Mexico 1966) at 812 (payments by corporation with knowledge of material facts of contract regarded as ratification); Poweroil Manufacturing Company v Carstensen 419 P2d 793 (Wash 1966) at 796; Johnson v Community Development Corporation of Wahpeton 222 NW2d 847 (No Dak 1974) at 850; Lowe v April Industries, Inc 531 P2d 1297 (Utah 1974) at 1299; Williams v Magnafici 397 NE2d 197 (Ill 1979) at 199.

289 Lowe v April Industries, Inc 531 P2d 1297 (Utah 1974) at 1299.
5.2 Limitation of Actions and Laches

Actions against directors are governed by time limitations. The rationale behind statutes of limitation which fix time limits on charges of alleged misconduct is that evidence to prove or disprove charges of misconduct become less certain and available with passage of time. In any event, policy considerations also demand that transactions should not be undone after a certain lapse of time.

It is generally held that directors and other officers of a corporation are not trustees of an express trust, so as to preclude them from relying on a statute of limitations against a claim for losses due to official misconduct or mismanagement of the corporation’s affairs.

Statutes of limitations ordinarily bar derivative actions on corporate claims which if asserted by the corporation would have been barred. State practice statutes usually have a series of periods of limitations applicable to different kinds of actions. In some jurisdictions, specific statutes of limitations are applicable to at least certain kinds of derivative actions. For example, the Michigan statute provides that the period for actions against directors or officers is three years after the cause of action accrued, or two years after the cause of action was discovered or should reasonably have been discovered by the complainant, whichever occurs the sooner. In New York a six year period of limitations has been instituted for an action by or on behalf of a corporation against a former director, officer, or shareholder to recover damages for waste or for an injury to property or in respect of an accounting in connection therewith.

An equitable action, such as an action for an injunction or other equitable relief, or a derivative action, can also be barred by the equitable doctrine of laches. This doctrine has since been displaced in most states by enacted time

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290 *Feuer Liabilities* 202.

291 *Ibid*.

292 See also page 127 above.

293 *Payne v Ostrus* 50 F2d 1039 (8th Cir 1931) at 1042; *Potter v Walker* 11 NE2d 335 (NY 1937) (limi-
tation of ten years for equitable relief applied); *White v Federal Deposit Ins Corp* 122 F2d 770 (4th Cir 1941) at 774; *Turner v American Metal Corporation, Ltd* 66 NE2d 591 66 NE2d 591 (NY 1946) at 591. But the contrary view was expressed in *Jefferson County Truck Gravers Association v Tanner* 341 So 2d 485 (Ala 1977) where the court held that a corporate director is a *quasi* trustee, and that as long as the fiduciary relationship between him and the corporation exists, the statute of limitations will not run against a claim based on his wrongdoing (at 487-448).

294 *Henn & Alexander Laws of Corporations* 1032.


296 *Tobacco & Allied Stocks, Inc v Transamerica Corp* 244 F2d 902 (3rd Cir 1957).
statutes.\textsuperscript{297} Mere passage of time is usually not enough to constitute a lache. Inaction by the plaintiff-shareholder after acquiring knowledge of the wrong and the vesting of rights will, however, constitute a laches.\textsuperscript{298}

6 APPROPRIATION OF CORPORATE OPPORTUNITIES - THE CORPORATE OPPORTUNITY DOCTRINE

6.1 Introduction

The duty of loyalty includes the duty not to divert a corporate business opportunity for the fiduciary's personal gain.\textsuperscript{299} The underlying reason for this duty has been stated as that the compensated time of corporate fiduciaries is regarded as a corporate asset and therefore belongs wholly to the corporation.\textsuperscript{300} The duty is best fulfilled by avoiding situations in which the director may be tempted to profit personally to the detriment of the corporation. A very restrictive application of the duty of loyalty would therefore be to deny the director any purchase that could be advantageous to the corporation.\textsuperscript{301} However, such a restrictive rule does not consider that in the modern commercial world directors act on multiple boards and have extensive outside holdings, and that any duty to act on behalf of one corporation is breached by acting for another.\textsuperscript{302} The "corporate opportunity doctrine", which is recognised as a special corporate doctrine, overlapping with, but operating in addition to the usual fiduciary principles, has therefore been developed by American courts during the past century. Under this rule, certain property or busi-

\textsuperscript{297} Feuer \textit{Liabilities} 202.

\textsuperscript{298} Henn \& Alexander \textit{Laws of Corporations} 1035.

\textsuperscript{299} Popofsky "Corporate Opportunity and Competition" 1193; Ramsey "Power to Compete" 293; Wolfson "Critique" 980. According to Slaughter "Corporate Opportunity Doctrine" 96 fiduciary principles forbid directors and officers of a corporation, as insiders, from utilising their strategic positions for private benefit to the detriment of the corporation.

\textsuperscript{300} Kempin, Wiesen \& Bagby \textit{Management Process} 422. See par 2.4 above, where it was shown that, although directors are not entitled to compensation merely because of their office, a growing number of American corporations provide for substantial compensation to directors.

\textsuperscript{301} In Anon "Close Corporation Opportunity" 381 it is submitted that the English decision in \textit{Regal (Hastings) Ltd v Gulliver} [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) (discussed in chapter 4 page 69 above) would have that effect.

\textsuperscript{302} Anon "Close Corporation Opportunity" 381, who submits that any workable test for corporate opportunity must reflect this consideration.
Directors' Fiduciary Duties and Corporate Opportunities

ness opportunities may not be diverted for an officer's or a director's personal benefit.303

6.2 Evolution of the Corporate Opportunity Doctrine

Early American cases imposed a constructive trust upon property or trusts acquired by a director (or officer) only under relatively restricted circumstances.304 In the leading case of Lagarde v Anniston Lime and Stone Co,305 the defendants were directors and majority stockholders of a corporation which had purchased a one-third interest in a limestone quarry. The directors, aware of the fact that the corporation was itself interested in acquiring the two other one-third interests,306 acquired these for themselves. The court subjected one of the one-third interests, in which the corporation had contractual rights, to a constructive trust. It found no breach of duty in the purchase of the remaining one-third interest for which the corporation had merely negotiated, but had not acquired any rights. It stated that the legal restrictions imposed upon acquisitions of this nature were limited to property in which the corporation had an interest or expectancy growing out of an existing right, or to cases where the directors' interference would in some degree frustrate the corporation in effecting the purposes of its creation.307

In all of the early cases the imposition of liability did not require a separate corporate opportunity doctrine, although such a doctrine was mentioned. Appropriation of opportunities so directly related to the activities of the corporation would have fallen within the general prohibition against injuring the corporation.308

303 The phrase "corporate opportunity doctrine" is sometimes used more widely, to indicate the general fiduciary position as regards unauthorised profit-making activities by corporate directors. However, it is "fairly plain that there is now a special corporate doctrine in the United States, overlapping with but operating in addition to the usual fiduciary principles": Austin "Accountability" 141. Jacobs "Business Ethics" 1072 regards the law of corporate opportunities as nothing more than a convenient, but by no means exclusive, capsulisation of basic legal principles prohibiting conflicts of interest. On this doctrine generally, see Anon "Liability" 219ff; Anon "Close Corporation Opportunity" 187ff; Anon "Corporate Opportunity" 765ff; Brown "Corporate Opportunity Claims" 507ff; Brudney & Clark "Corporate Opportunities" 99ff; Cagle Fiduciary Duties; Carrad "Corporate Opportunity Doctrine" 1ff; Carrington & McElroy "Doctrine of Corporate Opportunity" 957ff; Clark Corporate Law 223ff; McLaughlin "Corporate Opportunity Doctrine" 121ff; Feuer Liabilities 78ff; Henn & Alexander Laws of Corporations 632ff; Menzies "Corporate Opportunity" 765ff; Popofsky "Corporate Opportunity and Competition" 1193ff; Segerson Corporate Opportunities Doctrine 471ff; Slaughter Corporate Opportunity Doctrine 96ff; Tovey Corporate Opportunity 99ff; Turnbull Corporate Opportunity 185ff; Wolfson "Critique" 980.

304 On constructive trusts, see also page 146 above.

305 126 Ala 26 (1900).

306 The corporation had already entered into negotiations in connection with one of these interests, and had contracted to purchase the other one.

307 At 201.

308 Anon "Corporate Opportunity Doctrine" 766.
Refusal by the courts to extend the doctrine can probably be ascribed to the severity of the constructive trust remedy.\textsuperscript{309} The restrictions imposed upon the corporate opportunity doctrine were gradually expanded. In \textit{Rosenblum v Judson Engineering Corp},\textsuperscript{310} for example, the defendants were directors and officers of a corporation which manufactured devices used for the alignment of automobile wheels. They formed a partnership to manufacture a wheel-balancing machine and other equipment for use in wheel alignment. Other directors of the corporation applied to court for the imposition of a constructive trust on the partnership. Although the corporation had no present interest or expectancy in the acquisition of the new business, and although it was not essential to their present needs, the court held that the directors could still be liable under the corporate opportunity doctrine. The issue to be determined was whether the business conducted by the partnership was so closely associated with the existing and prospective activities of the corporation that the defendants should fairly have acquired that business for, or have made it available to, the corporation.\textsuperscript{311}

This case represents a move towards wider liability than would be imposed under the general prohibition against injuring the corporation. It can also not be explained as enforcing a duty not to compete with the corporation, since no such general duty exists.\textsuperscript{312} The decision in \textit{Lincoln Stores, Inc v Grant}\textsuperscript{313} confirms that competition and corporate opportunity should be treated as separate doctrines. The plaintiff sought to have a constructive trust imposed on a competitive enterprise operated by two of its directors. The court held that no appropriation of a corporate opportunity was involved even though the defendants had acquired the store with the intent to compete against the plaintiff, because the corporation had previously rejected an opportunity to acquire the store for itself. However, the covert operation of the store with the help of confidential information taken from the corporation was found to be tortious. The corporation was awarded damages on that basis.\textsuperscript{314}

\textsuperscript{309} The imposition of a constructive trust sometimes permits the corporation to recover, in addition to separate damages for any injury suffered, all profits earned by the defendant. It is immaterial whether these profits were derived solely through the initiative and skill of the director, and even though he bore the risk of loss: Anon "Corporate Opportunity Doctrine" 766.

\textsuperscript{310} 109 A2d 558 (New Hampshire 1954).

\textsuperscript{311} At 563.

\textsuperscript{312} See par 3.2.3.2 above.

\textsuperscript{313} 34 NE2d 704 (Mass 1941).

\textsuperscript{314} At 708. The court's recognition of a distinction between unlawful competition and corporate opportunity thus had the practical importance of determining what remedy would be available: Anon "Corporate Opportunity" 767.
6.3 Content of the Corporate Opportunity Doctrine

The doctrine of corporate opportunities entails that if a business opportunity is deemed to be a corporate opportunity of any given corporation, the fiduciaries of that corporation may not take or usurp the opportunity for themselves.315 The doctrine has been stated as follows:

The rule is that if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, which is, from its nature, in the line of the corporation's business and is of practical advantage to it, and which is one in which the corporation has an interest or a reasonable expectancy, and if, by embracing the opportunity, the self interest of the officer or director will be brought into conflict with that of this corporation, the law will not permit him to seize the opportunity for himself. If he does, the corporation may claim the benefit of the transaction.316

Not all directors' personal interests amount to corporate opportunities. Directors may freely pursue some personal investments and business opportunities without breaching their fiduciary duties.317 The major tests which have been developed to identify corporate opportunities are discussed in the following paragraphs.

Corporate fiduciaries' obligations in respect of corporate opportunities continue, despite the resignation or discharge of the fiduciary, if the opportunity came to the knowledge of the fiduciary prior to the resignation.318 Although corporate directors and employees are usually free to resign and join a competitor, a restrictive covenant in the employment contract not to compete may discourage it. Even

315 Anon "Close Corporation Opportunity" 381; Acchiardio "Duty" 600; Begert "Corporate Opportunity Doctrine" 829; Carrad "Corporate Opportunity Doctrine" 1ff; Clark Corporate Law 223; Prentice "Doctrine" 464. Anon "Liability" 219 indicates that while a layman might consider a corporate opportunity anything the corporation is interested in doing and could do, the courts limit this term to opportunities to which the corporation is entitled, as against a director, because, for example, it has a pre-existing right to the opportunity, or it is necessary for the development of the company, or the director was specifically authorised to take it for the corporation.

316 Am Jur volume 18B par 1770.


318 Feuer Liabilities 92; Tovey "Corporate Opportunity" 107; Albert A Volk Co, Inc v Fleschner Bros, Inc 60 NYS 2d 244 (1945) at 245; Mile-O-Mo Fishing Club, Inc v Noble (1965) 210 NE2d 12 (Ill 1965) at 18; Patient Care Services SC v Segal 337 NE2d 471 (Ill 1975) at 480. In Mile-O-Mo property was purchased in the name of the acting president of a corporation's wife after he had resigned. The corporation had, during his term of office, been discussing the possibility of purchasing the same property. The contract was regarded as a corporate opportunity. In Southeast Consultants, Inc v McCrady Engineering Corp 273 SE2d 112 (Ga 1980) the court ordered an accounting of profits for the securing of a contract for the demolition of a generating station. It held that the contract represented a profitable business opportunity which had been diverted by the directors in violation of their fiduciary duties to the plaintiff, since knowledge of it had come to their attention prior to their resignation.
without such covenants, a fiduciary may be prohibited from abusing his corporate position to enhance a competing business.\footnote{319}

An alleged breach of duty might involve multiple aspects, only part of which might be construed as involving a corporate opportunity.\footnote{320}

Usually the complainant must prove that the opportunity on which the claim is based constitutes a corporate opportunity. Once it has been established that such an opportunity exists, the burden of proof shifts to the fiduciary to prove that, in the circumstances, it was not wrongful to appropriate the opportunity.\footnote{321} The predominant question is whether the opportunity was communicated to the fiduciary in his capacity as a corporate representative. The director's behaviour after learning of the opportunity is also important. Actions taken in good faith after the opportunity becomes available assist the fiduciary. For example, full and fair disclosure of the opportunity to the board permits careful consideration by a disinterested majority of the board.\footnote{322} On the other hand, the fiduciary's misuse of corporate assets to acquire or develop the opportunity is strong evidence of misappropriation.\footnote{323} The outcome of a particular case is not necessarily dependent upon any one of these factors. It depends upon all the circumstances relevant to the particular situation.\footnote{324}

Should a business opportunity, which potentially belongs to the corporation, arise, it is the director's duty to disclose the pertinent facts to the corporation, in order to enable it to decide whether or not it wishes to pursue the opportunity. The fiduciary is not necessarily relieved from this obligation by his belief that the corporation is legally or financially unable to take advantage of the opportunity.\footnote{325} It seems that the desire of a director or officer to appropriate a business opportunity upon rejection by the corporation is a material fact which should also be disclosed to the company and its shareholders. If the corporation declines the opportunity, the director is free to pursue it.\footnote{326}

\begin{footnotes}
\item[319] See par 3.2.3.2 above.
\item[320] In \textit{Litwin (Rosemarin) v Allen} 25 NYS 2d 667 (1940), for example, only one of the questioned four transactions was decided against the directors (at 737).
\item[321] Kemppin Wiesen & Bagby \textit{Management Process} 428.
\item[322] Kemppin Wiesen & Bagby \textit{Management Process} 428. On rejection by the board, see par 7.4 below.
\item[323] Kemppin Wiesen & Bagby \textit{Management Process} 428.
\item[324] \textit{Ibid.}
\item[325] In this regard, see par 7.3 below.
\item[326] \textit{Kerrigan v Unity Savings Association} 317 NE2d 39 (Ill 1974) at 43; \textit{Diedrick v Helm} 14 NW2d 913 (Minn 1944) at 920-921. In \textit{Diedrick} the secretary of a saving and loan association was permitted to establish his own separate insurance agency after the association had considered and rejected the possibility of operating its own agency. See also par 7.4 below.
\end{footnotes}
6.4 Tests for Determining Corporate Opportunity

Commentators agree that the most difficult aspect of the corporate opportunity doctrine is to determine in specific factual situations whether a business opportunity properly belongs to the corporation. What constitutes a corporate opportunity may vary from state to state and may change depending upon the state's criteria for its identification, such as disclosure of the opportunity to the corporation and consideration by a disinterested board, and the ability of the corporation to have accepted and exploited the particular opportunity. In the determination of what constitutes a corporate opportunity a balance should be struck between a corporation's desire for and equitable right to certain opportunities, and the preservation of the corporate fiduciary's freedom to take opportunities when doing so is not inconsistent with his duty of loyalty. Tests for determining the existence of corporate opportunities should protect the legitimate interests of both corporations and their fiduciaries.

The fundamental principle of the corporate opportunity doctrine is that a participant may not take for himself any opportunity to the development of which assets of the corporation have been applied. In this context the concept "assets" includes tangible assets such as cash, facilities and contracts, as well as non-tangible assets such as goodwill, working time and confidential corporate information.

Although the executive's obligation is affirmative, the corporate opportunity provides only a negative enforcement of that obligation. Courts only remedy misappropriation of corporate opportunities, by providing a remedy which transfers to the corporation the opportunity which rightfully belongs to it plus whatever profit has

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327 Brown "Corporate Opportunity Claims" 509; Kempin, Wiesen & Bagby Management Process 427; Knepper & Bailey Liability 100; Miller "Duties" 266; Sardell "Corporate Opportunity" 278; Slaughter "Corporate Opportunity Doctrine" 96. In Miller v Miller 222 NW2d 71 (Minn 1974) at 79 the court stated that, having searched the case law and commentary in vain for an all-inclusive test by which a wrongful appropriation could be determined, it was persuaded that the corporate opportunity doctrine was not capable of precise definition.

328 Cagle Fiduciary Duties 39. Under New York law, for example, a prima facie case of misappropriation of a corporate opportunity is established if it is shown that the corporation was in the process of negotiating for such an opportunity, or that the director had acquired the property in his official capacity as director: In re Dunlop's Sons, Inc v Dunlop 14 NYS2d 452 (1939) at 455; Kelly v 74 & 76 West Tremont Avenue Corporation 151 NYS2d 900 (Sup Ct 1956) at 903. When neither of these circumstances are present, it becomes more difficult to determine such a breach of fiduciary duty. See, in general, Anon 'Property' 187; Coffey 'Firm Opportunities' 155; Ruder "Duty of Loyalty" 1400; Slaughter "Corporate Opportunity Doctrine" 97ff.

329 Brown "Corporate Opportunity Claims" 509.

330 Brudney & Clark "Corporate Opportunities" 1006.

331 Brudney & Clark "Corporate Opportunities" 1006-1007. The authors indicate that, generally speaking, the case law accepts and applies this principle more consistently when tangible assets are used than when non-tangible assets are involved. On what constitutes confidential information, see page 140 above.
been realised, and by formulating a test which seems ordinarily to permit an executive to determine with reasonable certainty whether he is breaching his corporate duty by appropriating a particular business opportunity.\textsuperscript{332}

Three variant, but often overlapping, tests have been applied to determine whether a business opportunity properly belongs to the corporation. They are the "interest or expectancy" test, the "line of business" test and the "fairness" test.\textsuperscript{333} A combination of the latter two tests has also emerged as a separate test.

\textbf{6.4.1 The Interest or Expectancy Test}

The interest or expectancy test precludes the acquisition by corporate directors of property or a business opportunity in which the corporation has a legal or equitable interest or expectancy which arises from a pre-existing right or relationship,\textsuperscript{334} or which is essential to the corporation.\textsuperscript{332} In \textit{Farber v Servan Land Company}, for example, the corporation operated a golf course. It had been discussing the possibility of purchasing an additional one hundred and sixty acres of adjoining land for use as an additional golf course. No decision had yet been taken on the matter. Subsequently, two of the directors purchased the property in their individual capacities. The court held that it was clear from the facts that the opportunity to acquire the land was an advantageous one that fitted into a present, significant corporate purpose, as well as an ongoing policy, and that the corporation had an active interest in it.\textsuperscript{336} The directors were held accountable for misappropriation of a corporate opportunity.

\textsuperscript{332} Anon "Corporate Opportunity" 768 shows that the courts' refusal to allow suits to compel affirmative executive action or to recover damages for inaction seems based on sound policy, since to allow such actions might encourage a plethora of strike suits, and would require frequent review of business judgment, with the likely result of subjecting corporate management to the danger of unpredictable liability. Furthermore, the calculation of damages would be virtually impossible. In this regard, see also Slaughter "Corporate Opportunity Doctrine" 116.

\textsuperscript{333} For critiques of these tests, see Begert "Corporate Opportunity Doctrine" 839ff; Chew "Competing Interests" 457ff.

\textsuperscript{334} \textit{Blaustein v Pan American Petroleum & Transport Co} 56 NE2d 705 (NY 1944) at 714; \textit{Rosenblum v Judson Engineering Corp} 109 A2d 558 (New Hampshire 1954) at 563; \textit{Alvest, Inc v Superior Oil Corporation} 398 P2d 213 (Ala 1965) at 215; \textit{Northwestern Terra Cotta Corporation v Wilson} 219 NE2d 860 (Ill 1966) at 864; \textit{Burg v Hom} 380 F2d 897 (2d Cir 1967), discussed by Anon "Property" 187, at 900; \textit{Kaplan v Fenton} 278 A2d 834 (Del 1971) at 836; \textit{Abbott Redmont Thinline Corporation} v \textit{Redmont} 475 F2d 85 (2nd Cir 1973) at 89; \textit{Patient Care Services SC v Segal} 337 NE2d 471 (Ill 1975) at 480; \textit{Zidell v Zidell, Inc} 560 P2d 1091 (Or 1977) at 1093-1094; \textit{Schreiber v Bryan} 396 A2d 512 (Del 1978) at 519; \textit{Science Accessories Corporation} v \textit{Summagraphics Corporation} 425 A2d 957 (Del 1980) at 963; \textit{Southeast Consultants, Inc} v \textit{McCray Engineering Corporation} 273 SE2d 112 (Ga 1980) at 117; \textit{Farber v Servan Land Company, Inc} 662 F2d 371 (5th Cir 1981) at 378; \textit{United Seal and Rubber Company, Inc} v \textit{Bunting} 285 SE2d 721 (Ga 1982) at 722-723; \textit{Taylor v Terry} 649 SW2d 392 (Ark 1983) at 393.

\textsuperscript{335} Anon "Liability" 221; Clark \textit{Corporate Law} 225.

\textsuperscript{336} At 378.
This test permits a director to personally acquire a business opportunity in certain circumstances. The opportunity would have to be acquired in the director's individual capacity, rather than by virtue of his office.\textsuperscript{337} In addition, it should not be regarded as essential to the corporation, which must not have an interest or expectancy in it.\textsuperscript{338} Geographical considerations may impose limits on what is deemed to be the scope of a corporation's normal business.\textsuperscript{339}

If the corporation is interested in a transaction, but the opportunity falls beyond the field of the director's duties, he may avail himself of it. In \textit{Tovrea Land and Cattle Company v Linzenmeyer}\textsuperscript{340} the court pointed out that precluding a director from taking all business opportunities in which the company might be interested would go too far, since many activities fell beyond the duties of directors, but within the scope of the corporation's business.\textsuperscript{341}

A corporation will prove its expectancy in property by showing not only that the property was of value to it, but also that it had a practical, as opposed to only a theoretical, use for it.\textsuperscript{342} Furthermore, there must be some link between the specific property and the nature of the corporate business. In a well-known Delaware decision, for example, the president of a corporation learned of an opportunity to acquire the business of manufacturing self-locking nuts used in aircraft, and the patents relating thereto, in his personal capacity, as a friend of the seller.\textsuperscript{343} At the time of acquisition the corporation had no well-defined object or purpose other than that of applying its liquid assets for the profit of its stockholders.\textsuperscript{344} The court held that the business acquired had no direct or close relation to the conduct of the cor-

\textsuperscript{337} By contrast, in \textit{Industrial Development Consultants Ltd v Cooley} [1972] 1 WLR 443, [1972] 2 All ER 162 (see chapter 4 page 98 above), the court considered it irrelevant in English law that the opportunity could be regarded as having been obtained in the director's individual capacity. See also chapter 4 par 3.2.1 above in respect of the various tests for accountability for secret profits.

\textsuperscript{338} \textit{Equity Corp v Milton} 221 A2d 494 (Del 1966) at 497.

\textsuperscript{339} Thus in \textit{Blaustein v Pan American Petroleum & Transport Co} 56 NE 2d 705 (NY 1944) the court held that an oil company which had not engaged in crude oil production in Texas had no "tangible expectancy" in oil properties situated in Texas (at 714).

\textsuperscript{340} 412 P2d 47 (Ariz 1966).

\textsuperscript{341} At 57.

\textsuperscript{342} Bean "Director Liability" 70; \textit{Peterson Welding Supply Company, Inc v Cryogas Products, Inc} 467 NE2d 1068 (Ill 1984) at 1072. In \textit{Equity Corp v Milton} 221 A2d 494 (Del Supr 1966) it was confirmed that a necessary element of the corporate opportunity rule is that the opportunity must be one which is of practical advantage to the corporation. Financial consideration of the transaction involved (the acquisition of Equity stock) led to the court's decision that no corporate opportunity had been involved.

\textsuperscript{343} \textit{Johnston v Greene} 121 A2d 919 (Del 1956).

\textsuperscript{344} At 921.
poration's business. Accordingly, no corporate opportunity had been appropriated.

The interest or expectancy test therefore does not prevent directors from purchasing any property that might be useful to the corporation. Rather, it prevents the acquisition of property that the corporation needs or is seeking, or that the directors have a duty to acquire for the corporation. The opportunity must fall in the scope of business of the corporation, or fit into an established corporate policy which the acquisition of the opportunity would advance. In some decisions, fulfillment with this requirement is determined by asking whether the director had a specific duty to act or to contract in respect of the particular matter as the representative of the corporation.

6.4.2 The Line of Business Test

According to the strict application of the second test, the line of business test, which was developed in Delaware, the director is accountable for appropriation of a corporate opportunity if the particular opportunity falls within the line of business of the corporation. An opportunity is said to be in the line of a corporation's business when it embraces an activity regarding which the corporation has fundamental knowledge, practical experience, and the ability to pursue. The opportunity should also be logically and naturally adaptable to the corporation's business and its appropriation must fall within the financial ability of the company.

This test was applied in the leading Delaware decision in Guth v Loft, Inc. Guth, the director of Loft Inc, a soda fountain chain, endeavoured to find a substitute for Coca Cola to sell in the corporation's stores. He decided on the Pepsi Cola formula, which he purchased for himself. Using corporate money and personnel, he then developed the Pepsi Company and caused it to sell large quantities of the product to Loft Inc. In response to a lawsuit brought by the corporation, the
Delaware Supreme Court confirmed that the restriction on the ability of corporate directors and officers to take opportunities for themselves is one manifestation of the general duty owed to the corporation by corporate fiduciaries.351 The court held that Guth's Pepsi-Cola shares were a corporate opportunity of Loft Inc and had to be transferred to that corporation. In Guth the director had made clandestine use of the corporation's resources.352 The decision was not based upon this aspect. Even if the resources had not been utilised, the particular opportunity would still have been regarded as corporate in nature.

Subsequent decisions in Delaware, as well as in other jurisdictions, have adopted the line of business test.353 Later decisions confirm that this test is cumulative to the interest or expectancy test. An opportunity will therefore be a corporate one if it meets either the interest or expectancy or the line of business tests.354 Thus the range of opportunities which may be deemed corporate in nature, and accordingly possible liability incurred by directors, is wider.355

However, the view that any opportunity which falls within the line of business of a corporation constitutes a corporate opportunity, has been considered too general.356 The particular facts and circumstances of each case therefore remain of great importance.

351 At 510. The importance of the particular facts of each individual case is apparent from the judgment. The court stated (at 510) that "when a business opportunity comes to a corporate officer or director in his individual capacity, and the opportunity is one which, because of the nature of the enterprise, is not essential to his corporation, and is one in which it has no interest or expectancy, the officer or director is entitled to treat the opportunity as his own, and the corporation has no interest in it, if, of course, the officer or director has not wrongfully embarked the corporation's resources therein." For an analysis of Guth and other early American cases on the corporate opportunity doctrine, see Carrington & McElroy 'Doctrine of Corporate Opportunity' 959ff, especially note 10.

352 *Inter alia* the corporation's employee time, facilities, and credit: Brown "Corporate Opportunity Claims" 509.

353 Diedrick v Helm 14 NW2d 913 (Minn 1944) at 919; Blaustein v Pan American Petroleum and Transp Co 56 NE2d 705 (NY 1944) at 713-714; Central Ry Signal Co v Longden 194 F2d 310 (CA 1952) at 318-319; Kerrigan v Unity Savings Association 317 NE2d 39 (IL 1974) at 43-44; Science Accessories Corporation v Summagraphics Corporation 425 A2d 957 (Del 1980) at 963; Peterson Welding Supply Company, Inc v Cryogas Products, Inc 467 NE2d 1068 (IL 1984) at 1072. For examples of opportunities which have, in their particular circumstances, been considered to be in the line of business of the corporation, see Rigelhaupt 'Line of Business' 961.

354 Clark Corporate Law 228; Equity Corp v Milton 221 A2d 494 (Del 1966) at 497.

355 This is in accordance with the trend to impose wider liability than would be imposed under the general prohibition against injury to the corporation. See also par 4 above.

356 In Burg v Horn 380 F2d 897 (2d Cir 1967) the court held that a New York court would, in each case, by consideration of the relationship between the director and the corporation, have to determine whether a duty to offer the corporation all opportunities within its "line of business" can fairly be implied (at 900). The following facts and circumstances should be considered to determine whether a particular business opportunity falls within the line of business of a corporation for purposes of establishing whether a corporate opportunity was wrongfully usurped: fundamental knowledge concerning the opportunity; ability of the corporation to pursue the opportunity, essentiality and adaptibility of the opportunity to the business of the corporation; practical experience of the corporation concerning the opportunity; whether the opportunity falls within the corporate powers of the corporation; the competi-
6.4.3 The Fairness Test

Another test employed by the courts to determine whether the appropriation of a business opportunity or property constitutes the appropriation of a corporate opportunity, is the fairness test. This test, which originated in the Massachusetts case of *Durfee v Durfee & Canning, Inc*, sets out to determine the existence of a corporate opportunity by applying "ethical standards of what is fair and equitable to particular sets of facts."357

In *Durfee* it was alleged that the defendant was profiting from transactions between a corporation of which he was an officer, director and stockholder and the plaintiff corporation. The court found that he had, in violation of his duty of loyalty, fraudulently and in bad faith, induced the plaintiff corporation to purchase natural gasoline from his own corporation in excess of general market prices. The transaction was found unfair to the corporation and the director was ordered to account for profits made.

The relevant issue is thus whether the acquisition of the particular opportunity would be unfair to the corporation.358 In the application of this test, some courts consider factors such as the manner in which the offer was communicated to the director; his good faith; the use of corporate assets to acquire the opportunity; whether there was disclosure to the corporation and what action was taken upon such disclosure; the financial ability of the corporation to acquire the opportunity; and the need for, or interest of the corporation in, that opportunity.359

The question whether a director has appropriated for himself an opportunity which in fairness should belong to his corporation is factual and must be decided by reasonable inference from objective facts.360 Therefore, the result in any particular case has hinged on the surrounding circumstances and particular actions that allegedly caused a breach of the corporate opportunity doctrine. Where customers of the corporation have been solicited, the director has been found liable for a

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357 *Durfee v Durfee & Canning, Inc* 80 NE2d 522 (Mass 1948) at 529.

358 In *Guth v Loft, Inc* 5 A2d 503 (Del 1939) (see page 171 above) the court applied the line of business test. However, it considered the factor of fairness to the corporation in determining liability (at 510ff). In *Am Jur volume 18B par 1785*, the commentators submit that the language of this decision clearly supports the application of the fairness test.

359 Segerson "Corporate Opportunities Doctrine" 471; *Paulman v Kritzer* 219 NE2d 541 (Ill 1966) at 545-546.

360 The authorities cited in note 334 above also stress the importance of the objective facts and surrounding circumstances of each case.
breach of the doctrine.\textsuperscript{361} Similar results have been reached in cases which involved interference by officers or directors with their corporations' interest or expectancy in the lease of business premises.\textsuperscript{362} However, in \textit{Gross v Neuman}\textsuperscript{363} a corporation had two hospital properties which it could not operate due to a public health statute. The president was in substantial control of the corporation. With the approval of the board of directors, he entered into a twenty year lease agreement for the properties, so that he could operate them. The transaction was considered fair. The court held that the corporation's president had not deprived it of an opportunity.\textsuperscript{364} Directors have been held liable for sale of stock in competition with their corporations.\textsuperscript{365} Similarly, they have been found liable in circumstances where they purchased outstanding financial obligations of their corporations.\textsuperscript{366} It is apparent from the case law that decisions regarding fairness depend largely on whether the opportunity presented is speculative and in the line of the corporation's business. If it is in the line of the corporation's business, the corporate opportunity doctrine is likely to be considered violated.\textsuperscript{367} Opportunities that are highly speculative or of a different type than that ordinarily pursued by the corporation are likely to result in a contrary determination.\textsuperscript{368} The outcome of a case has often depended upon whether the corporations involved had taken an active interest

\textsuperscript{361} \textit{Hartung v Architects Hartung/Odle/Burke, Inc} 301 NE2d 240 (Ind 1973) at 245; \textit{Epperly v E & P Brake Bonding, Inc} 348 NE2d 75 (Ind 1976) at 81.

\textsuperscript{362} \textit{Hartung v Architects Hartung/Odle/Burke, Inc} 301 NE2d 240 (Ind 1973) at 244; \textit{Eltzey v Fyr-Pruf, Inc} 376 So 2d 1328 Miss 1979) at 1332-1333; \textit{Golden Nugget, Inc v Ham} 646 P2d 1221 (Nev 1982). In \textit{Golden Nugget}, the defendant, while serving as corporate director of the plaintiff corporation, leased an interest in an option to purchase certain property from his wife. The corporation was at the same time conducting several property transactions on the street where the property in question was situate. The court considered the transaction concluded by the director unfair to the corporation (at 1223).

\textsuperscript{363} 337 NYS2d 623 (AD 1972).

\textsuperscript{364} At 624. On the corporation's inability to pursue a particular opportunity, see also par 7.3 below.

\textsuperscript{365} \textit{Perlman v Feldman} 219 F2d 173 (2nd Cir 1955) at 179; \textit{International Bankers Life Insurance Company v Holloway} 368 SW2d 567 (Tex 1963) at 578. But in \textit{Litwin (Rosemarin) v Allen} 25 NYS2d 667 (1940) directors of a trust company that had been employed for a commission to retail shares of stock were found not to have appropriated a business opportunity. The facts indicated that they had purchased additional shares of the same stock individually and sold them at a profit. But the trust company had not considered it desirable or expedient to take a larger interest in the stock, the directors' interest differed from that of the company, and resale of the stock was not in competition with the marketing operation of the company.

\textsuperscript{366} \textit{Weissman v A Weissman, Inc} 97 A2d 870 (Penn 1953) at 872 (constructive trust imposed where a mortgage was purchased); \textit{Brown v Presbyterian Ministers Fund} 484 F2d 998 (3rd Cir 1973) at 1005.

\textsuperscript{367} \textit{Alvest, Inc v Superior Oil Corporation} 398 P2d 213 (Ala 1965) at 215; \textit{Schreiber v Bryan} 396 A2d 512 (Del 1978) at 519.

\textsuperscript{368} \textit{New v New} 306 P2d 987 (Cal 1957) at 989; \textit{Fliegl er v Lawrence} 361 A2d 218 (Del 1976) at 224. In \textit{New} highly speculative oilwell drilling was not considered to be a corporate opportunity which the corporation could have pursued.
in the opportunities presented. In Southeast Consultants, Inc v McCrary Engineering Corporation, the plaintiff corporation specialised in planning, design and supervision of construction of water and sewerage projects for municipalities, counties and industry. It entered into a contract for preliminary study with the city of Danielsville. However, it was not awarded the final contract. The president of the corporation subsequently formed a competing firm and entered into a contract for the same work. The court held him in breach of his fiduciary duties to the corporation, notwithstanding the fact that the plaintiff had not been awarded the contract.

In Miller v Miller the court indicated that the following factors would be relevant in the application of the fairness test: the relationship of the official to management and control of the corporation; whether the opportunity was presented to the official in an individual or official capacity; prior disclosure of all material facts relating to the opportunity to the corporation; absence of exploitation of corporate resources in obtaining and developing the opportunity; benefit to the corporation as a result of the acquisition of the opportunity by the official; and the good faith of the official.

6.4.4 Test Combining the Line of Business and Fairness Tests

In Miller v Miller the dispute involved a son who left the family business to become a securities analyst. After the death of his parents, he sued, as shareholder, for some of the benefits acquired by his brothers in separately incorporated side ventures. The two brothers had continued actively in the family business. The Minnesota Supreme Court adopted a two-step process to determine when liability for the appropriation of a corporate opportunity should be imposed. This approach combines the line of business and fairness tests. The first step entails a determination of whether the business opportunity also constitutes a corporate opportunity, that is, whether it is of sufficient importance and so closely related to the existing or prospective activity of the corporation as to warrant judicial sanction

369 Johnston v Greene 121 A2d 919 (Del 1956) at 924-925; Paulman v Kritzer 219 NE2d 541 (Ill 1966) at 546; Burg v Horn 380 F2d 897 (2d Cir 1967) at 899; Tower Recreation, Inc v Beard 231 NE2d 154 (Ind 1967) at 156; Epperly v E & P Brake Bonding, Inc 348 NE2d 75 (Ind 1976) at 83; Borden v Sinskey 530 F2d 478 (3rd Cir 1976) at 490; Maryland Metals Inc v Metzner 382 A2d 564 (Md 1978) at 568-570; Southeast Consultants, Inc v McCrary Engineering Corporation 273 SE2d 112 (Ga 1980).

370 273 SE2d 112 (Ga) 1980).

371 At 118.

372 222 NW2d 71 (Minn 1974). In this decision the line of business and the fairness tests were combined: see par 6.4.4 below.

373 222 NW2d 71 (Minn 1974). See also par 6.4.3 above.

374 The court indicated that the corporate opportunity doctrine has often been criticised as vague and as subjecting corporate management to the danger of unpredictable liability (at 81).
against its personal acquisition by a director of the corporation. If the facts are undisputed that the business opportunity presented bears no logical or reasonable relation to the existing or prospective business activities of the corporation or that it lacks either the financial or fundamental practical or technical ability to pursue it, the opportunity is noncorporate. In the absence of fraud or any other breach of fiduciary duty, the corporate officer will then escape liability. This first step thus closely resembles the line of business test. But the second step, taken if the opportunity is corporate, limits the director's liability. It must then be established whether the officer who took the corporate opportunity violated his fiduciary duties of loyalty, good faith, and fair dealing towards the corporation. This second step involves close scrutiny of the equitable considerations existing prior to, at the time of, and following the acquisition. Plaintiff has the burden of proof with respect to the first step; the defendant has it in respect of the second.

6.4.5 Other Relevant Factors

The use of corporate resources to acquire and develop an opportunity for a director's personal use is sometimes treated as a separate test. Courts in certain jurisdictions, for example Delaware, attach considerable importance to the question how information regarding an opportunity came to the attention of the director. If he learnt of it in his official capacity, that is, by virtue of his connection with the corporation, he may be bound by the stricter line of business test. If, however, he came to know of it in his individual capacity, he is bound only by the interest or

375 This determination is one of fact and is best resolved by resort to a flexible application of the line of business test: Am Jur volume 18B par 1787; Clark Corporate Law 229. On the line of business test, see par 6.4.3 above.

376 For criticism of this approach, see Brudney & Clark "Corporate Opportunities" 998 n2; Clark Corporate Law 229. Hamilton Corporations 819 submits that the new methodology introduced by Miller "in fact adds only a new layer of confusion to an already murky area of law, without forwarding the analysis in any significant fashion." Turnbull "Doctrine of Corporate Opportunity" 190 suggests a "market value"-test to establish whether an opportunity is a corporate one: if the business opportunity could be reasonably anticipated as belonging to the firm and the appropriation affects or could be expected to affect the market value of the firm, then the opportunity is a corporate one. Clark Corporate Law 229 submits that the result reached in Miller is the intuitively correct one. However, the author indicates that the decision muddied the waters in several ways: semantically, by changing accepted usage so that an opportunity found to be a corporate one might nevertheless be taken by a fiduciary if his doing so is "fair"; and substantively, by relying on an "all relevant factors" fairness approach without explicitly recognising the key importance of determining what expectations and understandings the parties had, or ought to have had, in the particular case.

377 Clark Corporate Law 229.

378 Clark Corporate Law 230.

379 Guth v Loft, Inc 5 A2d 503 (Del 1939) at 510 (see page 171 above for the facts of this case); Kaplan v Fenton 278 A2d 834 (Del 1971) at 836.
expectancy test. The facts and circumstances of the specific situation are therefore of great importance.

The abovementioned distinction in effect treats some information as corporate property as between the corporation and the fiduciary, namely information received by an insider by virtue of his exercise of the office of corporate fiduciary. The cases based on this distinction therefore represent a sub-category of instances where corporate assets are misused. It is submitted that this could lead to confusion. The distinction can, furthermore, create endless argument about the proper characterisation of facts. In the leading Canadian case on corporate opportunities, Canadian Aero Service Ltd v O'Malley, the court pointed out that the American law on this issue leads to an "imprecise ethical standard."

6.4.6 Proposals by the American Law Institute

It was mentioned above that the proposals of the American Law Institute ("ALI") are important, because they not only restate existing law, but also point out specific problematic areas of company law. The Institute's corporate governance project originated in the intense interest in corporate governance that followed disclosures during the aftermath of Watergate concerning corporate misconduct. The first draft appeared in 1982, amidst much criticism. The proposals originally intended to "restate" the law of corporate governance without departing from the primary goal stated in the Law Institute's charter, namely to promote the clarifica-

380 Kaplan v Fenton 278 A2d 834 (Del 1971) at 836.

381 See, in general, Feuer Liabilities 78ff; Burg v Horn 380 F2d 897 (2d Cir 1967); Irving Trust Co v Deutch 73 F2d 121 (2d Cir 1934).

382 Clark Corporate Law 230.

383 In other jurisdictions, the "information-as-property" approach has also been criticised. In respect of Canadian law, see Roberts "Corporate Opportunity and Confidential Information" 68ff, and chapter 8 par 3.4.3 below. See also chapter 4 par 4.6 above with regard to the position under English law, and chapter 9 par 4.7 below in respect of the South African law.

384 Clark Corporate Law 230 illustrates this point with the example of a director who is invited to a cocktail paty at a private individual's home. While he is there he learns of a business opportunity that would be profitable if purchased by someone like himself or by a corporation such as the one he serves. If it is clear that the hostess invited him only because he is the chief executive of a large corporation, it becomes difficult to determine in which capacity he received the information. This problem is indicative of the difficulty generally experienced to decide when an executive has stepped completely outside his role.

385 [1974] SCR 592 at 612, (1973) 40 DLR (3d) 371 at 385. (See also chapter 8 par 3.4.2 below.)

386 See page 126 above.

387 Sommer "ALI's Corporate Governance Project" 724.

388 Fine "ALI Proposals" 695ff; Sommer "ALI's Corporate Governance Project" 724.
tion and simplification of the law and its better adaptation to social needs. The proposals have, however, suggested reforms in addition to restatements.

The American Law Institute's proposals consist of tentative drafts, each containing substantial revisions of the previous draft. A final draft appeared in 1993. Each draft and its subsequent commentary was intended to help mould the proposals into a realistic approach to governing modern corporations.

In 1986 the Institute adopted a draft concerning directors' and officers' duty of loyalty to the corporation. It provides that the duty of loyalty requires directors, when personally interested in a matter which affects the corporation, to deal fairly with the corporation. This phase of the corporate governance project also includes a reformulation of the corporate opportunity doctrine.

Section 5.05(b) of the draft suggests the following definition of a corporate opportunity:

(1) any opportunity to engage in a business activity of which a director or senior executive becomes aware either:
   (A) in connection with the performance of his functions as a director or senior executive, or under circumstances that should reasonably lead him to believe that the person offering the opportunity expects him to offer it to the corporation; or
   (B) through the use of corporate information or property, if the resulting opportunity is one that the director or senior executive should reasonably be expected to believe would be of interest to the corporation; or
(2) any opportunity to engage in a business activity of which a senior executive becomes aware, if he knows or reasonably should know that the activity is closely related to the business in which the corporation is engaged or may reasonably be expected to engage.

A 'business activity' includes the acquisition or use of any contract right or other tangible or intangible property.

The ALI proposes that a director or senior executive may not take advantage of a corporate opportunity unless he first offers it to the corporation and discloses all relevant information concerning it. If the corporate opportunity is rejected by the corporation and the rejection is either fair to the corporation, or is authorised by disinterested directors in a manner that satisfies the standards of the business judgment rule, or is authorised or ratified by disinterested shareholders, the director or senior executive may appropriate it for his personal use. The shareholders' action may, however, not amount to a waste of corporate assets. A transaction constitutes a

389 Fine "ALI Proposals" 694.
390 Ibid.
391 Fine "ALI Proposals" 700. See also note 10 above.
393 On the requirement of fairness, see page 146ff above.
"waste of corporate assets" if its terms are such that no person of ordinary sound business judgment would say that the consideration received by the corporation was a fair exchange for what was given by the corporation.394

The proposals make it clear that the corporate opportunity doctrine applies not only to corporate directors, but also to senior executives. This was confirmed in O'Malley in respect of Canadian law.395 It is submitted that this is also the position under South African law.396 The principle of fairness in the particular circumstances, is also clearly regarded as important. It is further specified that a corporate opportunity includes the acquisition or use of any contract right or other tangible or intangible property.397 It is suggested that the American Law Institute's recommendation presents a workable definition of a corporate opportunity in any legal system.

From the abovementioned, it is clear that whether a business opportunity is a corporate one or one which falls within the legitimate scope of the individual interests of the director, depends largely upon the facts and circumstances of the particular case.398 The facts and circumstances to be considered are those present when the opportunity arises without regard to events subsequently occurring, such as when the opportunity was appropriated. Should the facts be disputed, or if there is doubt whether the opportunity is closely associated with the existing or prospective activities of the corporation, the burden of proof rests upon the party who attacks the acquisition by the director. If it is proved that the opportunity was in fact a corporate opportunity, the director thereafter carries the burden of proof to absolve himself from liability.399

Generally, the opportunity will be regarded as a corporate opportunity if the corporation has a right, property interest, or expectancy in the opportunity,400 or if

394 Paragraph 1.34 of the commentary on s 5.05(a). For critiques of the American Law Institute's corporate opportunity rule, see Begert "Corporate Opportunity Doctrine" 847ff; Fine "ALI Proposals" 728ff.

395 See par 2.3 above and chapter 8 par 3.4.2 below.

396 See chapter 9 par 3 below.

397 See also page 168 above.

398 Industrial Indemnity Co v Golden State Co 256 P2d 677 (Del 1953) at 686-687; Johnston v Greene 121 A2d 919 (Del 1956) at 923; Equity Corporation v Milton 221 A2d 494 (Del 1966) at 497.

399 The director can, for example, establish ratification upon full and continuing disclosure of material facts, inherent fairness, or other circumstances which indicate discharge by the fiduciary of his duty to the corporation. In this regard, see par 7 below.

400 Broderick v Blanton 59 NYS2d 136 (1945); Burg v Horn 380 F2d 897 (2d Cir 1967) at 899; Miller v Miller 222 NW2d 7 (Minn 1974). In Broderick, for example, certain purchases in bulk whiskey were made by the directors of a corporation. The corporation, which was mainly engaged in distilling and bottling liquor for sale, did, on occasion, buy bulk whiskey in comparatively small quantities, but for its own use and not for speculation. On the facts, it was found that the purchases made by the directors were not corporate opportunities.
the opportunity is one which in justice should belong to the corporation. That would be the case if the corporation has been seeking the opportunity; or if its funds, facilities or personnel have been involved in financing the opportunity. On the other hand, should an opportunity arise unexpectedly, or be offered personally to a person who happens to be a director or officer, and corporate funds are not involved, it need not be regarded as a corporate opportunity. The fiduciary must act in good faith, but *bona fides* is not all that is required. A fiduciary who has been authorised to act on behalf of the corporation usually cannot regard the opportunity as a personal one.

6.5 Remedies

A corporation need apparently not suffer any actual harm in order for the corporate opportunity doctrine to apply. In *Freeman v Decio* the court reasoned

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401 Henn & Alexander *Laws of Corporations* 634.

402 *Irving Trust Co v Deutch* 73 F2d 121 (2d Cir 1934); *Guth v Loft, Inc* 5 A2d 503 (Del 1939) (see page 171 above for the facts of this case); *Greene v Allen* 114 A2d 916 (Del 1955); *Johnston v Greene* 121 A2d 919 (Del 1956) (for the facts, see page 170 above). In Greene, the alleged corporate opportunity concerned the purchase of patents by the president of a corporation after the opportunity had been rejected by the board of directors. The capacity in which the director had heard of the opportunity was regarded as immaterial. The court did not consider the rejection to have been obtained in good faith (at 919). The opportunity was considered corporate in nature.

403 Henn & Alexander *Laws of Corporations* 635; *Guth v Loft, Inc* 5 A2d 503 (Del 1939) (for the facts, see page 171 above); *Broadway Federal Savings and Loan Association of Los Angeles v Howard* 285 P2d 61 (Cal 1955) at 69; *Brown v Dolese* 154 A2d 233 (Del 1959) at 239 (purchase of stock), affirmed in *Dolese Brothers Co v Brown* 157 A2d 784 (Del 1960).

404 *Johnston v Greene* 121 A2d 919 (Del 1956). For the facts of this case, see page 170 above.

405 In *Equity Corp v Milton* 221 A2d 494 (Del 1966) the re-acquisition by a director of one million eight hundred thousand shares in an investment company was upheld. Factors taken into account were that the opportunity had come to the director personally, and that the corporation had no policy to acquire its own shares.

406 *Johnston v Greene* 121 A2d 919 (Del 1956); *Litwin (Rosemarin) v Allen* 25 NYS2d 667 (1940) at 685.

407 *Litwin (Rosemarin) v Allen* 25 NYS2d 667 (1940) at 678.

408 In *Irving Trust Co v Deutch* 73 F2d 121 (2d Cir 1934), the president of the corporation had been instructed to endeavour to obtain sufficient funds with regard to the acquisition of stock. The court held that the acquisition of the stock in his own name was a breach of his fiduciary duty.

409 In *Central Ry Signal Co v Longden* 194 F2d 310 (CA 1952) the court held that if directors make a personal profit through the use of corporate assets they must account to their stockholders for it. The court considered it immaterial that their dealings may not have caused a loss or have been harmful to the corporation (at 319).

410 584 F2d 186 (7th Cir 1978).
that one should look to the "potential loss to the corporation" in order to find that
insider trading constituted wrongful use of a corporate asset and caused the corpo-
ration harm.411 According to this suggestion, while courts will require a director to
automatically account to the corporation for diversion of a corporate opportunity
for personal use, they will first inquire to see whether there was a possibility of a loss
to the corporation (namely whether the corporation was able to avail itself of the
opportunity) before deciding that a corporate opportunity in fact existed. This
implies that the corporation had to be in a position to avail itself of the opportunity
to make the profits which were made by the fiduciary.412 However, Guth v Loft,
Inc,413 which is the case most often cited for the rule that the corporation must be in
a position to avail itself of the opportunity,414 does not support the injury require-
ment. The impression that the corporation should have suffered a loss, seems to
derive from the court's statement that corporate directors and officers should
refrain from doing anything that would cause injury to the corporation.415 However,
the Delaware Supreme Court emphasised that the issue was the ethics of the fiduci-
ary and not injury to the corporation:

The rule that requires an undivided and unselfish loyalty to the corporation demands that
there shall be no conflict between duty and self-interest. ...

If an officer or director of a corporation, in violation of his duty as such, acquires gain or
advantage for himself, the law charges the interest so acquired with a trust for the benefit
of the corporation, at its election, while it denies to the betrayer all benefit and profit. ...

The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow
ground of injury or damage to the corporation resulting from a betrayal of confidence,
but upon a broader foundation of a wise public policy that, for the purpose of removing
all temptation, extinguishes all possibility of profit flowing from a breach.416

The decision in Guth has been followed in some cases in respect of insider
trading.417 However, the decision in Freeman,418 that in cases of insider trading

411 At 193.
412 Freeman v Decio 584 F2d 186 (7th Cir 1978) at 193.
413 5 A2d 503 (Del Supr 1939). See also page 171 above.
414 Wimberly "Recovery of Profits" 231.
415 At 510.
416 At 510.
417 Brophy v Cities Service Co 70 A2d 5 (Del Ch 1949) at 8 and Diamond v Oreamuno 248 NE2d 910
(NY 1969) at 914. In Oreamuno the court confirmed that an agent who acquires confidential informa-
tion in violation of his duties or in the course of his employment has a duty to account for any profits
made by the use of such information although the principal does not suffer any loss thereby.
418 584 F2d 186 (7th Cir 1978). See page 180 above.
potential loss to the corporation should be a consideration, seems sounder. It should be borne in mind that, while both insider trading and appropriation of corporate opportunities are instances where a corporate fiduciary breaches the fiduciary position, they are based on different principles. In insider trading, the privileged position of the fiduciary in respect of the information received is paramount. The court in *Freeman* emphasised that insider trading is deterred from a policy point of view because equality of access to information should be promoted. Its suggestion that the same approach should be followed in respect of the corporate opportunity doctrine, was, it is suggested, *obiter.*

With regard to corporate opportunities, it was confirmed in *Farber v Servan Land Co, Inc* that if the corporate opportunity doctrine is otherwise applicable, it is not made inapplicable by the fortuitous sale of its assets at the same time as the sale of the property asserted to be a corporate opportunity, even if it is shown that the purchaser would not have bought the one asset without the other.

The primary relief to be afforded in an action against a director for misappropriation of corporate opportunity is the imposition of a constructive trust on the property, commissions and profits which were wrongfully diverted. The

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419 At 189.

420 At 193.

421 See also Wimberly "Recovery of Profits" 232, where it is noted that an accounting of profits has been imposed in numerous cases without showing injury or corporate availability.

422 541 F2d 1086 (5th Cir 1976), confirmed in *Farber v Servan Land Company, Inc* 662 F2d 371 (5th Cir 1981). It was contended on behalf of the defendants that the fact that two properties, one of which was alleged to be a corporate opportunity, the other belonging to the corporation, could be sold together, increased the value of each property. The court considered this immaterial (at 380).

423 At 380.

424 Anon "Corporate Opportunity" 765; Anon "Close Corporation Opportunity" 381; Anon "Duty not to Compete" 1192; Anon "Liability" 233; Acchiardio "Duty" 600; Carrad "Corporate Opportunity Doctrine" 4; Cary & Eisenberg *Cases* 571; Foposky "Corporate Opportunity and Competition" 1194 and 1214; Tovey "Corporate Opportunity" 108; Webber "Interested Directors' Contracts" 65; Guth v *Loft*, Inc 5 A2d 503 (Del 1939) at 510; Central Ry Sigmal Co v *Longden* 194 F2d 310 (CA 1952) at 319; International Bankers Life Insurance Company v *Holloway* 368 SW2d 567 (Tex 1963) at 577; Brown v Presbyterian Ministers Fund 484 F2d 998 (3rd Cir 1973) at 1004; Miller v Miller 222 NW2d 71 (Minn 1974) at 78; Patient Care Services SC v *Segal* 337 NE2d 471 (Ill 1975) at 481; Canion v Texas Cycle Supply, Inc 537 SW2d 510 (Tex 1976) at 513; *Farber v Servan Land Company, Inc* 662 F2d 371 (5th Cir 1981) at 380; Poling Transportation Corporation v A & P Tanker Corporation 443 NYS2d 895 (1981) at 897; Graham v *Minims* 444 NE2d 549 (Ill 1982) at 556. On constructive trusts generally, see page 146 above.

425 The basic principle applicable is that when there has been a breach of faith or duty, the wrongdoer should not gain by his misconduct even though the one wronged has lost nothing thereby. Since the remedy acts as a deterrent, all profits, past and future, should be taken from the fiduciary: Anon "Liability" 235. See also page 143 above. The corporation will have to reimburse the director for his outlay in acquiring the opportunity: Cary & Eisenberg *Cases* 571. Since a transaction concluded in breach of the director's fiduciary duty is voidable at the instance of the corporation (see the quote from *Guth* on page 181 above), it is submitted that the director will have to bear any loss that he may suffer. No direct authority could, however, be traced on this point. However, the American Law Institute's Tentative Draft No 8 (1988), which pertains to the duty of care, provides that a plaintiff bears the bur-
executive's affirmative obligation of loyalty to his corporation is enforced by the courts only in order to remedy his misappropriations of corporate opportunities by transferring to the corporation the opportunity which belongs to it, plus whatever profit has been realised.\textsuperscript{427} The director is obliged, at the request of the corporation, to transfer the property to it on his own cost.\textsuperscript{428} One purpose for preserving the use of a constructive trust is to avoid forcing individuals into business together under strained circumstances. While the courts should strive to place the parties in their proper financial positions, they should not force individuals into business arrangements they clearly do not want.\textsuperscript{429} In such instances, the director is reimbursed for any monetary investment he has made.\textsuperscript{430} It may, however, in the particular circumstances be appropriate for the court to award both actual and exemplary damages.\textsuperscript{431} Wrongdoers are jointly and severally liable in respect of breaches of fiduciary duties.\textsuperscript{432}

den of proving causation and the amount of any losses incurred by the corporation or the shareholders as the result of a director's violation of his duty. A defendant is entitled to offset against such liability any gains to the corporation that he can establish arose out of the same transaction (par 7.16).

\textsuperscript{426} Sialkot Importing Corporation \textit{v Berlin} 68 NE2d 501 (NY 1946) at 503. The directors had secured the cancellation of a contract for exclusive sale and distribution of the products of a firm in India. Thereafter they concluded contracts of the same nature for their rival business. The court indicated (at 503) that the corporation's loss was represented by the destruction of the unexpired portion of the exclusive sales contract. The defendant's opportunity for profit was, however, not limited to that, since a new contract concluded with the corporation might have endured beyond that term. Anon "Liability" 234 indicates that when a director has gained by a contract which should have been given to the corporation, and has not invested therein, he must clearly account for all profits. Where the director has mingled his own funds with corporate assets, the issue is more complex. It seems that the net gain is then given to the corporation: \textit{Red Top Cab Co v Hanchett} 48 F2d 236 (Cal 1931) at 238; \textit{Irving Trust Co v Deutch} 73 F2d 121 (2d Cir 1934) at 125.

\textsuperscript{427} Slaughter "Corporate Opportunity Doctrine" 116 suggests that this remedy, based as it is upon a determination of unfairness, appears to make the corporate opportunity doctrine a practicable and equitable judicial sanction for enforcing corporate loyalty by insiders in today's era of public corporate ownership.

\textsuperscript{428} \textit{New York Trust Co v American Realty Co} 244 NY 209, 135 NE 102.

\textsuperscript{429} Am Jur volume 18B par 1774.

\textsuperscript{430} Anon "Liability" 234.

\textsuperscript{431} Cary & Eisenberg \textit{Cases} 572-573; \textit{Jno Dunlop's Sons v Dunlop} 34 NE2d 344 (NY 1941) at 344; \textit{International Bankers Life Insurance Company v Holloway} 368 SW2d 567 (Tex 1963) at 582-583. Since a court of equity, which is usually the forum for a suit by a corporation against its directors, has plenary powers, the remedy may be adjusted to the need: \textit{Newton v Porter} 69 NY 133 (1877) at 139. In \textit{William B Weinberger v UOP, Inc} 457 A2d 701 (Del 1983) the court stated that in determining the plaintiff's damages, the trial court should consider all relevant factors, including rescissory damages (at 714). Daniel "Developments" 651 infers that this appraisal proceeding will allow a court to use any valuation method generally considered acceptable in the financial community.

\textsuperscript{432} Henn & Alexander \textit{Laws of Corporations} 628.
The determination of when a director has violated his fiduciary duty in connection with the business interests of the corporation, is usually a two-step process. Initially, the court must evaluate the facts to establish whether the taking of a business opportunity which rightfully belonged to the corporation actually occurred. Once it has been determined that such an opportunity has been appropriated, the court must consider whether such appropriation constitutes a breach of the director's fiduciary duty.

A fiduciary who takes an opportunity could also be compelled to account on the basis of having made a secret profit if he has resold the opportunity to the corporation. This will, typically, be the case where the director has been authorised to purchase a particular asset and then purchases it in his own name.

7 FACTORS RELIEVING DIRECTORS FROM LIABILITY FOR APPROPRIATION OF CORPORATE OPPORTUNITIES

7.1 Introduction

The defenses to corporate opportunity claims have, like the doctrine itself, been developed by the courts from common law and general equitable principles rather than through statutory enactment. The three defenses generally recognised are ratification, the corporation's inability to make use of the opportunity, and rejection of the opportunity by the corporation after tender to it. These defenses are discussed below.

7.2 Ratification

The ratification of breaches of directors' fiduciary duties in general was discussed above. The taking of corporate opportunities, engaging in a competing business, or use of corporate facilities may be permitted by contract or formal

433 Acchiardo "Duty" 601.
434 Ibid.
435 Farber v Servan Land Co, Inc 541 F2d 1086 (5th Cir 1976) at 1088, confirmed on appeal in Farber v Servan Land Co, Inc 662 F2d 371 (5th Cir 1981); Poling Transportation Corporation v A & P Tanker Corporation 443 NYS2d 895 (1981) at 897. In Dravosburg Land Co v Scott 16 A2d 415 (Penn 1940) the fiduciary was held accountable for profits made from the resale of farmland which had been purchased by him personally to the corporation (at 417). On secret profits, see par 3.2.3.1 above.
436 See, for example, Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168, discussed in chapter 9 par 4.3 below.
437 Carrad "Corporate Opportunity Doctrine" 15-16.
438 See par 5.1 above.
acquiescence before the act. Similarly, these acts may be ratified by formal or informal permission or acquiescence after the act. The ratification need not be in the form of a formal resolution. Action by the directors as a board, though not merely individually, lends enough formality to validate the director's conduct. If the corporation has notice of the act after its occurrence, and does nothing to contest it, then ratification may also be inferred. A director's usurpation of a corporate opportunity may be ratified, for example, where the director is the sole shareholder of the corporation. In *Farber v Servan Land Company, Inc.*, the court confirmed that, when ratification is possible and the proceedings are proper, stockholders may sanction the act of a corporate director and thus abolish any cause of action that the corporation may have against the individual. However, ratification based on approval of the shareholders, the majority of whom directly participated in the transactions in question, would be void. In some jurisdictions shareholder ratification will apparently not condone the usurpation of a corporate opportunity. But in *Canion v Texas Cycle Supply, Inc* it was considered valid, provided that it was obtained by a majority of stockholders. The American Law Institute also proposed that ratification by disinterested shareholders should absolve the fiduciary.

If the directors acted fraudulently, their actions cannot, according to the general principles discussed above, be ratified, except by a unanimous, fully informed shareholder vote.

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439 Anon "Liability" 231.
442 662 F2d 371 (5th Cir 1981).
443 At 379. *In casu,* the manner of the purported ratification in any event rendered it a nullity.
445 Henn & Alexander 636; *Remillard Brick Co v Remillard-Dandini Co* 241 P2d 66 (Cal 1952) at 74-75 (errant directors had used their influence to obtain the ratification by the shareholders). In *Farber,* the court stated that the position was still not clear in Florida (at 379).
446 537 SW2d 510 (Tex 1976).
447 At 514.
448 Tentative Draft No 5 (1986) par 5.12. See also page 178 above.
449 See par 5.1 above.
7.3 Inability or Unwillingness by the Corporation to Pursue the Opportunity

A substantial body of case law permits diversion of a business opportunity by directors when the corporation is definitely no longer able to avail itself of it. The inability may arise from various circumstances. It could be either because someone refuses to deal with the corporation, or because the corporation was unsuccessful in its endeavors to acquire the opportunity. The inability could also arise from the corporation's own lack of skill to manufacture a particular object. In Robinson v Brier, for example, the court held that a director of a corporation had not usurped a corporate opportunity by permitting a corporation in which the director had an interest to sell goods to the former corporation instead of the former making the goods itself. It was apparent from the facts that the corporation was unable to make the goods itself and therefore could not avail itself of the opportunity. And in Fliegler v Lawrence, a disinterested board of directors decided that the corporation's legal and financial position did not permit the acquisition and development of certain properties. A bylaw which prohibits a particular undertaking will

450 Anon "Liability" 224; Knepper & Bailey Liability 103-104; Slaughter "Corporate Opportunity Doctrine" 100; Hart v Bell 23 NW2d 375.

451 Anon "Duty not to Compete" 1192; Knepper & Bailey Liability 103-104. In Urban J Alexander Co v Trinkle 224 SW2d 923 (Ky 1949) the court stated that the inability may arise from financial inability, legal restrictions or from any other factor (at 926). See also Hauben v Morris 5 NYS2d 721 (AD 1938) at 731 (in casu the corporation also lacked the liquid assets with which to purchase the stock in question); Washer v Seager 71 NYS2d 46 (AD 1947) at 47 (the seller refused to sell fabric to the corporation. The purchase of the fabric by an officer in his own name was held not to be in breach of his fiduciary duty); New v New 306 P2d 987 (Cal 1957) at 996-997; Gross v Neuman 337 NYS2d 623 (AD 1972) at 624 (corporation could not acquire a lease agreement due to Public Health Laws); Fliegler v Lawrence 361 A2d 218 (Del 1976) at 220; Field v Allyn 457 A2d 1089 (Del 1983) at 1099, affirmed in Field v Allyn 467 A2d 1274 (Del 1983). Contra Anon "Corporate Opportunity" 773, where it is submitted that in view of the difficulty of verification of unwillingness after the fact and the risk of encouraging executives to induce unwillingness, permitting its assertion as an affirmative defense seems undesirable. See also Begert "Corporate Opportunity Doctrine" 835, who suggests that if third parties show an unwillingness to deal with the corporation, directors should disclose this fact and attempt to cure the problem. This was also the view of the Massachusetts Appeal Court in Energy Resources Corporation Inc v Porter 438 NE2d 391 (Mass 1982) at 394: "For the reason that the firmness of a refusal to deal cannot be adequately tested by the corporate executive alone, it has not been favored as a defense unless the refusal has first been disclosed to the corporation. Without full disclosure it is too difficult to verify the unwillingness to deal and too easy for the executive to induce the unwillingness."

452 194 A2d 204 (Penn 1963).

453 The goods in question were wooden frames used to give rigidity to soft luggage bags.

454 At 206. The corporation had neither the space, nor the experience to make the wooden frames itself.

455 361 A2d 218 (Del 1976).
apparently not prevent the undertaking from being a corporate opportunity, if the bylaws can be amended by the directors themselves.456

Two instances of corporate inability deserve specific mention, namely ultra vires transactions and financial inability.

7.3.1 Ultra Vires Transactions

There is some support for the rule that a director or officer of a corporation may avail himself of opportunities which he acquires through his position in the corporation, if those opportunities are ultra vires the corporation.457 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 the corporate assets.

7.3.2 Financial Inability

The corporation’s financial ability to undertake the specific business opportunity is one of the factors which is considered to determine whether the opportunity belongs to the corporation.458 The 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. One of the earliest cases in which the defense was denied, is Irving Trust Co v Deutch.459 The directors of the Sonora Company had exercised in their own names an option procured by the company for shares worth one hundred thousand dollars in another corporation which controlled patents needed in the business of Sonora. The defense by the directors entailed that Sonora was financially unable to take up the option. The Second Circuit Court of Appeals held that, where the corporation was not actually insolvent, the corporation's financial inability to take up the option was not a sound defense. The directors were held accountable jointly and severally for profits made. In this case, the directors had actually created the financial inability by failing to repay debts that they owed to the corporation. The court did not base its decision on this aspect, but rather stated the principle broadly:

456 Anon "Corporate Opportunity" 774.

457 Diedrick v Helm 14 NW2d 913 (Minn 1944) at 920; Urban J Alexander Co v Trinkle 224 SW2d 923 (Ky 1949) at 926; Hawaiian International Finances, Inc v Pablo 488 P2d 1172 (Hawaii 1971).

458 See, in general, 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 “Duty not to Compete” 1199; Chew “Competing Interests” 472-473; Clark Corporate Law 242; Feuer Liabilities 881f; Henn & Alexander Laws of Corporations 636; Rivers “Financial Inability” 229.

459 73 F2d 121 (2nd Cir 1934).
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.460

The court upheld the strict rule generally applied by courts of equity in decisions on the duty of undivided loyalty.461

Commentators and courts supporting this decision have pointed out that, if financial disability excuses the director, the inevitable result will be to permit the diversion.462 In New York, this is the current view.463 It supports the argument that if directors are uncertain whether their corporation can make the necessary outlays, they need not embark on the venture. If they do embark upon it, they may not at any time substitute themselves for the corporation and divert possible benefits into their own pockets.464 The rationale is that if directors are permitted to justify their conduct on the theory of financial inability, there will be temptations to refrain from exerting their strongest efforts on behalf of the corporation since an opportunity for profit will be available to them personally. However, under New York law, where a corporation is insolvent and defunct, its officers are free to act for themselves, since such condition is ascertainable and not easily feigned.465

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 is a sound defense for corporate directors charged with liability for taking an

460 At 124.

461 At 124. 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). The decision in Irving Trust Co v Deutch was applied in inter alia Durfee v Durfee & Canning, Inc 80 NE2d 522 (Mass 1948) at 530; Foley v D'Agostino 248 NYS2d 121 (AD 1964) at 129 and approved in Paulman v Kritzer 219 NE2d 541 (Ill 1966) at 545-546. According to Knepper & Bailey Liability 102 this view appears to reflect the trend of the decisions of the 1980's.

462 Brudney & Clark "Corporate Opportunities" 1021; Clark Corporate Law 242; Knepper & Bailey Liability 102; WH Elliott & Sons Co, Inc v Gotthardt 305 F2d 544 (1st Cir 1962) at 547; Klinicki v Lundgren 678 P2d 1250 (Or 1984) at 1253-1254.

463 Foley v D'Agostino 248 NYS2d 121 (AD 1964) at 129. The court pointed out that an officer or director, so long as he remains in office and is in the employment of the corporation, has a continuing and overriding obligation of loyalty and good faith to the company. Earlier cases in the same jurisdiction held the contrary view, stating generally that the corporate opportunity doctrine was not applicable if the opportunity was one that the corporation was financially unable to undertake: Blaustein v Pan American Petroleum and Transp Co 56 NE2d 705 (NY 1944); Kelly v 74 & 76 West Tremont Avenue Corporation 151 NYS2d 900 (1956) at 903.

464 WH Elliott & Sons Co, Inc v Gotthardt 305 F2d 544 (1st Cir 1962) at 547.

465 Anon "Duty Not to Compete" 1193.
opportunity. 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 his corporation if it is financially unable to avail itself of the opportunity at the time or if it is clearly undesirable for the corporation to attempt to undertake the opportunity because of other factors. The application of "the rule of uncompromising rigidity" is considered too harsh. The financial inability must apparently amount to insolvency to the point where the corporation is practically defunct. A corporation which is not going to continue in existence can have no interest in future transactions. Mere technical insolvency, such as inability to pay current bills when due, or mere inability to obtain credit, is insufficient.

466 Chew "Competing Interests" 472; Rivers "Financial Inability" 231; Slaughter "Corporate Opportunity Doctrine" 100; Tovey "Corporate Opportunity" 110; Urban J Alexander Co v Trinkle 224 SW2d 923 (Ky 1949) at 926; AC Peters Company, Inc v St Cloud Enterprises, Inc 222 NW2d 83 (Minn 1974) at 86 (land which was only available to a cash purchaser was not regarded as a corporate opportunity where it was shown that the corporation was financially unable to purchase in that manner); Canion v Texas Cycle Supply, Inc 537 SW2d 510 (Tex 1976) at 513; Fliegler v Lawrence 361 A2d 218 (Del 1976) at 224; Eltze v Fyr-Pruf, Inc 376 So 2d 1328 (Miss 1979) at 1334; Anderson v Clemens Mobile Homes, Inc 333 NW2d 900 (Neb 1983) at 905. In Eltze it was, however, warned that a complainant'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 failure to exert his best efforts to prevent or cure the inability (at 1334).

467 Fliegler v Lawrence 361 A2d 218 (Del 1976). For a comprehensive discussion of the position under Delaware law, see Carrad "Corporate Opportunity Doctrine" 16.

468 See note 461 above.

469 Rivers "Financial Inability" 232-233 suggests that any rule should accomplish two aims. It should encourage, not impede, legitimate business transactions and should accomplish justice to all parties. The author submits that financial inability should be allowed as a defense when clearly established, since it is the more practical and equitable rule.

470 Brown "Corporate Opportunity Claims" 516 suggests that corporate fiduciaries should not be allowed to assert corporate financial inability short of actual insolvency as a defense to a corporate opportunity claim. The author opines that the fiduciary should not, in other instances, be allowed to make the determination regarding financial inability, since he would then be substituting his own judgment for that of the board of directors or shareholders: "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 NW2d 375 (Minn 1946) at 382. The purchase had, in this case, been made for the purpose of saving the corporation from a lawsuit and possible receivership. The director was held not to be in breach of his fiduciary duty.

471 Electronic Development Co v Robson 28 NW2d 130 (Neb 1947) at 138; Nicholson v Evans 642 P2d 727 (Utah 1982) at 731.

472 Tovey "Corporate Opportunity" 111.

473 Nicholson v Evans 642 P2d 727 (Utah 1982) at 731-732. See chapter 4 par 4.5 above where it is shown that a more lenient approach is followed in England.
Corporation must be actually insolvent. A director of a corporation has no specific duty to use or to loan his own personal funds to assist the corporation to take advantage of a business opportunity. The directors may not rely on the inability of the corporation to take advantage of an opportunity because of lack of funds if their own lack of diligence was responsible for the corporation's financial position. The insolvency must have arisen despite the discharge by the defendant fiduciaries of their strict duties of fidelity and diligence.

It was noted above that the American Law Institute proposes that a director or senior executive may appropriate an opportunity for his personal use if that opportunity has been rejected by the corporation after proper disclosure. In the commentary on this proposal, the commentators 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.

The burden of pleading and proving corporate financial inability is on the officer or director who allegedly appropriated the opportunity.

In the evaluation of the financial status of a corporate entity to determine whether the corporate opportunity doctrine has been violated, courts have considered the assets immediately available to the corporation, including cash, credit or other salable commodity. In *Knutsen v Frushour* a director of a real estate company purchased certain land for himself. His defense that the corporation had no funds to offer the seller was rejected on the ground that the corporation owned other land that the seller was prepared to accept.

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474 *Klinicki v Lundgren* 678 P2d 1250 (Or 1984) at 1253.

475 Knepper & Bailey Liability 104; Slaughter "Corporate Opportunity Doctrine" 101; Webber "Interested Directors' Contracts" 67; Urban *J Alexander Co v Trinkle* 224 SW2d 923 (KY 1949) at 927.

476 Knepper & Bailey Liability 104; *Daloisio v Peninsula Land Co* 127 A2d 885 NJ 1956) at 892.

477 Slaughter "Corporate Opportunity Doctrine" 101; *Ellzey v Fyr-Pruf, Inc* 376 So 2d 1328 (Miss 1979) at 1335.

478 See page 178 above.

479 This principle, based on the similarly worded Tentative Draft No 3 (1984), was approved in *Klinicki v Lundgren* 678 P2d 1250 (Or 1984).

480 *Canion v Texas Cycle Supply, Inc* 537 SW2d 510 (Tex 1976) at 513.

481 *Melgard v Moscow Idaho Seed Co, Inc* 251 P2d 546 (Idaho 1953) at 551; *Higgins v Shenango Pottery Company* 279 P2d 46 (3rd Cir 1960) at 51; *Knutsen v Frushour* 436 P2d 521 (Idaho 1968) at 526; *Katz Corporation v TH Canty & Co, Inc* 362 A2d 975 (Conn 1975) at 980; *Borden v Sinskey* 530 F2d 478 (3rd Cir 1976) at 493. See also Chew "Competing Interests" 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.

482 436 P2d 521 (Idaho 1978).

483 At 526.
Directors and officers have been held liable for the misappropriation of corporate opportunities where, despite claims regarding the corporation's financial inability, they were unable to show that attempts had been made to finance the acquisition of the particular opportunity.\textsuperscript{484}

In view of the uncertainty regarding the effect of the corporation's inability, the fiduciary should offer the corporation the right of first refusal. Only after a disinterested majority of the board of directors has, on the basis of informed consent, declined the opportunity, should the fiduciary pursue it.\textsuperscript{485}

\textbf{7.4 Rejection of the Opportunity by the Corporation}

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 domination.\textsuperscript{486} The leading Delaware case on this issue is \textit{Kaplan v Fenton},\textsuperscript{487} where a substantially similar offer, which had been rejected by the corporation one month previously, was not considered a corporate opportunity.\textsuperscript{488} Similarly, in \textit{Johnston v Greene},\textsuperscript{489} the court accepted that the disinterested directors' vote not to acquire certain patents had been influenced by the defendant, although he had not voted himself. The opportunity was, nevertheless, not regarded as corporate in nature.\textsuperscript{490} It has been held that a director may personally appropriate an opportunity if it has been declined by the corporation because of legal barriers,\textsuperscript{491} or if it is the accepted policy of the corporation not to engage in that particular line of business, or if the corporation has declined the opportunity for business reasons.\textsuperscript{492}

\textsuperscript{484} \textit{Borden v Sinskey} 530 F2d 478 (3rd Cir 1976) at 493; \textit{Hill v Hill} 420 A2d 1078 (Penn 1980) at 1083.

\textsuperscript{485} Kempen Wiesen & Bagby \textit{Management Process} 429. This is also in accordance with the American Law Institute's Proposals, discussed on pages 177-178 and 190 above.

\textsuperscript{486} Carrad "Corporate Opportunity Doctrine" 19; Feuer \textit{Liabilities} 93; Knepper & Bailey \textit{Liability} 105; Gross \textit{v} Neuman 337 NYS2d 623 (AD 1972) at 624; Fliegl\textit{er v Lawrence} 361 A2d 218 (Del 1976) at 222; Kerrigan \textit{v Unity Savings Association} 317 NE2d 39 (Ill 1974) at 43-44; \textit{Energy Resources Corporation, Inc v Porter} 438 NE2d 391 (Mass 1982) at 394; \textit{Field v Allyn} 457 A2d 1089 (Del 1983) at 1099; Meiselman \textit{v Meiselman} 307 SE2d 551 (NC 1983) at 569-570.

\textsuperscript{487} 278 A2d 834 (Del 1971).

\textsuperscript{488} At 836.

\textsuperscript{489} 121 A2d 919 (Del 1956).

\textsuperscript{490} At 925-926.

\textsuperscript{491} Chew "Competing Interests" 471-472; Knepper & Bailey \textit{Liability} 104.

\textsuperscript{492} Chew "Competing Interests" 473ff; Knepper & Bailey \textit{Liability} 104.
The rejection by the corporation must be by a disinterested vote of the board of directors after full disclosure to it.\textsuperscript{493} In \textit{Gaynor v Buckley}\textsuperscript{494} the court found that an officer had not diverted a corporate opportunity where he had urged the corporation to accept the opportunity (a stock option) and had fully disclosed his own interest, but the opportunity had been rejected by an independent board of directors. Similarly, in \textit{Franco v JD Streett & Co}\textsuperscript{495} directors were not held liable for profits made from another corporation they acquired, which transported their own corporation's goods. The opportunity had been offered to and rejected by their own corporation, the acquisition was approved by all shareholders and the rates were fair.

If the rejection is recent and was based on a full appreciation of the relevant facts, tender is unnecessary unless a notable change in circumstances has occurred in the interim.\textsuperscript{496} If the director acts without determining whether the previous rejection was an informed one, he acts at his own risk.\textsuperscript{497} If the rejection was informed, but occurred so long ago that a presumption of no significant change in circumstances cannot reasonably be exercised, the informed rejection will probably not be a sound defense.\textsuperscript{498} However, it has been submitted that to permit claims of disability to become the subject of judicial controversy when they can only be disproven by outsiders with great difficulty and at considerable expense is to tempt participants to actions whose impropriety is visible but rarely subject to effective challenge. In addition, availability of the defense reduces their incentive to solve corporate financing and other problems.\textsuperscript{499}

In conclusion, before the director may rely on refusal to deal as a reason for his appropriation of a corporate opportunity, all relevant facts with regard to the refusal must be disclosed to the corporation, together with a fair statement of the reasons for the refusal.\textsuperscript{500}

\textsuperscript{493} Anon "Corporate Opportunity" 774; Henn & Alexander \textit{Laws of Corporations} 636; Knepper & Bailey \textit{Liability} 105; \textit{Northwestern Terra Cotta Corp v Wilson} 219 NE2d 860 (III 1966) at 864.

\textsuperscript{494} 203 FSupp 620 (Ore 1962).

\textsuperscript{495} 360 SW2d 597 (Mo 1962).

\textsuperscript{496} Anon "Corporate Opportunity" 773.

\textsuperscript{497} \textit{Ibid}.

\textsuperscript{498} \textit{Ibid}.

\textsuperscript{499} Clark \textit{Corporate Law} 243.

\textsuperscript{500} \textit{Energy Resources Corporation Inc v Porter} 438 NE2d 391 (Mass 1982) at 394.
8 EVALUATION OF THE CORPORATE OPPORTUNITY DOCTRINE

Despite the fact that a separate doctrine of corporate opportunities has been recognised in America for many decades, it has been the subject of considerable criticism. Some regard it as among the least satisfactory limbs of doctrine in the corpus of corporate law, ... [since] not only are the common formulations vague, but the courts have articulated no theory that could serve as a blueprint for constructing meaningful rules.501

It has also been suggested that courts have, simplistically and unrealistically, focused on the protection of the corporation's interest in their application of the doctrine. The corporation is cast as the surprised, vulnerable and righteous victim of unscrupulous directors and officers who succumb in their personal greed in derogation of their proper corporate duties, which does not necessarily always reflect the true position.502

Specific problems encountered in this area of the law include whether a lenient or harsh standard should apply, whether the rule should be categorical or a flexible factor-weighed evaluation of conduct, and whether separate principles exist or are desirable for full-time executives and for part-time directors and for public and close corporations.503 It can therefore be said that the exact content of the corporate opportunity doctrine is as yet unsettled.

Two of the most important issues which arise in connection with the application of the corporate opportunity doctrine are its inconsistent application in case law and the possibility of different applications depending upon the nature of the corporation. These issues are discussed below.

8.1 Inconsistent Cases

The application of the various tests for determining corporate opportunity can lead to uncertainty in the sense that application of one test may hold a director liable, whereas he would escape liability if another test had been applied.504 This is illustrated by the events of the following two decided cases.

In Kerrigan v Unity Savings Association505 the line of business test was applied. Five controlling directors of a savings and loan organisation had organised an insurance agency and caused it to lease office space in the building owned and occupied by the savings association. The association would then refer its home loan

501 Brudney & Clark "Corporate Opportunities" 998.
502 Chew "Competing Interests" 436.
503 Austin "Accountability" 141.
504 On the different tests, see par 6.4 above.
505 Kerrigan v Unity Savings Association 317 NE2d 39 (Ill 1974).
borrowers to the agency, which would sell homeowners' insurance and other forms of insurance related to mortgage loans to them. A shareholder of the association brought a derivative suit. He alleged that the directors and the insurance agency had appropriated a business opportunity that belonged to the association. The trial court found the defendants not liable, since the savings association was forbidden by statute to write insurance.\footnote{506}

The Illinois Supreme Court reversed the decision. It found that the directors should have presented the disinterested directors or shareholders with the pertinent facts about the opportunity and thus should have given it the chance to make its own judgment on the question of legal capacity to either seize or reject the opportunity to enter a business that was reasonably incident to its present or prospective operations.\footnote{507} Thus the application of the line of business test found the directors liable.\footnote{508} But application of the interest or expectancy test would have saved the defendants from liability. The insurance company had no interest in the insurance agency before it was organised. Nor did it later acquire one by taking the necessary steps concerning the possible establishment of an insurance agency. The insurance agency was, furthermore, not essential to the association's existing business.

On the other hand, in \textit{Burg v Horn}\footnote{509} the defendants were found liable on the strength of the interest or expectancy test, whereas the opposite result would have followed had the line of business test been applied. The Horns owned three low rent buildings in Brooklyn through wholly owned corporations. They urged their friends, the Burgs, to become involved in real estate. Accordingly a corporation was formed, with stock issued in equal parts to Georg Horn, Max Horn and Mrs Burg. The corporation immediately purchased a low rent building in Brooklyn. The Horns served as the real estate managers, and Mr Burg was the corporation's accountant. The corporation bought further properties. The Horns were, meanwhile, acquiring nine other similar properties individually or through wholly owned corporations. Mrs Burg eventually brought a derivative action against the Horns. She claimed that all purchases of low rent properties in Brooklyn after their corporation had been formed, amounted to the usurpation of corporate opportunities of the jointly owned corporation.

The Second Circuit affirmed the finding by the district court that there had been no wrongful taking of corporate opportunities. The court expressly adopted the interest or expectancy test and rejected the line of business test. Had it adopted the line of business test, the opposite result would have followed. This result would, in the circumstances, obviously been unfair.\footnote{510}

\footnote{506}{In this regard, see also the discussion of inability of the company to pursue a particular opportunity in par 7.3 above.}

\footnote{507}{At 43.}

\footnote{508}{Clark Corporate Law 232.}

\footnote{509}{(CA2 NY) 380 F2d 897 (2d Cir 1967).}

\footnote{510}{Clark Corporate Law 233.}
It is difficult to see how both the abovementioned decisions can be correct. The problem is, to a large extent, a result of the fact that substantially the same statutory provisions are often interpreted differently in various states. In South African law, until an Appelate Division decision has been delivered, the same problem may well arise.

8.2 A Distinction between Close and Public Corporations

It has been suggested that the problem to reconcile conflicting decisions such as the two discussed above, lies in the differences between close and public corporations. Delaware, where the line of business test was developed, is the preeminent place of incorporation for large corporations. The line of business test is a more suitable rule for public corporations, such as the one in Kerrigan. For a close corporation such as the one in Burg, the interest or expectancy test may be more suitable.

Therefore, commentators have advanced the view that the selection of rules to apply in the appropriation of opportunities by corporations should depend upon whether one is dealing with a close corporation or a public corporation, and that categorical rules should apply only in respect of the latter.

In support of this argument, Clark points out five principal differences between close and public corporations. First, the stockholders of a close corporation have greater ability to select the fiduciaries to whom they entrust their capital. In the second place, they also have a greater ability to monitor their managers’ contributions to, and diversions from, the enterprise. There may, therefore, be less need of categorical rules against diversions by fellow participants. Thirdly and fourthly, both the scope of the duties and the nature of compensation of the managers differ in the two forms of enterprise. The duties of the executives of a public corporation normally require their full-time attention. The compensation arrangements are, furthermore, usually such that they are not allowed to take covert

511 See page 129 above.
512 See par 4.3.2 above.
513 See note 5 above.
514 See page 193 above.
515 Begert "Corporate Opportunity Doctrine" 841; Clark Corporate Law 235; Fine "ALI Proposals" 728ff; Knepper & Bailey Liability 101. Contra Austin "Accountability" 167-171, who submits that the case for having separate standards for public and private companies has not been made out. The author’s arguments for not differentiating include that further entities should not be added to an already extremely complicated law unless it is absolutely necessary, and the difficulty sometimes encountered in distinguishing between public and private companies.
516 Clark Corporate Law 235-237.
or indirect compensation. With respect to many close corporations, other expectations may be reasonable, and provided for by agreement. In the last instance, the scope of opportunity differs in the two enterprises. A publicly held enterprise may be treated as large and flexible enough to accept any new investment opportunities that offer an appropriate return per unit of risk. Therefore, it can take up virtually any business in which its executives might want to invest and take an active role. But, in the close corporation, the scope of opportunity is smaller. There may be many businesses that the officers of a closely held corporation may develop in their own time which would not deprive their enterprise of any opportunity it could reasonably hope to exploit.

It has therefore been suggested that the rules which should apply to publicly held corporations should be categorical, whereas the rules governing corporate opportunities should leave more room in the close corporation context for results to turn on the special facts, arrangements and understandings of each situation. The rules suggested for the different entities are the following:

8.2.1 Close Corporations

The following four guidelines are proposed in respect of closely held corporations:

1. If the disputed opportunity is functionally related to the corporation's business, then, whether or not it is necessary or of special value, the individual participants may not take it.
2. If the corporation has an interest or expectancy in the opportunity the individual participants may not take it.
3. If the participants consent in advance or contemporaneously to diversion of the new project, an individual participant can take it, even though (1) and (2) above would otherwise be contravened, provided that nothing less than express contemporaneous consent will permit the taking of a functionally related opportunity whose acceptance is necessary to prevent injury or loss to the corporation.
4. If the new project is not covered by the preceding rules, it may be taken by some individual participants, without sharing with the others, and without their consent.

The abovementioned guidelines omit the defense of corporate incapacity, which is discussed in paragraph 7.3 above.

517 See also par 2.4 above.
518 Clark Corporate Law 238.
519 Clark Corporate Law 240.
520 It would have to be established whether the consent should be by the board of directors or by shareholders. If the decision falls upon the latter option, it should be determined whether or not a unanimous vote is required.
8.2.2 Public Corporations

In respect of public corporations, it has been recommended that full-time executives may not take for themselves any active business opportunity. In support of this strict proposition, the similarity between directors and trustees is pointed out. It is also argued that this rule has advantages over the existing corporate opportunity doctrine, since the traditional tests are extremely ambiguous and uncertain in their application. This ambiguity is not considered appropriate for public corporations, and is, moreover, made ineffectual by the corporate incapacity defense.

It has further been proposed that the traditional tests also fail to enforce the basic notion that fiduciaries should do no harm to their corporations by interfering with their operations or competing with them.

It is submitted that, in South African law, a doctrine of corporate opportunities similar to the one recognised in American law, is not desirable in respect of close corporations, where the emphasis is on simplification of the law, and where present statutory provisions suffice. A distinction in the application of such a doctrine between public and private companies would, it is suggested, also not be practical.

9 CONCLUSIONS

In this chapter, it was attempted to provide an overview of the American law of corporate directors' fiduciary duties, with specific regard to the corporate opportunity doctrine which has been developed in that system. Comparison with American corporation law is of importance to South African lawyers, since both systems are based upon similar general principles of law and equity, which are derived from a common English heritage. It was acknowledged that any survey of American corporation law is complicated by the fact that each state has its own cor-

521 Clark Corporate Law 243.

522 In this regard, see chapter 2 par 3.1 above.

523 See pars 4.3.1-4.3.5 above.

524 Clark Corporate Law 245.

525 Clark Corporate Law 245. On this defense, see par 7.3 above.

526 Clark Corporate Law 245 submits that in economic theory, and in practice as evidenced by the growth of conglomerates, the modern publicly held corporation should accept any opportunity that it expects to produce a risk-adjusted rate of return that is not worse than that of its current operations.

527 On South African law generally, see chapter 9 below.

528 See note 1 above.
poration law, as well as the possible applicability of federal law. However, an attempt to generally state the law is, to some extent, facilitated by the Revised Model Business Corporation Act of the American Bar Association and the proposals by the American Law Institute, which are followed by many states.

In American law, the corporate director's position is regarded as *sui generis*, although the similarities between directors and trustees are recognised. Because *de facto* directors may not exercise the prerogatives of a corporate position and yet avoid its attendant fiduciary duties and liabilities, they are considered to have the same fiduciary duties as *de iure* directors. And, although so-called "inside" directors are required to exercise a higher standard of care in the exercise of their duties, their fiduciary obligation is not more stringent than that of "outside" directors.

The duties of corporate directors entail that they shall exercise their obligations *intra vires* and within their authority, exercise due care and observe the applicable fiduciary duties. These duties apply equally to officers of the corporation and must be maintained for the duration of the director's office. The fiduciary obligation, which was the main focus of this investigation, is clearly owed to the corporation. American law has gone further than many other jurisdictions in also recognising the claims of other interest groups. It can, however, not yet be generally stated that shareholders and creditors are direct beneficiaries of directors' fiduciary duties. Generally stated, his fiduciary duty entails that a director shall act with undivided loyalty to his corporation. State statutes and the Model Business Corporation Act do not refer to specific fiduciary responsibilities. The concept of a "duty of loyalty" therefore remains flexible. The existing authorities show that, generally stated, directors must maintain an unfettered discretion, may not manipulate the corporate structure to further their own position, and must avoid conflicts of interest.

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529 See page 125 above.
530 See pages 125, 178-179 above.
531 Henn & Alexander *Laws of Corporations* 563. See also page 127 above.
532 See par 2.1 above.
533 See par 2.2 above.
534 See page 130 above.
535 See par 2.3 above.
536 See par 3.3 above.
537 See par 3.1 above.
538 On these aspects, see par 3.2.1, par 3.2.2 and par 3.2.3 respectively.
It was seen that a breach of fiduciary duty is a ground for flexible equitable relief,\textsuperscript{539} which is usually obtained by means of a derivative action.\textsuperscript{540} In this regard, the requirement of demand and the establishment of Special Litigation Committees were briefly reviewed.\textsuperscript{541} The former requirement is not recognised in English law, where the rule in \textit{Foss v Harbottle} is still in existence.\textsuperscript{542} It was concluded that the shareholders' derivative suit can play an important and effective role in controlling directors' conduct in American corporation law.

In certain circumstances a director may be relieved from, or indemnified against, breaches of fiduciary duty. The most effective means of effecting such release is by ratification.\textsuperscript{543} The fiduciary may also be protected by limitation of actions or laches.\textsuperscript{544}

The investigation in this chapter concentrated on the "corporate opportunity doctrine", which is recognised as a special corporate doctrine, overlapping with, but operating in addition to the usual fiduciary principles. This doctrine, developed by American courts during the past century, entails that if a business opportunity is deemed to be a corporate opportunity of a given corporation, the fiduciaries of that corporation may not take or usurp the opportunity for themselves. Its application was, at first, quite restricted.\textsuperscript{545} Later decisions illustrate the gradual expansion of the doctrine.\textsuperscript{546}

The content of the corporate opportunity doctrine and tests used to determine the existence of such an opportunity were reviewed.\textsuperscript{547} It was seen that the definition of corporate opportunity tends to vary from state to state. The interest or expectancy of a corporation in a particular opportunity is sometimes regarded as conclusive,\textsuperscript{548} whereas some states, for example Delaware, regard the line of business of a corporation as of greater importance.\textsuperscript{549} In some jurisdictions, courts attempt to determine

\textsuperscript{539} See par 4 above.

\textsuperscript{540} See par 4.3.1 above.

\textsuperscript{541} See pars 4.3.1.1 and 4.3.1.2 above.

\textsuperscript{542} See chapter 4 page 78 above.

\textsuperscript{543} See par 5.1 above.

\textsuperscript{544} See par 5.2 above.

\textsuperscript{545} See, for example, \textit{Lagarde v Anniston Lime and Stone Co} 126 Ala 26 (1900), discussed on page 164 above.

\textsuperscript{546} For example, \textit{Rosenblum v Judson Engineering Corp} 109 A2d 558 (New Hampshire 1954), discussed on page 165 above.

\textsuperscript{547} See pars 6.3 and 6.4 above.

\textsuperscript{548} See par 6.4.1 above.

\textsuperscript{549} See par 6.4.2 above.
the existence of a corporate opportunity by applying ethical standards of what is fair and equitable to a particular set of facts.550 Other factors, such as the use of corporate resources and the way in which information regarding an opportunity came to the attention of the director, may also be important.551 Irrespective of which test is applied, it seems that the opportunity will be regarded as a corporate one if the corporation has a right, property interest, or expectancy in it, or it is an opportunity which in justice should belong to the corporation. That would be the case if the corporation has been seeking the opportunity, if the corporation's funds have been involved in financing it, or the corporation's facilities or personnel have been used in developing the opportunity. It was submitted that the American Law Institute's recommendation presents a workable definition of a corporate opportunity in any legal system.552

It was seen that the primary relief to be afforded in an action against a director for misappropriation of a corporate opportunity is the imposition of a constructive trust on the property wrongfully diverted, as well as on any commissions and profits thereby derived.553 Because of management's ability to prevent action, the shareholder's derivative suit is an important device for control of this type of misbehavior.554

The three defenses which are generally recognized to claims in respect of the misappropriation of corporate opportunities are ratification,555 the corporation's inability or unwillingness to make use of the opportunity,556 and rejection of the opportunity by the corporation after tender to it.557 It was, however, apparent that there is still considerable uncertainty with regard to these factors.

Several criticisms have been raised against the recognition of a doctrine of corporate opportunities in American law.558 Amongst these are that application of the different tests for determining corporate opportunity lead to varying results.559 It was submitted that the same problem may well arise in South African law.

550 *Durfee v Durfee & Canning, Inc* 80 NE2d 522 (Mass 1948). See par 6.4.3 above.

551 See par 6.4.5 above.

552 See par 6.4.6 above.

553 See par 6.5 above.

554 It appears that the derivative suit has been more effectively used in the United States than hitherto in England in this regard: Schreiner "Derivative Action" 220.

555 See par 7.2 above.

556 See par 7.3 above.

557 See par 7.4 above.

558 See par 8 above.

559 This was illustrated by the different results in *Kerrigan v Unity Savings Association* 317 NE2d 39 (Ill 1974) and *Burg v Horne* 380 F2d 897 (2d Cir 1967), discussed on pages 193ff above.
Commentators have further suggested that it is incorrect to apply one standard for close and public corporations in American law. This criticism, it was submitted, is not applicable in South African law, where a separate Close Corporations Act exists and where a corporate opportunity doctrine would, in any event, not be expedient.

The comparative value of the American corporation law lies especially in the fact that, unlike the position under English law, a separate doctrine has been developed in respect of corporate opportunities. Despite the criticisms levelled against it, the deliberations by American courts and commentators over the past century are important, since the development in some Commonwealth countries is in the direction of also establishing a separate corporate opportunity doctrine.

560 See par 8.2 above.


562 Under English law, this aspect is dealt with under the general law which applies to directors' fiduciary duties. See chapter 4 par 3 above.

563 See chapter 8 par 3 below for a brief discussion of developments in Canada, Australia and New Zealand.
1 INTRODUCTION

In France, Act 66-537 of 1966\textsuperscript{1} and articles 1832-1873 of the Civil Code (\textit{Code Civil})\textsuperscript{2} form the fundamental charter for companies.\textsuperscript{3} These enactments regulate both public and private companies, which represent the overwhelming majority of commercial companies, and make up the legal infrastructure of economic life.\textsuperscript{4} The comparative study undertaken in this chapter is restricted to these types of company.

Two forms of public company can be distinguished.\textsuperscript{5} The fully limited company (\textit{société anonyme}) limits the responsibility of each member to the amount of his contribution. The company carries on business under a corporate name, which clearly indicates that members are not personally responsible for its debts. In the public company with personally responsible directors (\textit{société en commandite par actions}), one or more of the members does not enjoy the benefit of limited liability. There are two types of members of such a company, namely the \textit{commanditaires}, who are individually liable for all the debts of the company and whose liability to contribute is restricted to the extent of their contribution, and the \textit{commanditaires} or shareholders who hold shares in the company and whose liability is restricted to the extent of their capital. Beginning of the nineteenth century, when fully limited companies were formed with the special permission of the register, this type of company was relatively rare and only registered a considerable amount of outside capital.\textsuperscript{6}

\textsuperscript{1} This Act, Loi n 66-537 du 24 juillet 1966 sur les \ldots\ specific article of the Act, for example article 34, is by various other enactments, the most important of which is Decree 67-236 of 1967. This decree is hereafter referred to as "D". A specific article of the decree, for example article 13, is cited as follows: D, art 13. Both the Act of 1966 and the Decree of 1967 form part of the \textit{Code de Commerce}, which governs French commercial law. Commercial law, including company law, is administered in France by separate, commercial courts at first instance: Weston \textit{French Legal System} 51-52.

\textsuperscript{2} The \textit{Code Civil} defines a company as a contract (art 1832) and regulates its validity and its specific elements. In many respects, the commercial company has, however, lost its purely contractual character: Cozian & Viandier \textit{Sociétés} 4; Le Gall & Morel \textit{French Company Law} 1.

\textsuperscript{3} Cozian & Viandier \textit{Sociétés} 4; Guyon "French Law" 440.

\textsuperscript{4} Le Gall & Morel \textit{French Company Law} 21.

\textsuperscript{5} Le Gall & Morel \textit{French Company Law} 21-22.

\textsuperscript{6} Le Gall & Morel \textit{French Company Law} 22.
management of the company in the hands of a few members. It is, however, not discussed separately, since its management resembles that of the fully limited company, except that the management powers are exclusively conferred upon the commandités. Special rules aimed at the protection of investors apply to limited companies which raise money from the public by means of subscription for shares or bonds. These companies are sometimes called closed public companies (sociétés anonymes fermées), and are not discussed separately, since their management structure corresponds with that of the ordinary public limited company.

The private company (société à responsabilité limitée or société à risque limité) resembles a partnership in the recognition of the importance of the personal element in its membership. Shares held by its members cannot be represented by freely transferable securities. It also resembles the French public limited company in the sense that all its members are liable to contribute to its debts and obligations only to the extent of their agreed contributions. This type of company is extremely popular and constitutes more than half of the companies registered in France.

2 MANAGEMENT OF COMPANIES WITH A SHARE CAPITAL

2.1 Introduction

As a legal entity (personnalité morale), a French company must of necessity be managed by legal persons. The management systems of public limited companies and private companies differ, and are therefore discussed separately.

2.2 The Public Limited Company (Société Anonyme)

French law provides two alternative systems of management for the public limited company. The traditional form divides management functions between two organs, the board of directors (conseil d'administration) and the chairman of the

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7 Ibid.

8 Exchangeable bonds (obligations échangeables contre des actions) can be issued only by companies which are listed on the stock exchange (L, art 201ff). Bonds giving their holders the right to subscribe to or to receive shares may have warrants attached, or be convertible or reimbursable into shares. They are similar to the debentures of South African company law. On capital in French companies generally, see Le Gall & Morel French Company Law 196-229.

9 Le Gall & Morel French Company Law 23.

10 Cozian & Viandier Sociétés 353.

11 Legal personality arises upon registration (immatriculation): Code Civil art 1842. An interesting feature of the French company is that its duration is limited to ninety nine years: Code Civil art 1838. Legal personality can thus not exceed that period.

12 See pars 2.2 and 2.3 below.
board (*président du conseil d'administration*).\(^{13}\) The alternative scheme follows the German example and vests all management functions in one body, the executive board (*directoire*).\(^{14}\) Another body, the supervisory board (*conseil de surveillance*) oversees and, to some extent, controls the executive board.\(^{15}\)

The founders of the company decide which of the two management forms will be specified in the articles of association. If the new form is not affirmatively elected in the articles, the company will have the traditional management form.\(^{16}\) Shareholders may at a later stage vote to change the management form through a special meeting.

### 2.2.1 Differences in the Management Structures of Public Limited Companies

The two management structures are discussed below.\(^{17}\) For purposes of convenience, the main differences between these two structures are listed below:\(^{18}\)

(a) In the traditional structure, the board of directors not only controls, but also participates (in theory) in the management of the corporation which is more specifically entrusted to the chairman of the board and the executive officers. In practice, however, the role of the board of directors is often limited to one of control and the chairman exercises the real power. In the alternative structure, there is a clear separation between the executive board, which manages the corporation, and the supervisory board which merely controls the action of the executive board without taking part in the conduct of the company's affairs.

(b) The office of the members of the executive board is better protected than that of the chairman and executive officers. For example, members of the executive board are appointed by the supervisory board, but can be dismissed only by a share-

\(^{13}\) See par 2.2.2 below.

\(^{14}\) On German company law, see chapter 6 below.

\(^{15}\) See par 2.1.3 below. The alternative scheme was, initially, not very successful in France: Cozian & Viandier *Sociétés* 197; Lefebvre *France* 51. At the beginning of January 1989, companies managed in this fashion represented only one per cent of all registered public companies. The proposed European company (see chapter 8 par 2.3 below) follows the German example. It can therefore be expected that this style of management will become more popular in France. Foreign investors may find the new form of management an attractive option, in particular because of the limited liability of supervisory board members, who may well be foreign nationals and unwilling to submit themselves to French jurisdiction. In addition, a change in management structure can facilitate the removal and replacement of ineffective management, or replacement of management after the acquisition of an existing public company by foreign investors. Former management still loyal to the former owners could, for example, be lifted from their positions by a change from the old form of management to the new one: Lefebvre *France* 51.

\(^{16}\) Lefebvre *France* 50.

\(^{17}\) See pars 2.2.2 and 2.2.3.

\(^{18}\) See, generally, Campbell *Liability of Corporate Directors* 276ff; Lefebvre *France* 50-51; Le Gall & Morel *French Company Law* 96-97.
holders' meeting upon a proposal by the supervisory board. The dismissal of the chairman of the board of directors and the executive officers can be decided at any moment and without cause by the board of directors which also appoints them.

(c) Members of the executive board are entitled to damages if they have been dismissed without just cause, whereas the chairman and the executive officers may be entitled to damages only if they were dismissed in injurious or persecutory circumstances.

(d) Members of the executive board can be, or become, employees of the company, whereas the executive officers (if they are also directors) and the chairman of the board of directors may not enter into an employment agreement with the company after they have assumed office. Employees of a corporation may become directors only in limited situations. In French context this distinction is important, since the executive officers or directors and the chairman of the board of directors, unlike employees, are not entitled to severance indemnities in the event of their dismissal, need not be dismissed in accordance with established procedures (such as a notice period or prior hearing) and have no access to unemployment benefits under the social security system.

(e) Unlike the directors and chairman of the traditional management structure, members of the executive board do not have to be shareholders.

(f) The duties and liabilities of the members of the supervisory board are less cumbersome than those of the members of boards of directors. Members of the supervisory board do not become personally responsible for acts of management, but only for negligence in the supervision of the affairs of the corporation and of the management of the executive board, or if they interfere with the management of the corporation. The chairman of the supervisory board need not hold a trader's card. Despite these differences in the management structures, there are many common features between them, for example the age limits for holding directors' offices, the regulations applicable to agreements between the corporation and the members of management bodies and the tax and social security requirements in respect of management remunerations.

19 This makes it difficult for the supervisory board effectively to control the directorate: Lefebvre France 51.

20 Le Gall & Morel French Company Law 97.

21 A person of foreign nationality needs a foreign trader's card (carte de commerçant étranger) to take part in management of business enterprises in specified capacities: Decree of 2 February 1939, art 5, as amended by Decree of 27 October 1969.

22 Le Gall & Morel French Company Law 97-98.
2.2.2 Traditional Management

In the traditional form of management, the board of directors is elected by a general meeting of shareholders. It possesses wide executive, administrative and management powers.

An individual or a corporate body may serve as director. The management of the company’s business is entrusted to the president (chairman) of the board, who is elected by the board from its members. He represents the company in dealings with outsiders and exercises all the powers of the board in respect of day-to-day administration and management of the company’s affairs. The board is authorised to appoint a general manager to assist him, if such an appointment is proposed by the president.

2.2.2.1 The Chairman of the Board

The chairman carries out, on his own responsibility, the general management of the company. To this end, he has "the widest powers to act on behalf of the company in all circumstances", but this is subject to some limitations. In the first instance, the chairman may not encroach upon the functions of the general meeting and the board of directors as provided by statute. Secondly, the powers of the chairman may only be exercised within the limits of the company’s purpose. In this regard, it is important to note that the limitation on the powers of directors only concerns their liability in the event of mismanagement. The company is seen to have the same legal capacity as any individual being. In France, it is taken for granted

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23 L, art 91 par 1; Cozian & Viandier Sociétés 199; Lefebvre France 52; Le Gall & Morel French Company Law 100. During the nomination procedure, the legal entity’s officers will officially designate an individual as its permanent representative, subject to the same duties and liability as other administrators. The corporate body he represents is jointly responsible with him for his defaults. By contrast, English law (see chapter 4 par 2 above) requires all directors to be natural persons. Apparently no problems are experienced in French company law in this regard. This may be due to the fact that the civil and criminal liability of directors is extensively regulated: see par 3 below. Executive officers (directeurs généraux), if appointed, must be individuals: L, arts 116 and 117.

24 L, art 115.

25 L, art 113 par 1. Provisions regarding appointment, remuneration and removal from office are contained in L, arts 110, 111, 112 and 115. The age limit for chairmen is sixty five years, if not otherwise specified in the statutes. The same person cannot hold the office of chairman in more than two corporations which have their registered offices in metropolitan France. Exceptions to this rule include the office of chairman in research corporations, or in corporations in which the office of chairman is mandatorily an unpaid position, and chairmen or directors who occupy positions in groups of companies. The retirement of the chairman for whatever reason is subject to registration with the Registry of Commerce and Companies.

26 L, art 113 par 2 (translation by Le Gall & Morel French Company Law 112).

27 Thus he may therefore not mortgage assets of the company or furnish a guarantee in the company’s name without express or general authorisation of the board: D, art 89.
when entering into a contract with a company, that it has a legal right to do so.\textsuperscript{28} No contract can be deemed to be void on the sole ground that it falls beyond the scope of the objects as stated in the articles of association.\textsuperscript{29} But, although the contract is valid,\textsuperscript{30} the director may incur liability based upon mismanagement of the affairs of the company.\textsuperscript{31}

The statutes and resolutions passed by the board may further limit the powers of the chairman. These restrictions are effective between the company and the chairman, but cannot be invoked against third parties.\textsuperscript{32}

\textbf{2.2.2.2 The Board of Directors}

The board, sometimes referred to as an administrative board,\textsuperscript{33} possesses the widest powers to act in all circumstances on behalf of the company.\textsuperscript{34} These powers must be exercised within the limits of the objects of the company. They are also subject to the powers which are expressly reserved by law to the general meeting of shareholders.\textsuperscript{35}

The board of directors is a collegial body. Individually, the administrators do not have any power.\textsuperscript{36} A company is bound by transactions entered into by its board of directors even if they fall beyond the scope of the company's objects.\textsuperscript{37} The French equivalent of the Anglo-American \textit{ultra vires} doctrine is the principle of the company's \textit{spécialité statutaire}. It requires a board of directors to operate within the limits of the company's business purpose. The corporation's activities are therefore limited to a particular and well defined area of business or a specific trade or

\begin{footnotesize}
\textsuperscript{28} Escarra "Comparison" 25.
\textsuperscript{29} The doctrine of \textit{ultra vires} is thus not recognised in French law: Escarra "Comparison" 24.
\textsuperscript{30} The company is bound to third parties by acts which fall beyond the objects of the company, unless it can prove that the third party knew or should in the circumstances have known that the act was unrelated to the company's objects; L, art 113 par 3; Escarra "Comparison" 24. Mere publication of the statutes is not evidence of the third party's knowledge or inferred knowledge of the scope of the company's objects: L, art 113 par 4. Thus French law does not recognise any doctrine of constructive notice.
\textsuperscript{31} See par 3.2 below.
\textsuperscript{32} L, art 113 par 4.
\textsuperscript{33} Lefebvre \textit{France} 50.
\textsuperscript{34} L, art 98 par 1.
\textsuperscript{35} L, art 98 par 3. Examples of such powers are the approval of the annual accounts and amendment of the statutes.
\textsuperscript{36} De Précigout "Directors' Duties" 462; Lefebvre \textit{France} 53.
\textsuperscript{37} See also note 29 above.
\end{footnotesize}
industry. The only exception is if the company can prove that the third party with whom the particular transaction was concluded knew, or should in the circumstances have known, that the transaction fell beyond the objects of the company. This exception is the result of a European Directive. Restrictions placed on the powers of the board by the statutes may not be invoked against any person who deals with the board, irrespective of whether he has actual knowledge of such restrictions. Clauses in the statutes which limit the company's objects or restrict the powers of its board, merely enable the company, or its shareholders, to claim damages for loss caused by directors who disregard such restrictions.

2.2.2.3 Agreements between Companies and Directors

The conclusion of agreements between companies and their directors is regulated in order to take into account potential conflicts of interest. Contracts between a director and his company are either specifically prohibited, or are regulated. For example, loans by a company to its directors or the giving of a guarantee or security by the company for a loan made to directors by third persons, are prohibited. A contract in respect of such a transaction is void. Regulated transactions are governed by an authorisation procedure. For example, any contract between a company and one of its directors or general managers, and any contract in which a director or general manager has an indirect interest or which he has negotiated with the company through an intermediary, must be expressly authorised in advance by the board. The authorisation procedure applies equally to contracts

38 Campbell Liability of Corporate Directors 281.
39 L, art 98 par 2, as amended by Ordinance 69-1176 of 20 December 1969.
41 L, art 98 par 3.
42 Le Gall & Morel French Company Law 134.
43 Lefebvre France 57-58; Le Gall & Morel French Company Law 108.
44 L, art 106. Certain exceptions are provided for in article 106 par 2, namely a loan, security or a guarantee so furnished by a company which carries on a banking or finance business and loans or guarantees for the benefit of corporate directors. However, the prohibition applies to their permanent representatives on the board of the company which gives the financial assistance: L, art 106 par 2.
45 L, art 101; Campbell Liability of Corporate Directors 287.
46 On general managers, see par 2.2.2.4 below.
47 L, art 101 pars 1 and 2.
between a company and another enterprise where the director or manager of the company also participates in the management of the other enterprise.\textsuperscript{48} However, authorisation is not required in respect of transactions entered into in the ordinary course of the company's business on usual terms.\textsuperscript{49}

The authorisation procedure involves five steps.\textsuperscript{50} The director or officer concerned must inform the board of directors of any proposed agreement subject to the regulation. The agreement must be submitted to, and approved by, the board of directors before being concluded. The director (or executive officer) concerned cannot vote in respect of the agreement. His presence is also not taken into account in determining the existence of a quorum. The statutory auditor or auditors (\textit{commissaires aux comptes}) of the company must be informed of the conclusion of any authorised agreement within one month of its conclusion.\textsuperscript{51} The auditor must, each year, inform the shareholders at the annual general meeting of the existence of all authorised agreements effective during the last financial year, irrespective of when they were concluded.\textsuperscript{52} The names of the directors involved must be specifically mentioned. The meeting of shareholders must consider the existence of these agreements and must approve or reject them. The interested director, if he is a shareholder, cannot vote on any resolution concerning the approval of an agreement with which he is concerned.\textsuperscript{53} Neither is his presence taken into account in order to determine the presence of a quorum.

Once they have been submitted to the shareholders' meeting, agreements which fall within the scope of the abovementioned transactions, can no longer be challenged with respect to third parties, irrespective of whether they are approved or rejected.\textsuperscript{54} But the corporation can claim damages against the interested director, and/or the other directors if a rejected agreement is harmful or disadvantageous to it.\textsuperscript{55}

Regulated agreements may be voided by the Commercial Court at the request of the corporation or its shareholders if they have neither been authorised by the board of directors, nor been submitted to the shareholders' meeting and are damag-

\textsuperscript{48} L, art 102 par 3.

\textsuperscript{49} L, art 102. Usually excluded from the requirement of authorisation are business transactions that fall within the terms and conditions usually extended or imposed upon outsiders: Campbell \textit{Liability of Corporate Directors} 287.

\textsuperscript{50} L, art 103; De Précigout "Directors' Duties" 164; Le Gall & Morel \textit{French Company Law} 110.

\textsuperscript{51} On the appointment of statutory auditors generally, see Le Gall & Morel \textit{French Company Law} 146ff.

\textsuperscript{52} L, art 103 pars 2 and 3.

\textsuperscript{53} L, art 103 par 4.

\textsuperscript{54} L, art 104. They may, however, be annulled for fraud.

\textsuperscript{55} L, art 104 par 2; Le Gall & Morel \textit{French Company Law} 110.
ing to the corporation. The interested director may also be ordered to compensate the company for any loss it has suffered, unless the contract is ratified by the company in general meeting.

Should the general meeting approve the transaction, its validity cannot thereafter be attacked on the ground of the director’s interest, and he cannot be sued for any loss suffered as a result of its being carried out.

The abovementioned regulation is provided for by statute. French company law does not recognise any fiduciary doctrine as is the case in the other systems investigated.

2.2.2.4 General Managers

With the approval of the president, the board of directors may determine the scope and duration of the powers delegated to a general manager. In relation to third parties the general managers have the same powers as the president. The company is therefore bound by transactions entered into by a general manager as if they had been concluded by the president.

2.2.3 The Société Anonyme with an Executive Board

As was mentioned above, this management system is optional and may only apply if it is provided for in the statutes of the company when it is formed or by subsequent amendment.

2.2.3.1 The Executive Board

The executive board is responsible collectively for the management of the affairs of the company. Its members and chairman are appointed by the supervisory

56 L, art 105.
57 L, arts 105 par 1 and par 3.
58 L, art 104 par 1.
59 The fact that French law does not recognise any fiduciary doctrine is seen by one commentator as a serious lacuna in French law, even if its consequences cannot be accurately measured: Tunc "British Law" 13; Tunc "American Law" 767.
60 L, art 117 par 1.
61 L, art 117 par 2.
62 Le Gall & Morel French Company Law 115.
63 L, art 118. See also page 205 above.
board.64 The executive board substitutes the president of the traditionally structured société anonyme.65 In the case of companies with a capital below a certain amount, the functions of the executive board may be vested in one person, the sole executive officer (directeur général unique).66

No person may at the same time be a member of the executive board or the sole managing director of more than two companies.67 The member of an executive board or sole manager who wishes to accept a second appointment, can only do so with the consent of the supervisory board of the company already served by him.68

The powers of the executive board are defined in the same way as those of the board of directors of a traditionally structured société anonyme.69 The same rules also apply in respect of contracts concluded with third parties70 and general managers.

Similarly, the same rules apply in respect of contracts between members of the executive board or the sole general manager and the company as between the directors of a traditionally structured société anonyme and the company.71 The supervisory board has the same powers as the board of directors to approve such contracts, subject to the overriding power of disapproval by a general meeting.72

2.23.2 The Supervisory Board

The members of the supervisory board collectively supervise the management of the company by the executive board.73 The statutes may require the approval of specified transactions by the supervisory board before the executive board or its

64 L, art 120 par 1. Unlike the directors of the traditional management system, the members of the executive board must be individuals: L, art 120 par 3.

65 Le Gall & Morel French Company Law 115.

66 L, art 119 pars 1 and 2.

67 L, art 127 par 1.

68 L, art 127 par 2.

69 L, art 124 par 1 reads exactly the same as L, art 98 par 1, referred to in note 34 above.

70 L, art 124 par 2 and par 3 are identical to L, art 98 par 2 and par 3, discussed under par 2.22.2 above.

71 See par 2.2.2.3 above.

72 L, arts 143-148.

73 L, art 128 par 1. Act 86-1134 of October 21, 1986 complements this article by allowing greater employee representation on supervisory boards. In this regard, see Guyon "French Law" 446; Guyon "Entwicklung" 250-251.
chairman, or the sole general manager, may conclude them. The members of the supervisory board are elected from the shareholders. The rules with regard to contracts between members of the board and the company are the same as those which apply to directors of a traditionally structured société anonyme. The supervisory board has the same powers to approve such contracts subject to the overriding power of disapproval by a general meeting.

2.3 The Private Limited Company (Société à Responsabilité Limitée)

This is the most popular type of company in France. It is based on the German private limited liability company and is particularly well-adapted to small and medium-sized companies, since it combines the advantage of flexibility in structure and functioning with the limitation of the liability of its members for its debts. Since 1985 a société à responsabilité limitée may consist of a single shareholder from the time of its constitution. In such a case the company is known as a single member limited liability company (entreprise unipersonnelle à responsabilité limitée).

Private companies are managed by only one organ, namely one or more managers (gérants), who must be individuals. Managers are appointed for the duration of the company's existence unless the statutes provide otherwise. In practice managers are appointed for life or for indefinite periods, or, if they are not substantial shareholders in the company, for fixed terms of years. A distinction is drawn between managers who hold a majority of the shares of the company, and those who hold a minority, whether by themselves or through nominees. The former are regarded as independent traders for the purposes of fiscal and social security law.

74 L, art 128 par 2.

75 By contrast, the members of the executive board or the sole general manager must, in terms of L, art 120 par 3, be individuals, but need not be shareholders.

76 See par 2.2.2.3 above.

77 L, arts 143-148.

78 Le Gall & Morel French Company Law 40.

79 Meister/Heidenhain German Limited Liability Company 24 note 9.

80 The disadvantage of this legal limitation of liability is that outsiders who deal with the company often require personal guarantees for performance of the company's obligations from its managers. They then become personally liable for the company's defaults in much the same way as a partner: Le Gall & Morel French Company Law 40.

81 Lefebvre France 79; Le Gall & Morel French Company Law 40.

82 L, art 49 par 1; Cozian & Viandier Sociétés 360; Lefebvre France 87; Le Gall & Morel French Company Law 48.

83 L, art 49 par 3.
The manager with a minority shareholding, on the other hand, is regarded as an employee of the company.84

If there are several managers, each may validly represent the company without the concurrence of the others.85 The managers have extensive powers. They may act on behalf of the company in all circumstances, provided that they do not infringe the provisions of the statutes and that they do not act beyond the scope of managing a business of the nature conducted by the company.86 Their powers may be curtailed either by the statutes of the company or by the provisions of the Law of 1966. The statutes may limit the powers of managers by restrictive provisions.87 They may, for example, prohibit the sale or mortgage of land owned by the company, or forbid the managers to borrow more than a certain amount in the company's name. If there are several managers, the statutes may define the powers and functions of each. But in relation to third parties the manager has full power to act in all circumstances on behalf of the company.88 Even if a manager enters into a transaction which falls beyond the objects of the company, the company is bound by his acts, unless the other party knew that the transaction was unrelated to the company's objects, or should have known that this was so.89 The registration and publication of the company's statutes, which are provided for by law, are not evidence of the outsider's knowledge for this purpose.90 French company law therefore does not recognise a doctrine of constructive notice.

2.3.1 Contracts between Managers and the Company

The Law of 1966 also imposes certain restrictions on the powers of managers. Managers (as well as shareholders) of private limited companies are forbidden to borrow from the company, or to have the company provide any guarantee or security for their personal debts and obligations.91

84 The provisions of company and tax law are more favourable to employees than independent traders. The manager is therefore encouraged to be a minority shareholder. The tax authorities may, however, show that a manager with an apparently minority holding is in fact a majority shareholder when shares held by other persons for his benefit are taken into account: Le Gall & Morel French Company Law 49.

85 L, art 49 par 7.

86 L, art 49 par 4.

87 Ibid.

88 Cozian & Viandier Sociétés 362; Le Gall & Morel French Company Law 51.

89 Le Gall & Morel French Company Law 51.

90 L, art 49 par 7. See also note 30 above.

91 L, art 51 par 1. The prohibition is also applicable to their spouses, issue and ancestors: L, art 51 par 3.
Contracts between a private company and any of its managers or members, if they are not prohibited, are subject to ratification by a general meeting of members. The authorisation procedure is similar to that for public limited companies. But the actual contract does not have to be screened in advance. The review by the managers takes place after conclusion of the contract. If the private company has an official auditor, its manager must notify him of the contract within one month of its conclusion. The official auditor, or the managers, if the company does not have such an auditor, compiles a report which evaluates the contract and informs shareholders of its effect on the company. The report is submitted to all shareholders, either at an actual meeting, or by making use of a consultation by mail procedure. The contract must be approved by a majority of shareholders at a general meeting. The interested manager is not counted to determine a quorum, nor may he vote on the matter.

The shareholders' refusal to approve the contract does not have the consequence that it is void. However, any damages caused to the company by the contract exposes the manager (or shareholder) to liability.

It must, once again, be pointed out that the regulations discussed above are not the result of the recognition of a general fiduciary obligation, but are specifically provided for by statute.

3 DIRECTORS' LIABILITY FOR BREACHES OF DUTY

It was pointed out above that French company law does not recognise any general doctrine of directors' fiduciary obligations. However, directors are subject to onerous statutory liability, which may be civil or criminal in nature.

The directors must, while performing their statutory duties, comply with a number of rules and guidelines, which are discussed below. These can be summarised as follows:

(a) They must not encroach on the powers specifically granted by the Law of 1966 to other organs of the company, such as the general meeting of shareholders and the chairman of the board.

92 L, art 50; Lefebvre France 89; Le Gall & Morèl French Company Law 51-52. In respect of public limited companies, see par 3.2.2.3 above.

93 Larger companies are required to have at least one official auditor, elected by a majority of shareholders, who serve a term of six years. Their role is to review some of the financial documents concerning the company's financial year. This serves as additional supervision of managers' conduct: Lefebvre France 89.

94 If a quorum was not established at a first meeting, a simple majority present or represented at a second meeting suffices: Lefebvre France 89.

95 L, art 50 par 4.

96 See page 211 and par 3.2 above.
(b) They must refrain from acting beyond the corporate purpose, even though such acts would normally be binding on the company, and must refrain from taking any action which would be contrary to the best interests of the company.

(c) Directors should refrain from furthering their own interests while acting in the name of the corporation.

(d) They must comply with any limitation on their powers which result from the statutes or which are imposed by the board of directors, or otherwise.

(e) They are responsible for the proper compliance by the corporation and its employees with all applicable laws and regulations.

Non-compliance with or violation of the above principles may lead to civil, criminal or tax liability in certain circumstances.

3.1 Actions against Directors

The French Companies Act encourages and facilitates shareholders’ suits against members of the board on behalf of the company. Actions against directors may take one of three forms. Shareholders may institute personal actions when the loss caused by the defendants has been suffered by them in their individual capacities (action individuelle). For example, shareholders may institute personal actions for fraudulent misrepresentations by directors which induced the plaintiff shareholders to subscribe for additional shares on the basis of false balance sheets. Shareholders who have suffered personal damage caused by the same facts, may appoint one of them to act on behalf of all such shareholders in court proceedings.

Secondly, an action against directors may be brought by the company where the loss caused by the defendants has been suffered by the plaintiff company itself, for instance actions for negligent mismanagement. Since the legal representatives of the company (the directors) are unlikely to initiate such an action, shareholders who hold at least five per cent of the issued capital of the company may designate one or more of their members, at their own expense, to enforce the company’s rights in an action brought in the name of the company against the directors.

97 See pages 208 and 214 above.
98 Tunc “Judge and Businessman” 555.
99 Cozian & Viandier Sociétés 236ff; De Précigout “Directors’ Duties” 463; Le Gall & Morel French Company Law 144.
100 Cozian & Viandier Sociétés 237.
101 D, art 199 as amended by Act 88-56 of 19 January 1988. In this regard, see also Cozian & Viandier Sociétés 237.
102 Cozian & Viandier Sociétés 236ff. In respect of negligent mismanagement, see also page 220 below.
103 L, art 245; D, art 200 par 1.
(action sociale) is similar to the derivative action recognised under South African law.\textsuperscript{104}

In the third place, one or more shareholders may personally enforce a right of action vested in the company.\textsuperscript{105} The plaintiffs then sue for the total loss suffered by the company, but the court order in favour of the plaintiffs is in respect of that portion of the loss which they have personally suffered. This portion is deemed to be proportionate to their share of the company's capital. This type of action (known as the action sociale à titre individuel) has no equivalent in English or South African company law.

In addition to the abovementioned shareholders' actions a number of other provisions of the Law of 1966 enable shareholders to exercise control over the decisions taken by management. In the event of serious difficulties preventing the normal operation of the company, such as deadlock in the board of directors, any shareholder may petition the Commercial Court to obtain the appointment of a trustee (administrateur judiciaire) to temporarily manage it.\textsuperscript{106}

Shareholders who collectively or individually hold at least ten per cent of the share capital may submit written questions twice a year to the chairman of the board about any matter which may jeopardise the operations of the corporation. Answers to these questions must be given in writing within one month, and copies must be sent by the corporation to its statutory auditors.\textsuperscript{107} The aim of this procedure is to alert the auditors to any financial difficulties that the corporation may find itself in.\textsuperscript{108} Provided that the shareholders hold the abovementioned percentage of shares, they may petition the court to appoint one or several experts to report on a particular management decision or decisions.\textsuperscript{109} They may also object to the appointment of statutory auditors,\textsuperscript{110} apply to court for the dismissal of any statutory auditor who does not, or is unable to, properly discharge his duties.\textsuperscript{111}

\textsuperscript{104} See chapter 9 par 4.8 below.

\textsuperscript{105} L, art 245; Cozian & Viandier Sociétés 236.

\textsuperscript{106} This remedy is not easily obtainable because of the necessity to prove that the company cannot be managed: Le Gall & Morel French Company Law 144.

\textsuperscript{107} L, art 226 par 1.

\textsuperscript{108} Le Gall & Morel French Company Law 144-145.

\textsuperscript{109} L, art 226 par 1.

\textsuperscript{110} L, art 225 par 1. The objection must be lodged within thirty days of such appointment.

\textsuperscript{111} L, art 227.
3.2 Civil Liability

Any claim involving the civil liability of a director must comply with the general law on liability as set out in the Civil Code.\textsuperscript{112} This requires the occurrence of a breach of duty, the existence of damage suffered by the claimant and a causal link between the breach of duty and the resulting damage.\textsuperscript{113} Specific provisions of the Act of 1966 also apply.

3.2.1 The Public Limited Company

Directors of a traditionally structured company are, jointly and severally, liable in damages to the company, its shareholders and third persons for loss caused by breaches of the Law of 1966 or regulations made thereunder, or by disregard of the provisions of the company’s statutes, or by their deliberate or negligent misconduct.\textsuperscript{114} Action must be brought within three years following the occurrence of the event which caused the liability, or, if that event was concealed, from the date on which it was discovered.\textsuperscript{115}

Liability can be imposed only as a consequence of events that occurred while the director was carrying out his duties. A director cannot be held liable for events which occurred before or after the time when he was actually exercising his duties.\textsuperscript{116} If previous directors’ actions are continued or given effect by a new director, they may cause liability.\textsuperscript{117}

In principle, each director is only personally liable for his own acts and omissions.\textsuperscript{118} However, the directors form a collegiate body. Acts involving liability may therefore be done by the directors together, in which case they are collectively liable.\textsuperscript{119} Where several directors are jointly liable as participants in the same act,

\textsuperscript{112} Code Civil art 1382. In 1987 the Commercial Court confirmed that the general principles of tort apply when company law rules are inadequate to provide a solution: Cass Com 7 July 1987; Campbell Liability of Corporate Directors 275.

\textsuperscript{113} De Précigout "Directors’ Duties" 463; Le Gall & Morcl French Company Law 123.

\textsuperscript{114} Code Civil, art 1850; L, art 244 par 1.

\textsuperscript{115} L, art 247.

\textsuperscript{116} Campbell Liability of Corporate Directors 184; Le Gall & Morel French Company Law 123.

\textsuperscript{117} Campbell Liability of Corporate Directors 284.

\textsuperscript{118} L, art 244 par 2. Cozian & Viandier Sociétés 235 confirm that it is the liability of the president that is more frequently challenged, as it is he who is involved with the day-to-day management of the company.

\textsuperscript{119} L, art 244; Campbell Liability of Corporate Directors 284.
the court must determine each one's share of responsibility when awarding damages against them.\textsuperscript{120} The statutes of a company may not subject the enforcement of a right of action vested in the company to prior authorisation by the general meeting.\textsuperscript{121} Neither may a general meeting be called to decide upon the desirability of an action being instituted.\textsuperscript{122} Shareholders may also not renounce their rights to sue in their own or the company's name,\textsuperscript{123} and no resolution passed by a general meeting may release or discharge directors from liability for breaches of duty in the carrying out of their duties.\textsuperscript{124}

The rules relating to the civil liability of the directors of a traditionally structured company apply to the members of the executive board of a company with separate executive and supervisory boards. Their liability is enforced in the same way as the liability of such directors.\textsuperscript{125} The members of the supervisory board are, in principle, liable for mismanagement or negligent management in the same circumstances as directors of a traditionally structured company. Since they have no powers of management themselves, they can, however, be made liable only for failing to supervise the executive board properly and effectively.\textsuperscript{126} They are also liable for loss caused by breaches of duty committed by the executive board if they know of the breaches, but do not report them to the general meeting as soon as possible.\textsuperscript{127}

The grounds for civil liability are numerous and varied. Directors may incur liability if they violate any legislative or regulatory provision.\textsuperscript{128}

\textsuperscript{120} L, art 244 par 2.
\textsuperscript{121} L, art 246 par 1.
\textsuperscript{122} Ibid.
\textsuperscript{123} Ibid.
\textsuperscript{124} L, art 246 par 2.
\textsuperscript{125} L, art 249 par 1.
\textsuperscript{126} L, art 249. French law distinguishes between three different types of management acts: \textit{administrer} refers to acts of a director generally, \textit{diriger} refers to the acts of the president or general director and \textit{gérer} refers to the acts of an ordinary manager. See, in general, Campbell \textit{Liability of Corporate Directors} 283.
\textsuperscript{127} L, art 250.
\textsuperscript{128} Code Civil art 1850; L, art 244 par 1; Cozian & Viandier \textit{Sociétés} 235; Lefebvre \textit{France} 58; Le Gall & Morel \textit{French Company Law} 123.
Unlike corporate law in America and Commonwealth countries, directors are liable for any damages caused by managerial errors. A board member or members could therefore become liable for complacent management, negligence, abuse of corporate funds, payment of excessive salaries or commissions, and lax supervision of corporate employees or the chairman of the board.

In their management of company affairs, directors are expected to exercise the standard of care of a bon père de famille. The test applied to measure whether the director's conduct meets this standard is not subjective as in England, but objective. Subjective standards such as good faith, the individual's health, age and inexperience will not excuse wrongdoing or negligence. The courts do not require that directors exercise special powers of clairvoyance, but they do expect them to show reasonable anticipation of the consequences of certain acts or omissions. Accordingly, a director's decisions are not judged in the light of the negative results obtained, but rather in view of those adverse circumstances or risks that were reasonably foreseeable at the time of the decision.

A distinction is made between salaried and non-salaried directors in the application of the standard of care required. Directors whose office is remunerated and those who undertake management functions are expected to exercise a higher degree of care. They may be held liable for even slight negligence. If a director is not salaried, the standard remains objective. However, courts are far more lenient in their determination whether or not a breach of duty has occurred.

In addition to their duties of supervision with respect to negligent acts, directors of French companies must take care not to engage in actions that might be qualified as an abuse of rights (abus de droit). When applied to company law, this general French legal concept requires directors to exercise their authority in the best interest of the corporation and not for their own good. A director's abuse of his legal authority may be grounds for an action in negligence.

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129 L, art 244 par 1; Campbell Liability of Corporate Directors 282ff; Cozian & Viandier Sociétés 235; Lefebvre France 58-59; Tunc "Judge and Businessman" 555. The court (Cour de Cassation) has gone even further, and has ruled that any fault, even if it is not a fault of management, entails liability: Maisant v Sinai (Cass. 4 May 1982), Revue de Société 1984, 573. The concept of fault is very wide. It covers any mistake or error. The abovementioned article and decision confirm the general principle of the Code Civile, art 1382 that every fault which causes damage is a source of liability.

130 Lefebvre France 59; Tunc "Judge and Businessman" 554-555.

131 Literally, a "good family father", which is the equivalent of the Anglo-American fiction of the reasonable person: Campbell Liability of Corporate Directors 283.

132 See chapter 4 par 3.1 above.

133 Campbell Liability of Corporate Directors 283.

134 Ibid.

135 Ibid.

136 Campbell Liability of Corporate Directors 285.
Special provisions apply in the event of bankruptcy of a company. The strictness of the previous provisions, which provided for strict liability of managers of companies that encounter financial difficulties, were abrogated in 1985. The object of the amendment was to encourage individuals to take management positions in firms experiencing difficulties. The directors and officers are now only liable for damages if the representative of the creditors can prove that the director or officer wrongfully committed an act that caused the assets of the company to be insufficient to satisfy legal liabilities.

The only remedy awarded against directors in respect of civil liability is damages. Frequent use is made of directors' insurance in this regard. The nature of damages that must result from a negligent act before that act can become the basis of a lawsuit varies. It usually involves material or economic damages, but it may also take the form of loss of reputation or loss of business opportunity. In some cases, action can be instituted for personal injury.

3.2.2 The Private Company

As is the case with a public company, managers of a private company are jointly and severally liable for damages resulting from infringements by them of legal and regulatory rules, infringements of the statutes of their company and from deliberate or negligent acts of mismanagement. The liability may be incurred to third parties, to the company, or to members individually. If a company does not institute action against defaulting managers, one or more of its members who hold at least one-tenth of the capital of the company may bring a derivative action. Any

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137 Act 85-98 of 25 January 1985, art 180. The provisions of this act were adopted in L, art 248 and L, art 249.
138 Guyon "French Law" 444 is of the opinion that this return to common law principles must be approved.
139 Campbell Liability of Corporate Directors 284; Le Gall & Morel French Company Law 123.
140 De Précigout "Directors' Duties" 463; Le Gall & Morel French Company Law 123; Safa "Directors' and Officers' Liability" 365. A form of insurance against management risks known as responsabilités civiles des mandataires sociaux is available to corporate directors.
141 Campbell Liability of Corporate Directors 284.
142 For example, if there is evidence that any lack of supervision or non-compliance with work-place safety laws contributed to the accident: Campbell Liability of Corporate Directors 284.
143 See par 3.2.1 above.
144 L, art 52 par 1.
145 L, art 52 par 1; Lefebvre France 88; Le Gall & Morel French Company Law 52.
damages awarded are then payable to the company. If more than one manager is responsible for the act or omission, the share of the damages for which each is liable is determined in proportion to their respective degrees of responsibility.

No provision in the statutes of the company and no resolution passed by a general meeting can extinguish the right of the company or its members to sue the managers for breaches of duty. Neither is any provision in the statutes which requires the authorisation or approval of the general meeting for an action brought by members in the name of the company, valid.

Actions against managers for breaches of duty become prescribed three years after occurrence of the particular breach, or, if the breach has been concealed, within three years after the discovery thereof.

Special provisions apply in the event of bankruptcy of a company.

3.3 Criminal Liability

Company directors can incur extensive criminal liability in France. Most breaches of duty in respect of their management of the company's affairs, and most defaults in respect of formal and procedural matters, involve infringements of the criminal law as well as civil liability. Directors should therefore at all times consider the potential criminal consequences of their actions.

3.3.1 The Public Limited Company

Most of the grounds of criminal liability are mentioned individually in the Act of 1966. The violation of these provisions constitutes a criminal offence involving imprisonment and fines of up to two and a half million French francs. In addition,
certain misdemeanours under the Criminal Code can be committed by company directors. These include fraud (escroquerie) and embezzlement (abus de confiance).\(^{156}\) No differentiation is made between the different forms of management discussed above.\(^{157}\)

Two criminal offences provided for in the Act of 1966 are of particular relevance with regard to the appropriation of corporate opportunities. They are the offence of misuse of the company's assets and the offence of abuse of power.\(^{158}\) The elements of and penalties imposed for these offences are identical.

The offence of misuse of the company's assets (abus de biens sociaux) is committed if the president, directors or general managers make use of the assets or credit of the company in bad faith for a purpose which they know is contrary to its interests, and this is done for their own personal gain or for the benefit of another company in which they have a direct or indirect interest.\(^{159}\)

The offence of abuse of power (abus de pouvoirs) is committed if any of the officials mentioned above make use of their powers, or votes they have in that capacity, in bad faith for a purpose which they know is contrary to the company's interests, and they do so for their own personal gain or for the benefit of another company in which they have a direct or indirect interest.\(^{160}\)

The penalties are onerous. A prison term of one to five years imprisonment and a fine of between two thousand and two and a half million French francs may be imposed.\(^{161}\) Restitution by the director and ratification, not even if it is unanimous, do not absolve the director.\(^{162}\)

The Act prescribes four elements. The accused must have used company assets or his own powers, these must have been used contrary to the interests of the company, for personal gain and in bad faith.

Abuse of company assets is recognised as a flexible term. It includes the personal use of company assets, using company employees to further the directors' own interests, payment of excessive salaries to directors and the acquisition of assets (for example, a speedboat) in the company's name for the directors' own use.\(^{163}\) Commentators accept that the misappropriation of a corporate opportunity is

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156 Criminal Code, art 405 and art 408.

157 L, art 437 par 1. On the management forms, see par 2.2.2 and par 2.2.3 above.

158 L, art 437.

159 L, art 437 par 3.

160 L, art 437, par 4.

161 L, art 437 par 1.

162 Cozian & Viandier Sociétés 238.

163 Cozian & Viandier Sociétés 238-239. For the interesting view that the purchase of directors' and officers' liability insurance might, in appropriate circumstances, constitute an abuse of assets, see Safa "Directors' and Officers' Liability Insurance" 365-367.
included under this offence. Nonetheless, only one French decision dealing pertinently with the appropriation of corporate opportunities could be traced. In that case, a director who purchased shares in a rival company that was the potential subject of a take-over by his own company was held not liable for abuse of his powers. Abuse of company assets also includes extending credit in unwarranted circumstances (abus du crédit de la société). The abuse of power (abus de pouvoirs) is an equally flexible term. It includes the omission to claim outstanding debts from a particular debtor, and the conclusion of agreements on particularly lenient terms. Also included are the use by directors' votes for purposes contrary to the company's interests.

Mere use of company assets or exercise of the directors' powers does not suffice to constitute a criminal offence. It must have harmed the company's interests. Impoverishment of the company, or the risk of impoverishment, is regarded as being contrary to the company's interests. A director may not act for his own personal gain, or for the gain of another company or business enterprise in which he has an interest. The concept of "gain" includes not only financial gain, but also moral gain, for example protection of reputation.

Bad faith is readily deduced by courts, but does not include negligent management.

3.3.2 The Private Company

As was seen above, in the case in respect of public companies, most of the grounds of criminal liability of directors of private companies are mentioned individually in the Act of 1966. The violation of these provisions constitutes a criminal offence involving imprisonment and fines of up to two and a half million French
francs. In addition, certain misdemeanours under the Criminal Code can be com-
mitted by company directors. These include fraud (escroquerie) and embezzlement
(abus de confiance).

Certain offences are common to the directors of public and private companies.
Thus managers who distribute fictitious dividends or submit inaccurate balance
sheets to shareholders are punishable by imprisonment or a fine. Other offences
apply particularly to private companies.

The two criminal offences particularly relevant with regard to the appropria-
tion of corporate opportunities, namely misuse of the company's assets and abuse of
power which were discussed above, apply equally to private companies.

4 UNFAIR TRADE

A last aspect of French law which deserves mention is that of unfair trade. The
general delictual principle is established in French civil law by the Code Civil, and
provides that a person who intentionally or negligently causes damage to another is
responsible to the injured party for damages. It applies equally to individuals
engaged in business and to individuals in their private lives. Thus, should one
businessman decide to engage in behaviour that intentionally or negligently causes
damage to another, the injured party may sue for the damages necessary to repair
the harm caused to his business.

Most of the more damaging types of behaviour covered by the provisions of
the Code Civil have now also become the subject of specific legislation. The delic-
tual principles of the Code Civil are therefore usually given as an alternative cause

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173 The penalties usually prescribed range between two thousand and sixty thousand French francs: Le
Gall & Morel French Company Law 53.

174 Criminal Code, art 405 and art 408.

175 L, art 425.

176 For example, L, art 429 prescribes a fine which may be imposed on managers who omit to set out
the name of the company, preceded or followed by the words "société à responsabilité limitée" or their
abbreviation "SARL", and a statement of the company's capital in all documents sent out by the com-
pany to third parties.

177 See par 3.3.1 above.

178 L, art 425 par 4 and par 5.

179 Code Civil, art 1382 and art 1383.

180 Lefebvre France 138.

181 Ibid.

182 For example, the Pricing Ordinance of 1945 and the Pricing and Competition Ordinance of 1986.
The provisions of these statutes do not merit further investigation for the purposes of this thesis.
of action to a more direct allegation of illegal behaviour.\textsuperscript{183} Under the civil law delictual principles, a \textit{prima facie} case of unfair trade (\textit{concurrence déloyale}) exists if the victim has suffered damages, the defendant who caused the damages committed some fault\textsuperscript{184} and a sufficient causal connection exists between the fault and the damages.\textsuperscript{185} The classic types of case which have been held actionable under these principles, include denigration,\textsuperscript{186} price cutting,\textsuperscript{187} imitating trade names or logos, exploiting commercial or technical knowhow, stealing clients, disorganising distribution networks,\textsuperscript{188} and stealing employees.\textsuperscript{189}

Apart from the specific criminal prohibition in the Act of 1966 which prohibits the misappropriation of corporate assets or powers,\textsuperscript{190} a company director, or former director, may therefore find himself liable for damages if the delict of unfair trade can be established. Especially the latter four examples mentioned above might be applicable to his situation.

5 CONCLUSIONS

French law provides for various types of company, of which the public and private limited companies are, for purposes of this survey, the most relevant.\textsuperscript{191} As a legal entity, a French company must necessarily be managed by legal persons. The management structures of companies differ, depending on the type of company and the system elected by the members of the company.\textsuperscript{192} But the effective management of the company is conducted, in the case of a public company, by a board of direc-

\textsuperscript{183} Lefebvre \textit{France} 138.

\textsuperscript{184} The behaviour need not have been intentional to constitute fault: Lefebvre \textit{France} 138.

\textsuperscript{185} Lefebvre \textit{France} 138.

\textsuperscript{186} A person who denigrates another’s products or workmanship by discrediting it commits the tort of unfair trade. This can occur when a business discredits the products of another, or when an employer casts aspersions on a former employee who engaged in a competing business, while not bound by a restraint of trade clause: Lefebvre \textit{France} 139.

\textsuperscript{187} A person who intentionally harms another merchant by specifically undercutting his prices, as would occur where the person establishes an outlet next door to the plaintiff’s store, trades unfairly: Lefebvre \textit{France} 139.

\textsuperscript{188} A person who intentionally encourages a distributor who is contractually bound to an exclusive or selective distribution arrangement to break the contract, will be liable to the supplier for damages when he knew or should have known of the particular contractual obligations: Lefebvre \textit{France} 139.

\textsuperscript{189} Lefebvre \textit{France} 138-139.

\textsuperscript{190} See pars 3.3.1 and 3.3.2 above.

\textsuperscript{191} See par 1 above.

\textsuperscript{192} See par 2 above.
tors and, in the case of a private company, its managers. Although there are differences between these organs, there are many similarities between them.

Unlike the other legal systems investigated in this thesis, French company law does not recognise any general fiduciary doctrine in respect of its management. Instead, it relies on statutory provisions for extensive civil and criminal liability in respect of mismanagement or lack of concern for company affairs. In addition, shareholders may apply to the Commercial Court for the appointment of a trustee to temporarily manage the company in appropriate circumstances. Provisions permitting shareholders with a minimum shareholding to challenge aspects of management not only facilitate shareholder involvement, but also alert the auditors to any financial difficulties that the company may find itself in. Special provisions apply if the company becomes insolvent.

Shareholders' actions against directors may take the form of personal actions, corporate actions or the personal enforcement of a right of action vested in the company. The former two actions are similar to the personal and derivative actions in South African law, whereas the latter action has no equivalent in English or South African company law.

Under French law no differentiation exists between liability in respect of managerial errors and other civil liability. In this respect the position differs considerably from South African law, where the director's duty of care and skill is accepted to be considerably less onerous than the fiduciary duties which he owes the company.

Any claim involving the civil liability of a director must comply with the general law on liability, which requires the occurrence of a breach of duty, the existence of damage suffered by the claimant and a causal link between the breach of duty

193 The managers of private companies must, for example, be individuals, whereas an individual or a corporate body may serve as director on the board of a public company: see pars 2.2.2 and 2.3 above.

194 See pages 211 and 215 above.

195 On civil liability, see par 3.2 above. Criminal liability is discussed under par 3.3 above.

196 See page 217 above.

197 See page 217 above.

198 See pages 221 and 222 above.

199 See par 3.1 above.

200 See chapter 9 par 3.1.2.2 below. The position under South African law is similar to that in other Anglo-American countries, which are discussed elsewhere in this thesis (see chapters 4, 5 and 8 in this regard).
and the resulting damage.\textsuperscript{201} In addition, the relevant provisions of the Act of 1966 must be observed. The only civil remedy is damages.\textsuperscript{202} In respect of criminal liability, it is accepted under French law that the offence of abuse of corporate assets includes the appropriation of corporate opportunities.\textsuperscript{203} The offence of abuse of power may also be relevant.\textsuperscript{204} In appropriate circumstances civil action may involve the proof of an unfair trade practice.\textsuperscript{205}

In conclusion, the investigation undertaken in this chapter shows that management can be effectively controlled by means of a codification of directors' powers and obligations. Extensive criminal regulation forms the basis of this means of control, which appears to be effective in French company law. It should, however, be borne in mind that French law generally is largely codified. The desirability of codification of directors' duties in a company law system such as the South African one, which is based upon common law rules, and where the emphasis is rather on decriminalisation, is discussed elsewhere.\textsuperscript{206} One aspect of French company law which is commendable is the facilitation of shareholder control over management decisions. In this regard, the action sociale à titre individuelle, which enables a plaintiff to directly receive his proportionate share of the loss suffered by the company, and the process of questioning the chairman and reporting to the company auditors are commendable.\textsuperscript{207} Similar shareholder remedies should, it is submitted, be considered in South African law.

\textsuperscript{201} See par 3.2 above.
\textsuperscript{202} See page 221 above.
\textsuperscript{203} See page 223 above.
\textsuperscript{204} See pars 3.3.1 and 3.3.2 above.
\textsuperscript{205} See par 4 above.
\textsuperscript{206} See chapter 9 par 4.10 below.
\textsuperscript{207} See par 3.1 above in respect of both these remedies.
1 INTRODUCTION

A comprehensive codification of German company law does not exist, and is apparently not foreseen in the immediate future.\(^1\) Various types of German enterprise are recognised, the law regarding which is contained in different statutes.\(^2\) However, company law is found not only in these statutes, but also in the Civil Code (\textit{Bürgerliches Gesetzbuch}) (\textit{BGB}) and the Commercial Code (\textit{Handelsgesetzbuch}) (\textit{HGB}).\(^3\) Furthermore, certain rules under other statutes,\(^4\) as well as rules which arise under common law, cannot be disregarded. In the last instance, the role played by the courts in the application of company law should not be underestimated in determining legal principles.\(^5\)

German law distinguishes between companies with a share capital and partnerships.\(^6\) Companies with a share capital comprise the public limited liability company (\textit{Aktiengesellschaft}), the public company with certain shareholders personally liable for debts (\textit{Kommanditgesellschaft auf Aktien})\(^7\) and the private limited liability company (\textit{Gesellschaft mit beschränkter Haftung}). The public and private limited liability companies, which are comparable to the companies recognised in South

\(^1\) Kraft/Kreutz \textit{Gesellschaftsrecht} 1.

\(^2\) See Kraft/Kreutz \textit{Gesellschaftsrecht} 1-2 and Schmidt \textit{Gesellschaftsrecht} 22 for comprehensive expositions of the various types of company and their sources.

\(^3\) Both these Codes came into operation on 1 January 1900 and have subsequently frequently been amended. While the Civil Code is of universal application in Germany, the Commercial Code applies only to merchants (\textit{Kaufmänner}). \textit{HGB}, par 1 sets out those mercantile activities which constitute a person a merchant. All companies are regarded as merchants because of their structure, regardless of the nature of their activities.

\(^4\) See, for example, Oliver \textit{Germany} 2 who regards the law of bankruptcy (\textit{Konkurs}) and arrangements (\textit{Vergleich}), which apply to companies as well as to individuals, and the relevant aspects of labour law as of particular importance. See also Schmidt \textit{Gesellschaftsrecht} 6ff for a detailed exposition of the relationship between company law and other disciplines.

\(^5\) Schmidt \textit{Gesellschaftsrecht} V.

\(^6\) Both companies and partnerships are referred to as "\textit{Gesellschaften}". See, in general, Eisenhardt \textit{Gesellschaftsrecht} 7; Kraft/Kreutz \textit{Gesellschaftsrecht} 90ff; Schmidt \textit{Gesellschaftsrecht} 33ff; Würdingerser German Company Law 1ff.

\(^7\) Würdingerser German Company Law 2 indicates that this type of company is not frequently encountered in practice and could be compared to a limited partnership which has an authorised capital divided into shares. It is therefore not discussed further.
African law, are regulated by different acts. Their management structures, and management's liability, are therefore discussed separately. Where appropriate, provisions of the BGB and the HGB are referred to. This is followed by a discussion of the fiduciary duties generally owed by management to the company, the origin of which is the common law. Directors' liability and the effect of ratification on unauthorised transactions are then considered.

2 MANAGEMENT OF COMPANIES WITH A SHARE CAPITAL

Since a company is a legal person and can therefore not act of its own accord, acts on behalf of the company are carried out by the company organs. These organs are the management board, the supervisory board or the general meeting of shareholders.

German law separates the functions of management and supervision. Often these functions are vested in different company organs.

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8 Naudé Maatskappydirekteur 205-206. There are important differences between the German Gesellschaft mit beschränkter Haftung and the South African private company: Du Plessis Grondslae 460. Nevertheless, its management structure, and the way in which effective control over management is realised, remain comparable.

9 For a comparison between the public and private limited liability companies, see Meister/Heidenhain German Limited Liability Company 19-21.

10 See pars 2.1 and 2.2 below.

11 See par 4 below.

12 See, in general, Gessler/Hefermehl Aktiengesetz Kommentar 16; Putt "Directors" 253; Schmidt Gesellschaftsrecht 201. See also BGB, par 164ff in respect of general provisions pertaining to agency. On the debate whether these general provisions should apply to company representatives, see Schmidt Gesellschaftsrecht 201ff. If the company representative acts without the necessary authority, certain provisions of the BGB, eg par 171, par 179, par 713 (which incorporates pars 664-670) and par 714 may apply: Schmidt Gesellschaftsrecht 203.

13 Schmidt Gesellschaftsrecht 194ff.

14 The historic purpose of supervision in both the French and German systems has been the protection of property interests, primarily those of the shareholders: Conard "Supervision of Management" 1466-1467. According to the author provisions for supervision of management are based on two assumptions. The first is that managers are normally competent, loyal and fair. The second assumption is that some managers sometimes will lack competence or lose competence that they once had, and that, if unrestrained, they will undertake imprudent expansions or make overgenerous arrangements for their own benefit; and that some will, at times, favour some sections of security holders over others. In order to inhibit and deter these deviations, supervisors are established who are sufficiently removed from management to view it objectively. In addition, these supervisors are sufficiently powerful to decide who will be managers and for how long they will occupy that position. However, Würdinger German Company Law 51 submits that the separation of the management and supervision of the company's business imposed by the Aktiengesetz, and the independence of the management board from the supervisory board and the general meeting, often do not correspond with the hard facts of life, especially in smaller companies.
2.1 The Public Limited Liability Company

The public limited company (*Aktiengesellschaft*) is governed by the Stock Corporation Act (*Aktiengesetz*) of 1965. This type of company is used for large undertakings with substantial capital requirements.

In an *Aktiengesellschaft*, the function of management is vested in the management board (*Vorstand*), and that of supervision of management in the supervisory board (*Aufsichtsrat*). No person may at the same time be a member of both boards. Shareholders have only limited participation in corporate management. Their participation is restricted to appointment of corporate managers, alteration of the articles of association, settlement of corporate claims against managers and shareholders and, in the case of a private limited liability company, ratification of contracts between the corporation and its managers.

2.1.1 The Management Board

The management board (*Vorstand*) is charged with the management of the company. Management of the company is not defined in the Act, but is a broad concept and includes carrying on the kind of business specified in the statutes of the company, the organisation of production and the preparation and execution of long-term planning for that purpose. It therefore comprises the entire policy in respect of trading, investment and earnings of the company. Also included are certain

15 This Act is hereafter referred to as *Aktg*. A specific paragraph of the Act, for example paragraph 13, is referred to as *Aktg*, par 13.

16 Goltz "Directors' Duties" 120; Kraft/Kreutz *Gesellschaftsrecht* 191. See, in general, Kraft/Kreutz *Gesellschaftsrecht* 191ff; Gessler/Hefermehl *Aktiengesetz Kommentar* 1ff; Schmidt *Gesellschaftsrecht* 596ff.

17 *Aktg*, par 76.

18 *Aktg*, par 111(1). This two-tier management style is followed in the proposal for a European company: see the Proposal for a Council Regulation on the Statute for a European Company COM(89) 268final - SYN 218 Title IV. See also chapter 6, note 15 above in respect of its influence on French law.

On the inter-relationship between the management and supervisory boards, see Mertens "Organstreit" 24ff; Schilling "Macht und Verantwortung" 159ff; Stodolkowitz "Organpflichten" 2ff.

19 *Aktg*, par 105(1).

20 Falkenhausen & Steefel "Shareholders' Rights" 410. See also par 2.2 below.

21 *Aktg*, par 76(1) provides that the board must manage the company on its own responsibility. See, in general, Gessler/Hefermehl *Aktiengesetz Kommentar* 16ff; Rittner "Verantwortung des Vorstandes" 139ff; Schmidt *Gesellschaftsrecht* 613ff.

22 Eisenhardt *Gesellschaftsrecht* 262; Kossen "Haftung" 1785; Würdinger *German Company Law* 45.
specific duties, such as the keeping of the required books and records,23 convening of general meetings,24 etcetera.25 Since the board acts on its own responsibility,26 it is subject to the directions of neither the supervisory board nor the general meeting.

The management board is also the representative organ of the company. Its power of representation is, as far as third parties are concerned, unlimited and unlimitable.27 The doctrine of ultra vires is unknown in German company law.28 The company is consequently bound by contracts entered into by the board outside the scope of the company's business as specified in the statutes, including contracts to which the consent of the supervisory board was required but not obtained. However, the members of the management board are obliged to act within the parameters of the limitations imposed by the constitution of the company, the supervisory board, the general meeting of shareholders or its own regulations. A breach of this duty could lead to a claim for damages.29 Statutory limitations do not operate in favour of third parties, that is, an outsider may not rely on the unlimited powers of management board members in order to hold a company liable in respect of contracts which are expressly limited by statute.30

A third party may also not rely on the unlimited powers of Vorstand members if he was aware of the limitation and colluded with those members to the detriment of the company, or if he should have been aware of the limitation.31

The members of the management board are appointed by the supervisory board by resolutions passed by a simple majority of the votes cast.32 The power of the supervisory board to appoint the members of the management board is exclusive, and cannot be altered or restricted by the statutes. The right of appointment therefore cannot be transferred to the general meeting, nor can it be attached to a particular shareholding or made subject to the approval of a third party, such as the

23 Aktg, par 91.
24 Aktg, par 121(2).
25 For further examples, see Würdinger German Company Law 45.
26 See note 21 above.
27 Aktg, par 82(1) explicitly provides that the power of representation may not be limited.
28 Falkenhausen & Steefel 'Shareholders' Rights' 409; Kraft/Kreutz Gesellschaftsrecht 205.
29 Aktg, par 82(2).
30 Kraft/Kreutz Gesellschaftsrecht 205. Examples of such statutory limitations are found in Aktg, paras 52(1), 112, 293, 295, 340 and 361.
31 Kraft/Kreutz Gesellschaftsrecht 205.
32 Würdinger German Company Law 43.
state. The board itself also cannot increase its own numbers.\(^{33}\) Only natural persons may be members of the board.\(^{34}\) No share qualification is required. The same person may be a member of the board of management of another company if the consent of the supervisory board is obtained.\(^{35}\) The right to revoke the appointment of a management board member is restricted to the supervisory board.\(^{36}\) In most instances, a service contract is concluded with the company,\(^{37}\) in which case the general rules of contract, particularly service contracts, apply.\(^{38}\)

Management of the undertaking is conducted independently and without reference to the wishes of the general meeting.\(^{39}\) This independence of the board cannot be restricted by the company's statutes.\(^{40}\) The board may, at its own discretion, request decisions on particular matters by the general meeting. These decisions may then be adopted by the board.\(^{41}\) In matters which fall within the powers of the general meeting, the board must carry out decisions made by that meeting.

\(^{33}\) Although the management board often proposes persons for appointment to itself, the supervisory board is not bound by such proposals: Würdinger German Company Law 43.

\(^{34}\) Aktg, par 76(3).

\(^{35}\) Aktg, par 88(1).

\(^{36}\) The appointment may be revoked only if substantial grounds exist, for instance, if the member has breached a duty, is incapable of management, or if the general meeting has lost confidence in him. See, in general, Würdinger German Company Law 44; Aktg, par 84(3).

\(^{37}\) Kraft/Kreutz Gesellschaftsrecht 204.

\(^{38}\) These rules are contained in BGB, pars 611ff.

\(^{39}\) Gessler/Hefermehl Aktiengesetz Kommentar 114; Würdinger German Company Law 38. The general meeting may therefore not give binding directions to the board.

\(^{40}\) It should be noted that special provisions apply to ensure participation and co-determination by employees. The Business Organisation Law (Betriebsverfassungsgesetz (BetrVG)) of January 15, 1972 applies to all profit-making enterprises in which a specified number of persons are employed. The employees elect a workers' council by means of which employees participate in decision-making. Enterprises in the mining, coal and steel industries are subject to further special provisions. See, in general, Würdinger German Company Law 5, 39ff. See also notes 43 and 94 below.

\(^{41}\) Gessler/Hefermehl Aktiengesetz Kommentar 114-115; Würdinger German Company Law 38. Aktg, par 119(2) provides that the general meeting may only decide on matters concerning the management of the company when so required by the management board. An exception to this general rule is made in Aktg, par 221, which provides that the board may only issue convertible bonds and bonds carrying the right to a share of the company's profits if the consent of the general meeting has been obtained. A breach of this requirement results in personal liability of board members towards the company. The validity of securities issued by the company is not affected: Würdinger German Company Law 46.
2.1.2 The Supervisory Board

The main duties of the supervisory board (Aufsichtsrat) are the appointment and dismissal of the members of the management board, supervision of management by that board and the approval of the annual accounts.42

The members of the supervisory board, other than employees' representatives,43 are appointed by the general meeting by a resolution passed by a simple majority of the votes cast.44 A majority shareholder may therefore elect himself to the supervisory board by using his own votes. Only natural persons may serve on the supervisory board.45 No provision is made for the representation of minority shareholders.46 However, they are entitled to submit proposals on matters which include their representation on the supervisory board to the general meeting for consideration.47

Since it is a supervisory organ, the supervisory board is incapable of issuing instructions to the management board.48 The membership of these two boards is

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42 On the rights, duties and responsibility of the supervisory board in general, see Gessler/Hefermehl Aktiengesetz Kommentar 11f; Lutter/Krieger Aufsichtsrat 85ff, 240; Meier & Budde "Verantwortlichkeit des Aufsichtsrats" 1271-1272; Würdinger German Company Law 48-49. For a comparison between the supervisory boards of the Aktiengesellschaft and the Kommanditgesellschaft auf Aktien, see Kallmeyer "Kommanditgesellschaft" 57ff. For specific powers of the supervisory board, see Würdinger German Company Law 50-51; Aktg, par 111.

43 The election of these representatives takes place in accordance with the Co-Determination Act (Mitbestimmungsgesetz) 1967, the Supplementary Coal and Steel Co-Determination Act (Montanmitbestimmungs-Ergänzungsgesetz) 1956 or the Labour-Management Relations Act Betriebsverfassungsgesetz 1952.

44 Aktg, par 101(1). The statutes of a company may, however, entitle specific shareholders (for example the State), or the holders for the time being of certain shares whose transfer requires the approval of the company, to appoint a member of the supervisory board. The supervisory board may also be established directly in the articles of association of the company. In a decision by the Landesgerichtshof, Frankfurt of 14.10.1986 - 3/11 T 29/85, reported in (1987) 40 Neue Juristische Wochenschrift 505-506, it was confirmed that it is essential that the members of the supervisory board must be able to rely upon being informed of the actions of other board members. The court held that co-operation between members was, on the facts of the particular case, not possible since one of the members had been appointed from outside (in the particular circumstances, companies had merged and the court confirmed that the newly formed company was entitled to appoint a new supervisory board).

45 Aktg, par 100(1). This section also provides that members of the management board of a subsidiary company may not be appointed to the supervisory board of the holding company. If a member of the management board of one company belongs to the supervisory board of another company, a member of the management board of the latter company may not serve on the supervisory board of the former company. No person may hold more than ten supervisory board appointments.

46 Würdinger German Company Law 49.

47 Aktg, par 127 and par 137.

48 See also page 232 above.
separate. Managerial functions may not be transferred to the supervisory board. However, the statutes of the company or the supervisory board itself may specify that a particular type of transaction may only be carried out with the consent of the supervisory board. Should the supervisory board refuse approval for a particular transaction, the management board may refer the matter to the general meeting. The law also requires certain acts of the management board to be approved by the supervisory board. The validity of the transactions is not affected if such approval is not obtained.

Of particular relevance to the appropriation of corporate opportunities, is the provision that members of the management board may not, without the consent of the supervisory board, conduct any other business undertaking of any nature nor enter into business transactions within the field of the company’s activities on their own account or on behalf of others. The directors are liable to the company for any loss suffered by it as a result of the conclusion of such contracts. Alternatively, the company may elect to regard the transaction as concluded on behalf of the company. The board member must then surrender possession of the asset to the company, hand over any remuneration obtained by him or transfer his claim to any remuneration to the company. The company’s claims become prescribed three months after the other management board members and the members of the supervisory board became aware of the conclusion of the transaction and, in any event, five years after the transaction was concluded. Transactions in breach of this provision by a member of the management board may also provide grounds for his removal from that board by the supervisory board.

49 Aktg, par 105(1). Würdinger German Company Law 49 indicates that in many companies, the supervisory board includes not only the major shareholders, but also representatives of the company’s bank and persons with connections useful to the company. For a comprehensive discussion of bank representatives in the supervisory board, see Lutter “Bankenvertreter” 224ff.

50 Aktg, par 111(4); Goltz “Directors’ Duties” 121.

51 Aktg, par 111(4). According to Würdinger German Company Law 45 this amounts to a preventive form of supervision.

52 Aktg, par 111(4). Approval by the general meeting requires a resolution passed by a majority of three-quarters of the votes cast.

53 See, for example, Aktg, par 202(3) and par 204(1) in respect of the issue of new shares out of an increase of capital which has been approved in advance by a general meeting.

54 Aktg, par 88(1). See, in general, Gessler/Hefermehl Aktiongesetz Kommentar 213ff. See also HGB, pars 112 and 113, which apply to all companies.

55 Aktg, par 88(2).

56 Ibid.

57 Aktg, par 88(3).

58 Oliver Germany 8; Würdinger German Company Law 46.
Decisions by the supervisory board are taken by a simple majority of the votes cast. If a member has a personal interest in a particular matter, he may not vote on it. The supervisory board may appoint committees of its members.

2.2 The Private Limited Liability Company

The private limited liability company (Gesellschaft mit beschrankter Haftung) is a much more flexible and procedurally less demanding form of company than the Aktiengesellschaft. It is an invention of the legislature, created by the Gesellschaft mit beschrankter Haftung Gesetz of 1892, and has no precedent in German or European law. At present it is the most popular type of corporate entity in Germany.

In the public limited liability company, the rights, duties and powers of the company organs are strictly regulated. By contrast, the organisation of the private company is elastic, and considerable freedom is permitted in its constitution. Traditionally, the management of a private limited liability company has a two-tier structure, consisting of the managing director(s) (Geschäftsführer) and...
the shareholder(s) (*Gesamtheit der Gesellschafter*).\textsuperscript{70} If the company has only a few shareholders, they are usually also its managing directors.\textsuperscript{71} The shareholders may provide in the articles for a three-tier structure, which also includes a supervisory board. In certain instances the creation of a supervisory board is mandatory.\textsuperscript{72}

The ability of the shareholders to guide and influence the policy and management of the private limited liability company is considerably stronger and much more direct than is the case in a public company.\textsuperscript{73}

### 2.2.1 Managing Directors

The *Gesellschaft mit beschränkter Haftung* must have one or more managing directors (*Geschäftsführer*).\textsuperscript{74} They form the executive organ\textsuperscript{75} of the company and are responsible for its management and representation, both in and out of court.\textsuperscript{76} Only natural persons, with full legal capacity, are eligible for the position of managing director.\textsuperscript{77} The appointment and removal of managing directors are effected by a shareholder resolution with a simple majority of the votes cast,\textsuperscript{78} unless otherwise

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\textsuperscript{70} *GmbH*-Act, par 45.

\textsuperscript{71} *Wir"{u}rdinger German Company Law* 197.

\textsuperscript{72} See par 2.2.2 below.

\textsuperscript{73} Eisenhardt *Gesellschaftsrecht* 235; Meister/Heidenhain *German Limited Liability Company* 127; Sudhoff *Geschäftsführer einer GmbH 1*. *GmbH*-Act, pars 46-51 confer wide powers on the general meeting. Not only does the power to appoint and remove the managing directors vest in the general meeting by law, but the shareholders can also, in their own discretion, expand or reduce the management. In addition, they may delegate powers from the managing directors to themselves. The general meeting of shareholders can therefore be regarded as the supreme organ of the company: Schmidt *Gesellschaftsrecht* 805. These provisions apply in the absence of special provisions in the articles of association: *GmbH*-Act, par 45(1).

\textsuperscript{74} *GmbH*-Act, par 6(1).

\textsuperscript{75} Sudhoff *Geschäftsführer einer GmbH 1*.

\textsuperscript{76} *GmbH*-Act, par 35(1).

\textsuperscript{77} *GmbH*-Act, par 6(2). The appointment of the managing directors is a corporate act governed by corporate law. As such it must be distinguished from the conclusion of service agreements with the managing directors. These agreements, which may set out additional rights and duties of the managing directors, are primarily governed by the law of contract: Meister/Heidenhain *German Limited Liability Company* 129.

\textsuperscript{78} *GmbH*-Act, par 46(5) and par 47(1).
provided by the articles or one of the co-determination Acts. No qualification shares are required. A managing director cannot at the same time be a member of the supervisory board of the same company, if the company has such a board.

The managing directors perform their services on the basis of service agreements, which may be express or implied. Unless otherwise provided, managing directors represent the company jointly. The statutory management concept is therefore one of joint management of the company by all managing directors. Each managing director is specifically empowered to represent the company alone in respect of the company's receipt of statements of a legal nature. The articles, or a shareholders' resolution, may furthermore, modify the power of representation of individual managing directors. The right of representation, or any extension thereof, must be entered in the commercial register and published in certain publications. Any limitation of the managing directors' statutory authority to represent the company has no effect in respect of third parties. However, a violation of an

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79 The articles may provide that the appointment of managing directors by shareholder resolution requires more than a simple majority, or that one or more of the managing directors are to be appointed by specific shareholders, by a specific group of shareholders, or by the supervisory board if such a board exists: GmbH-Act, par 45(2); Meister/Heidenhain German Limited Liability Company.

80 If a company is subject to parity co-determination or near-parity co-determination under one of the co-determination Acts, one of its managing directors must be a labour director (Arbeitsdirektor). See also note 94 below.

81 GmbH-Act, par 6(3) provides that both shareholders and other persons may be appointed as managing directors.

82 Aktg, par 105; GmbH-Act, par 52(1). Certain other positions are also incompatible with the office of managing director. See, in general, Meister/Heidenhain German Limited Liability Company.

83 Meister/Heidenhain German Limited Liability Company; Sudhoff Geschäftführer einer GmbH. Such agreements are subject to the general rules of contract law and in particular to the rules governing service agreements (Dienstverträge). In this regard, see BGB, pars 611-630.

84 GmbH-Act, par 35(2); Sudhoff Geschäftführer einer GmbH 52ff.

85 Meister/Heidenhain German Limited Liability Company.

86 GmbH-Act, par 35(2).

87 GmbH-Act, par 35(2) permits other arrangements in respect of representation by the managing directors. See also GmbH-Act, par 37(1), which provides that the managing directors have a duty to adhere to restrictions imposed on their power of representation by the articles or by decisions taken by the shareholders.

88 GmbH-Act, par 39(1) and (2).

89 GmbH-Act, par 37(2); Kraft/Kreutz Gesellschaftsrecht 236; Lutter/Hommelhoff GmbH-Gesetz Kommentar 368ff; Schmidt Gesellschaftsrecht 809. The ultra vires doctrine is not recognised in German law. See also page 232 above and page 246 below.
internal limitation constitutes a breach of the service agreement between the managing director and the company. This may lead to a claim by the company against the managing director for damages, or justify his dismissal.\textsuperscript{90} It may also lead to a claim in respect of non-compliance with management duties.\textsuperscript{91}

If the shareholders do not specifically allocate responsibilities to the managing directors, the managing directors themselves can, by unanimous decision, agree to an allocation of responsibilities which deviates from the concept of joint management.\textsuperscript{92} No managing director may, however, be completely released from the joint general responsibility for the well-being of the company.\textsuperscript{93}

2.2.2 The Supervisory Board

In principle, the creation of a supervisory board (\textit{Aufsichtsrat}) is purely optional for the shareholders.\textsuperscript{94} The \textit{GmbH-}Act contains references to a number of provisions of the \textit{Aktiengesetz} concerning the mandatory supervisory board of the \textit{Aktiengesellschaft}.\textsuperscript{95} These provisions, which are discussed under paragraph 2.1.2 above, apply equally to the optional supervisory board of the \textit{Gesellschaft mit bes-

\begin{itemize}
\item \textsuperscript{90} Meister/Heidenhain \textit{German Limited Liability Company} 137. On management's liability in this regard, see also BGH reported in (1984) 37 Neue Juristische Wochenschrift 1461.
\item \textsuperscript{91} \textit{GmbH-}Act, par 43; Kraft/Kreutz \textit{Gesellschaftsrecht} 236. In this regard, see also page 243 below.
\item \textsuperscript{92} Meister/Heidenhain \textit{German Limited Liability Company} 138; Sudhoff \textit{Geschäftsführer einer GmbH} 52ff.
\item \textsuperscript{93} According to Meister/Heidenhain \textit{German Limited Liability Company} 139 any managing director in charge of a special area of responsibility must therefore refer to the other managing directors whatever matters arise in his particular area which have an effect on the overall well-being of the company. Similarly, any managing director may concern himself with matters in an area of responsibility assigned to another managing director, if he believes that the general well-being of the company may be affected by decisions taken in respect of those matters.
\item \textsuperscript{94} Kraft/Kreutz \textit{Gesellschaftsrecht} 234; Lutter/Hommelhof \textit{GmbH-Gesetz Kommentar} 564ff; Meister/Heidenhain \textit{German Limited Liability Company} 146-147; Schmidt \textit{Gesellschaftsrecht} 828-829; Sudhoff \textit{Geschäftsführer einer GmbH} 2, 7. However, it is mandatory if it is required by the Coal and Steel Co-Determination Act (\textit{Montanmitbestimmungsgesetz}) 1951, the Supplementary Coal and Steel Co-Determination Act (\textit{Montanmitbestimmungs-Ergänzungsgesetz}) 1956, the Co-Determination Act (\textit{Mitbestimmungsgesetz}) 1967 or the Labour-Management Relations Act (\textit{Betriebsverfassungsgesetz}) 1952, or if the company is a capital investment company. The Co-determination Acts are aimed at ensuring employee representation on the supervisory board. When the establishment of a supervisory board is required by one of the four Co-determination Acts, the rules by which it is governed, are found in the relevant Act. They are set out partly directly and partly by reference to the Stock Corporation Act (\textit{Aktiengesetz}). References in the Co-determination Acts to provisions of the Stock Corporation Act are mandatory. They take precedence over any conflicting provisions of the \textit{GmbH-}Act, the articles of the company and shareholder resolutions. Because of its specific aims, the mandatory supervisory board is not discussed further. On the theory of co-determination in general, see Conard "Supervision of Management" 148ff.
\item \textsuperscript{95} \textit{GmbH-}Act, par 52.
\end{itemize}
Directors' Fiduciary Duties and Corporate Opportunities

*chränkter Haftung*, unless the shareholders have elected, in the articles, to allocate other rights and responsibilities to that board.96

If the articles do not provide otherwise, the rights and duties of the supervisory board are thus the same as those of the supervisory board of the public limited company. It supervises the managing directors without participating in management activities.

3 DIRECTORS' DUTIES

Directors' duties and responsibilities are based on law,97 on the articles and on any service agreement98 concluded with the company. Should there be conflicting provisions, mandatory provisions of law take precedence over conflicting provisions in the articles and the service agreement. To the extent that provisions of the law are not mandatory, the articles or service agreement may derogate from them.99

Company directors owe a considerable variety of duties and responsibilities, primarily to the company itself, and in limited circumstances to its shareholders, to third parties and to the creditors of the company.100

Primarily, it is the company which is liable to its creditors (*Gesellschaftsgläubigen*).101 The Civil Code provides that any association is liable for any damage which the board, a member of the board, or any other duly appointed representative may, in carrying out his duty, cause a third party, if the Act obliges the making of compensation.102 In addition hereto, the Act provides that a debtor is responsible for the fault of his legal representative and of persons whom he employs in performing his obligation, to the same extent as for his own fault.103 In specific

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96 This they are empowered to do, but it should be noted that if the articles remove the basic responsibility to supervise the management of the company from the board, it ceases to be a supervisory board and becomes a mere advisory body: Meister/Heidenhain *German Limited Liability Company* 153.

97 General provisions in respect of compensation of damages are contained in *BGB*, par 823ff. Paragraph 823 provides that a person who wilfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another is bound to compensate him for any damage arising therefrom (translation by Forrester, Goren & Ilgen *German Civil Code* 134). The Acts on the various types of company also contain specific provisions in this regard.

98 Service agreements are regulated by *BGB*, par 611ff.

99 In respect of the private limited liability company see, generally, Meister/Heidenhain *German Limited Liability Company* 139-140.

100 Sudhoff *Geschäftsführer einer GmbH* 129ff.

101 Sudhoff *Geschäftsführer einer GmbH* 135.

102 *BGB*, par 31 (translation by Forrester, Goren & Ilgen *German Civil Code* 5).

103 *BGB*, par 278 (translation by Forrester, Goren & Ilgen *German Civil Code* 46).
instances, the provisions of section 823\textsuperscript{104} or section 831\textsuperscript{105} of the Civil Code may apply, and the directors may incur direct liability towards creditors. Liability will only arise if a director was aware of the particulars of the transaction which caused the damages.\textsuperscript{106} This knowledge is not presumed.\textsuperscript{107} A direct duty to creditors is thus recognised only in exceptional circumstances.\textsuperscript{108}

Direct management liability towards shareholders of the company too, is only recognised in exceptional circumstances.\textsuperscript{109} These circumstances include the obligation to ensure that the subscribed share capital is contributed to the company and that it is preserved.\textsuperscript{110} The directors must summon the shareholders to make the contributions,\textsuperscript{111} and must convene a shareholders' meeting if half of the share capital has been lost.\textsuperscript{112} In particular, they must ensure that the share capital is not distributed to the shareholders otherwise than by way of a properly declared dividend.\textsuperscript{113} If the director does not comply with these duties, he may become jointly liable with the concerned shareholders to the company for the missing funds, or even towards one or several shareholders.\textsuperscript{114} Managing directors are also liable to the shareholders if they provide them with false information, or if they commit tortious acts.\textsuperscript{115}

Directors' duties are, therefore, owed primarily towards the company. Liability

\begin{enumerate}[\textsuperscript{104}]
\item See note 97 above.
\item This section provides for liability for actions by employees.
\item Scholz/Schneider \textit{Kommentar} 1470ff; Sudhoff \textit{Geschäftsführer einer GmbH} 135.
\item Sudhoff \textit{Geschäftsführer einer GmbH} 135.
\item Campbell \textit{Liability of Corporate Directors} 303; Sudhoff \textit{Geschäftsführer einer GmbH} 135.
\item Campbell \textit{Liability of Corporate Directors} 303; Goltz "Directors' Duties" 122; Sudhoff \textit{Geschäftsführer einer GmbH} 133-134.
\item \textit{Aktg}, par 93(3); \textit{GmbH-Act}, par 9a and 57. These sections also protect creditors and potential creditors, as well as the general interest of the public: Goltz "Directors' Duties" 122.
\item \textit{Aktg}, par 63; \textit{GmbH-Act}, par 19.
\item \textit{Aktg}, par 92; \textit{GmbH-Act}, par 49.
\item \textit{Aktg}, par 93(3); \textit{GmbH-Act}, par 30ff.
\item For example, if he is not able to recover the assets from the privileged recipient and the other shareholders have to compensate the shortfall to the company: Goltz "Directors' Duties" 122.
\item Campbell \textit{Liability of Corporate Directors} 304.
\end{enumerate}
Directors' Fiduciary Duties and Corporate Opportunities

arises mainly from the Civil Code\textsuperscript{116} and the specific company statutes.\textsuperscript{117} A fiduciary relationship is also recognised between a director and his company.\textsuperscript{118}

3.1 Statutory Duties

Certain general provisions of the Civil Code were referred to above. In addition thereto, this Code also prohibits self-dealing (selbstkontrahieren). An agent may not without leave, enter into a legal transaction in the name of his principal with himself in his own name or as agent of a third party, unless the legal transaction consists exclusively in the fulfilment of an obligation.\textsuperscript{119} Contracts concluded in violation of this rule must be ratified by the company, acting through the supervisory board, or, in the case of a private company without a supervisory board, the shareholders' meeting, in order to release the director from liability.\textsuperscript{120} In the latter case, the director concerned may not vote his own shares in favour of ratification.\textsuperscript{121} Other directors may give prior consent to the transaction, provided that it will not be to the detriment of the company, either because the company is no longer interested in the particular transaction, or because it is financially unable to pursue it or because of any other reason.\textsuperscript{122}

The application of this prohibition to the management board of a public company and to the managing directors of a private company previously posed problems where a one-man company was concerned.\textsuperscript{123} The \textit{GmbH}-Act now expressly

\textsuperscript{116} \textit{BGB}, par 276(1) provides that a debtor is responsible, unless it is otherwise provided, for wilful conduct and negligence. A person who does not exercise ordinary care acts negligently. Paragraph 276(2) provides that a debtor may not be released beforehand from responsibility for wilful conduct (translation by Forrester, Goren & Ilgen \textit{German Civil Code} 46). \textit{BGB}, pars 823 (see note 97 above) and 831 (see note 105 above) may also be applicable. In respect of self-dealing transactions, see par 3.1 below.

\textsuperscript{117} See par 3.1 below.

\textsuperscript{118} See par 3.2 below.

\textsuperscript{119} \textit{BGB}, par 181 (translation by Forrester, Goren & Ilgen \textit{German Civil Code} 27).

\textsuperscript{120} \textit{Aktg}, par 97; Falkenhausen & Steefel "Shareholders' Rights" 416.

\textsuperscript{121} \textit{GmbH}-Act, par 47(4) provides that a shareholder who shall be discharged from his responsibilities or released from an obligation by the passing of a resolution has no voting rights herein and shall not exercise such right for others. The same applies to the passing of a resolution concerning the conclusion of a transaction with, or the institution or termination of a law suit against, a shareholder (translation by Meister/Heidenhain \textit{German Limited Liability Company} 287).

\textsuperscript{122} \textit{Scholz Kommentar zum GmbH-Gesetz} 1451.

\textsuperscript{123} Blomeyer "Problematik" 127ff; Boesebeck "In-sich-Geschäfte" 481ff; Lutter/Hommelhoff \textit{GmbH-Gesetz Kommentar} 358-359; Schmidt \textit{Gesellschaftsrecht} 207. The controversy was started by the decision in \textit{BGHZ} 33 189 No 23 that a member of a one-man company can only conclude a contract with himself after amendment of the constitution of the company (at 194). However, in \textit{BGHZ} 56 97 No 16 the court gave a dissenting judgment. It held that the aim of \textit{BGB}, par 181 was to avoid conflicts of interests and that this was not relevant in the case of a one-man company (at 101). The court further held that the single member of a company could conclude contracts between the company and himself by a
provides that it applies to a private company which has only one shareholder, or if all the shares in the company are held by the company and only one other shareholder, if that shareholder is also the managing director of the company.124

Because this situation is dealt with under paragraph 181 of the Civil Code, fiduciary duties are normally not applied in connection with the conclusion of a contract between a director and his own company.125 The prohibition against self-dealing does not arise from fiduciary duties as it does in Anglo-American law, but is a rule of evidence.126 The rule is satisfied whenever the parties to a contract are represented by two different persons.127 The corporation and its shareholders are therefore not accorded the measure of protection apparently promised to them in conflict of interest situations by the existing statutory provisions.128

Both the Aktiengesetz and the GmbH-Act provide for liability of members of the management and supervisory boards to the company.129 In all matters that concern the company, a director must exercise the diligence and care of a prudent and conscientious manager.130 The obligation of diligent management is owed to the simple resolution taken in accordance with GmbH-Act, par 47. The latter case is criticised by Winkler in a note on the reported case in Neue Juristische Wochenschrift (1971) 24 1355, but was followed in BGHZ 75 358 No 48.

124 GmbH-Act, par 35(4).

125 Naudé Maatskappydirekteur 220 and authorities cited. On directors' fiduciary duties, see par 3.2 below.

126 Falkenhausen & Steefel "Shareholders' Rights" 416.

127 According to Falkenhausen & Steefel "Shareholders' Rights" 416 it is immaterial whether one of them is a dummy of the other. Corporate managers may therefore evade the prohibition against self-dealing by appointing a sub-agent to represent their side or that of the corporation.

128 Falkenhausen & Steefel "Shareholders' Rights" 416.

129 Aktg, par 93 contains specific provisions in respect of the members of the management board. Aktg, par 116 provides that s 93 regarding the duty of diligence and the liability of the members of the board of management applies accordingly to the duty of diligence and the liability of members of the supervisory board (translation by Meister/Heidenhain German Limited Liability Company 297). For comprehensive discussions of Aktg, par 93, see Gessler/Hefermehl Aktiengesetz Kommentar Section 1, 269ff; Schmidt Gesellschaftsrecht 621ff. See also Kossen "Haftung" 1790-1791. But Peltzer "Haftung" 349 is of the opinion that, in as far as liability is concerned, the reference to s 93 in s 116 does not mean much, since the two organs have totally different tasks. In respect of the Gesellschaft mit beschränkter Haftung, GmbH-Act, par 43 sets out the liability of managing directors. On this paragraph, see Kion "Haftung" 866ff. GmbH-Act, par 52 provides that the liability of the members of a supervisory board of the private company is the same as that of a member of the supervisory board of a public limited liability company.

130 Aktg, par 93(1); GmbH-Act, par 43(1). On the concept of diligent management, see in general Goltz "Directors' Duties" 122; Sudhoff Geschäftsführer einer GmbH 130.
Directors' Fiduciary Duties and Corporate Opportunities

The test of compliance must be carried out on an objective basis. The test of compliance must be carried out on an objective basis.132

What exactly diligent management entails, is not described in the Acts. Certain duties are specifically mentioned, but they are not exhaustive.133 The general interpretation is that board members should in all circumstances act to the advantage of the company and should avoid anything which might cause it harm.134 This includes the obligation of the director to promote the goal and business interests of the company, not to make or accept improper payments, to devote his entire working capacity in the company's interests, to comply with all legal obligations and requirements and to ensure that the company complies with all applicable rules and laws.135 For example, a director must carefully examine the creditworthiness of a customer and, if doubts arise, abstain from shipping merchandise to the customer without prepayment or simultaneous payment. If he fails to comply with this duty, the director will be liable to the company for the unpaid purchase price.136

The duty to promote the business of the company comprises some prohibitions for the director. He may not appropriate the business opportunities of the company.137 Neither may he compete with the company, or disclose to outsiders trade or business secrets or other confidential information which belongs to the company. These principles are, in the case of public companies, entrenched by specific statutory provisions.

Competition between a director and his company is prohibited.138 In the Aktiengesellschaft, this prohibition (Wettbewerbsverbot) prevents a director to com-

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131 Meister/Heidenhain German Limited Liability Company 140.

132 Goltz 'Directors' Duties" 122. In BGH reported in (1983) 36 Neue Juristische Wochenschrift 1856 the Federal Supreme Court refused to accept the director's excuse that the shareholders had failed diligently to select and carefully to supervise him. The court held that a director who realises that he is not qualified for his office, should resign.

133 Aktg, par 93(3) mentions nine specific instances when a director would be liable in damages. These deal mainly with unauthorised payments to shareholders and management. GmbH-Act, par 43(3) states that the managing directors shall, in particular, be liable for damages if they, contrary to other provisions of the Act, made payments out of the assets of the company which were required for the preservation of the share capital, or acquired the company's own shares. In some instances, for example GmbH-Act, par 79ff, the relevant statutes provide for specific penalties to be imposed in certain circumstances.

134 Gessler/Hefermehl Aktiengesetz Kommentar 274ff; Kossen "Haftung" 1785.

135 Goltz 'Directors' Duties" 122.

136 Ibid.

137 This obligation is recognised as being fiduciary in nature, and is discussed on page 250 below.

138 Aktg, par 93(1); Campbell Liability of Corporate Directors 307. Where a director has competed with his company, HGB, par 75a which enables the principal to waive his right to compensation may apply: Anon "Verzicht auf Wettbewerbsverbot" 936. This general provision is also applicable to company directors, despite the particular relationship which exists between the company and its directors: Judgment of the Bundesgerichtshof of 17.2.1992 - II ZR 140/91 reported in (1992) 45 Der Betrieb 936.
pete with the company, or any branch of it if the permission of the supervisory board has not been obtained.\textsuperscript{139} The board's permission must be in respect of specific transactions.\textsuperscript{140} A director who has contravened the prohibition is liable to the company for damages. According to paragraph 404 of the Aktiengesetz, any such breach leads not only to claims for damages, but constitutes a criminal offence punishable by fine or imprisonment if the secret became known to the director in his capacity as board member. The company may elect not to claim damages, but to regard the competitive activity as having been undertaken on its behalf. Compensation that has been paid to the director may then be claimed, or he may be obliged to assign his right to compensation to the company.\textsuperscript{141} The company's claim in this respect becomes prescribed three months after the other directors and the supervisory board learn of the competitive activity, and, in any event, after five years of its origin.\textsuperscript{142}

Directors have a duty of confidentiality in respect of confidential statements and secrets of the association, especially trade and operational secrets, which have become known to them from their service on the board of management.\textsuperscript{143} Failure to observe this duty gives rise to a claim for damages.\textsuperscript{144} The obligation of secrecy (Schweigepflicht) refers primarily to confidential information which relates to the business conducted by the enterprise. This includes technical information, calculations, sales plans and potential mergers with other undertakings.\textsuperscript{145} It does not include general knowledge, but there need not have been any specific instruction to keep the information confidential.\textsuperscript{146} There is no obligation of secrecy amongst members of the supervisory board.\textsuperscript{147} Unlawful disclosure of confidential information or trade secrets acquired in a person's capacity as a director, may also lead to criminal liability.\textsuperscript{148}

\textsuperscript{139} Aktg, par 88(1). See, in general, Gessler/Hefermehl Aktiengesetz Kommentar 213ff. See also page 242ff above.
\textsuperscript{140} Ibid.
\textsuperscript{141} Aktg, par 88(2).
\textsuperscript{142} Aktg, par 88(3).
\textsuperscript{143} Aktg, par 93(1); Meister/Heidenhain German Limited Liability Company 140.
\textsuperscript{144} Aktg, par 93(2).
\textsuperscript{145} Säcker "Verschwiegenheitspflicht" 804.
\textsuperscript{146} Scholz/Schneider Kommentar 1441. The shareholders may, however, by separate order, instruct the directors to keep information confidential even if this is not required in the general interest of the company.
\textsuperscript{147} Semler "Ausschusse" 66.
\textsuperscript{148} Aktg, par 404(1); GmbH-Act, par 85; Oliver Germany 10; Säcker "Verschwiegenheitspflicht" 805 and 809.
In addition to the obligation of diligent management, the *GmbH*-Act contains specific provisions in respect of the liability of managing directors who have applied for the registration of a share capital increase in the commercial register, and in respect of liability of managing directors for payments made after the insolvency of the company has occurred or after its overindebtedness has been ascertained.

It was pointed out above that the *ultra vires* doctrine is not recognised in German company law, and that the corporation's legal capacity to act is unlimited. Nevertheless, the specification of the kind of business to be carried on by the management board remains of particular importance. Management is obliged by statute to carry on this business and may not enter into unrelated activities or transactions. If the corporation complies with the requirement of an orderly representation by a sufficient number of officers, then directors who enter into business transactions with third parties outside the purpose of the company or in violation of their duty to obtain the prior approval of the shareholders or of a supervisory board, nevertheless bind the company to the third party. Restrictions on a director's internal authority therefore bind the director internally, but do not restrict the company's or the director's capacity to act, nor do they have any effect on third parties. The rule is only set aside where the director has colluded or conspired with the third party to the detriment of the company, or where the third party knew that the director exceeded his authority. Should the transaction result in loss to or damage incurred by the company, the directors may be liable to it for breach of duty.

Special examiners may be appointed by the general meeting of a public company to investigate the activities of the board of management, in order to facilitate proof of the company's losses or of breaches of duty by members of the manage-

149 *GmbH*-Act, par 57(4).

150 *GmbH*-Act, par 64(2). See, in general, Kion "Haftung" 867.

151 See page 232 above. See also Falkenhausen & Steefel "Shareholders' Rights" 409; Goltz "Directors' Duties" 121; Oliver *Germany* 8; Würdinger *German Company Law* 46.

152 Würdinger *German Company Law* 46. Rittner "Unternehmensleitung" 113 confirms that any determination of management's responsibility must necessarily be closely connected to the goals of the company. The concept of the goals or objects of the company (*Unternehmensziele*) is extensively discussed by Raiser "Unternehmensziele" 206ff.

153 This would, however, contravene *Aktg*, par 82(2) and *GmbH*-Act, par 37(2). German law thus draws a sharp distinction between a director's power to represent the company towards third parties and his internal authority to conduct the business of the company: Goltz "Directors' Duties" 121.

154 Goltz "Directors' Duties" 121. It is immaterial whether such restriction be contained in the statutes of the company, or be only prescribed by a shareholders' resolution or by management rules issued by a supervisory board or by the employment contract.

155 Goltz "Directors' Duties" 121.
Minority shareholders who hold a prescribed minimum of the issued share capital, may apply to court for the appointment of special examiners. Certain provisions which are not contained in the company laws also impose liability on company directors. The directors may, for example, be liable in delict. A person who, wilfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another is bound to compensate him for any damage arising therefrom. The same obligation is placed upon a person who infringes a statute intended for the protection of others. If, according to the provisions of the statute, such an infringement is possible even without fault, the duty to make compensation arises only in the event of fault. A person who wilfully causes damage to another in a manner contrary to public policy is also bound to compensate the other for the damage. Specific provision is made in the Civil Code for the liability of persons who exercise a duty of supervision. A person who is bound by law to exercise supervision over a person who needs supervision by reason of minority, or by reason of his mental or physical condition, is bound to make compensation for any damage which the latter unlawfully causes to a third party. The duty to make compensation does not arise if he fulfills his duty of supervision, or if the damage would have occurred notwithstanding the exercise of proper supervision. The same responsibility attaches to a person who undertakes the supervision by contract.

156 Würdinger 48; Aktg, par 142(1).
157 Aktg, par 142(4). In respect of the appointment, duties and liability for the costs of an investigation, see Aktg, pars 143-146.
158 Kossen "Haftung" 1791.
159 BGB, par 823(1) (translation by Forrester, Goren & Ilgen German Civil Code 134). In some instances, delictual liability is provided for by the particular company act. Aktg, par 117, for example, imposes such liability on anyone who uses his influence to cause anyone to act to the detriment of the company.
160 BGB, par 823(2) (translation by Forrester, Goren & Ilgen German Civil Code 135). Examples of such statutory provisions (Schutzgesetze) in the Aktiengesetz are listed by Kossen "Haftung" 1791. They are AktG, pars 92(2), 92(3), 399(1), 400(1), 401(1), 402, 403 and 404.
161 BGB, par 826.
162 BGB, par 832(1) (translation by Forrester, Goren & Ilgen German Civil Code 136).
163 BGB, par 832(2).
3.2 Fiduciary Obligations

The expansive development of English trust law and its far-reaching implications for the fiduciary concept,164 did not occur in Germany.165 A possible explanation is that reliance is placed upon the supervisory board to properly supervise the functioning of management. However, there is agreement that besides such statutory duties as may be prescribed, a fiduciary relationship (Treuverhältnis) exists between the director and his company.166 There are some indications that this relationship will not necessarily exist in the case of a one-man company.167 The members of the supervisory board stand in a similar relationship towards their company.168 The authorities do not always agree on the origin of this relationship. Some indicate that it arises because of the director's appointment as an organ of the company.169 Others regard it as a result of the extended operation of paragraph 242 of the BGB, which imposes an obligation on a debtor to effect performance in accordance with the requirements of good faith, having regard to common usage.170 This obligation is applied in many areas where there is a duty to perform, and is not restricted to debtor/creditor relationships.171 Whatever its origin, there is agreement that the scope of the fiduciary duty now extends beyond the mere application of paragraph 242.172 Other views are that this duty arises from the directive that manage-

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164 In this regard, see chapter 2 above.

165 Eckert "Shareholder and Management" 48ff; Wiedemann Gesellschaftsrecht 413-414. Naudé Maatskappydirekteur 218 regards the uncertainty regarding the question to whom the fiduciary duty applies, as well as the modest role played by it in comparison to English and South African law as conspicuous aspects of the German law. For a comprehensive comparison between German and English law on management liability in general, see Dreymüller Haftung.

166 Gessler/Hefermehl Aktiengesetz Kommentar Section 1, 18; Kion "Haftung" 864; Scholz Kommentar zum GmbH-Gesetz 1442; Sudhoff Geschäftsführer 16, 129; Wiedemann Gesellschaftsrecht 432. This relationship, also at times referred to as a "Treuempflicht" should be distinguished from the duty of good faith which exists between shareholders, and which is not discussed further. The view expressed in 1960 by Eckert "Shareholder and Management" 48 that "it seems that the fiduciary idea is confined to special applications where it has found some expression in the wording of the statute" appears to be outdated.

167 Fleck "Treubruch" 37.

168 The fiduciary duty is expressed in only one statutory provision of the Aktiengesetz. Aktg, par 93, which prohibits the disclosure of confidential information (see note 143 above), applies to members of both the management board and the supervisory board.

169 Schmidt Gesellschaftsrecht 621. Rittner "Unternehmensleitung" 117 states that the responsibility of a company organ is judged by his actions as a fiduciary (Treuhand).

170 Translation by Forrester, Goren & Ilgen German Civil Code 41. See, in general, Erman BGB Handkommentar 450ff.

171 Erman BGB Handkommentar 455; Naudé Maatskappydirekteur 218.

172 Gessler/Hefermehl Aktiengesetz Kommentar 18.
ment must act on its own responsibility, or results from the general "Treuelpflicht" imposed upon members of a company.

Fiduciary duties were not discussed in any detail by the earlier authorities, nor are they specifically mentioned in the statutes. However, modern authorities and court decisions appear to recognise an ever increasing fiduciary liability of company directors. The general approach appears to be to categorise specific duties as they become evident in practice and case law. The fiduciary relationship between the director and his company entails that the director must protect the interests of the company and should refrain from everything that may be to the detriment of the company. Any personal interest which a director may have in an agreement concluded with the company, must be disclosed to the company. A director who pursues his own interests to the prejudice of his company, is liable in damages. A director must also be frank in all matters concerning the company towards members of a supervisory board.

A director's fiduciary obligation also implies that he may not receive any bribes or commission arising from transactions concluded between the company and third parties in connection with the day-to-day activities of the company. Neither may he negotiate any special privileges, for example special tariffs, for himself.

173 In respect of the public limited company, see note 21 above. See also Naudé Maatskappydirekteur 219.

174 This led to the deduction in 1960 by Eckert "Shareholder and Management" 70 that "German corporate law allows at present only partial application of the fiduciary idea."

175 See, for example, Dreher "Wahrung der Interessen" 2586; Gessler/Hefermehl Aktiengesetz Kommentar 18, 143, 150-151, 276ff; Kraft/Kreutz Gesellschaftsrecht 36, 240; Lutter/Krieger Aufsichtsrat 76; Scholz/Schneider Kommentar 1442ff; Schmidt Gesellschaftsrecht 437, 611, 779; Sudhoff Geschäftsführer einer GmbH 16.

176 Scholz/Schneider Kommentar 1442; BGHZ (1967) 49 30 No 6 at 31.

177 Gessler/Hefermehl Aktiengesetz Kommentar 18, 150-151; Kraft/Kreutz Gesellschaftsrecht 36; Scholz/Schneider Kommentar 1446; Schmidt Gesellschaftsrecht 621; BGH Wam (1967) 240 No 116 at 242; BGH Wam (1977) 102 No 30 at 104; BGH Neue Juridische Wochenschrift (1986) 584. Säcker "Verschwiegenheitspflicht" 803 suggests that the obligation of secrecy, although specifically referred to in AktG, par 93(1), is also an integral part of the duty of loyalty owed to the company by a member of the supervisory board. See page 245 above in respect of this paragraph.

178 Scholz/Schneider Kommentar 1449.

179 Scholz/Schneider Kommentar 1448. In respect of liability for breaches of duty, see also par 4 below. On conflicts of interests between a member of a supervisory board and the company, see Ulmer "Interessenkollision" 1603.

180 Gessler/Hefermehl Aktiengesetz Kommentar 18, 151; BGHZ (1956) 20 239 No 40 at 246; BGHZ (1967) 47 341 No 51 at 352.

181 Scholz/Schneider Kommentar 1451-1452.

182 Scholz/Schneider Kommentar 1452.
The fiduciary obligation does not necessarily terminate when the director's term of office expires. Whether the fiduciary obligation has terminated, will depend upon the circumstances. A retired director may, for example, not appropriate an opportunity which arose before his retirement. Since there is no longer a conflict of interests, the director may compete with the company after his term of office has expired. He also has no further obligation to promote the company to the detriment of his own interests. However, his obligation not to disclose confidential information does not end.

Certain aspects of directors' fiduciary obligations have been entrenched by statute in respect of public companies. These include the prohibition against competition between a director and the company on which board he serves, and the duty to respect the confidentiality of certain information. Although not specifically provided for in the Act on private limited companies, there is little doubt that the same prohibitions apply by virtue of the general obligation to act in the interests of the company.

3.2.1 Corporate Opportunities

German company law does not recognise any doctrine of corporate opportunities as is found in American law. However, as fiduciary, the director may not use corporate opportunities (Geschäftschancen) for his own advantage and thereby jeopardise the interests of the company. A corporate "opportunity" refers to a business opportunity which the company might utilise. The abuse of corporate

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183 Gessler/Hefermehl Aktiengesetz Kommentar 151; Lutter/Krieger Aufsichtsrat 85; Scholz/Schneider Kommentar 1446.

184 Scholz/Schneider Kommentar 1448 and 1454; Sudhoff Geschäftsführer einer GmbH 129.

185 Scholz/Schneider Kommentar 1446.

186 Ibid.

187 Lutter/Krieger Aufsichtsrat 85 suggest that although Aktg, par 93 and par 116 may not apply to the retired director, the fiduciary duty continues. See also Gessler/Hefermehl Aktiengesetz Kommentar 279; Scholz/Schneider Kommentar 1454.

188 See page 244ff above.

189 Scholz/Schneider Kommentar 1441ff.

190 Eckert "Shareholder and Management" 57; Falkenhausen & Steefel "Shareholders' Rights" 409.

191 Campbell Liability of Corporate Directors 307; Lutter/Hommelhoff GmbH-Gesetz Kommentar 72-73, 177; Putt "Directors" 254; Scholz/Schneider Kommentar 1449ff; Sudhoff Geschäftsführer einer GmbH 129; BGH reported in 1989 Zeitschrift für Wirtschaftsrecht 986 at 986-987; BGH reported in 1989 Zeitschrift für Wirtschaftsrecht 1390 at 1394.
assets is protected under the general provisions pertaining to care and diligence.\textsuperscript{192} When exactly an opportunity can be defined as a corporate opportunity, is not always clear. It will undoubtedly be one if the company has expressed interest in it, if the company entered into any negotiations regarding the transaction, or if an offer was made to the company in respect of it.\textsuperscript{193} The duty is, however, not restricted to these circumstances. It does not make any difference whether the director learnt about the opportunity in the conduct of business as director of the company, since information gained by him should in any event be utilised for the benefit of the company.\textsuperscript{194} If a company director breaches this fiduciary duty, the company may obtain a restraining interdict, or claim damages.\textsuperscript{195} Alternatively the company may decide not to claim damages, but to claim that the opportunity be deemed to have been concluded on its behalf. The director must then pay any compensation which he may have received to the company, or transfer his right to compensation to it.\textsuperscript{196} An opportunity is not regarded as corporate in nature if it was granted to the director personally, because of a family relationship or particular friendship. In such instances, it is irrelevant whether the particular opportunity fell within the sphere of business of the company and whether the company was in a financial position to pursue it. The director should, however, disclose his interest in the particular opportunity to the company.\textsuperscript{197}

The general meeting may consent to the appropriation of an opportunity by a director for his personal use.\textsuperscript{198} Consent may only be obtained from disinterested directors provided that the company is not prejudiced by it. Lack of prejudice could arise because the company has lost its interest in the opportunity, or because it lacks the financial means to pursue it, or because the prejudice is set off in some other way.\textsuperscript{199}

\textsuperscript{192} See page 243 above. There is, however, no general prohibition against the purchase of corporate property: Falkenhausen & Steefel "Shareholders' Rights" 409.

\textsuperscript{193} Scholz/Schneider \textit{Kommentar} 1450. According to the authors of this work, opportunities in respect of purchase or sale transactions are the most common (at 1449).

\textsuperscript{194} Scholz/Schneider \textit{Kommentar} 1450. The motivation is apparently that the director remains in the company's service at all times during his period of office.

\textsuperscript{195} Scholz/Schneider \textit{Kommentar} 1451. Damages will be claimable under \textit{Aktg}, par 93 and \textit{GmbH}-Act, par 43. See also page 243 above.

\textsuperscript{196} Scholz/Schneider \textit{Kommentar} 1451. This right arises by virtue of \textit{Aktg}, par 88(2) and \textit{HGB}, par 113.

\textsuperscript{197} Scholz/Schneider \textit{Kommentar} 1451.

\textsuperscript{198} Scholz/Schneider \textit{Kommentar} 1451; \textit{GmbH}-Act, par 47(4). See also par 4.1 below.

\textsuperscript{199} Scholz/Schneider \textit{Kommentar} 1451.
4 LIABILITY FOR BREACHES OF DUTY

The sanctions applicable if a director breaches his duties, vary depending upon the nature of the particular obligations, to whom they are owed, and what their source is. A violation of obligations owed to the company may entitle it to compensation for damages and justify the dismissal of the director. A violation of obligations owed to a third party which is imposed by law may also entitle the company to damages or dismissal of the director, since the director is generally responsible to the company to comply with all obligations imposed by law upon the company or upon himself. An interdict may, in appropriate circumstances, also be obtained against defaulting directors.

Directors who commit breaches of their duties, or who manage the company's business without taking due care, are jointly and severally liable to the company in damages. The general meeting may not release directors from this liability. All management board members of a public company thus share the responsibility for the management of its affairs. The chairman, who is elected from among the members of the board, may not take decisions against the wishes of the majority of the board. If a member of the management board usurps the functions of another member, his acts must be repudiated by the other members, otherwise they may also be liable for the loss caused by such member to the company. Similarly, managing directors of a private company who breach their obligations are jointly and severally liable to the company for any resulting damage suffered. However, no

\[\text{200 In certain instances, criminal sanctions may also be applicable. These have not been considered in detail for purposes of this discussion.}\]

\[\text{201 In respect of the duty of diligence and care, discussed on page 243 above, provision is made for compensation for damages in the applicable statutes.}\]

\[\text{202 Meister/Heidenhain German Limited Liability Company 140.}\]

\[\text{203 Scholz/Schneider Kommentar 1444, 1451.}\]

\[\text{204 It is immaterial whether these duties are imposed by law or by statute: Würdinger German Company Law 48.}\]

\[\text{205 AktG, par 93(2), par 116; GmbH-Act par 43(2), par 52. AktG, par 93(2) and GmbH-Act par 52 further provide that, should it be in dispute whether a member of the management board has exercised due care, he carries the burden of proof.}\]

\[\text{206 AktG, par 93(4) provides that the company may only waive any claims for damages or compromise any claims against the board after three years have elapsed from the time when the liability arose. Even after that period a minority, which holds at least ten percent of the issued share capital, may veto a decision by the general meeting. The corresponding GmbH-Act, par 43(4) provides that claims resulting from that paragraph are barred after five years.}\]

\[\text{207 Würdinger German Company Law 44.}\]
liability for damages arises if the conduct of the managing director was approved by a resolution of the shareholders, unless such resolution is illegal.208

The claim for damages in respect of breaches of duty by members of the management board belongs to the company as an entity, and not to the shareholders personally.209 The supervisory board of an Aktiengesellschaft is empowered to litigate in the name of the company to enforce claims for damages against members of the management board for breaches of their duties.210 The GmbH-Act provides that enforcement of a claim for damages by a company against its director(s) must be based on a shareholder's resolution.211 The right to damages must be enforced if so decided by a general meeting, or if so required by a minority of shareholders.212

The statutory provisions in respect of directors' liability do not, by their literal interpretation, extend to a person who has not been appointed as director.213 But the German Federal Supreme Court (Bundesgerichtshof) has extended directors' liability beyond the scope of the actual words of the statute. A person who has not been appointed as director can now be held liable as a de facto director (faktischer Geschäftsführer).214 The present requirement that such a person must have acted personally with respect to third parties means that the concept of a de facto director is not as wide as that of the shadow director under English law.215

208 Meister/Heidenhain German Limited Liability Company 141; GmbH-Act, par 46.
209 Goltz ‘Directors' Duties’ 122.
210 AktG, par 112.
211 GmbH-Act, par 46(8). See also Kraft/Kreutz Gesellschaftsrecht 205, 236; Meister/Heidenhain German Limited Liability Company 141. This provision is also applicable in respect of retired directors: BGHZ 28 355 No 49. No such resolution is required when a creditor of the company causes the company's claim for damages against the managing director to be attached and transferred to him by court order in the course of a forced execution against the company: Meister/Heidenhain German Limited Liability Company 141.
212 In this regard, AktG, par 147 permits a minority holding not less than one-tenth of the stated capital to assert the claims of the company to damages against the members of its managing board or the supervisory board.
213 Weber-Rey & Schneider “Shadow Directors” 438.
214 Liability extends beyond invalid appointments. Mere general agreement by the shareholders with respect to the actions taken by the person on the company's behalf was initially held to be sufficient to establish liability as a director: BGH reported in (1966) 19 Neue Juristische Wochenschrift 2225 at 2225-2226; BGH reported in (1983) 36 Neue Juristische Wochenschrift 240 at 240-241. At present the sole prerequisite for liability is that a person acted in the manner of a director with respect to third parties: BGH reported in (1988) 41 Neue Juristische Wochenschrift 1789 at 1789-1790.
215 See chapter 4, par 2.1 above. According to Weber-Rey & Schneider “Shadow Directors” 439, the development of German case law indicates a broader future application of the principles of liability of the de facto director.
Directors' Fiduciary Duties and Corporate Opportunities

Since a director's duties are owed primarily to the company, the company is entitled to hold the director liable for their breach. The director must accordingly compensate the company for any and all damages which it may suffer as a result of the director's failure to comply with his duties. Consequently the shareholders or creditors cannot, as a general rule, hold the managing director(s) liable for damages ensuing from a breach of legal duties. There are, however, significant exceptions. Creditors of the company may sue board members for damages recoverable by the company in so far as the creditors do not obtain satisfaction of their debts from the company itself. This applies even if the company has waived its claim for damages. The same applies to shareholders of a public company who have suffered damages otherwise than in their capacities as shareholders of the company. A shareholder of a private company may enforce the company's claim for compensation if the majority of the shareholders unreasonably refuse to pursue the claim for compensation against a director who has breached his duties and damaged the company.

4.1 Shareholder Ratification

Shareholders can only ratify directors' acts to the extent that the liability is towards the company or its shareholders. Ratification cannot affect the rights of third parties, nor prevent a criminal prosecution of the director who failed to abide by the law.

The right of the shareholders of a public company to ratify their directors' acts is substantially restricted. Prior approval of specific transactions is not common practice, unless specifically required by the Stock Corporation Act. Ratification of an action after the fact may be granted only three years after the company's claim against the director came into existence. However, such ratification will be deemed to have been rejected if shareholders representing ten per cent of the share capital oppose it.

The GmbH-Act does not contain similar provisions. But the institution of legal proceedings against a director requires prior approval by a shareholders' resolu-

216 See page 241 above.
217 Aktg, par 93(5).
218 Aktg, par 93(4).
219 Goltz "Directors' Duties" 122.
220 Goltz "Directors' Duties" 123.
221 Aktg, par 119(2).
222 Aktg, par 137; Goltz "Directors' Duties" 124.
Consequently, the shareholders should also have the right to resolve, by a shareholders’ resolution, the ratification of any act by a director that amounts to a breach of his duties. The validity of such ratification is not problematic in the event that all shareholders approve it. However, the director may not be able to rely on the ratification if it is not unanimous, or if it is unreasonable. A minority shareholder who opposes the ratification would then be entitled to have the majority resolution set aside by court, or would be entitled to sue the director. Moreover, a creditor of the company who has obtained an enforceable judgment against the company for the payment of a sum of money can obtain an assignment of the company’s claim against the managing director despite a ratification, if the ratification was unreasonable.

The shareholders’ ratification of a breach of duty by directors is thus only effective if all, or practically all, the shareholders agree and if the company remains in a position to continue its business normally.

5 CONCLUSIONS

No comprehensive codification of German company law exists. Company law is therefore found in various sources, including statutes dealing with the specific form of company, provisions in the Civil and Commercial Codes, common law, court decisions and the law concerning related disciplines. Of the various forms of German enterprise, the public and private limited companies most closely resemble the public and private companies recognised under South African law. The comparative investigation undertaken in this chapter therefore centred on these two types of company.

German company law separates the functions of management and supervision. The organ concerned with a particular function depends on the type of company concerned and, in some instances, the preference of the shareholders. Management and supervision of a public company (Aktiengesellschaft) are conducted by management and supervisory boards. In a private company (Gesellschaft mit beschränkter Haftung) these functions are fulfilled by the managing director(s) and gen-

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223 GmbH-Act, par 46(8).
224 Goltz “Directors’ Duties” 124.
225 Ibid.
226 Aktg, par 93(5); GmbH-Act, par 46(3).
227 Goltz “Directors’ Duties” 124.
228 In a private company, for example, the shareholders may provide for a supervisory board in the articles. See page 237 above.
229 See par 2.1 above.
eral meeting of shareholders. In most instances, the existence of a supervisory board is optional.²³⁰

In principle, the duties of directors of the German public and private companies are very similar. The two applicable companies acts have, however, structured and specified their duties differently. Company directors owe a considerable variety of duties and responsibilities, primarily to the company itself, and in limited circumstances to its shareholders, to third parties and to the creditors of the company.²³¹ These duties are based on law, the articles of the company and any service agreements that may exist between the directors and their company. They apply equally to ordinary and to de facto directors.²³² Moreover, supervisory board members have similar duties, and may be liable for a breach of duty should their conduct injure either the shareholders of the company or the company itself.²³³

The most important obligation imposed on directors by the German Civil Code, is the prohibition against self-dealing contained in paragraph 181.²³⁴ Unlike Anglo-American law, this prohibition does not arise from the fiduciary obligation, but is a rule of evidence.

Various duties are also prescribed by the company statutes. Criminal sanctions sometimes serve as additional deterrent. The obligation imposed upon a director to exercise the diligence and care of a prudent and conscientious manager is interpreted widely and implies that board members should in all circumstances act to the advantage of the company and should avoid anything which might cause it harm.²³⁵ Thus a director must promote the goal and business interests of the company, must not make or accept improper payments, should devote his entire working capacity in the interests of the company, comply with all legal obligations and requirements and ensure that the company complies with all applicable rules and laws. He may not compete with the company, or disclose to outsiders trade or business secrets or other confidential information which belongs to the company. These principles are, in the case of public companies, entrenched by specific statutory provisions.²³⁶ Some of these duties overlap with those arising from a director's fiduciary obligations.

It was seen that the ultra vires doctrine is not recognised in German company law. Restrictions on a director's internal authority bind the director internally, but do not restrict the company's or the director's capacity to act, nor do they have any

²³⁰ See par 2.2 above.
²³¹ See page 240 above.
²³² See page 253 above.
²³³ See par 2.1.2 above.
²³⁴ See page 242ff above.
²³⁵ See page 243 above.
²³⁶ See page 244ff above.
effect on third parties. Nonetheless, the specification of a company’s business remains important. A director who concludes a contract with outsiders may incur liability towards the company for a breach of duty if the contract falls beyond the scope of business envisaged by the company.

The concept of directors’ fiduciary duties is not as developed in German company law as it is in Anglo-American law. However, a fiduciary relationship between the company director and his company is generally acknowledged. The scope of the duties that arise from this relationship is undefined. The general approach is to categorise particular fiduciary duties as they become apparent in case law. Generally, it can be stated that a director must protect the interests of the company and should refrain from everything that may be to the detriment of the company. Any personal interest which a director may have in an agreement concluded with the company, must be disclosed to the company. Legislation emphasises the duties not to compete and not to disclose confidential information. Since this matter is dealt with in the Civil Code, the conclusion of contracts between a director and his company is not usually encountered under a discussion of directors’ fiduciary duties.

The investigation revealed that a director’s obligation not to use corporate opportunities for his own benefit is an accepted part of his general fiduciary obligation. However, there is no developed doctrine applicable similar to the American corporate opportunity doctrine. The reason for this appears to be that the statutory provisions which prohibit business ventures within the field of the company’s activities, as well as the general obligation to exercise the diligence of an ordinary and conscientious manager, applied in conjunction with general fiduciary principles, sufficiently provide for this situation.

In conclusion, corporate directors in Germany face a formidable array of statutes that serve to establish their duties and to determine their liability in the event that they should misuse their office. These statutory provisions are, however, not a comprehensive codification of all applicable principles. Effective control over management is achieved by a combination of the statutory regulation and the application of common law principles, such as the fiduciary obligation, by courts of law. The statutory entrenchment of certain obligations facilitates their enforcement,

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237 See pages 232 and 246 above.

238 See page 248 above.

239 See page 244 above.

240 See par 3.2.1 above.

241 See page 244 above.

242 See page 243 above.

243 A situation such as the one which arose in *Regal (Hastings) v Gulliver* (see chapter 4 page 69ff above) would, it is submitted, be satisfactorily resolved by application of these principles.
whilst not limiting directors' liability in respect of only these obligations. Thus the flexibility required to meet the demands of changing circumstances is retained. Should it be considered necessary in South African company law to provide for particular aspects of management by statute, it is suggested that this benefit should be borne in mind.
CHAPTER 8
MODERN PERSPECTIVES

1 INTRODUCTION

In this chapter, the focus is on recent developments which may bring new perspectives to the resolution of corporate opportunity issues.

The first section deals with the European Union, where the proposed European Company and the Draft Fifth Directive are of particular importance. Since a general fiduciary obligation is not recognised by all member states, corporate opportunity matters will have to be decided in accordance with specific statutory measures.\(^1\)

Developments in Australia, Canada and New Zealand are based upon the recognition of a general fiduciary duty owed to a company by every director which serves on its board. Largely because of the influence of the European Union on English law, the recent company law in all three of these countries, which is based on English common law principles, reflects a tendency to deviate from that system. Their company laws have, furthermore, been the subject of recent reform and may contain important guidelines for developments under South African law.\(^2\) The position in these countries is the topic of discussion in the second part of this chapter.\(^3\)

2 DEVELOPMENTS IN THE EUROPEAN UNION

2.1 Introduction

The European Community was established in 1958 with the implementation of the Treaty of Rome. One of its objectives is the promotion of harmonious development of economic policies and of closer relations between the member states, which should be attained by establishing a common market and by progressively harmonising the economic policies of the member states.\(^4\) This entity is, since the Maastricht-Treaty became operative in 1993, known as the European Union.\(^5\)

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\(^1\) See par 2 below.

\(^2\) Du Plessis "Internasionale Ontwikkelings" 562; Fourie "Reform" 770.

\(^3\) See par 3 below.


\(^5\) See De Vos "Europese Gemeenskap" 2 note 4 in respect of the changes in name of this Community.
The Treaty of Rome envisages the freedom to establish a company within the Union, as well as the co-ordination of the protection of members and creditors.\(^6\)

Union law consists essentially of the Treaty, including amending measures, secondary legislation and decisions of the European Court of Justice.\(^7\) The two main types of secondary legislation are Regulations and Directives.\(^8\) Several Directives and Draft Directives have been enacted in respect of company law.\(^9\) The Draft Fifth Directive, which concerns the composition and powers of governing organs, is dis-

\(^6\) The Treaty provides for the abolition as between member states of any obstacles to the freedom of movement for persons, services and capital (art 3(c)), and for the approximation of the laws of member states to the extent required for the proper functioning of the common market (art 3(h)).

\(^7\) See, in general, Gower *Company Law* 55ff.

\(^8\) Article 189 of the Treaty provides that the distinction between these types of legislation lies therein that Regulations apply to member states generally. They are binding and enforceable without any further action by the member states. Directives, on the other hand, are binding only upon those member states to whom they are directed and only as to the results to be achieved. The form and manner of implementation is left to the member states concerned. According to Gower *Company Law* 56 this distinction is, in practice, somewhat misleading. On the role and effect of Directives, see Steiner "EEC Directives" 144.

\(^9\) The harmonisation Council Directives thus far enacted in the field of company law are:

1. First Directive 68/151/EEC concerning the capacity of the company and its directors, and questions of publicity and nullity of the company (see OJ 1968 L65/8 and OJ 1968 Special Ed 41). In respect of this Directive, see also chapter 6 note 40 above.
9. Tenth Directive 89/117/EEC on the obligations of branches established in a member state by credit institutions and financial institutions having their head office outside that member state regarding the publication of annual accounting documents (see OJ 1989 L44/40).
10. Eleventh Directive regarding disclosure requirements in respect of branches opened in a member state by companies governed by the law of another member state (see OJ 1989 L395/36).

In addition to the abovementioned Directives, certain Commission Proposals for harmonising Directives have not yet been enacted by the Council of Ministers. The most important, for present purposes, is the Draft Fifth Directive on the structure of public limited companies and the powers and obligations of their organs (see OJ 1972 C131/49, as amended by OJ 1983 C240/2, OJ 1991 C7/4 and OJ 1991 C321/9). For a comprehensive list of Draft Directives, see Delport "European Community Directives" 203. The Directives are comprehensively discussed by Wooldridge *European Community Company Law* 10ff. On the development of company law in the Union generally, see Werlauff "Community Company Law" 207ff.
discussed below. A draft Statute for the proposed European Company, which contains many of the proposals put forward in the Directives, was also submitted to the Council, after the circulation of a working paper to various interested parties for their comment. The relevant aspects of this Statute are discussed under par 2.3 below.

2.2 The Draft Fifth Directive

The Draft Fifth Directive attempts to regulate the composition and powers of the governing organs of public companies in the European Economic Union. The Draft is essentially concerned with two issues, namely the effective supervision of corporate management and employee involvement in company decision-making. For purposes of this discussion, the first mentioned aspect is the more important.

The original Directive, as proposed by the Commission in 1972, contained two features based exclusively on a two-tier board system, which was mandatory in only two of the member states, namely the Netherlands and Germany. One of these was a two-tier structure of governance consisting of a supervisory council as the upper tier and a lower tier comprising a managing board of executives. It was proposed that the supervisory board exclude executives and be responsible for the selection and removal of executives. The lower tier would consist of a managing board of executives, which would conduct the ordinary business of the company without interference from the supervisory board.

The other feature of the first proposed Fifth Directive, was the representation of employees in the supervisory councils of companies with a specified number of employees. Alternative modes of representation were specified. One of them resembled the position under German law and provided that at least one third of the supervisory council members had to be chosen by employees or employee repre-

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16 Conard "Supervision of Management" 1462; Welch "Fifth Draft Directive" 85-86. On two-tier management under German law, see chapter 7 par 2 above.
sentatives. The other was analogous to certain provisions of Dutch company law.\textsuperscript{17} It provided that the supervisory council would appoint its own members, but that shareholders and employees could veto the appointments by majorities of votes cast in their respective meetings.\textsuperscript{18} Upon joining the European Community in 1973, England thus found itself faced with a radical proposal to impose a uniform management and employee participation structure on public companies throughout the Community.\textsuperscript{19}

After considerable debate and delays in Europe,\textsuperscript{20} a revised Fifth Directive was issued in 1983.\textsuperscript{21} With regard to the supervision of managers, a choice was permitted between the original two-tier structure and a one-tier structure in which a majority of the members would be non-executives.\textsuperscript{22} In respect of the participation of employees in the supervision of large companies, the minimum number of employees was raised from five hundred to one thousand. More choices were offered in respect of the election of representatives.\textsuperscript{23}

The provisions in respect of company organs, the rights and obligations of board members and conflicts of interest do not differ significantly from those contained in the proposed European Company and are discussed under paragraph 2.3 below.

2.3 The European Company

The possibility of a comprehensive company law for the European Union has been under investigation since 1959. This led to proposals by the Commission in

\textsuperscript{17} Conard "Supervision of Management" 1462; Welch "Fifth Draft Directive" 86-87.

\textsuperscript{18} Fifth Directive 1972, art 4(3). Proposals on procedures for informing and consulting employees, particularly in complex undertakings, are contained in the "Vredeling" Directives. In this regard, see OJ 1983 C217/3.

\textsuperscript{19} Welch "Draft Fifth Directive" 83.

\textsuperscript{20} See Welch "Draft Fifth Directive" 83 for reasons why the process was abnormally protracted even by Union standards.

\textsuperscript{21} OJ 1983 C240/2 (hereafter cited as "Fifth Directive 1983").

\textsuperscript{22} Fifth Directive 1983, arts 2(1), 3(1), 21a(1). The Directive attempts to assimilate the position of the non-executive directors in the single board system to that of the members of the supervisory board in the two-tier system: Schmitthoff "Fifth Directive" 457.

\textsuperscript{23} Fifth Directive 1983, arts 4b-d and 21d-f; Conard "Supervision of Management" 1462-1463; Schmitthoff "Fifth Directive" 457. In the two-tier system, one of four models of employee representation was suggested: (1) participation on the supervisory board (not less than one-third and not more than one-half), (2) participation by co-option to the supervisory board, (3) participation through an employees' representative body on company level, or (4) participation by collective agreements adopting a model analogous to one of the first three models. Co-option would not be available in the single board system and, if such a system was elected and the first option mentioned above adopted, employee participation had to be in the group of non-executive directors.

According to the proposal, a European Company will be formed in one of three ways. Companies will be able to merge or to come together to form such a company, which will be their parent company. Alternatively, they may create a joint subsidiary in which any public or private legal entity may participate. The third possibility is for an existing European Company to create another European Company by means of a merger, the creation of a holding company or a joint subsidiary.

Matters covered by the proposed regulation but not mentioned therein are governed by the general principles upon which the proposal is based. If these principles cannot resolve a particular problem, national law governs. The proposals relevant to company directors' duties in respect of corporate opportunities are discussed in more detail below.

2.3.1 *Organs of the European Company*

It is proposed that the statutes of a European Company shall provide for the company to have as its governing bodies the general meeting of shareholders and either a management board and a supervisory board, or an administrative board. Provision is therefore made for either a two-tier system or a one-tier system, at the

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27 Articles 17-37.

28 Article 7(1) provides that matters covered, but not expressly mentioned in the Regulation, shall be governed by the general principles upon which the Regulation is based. If those general principles do not provide a solution to the problem, the law applicable to public limited companies of the state in which the company has its registered office will apply: art 7(2).

29 The European Company is often referred to as the "Societas Europea" or "SE":

30 Article 61. The original proposed Draft Fifth Directive was based upon the German concept of two-tier boards of directors and "co-determination" (par 2.2 above). Later drafts deviate from this concept. All that is required in the 1989 Draft Fifth Directive is that a member state should provide for either one or both of a one-tier or a two-tier system. If it provides for both systems, it may permit each company to choose which to adopt. See, in general, Dine "EC Fifth Directive" 547; Farrar *Company Law* 30-31; Gower *Company Law* 62-63.
choice of the founder companies. The underlying philosophy is set out in the preamble to the proposed Statute. It is acknowledged that both management systems presently exist in the Union. The respective responsibilities of those in charge of management and supervision should be clearly defined. Consideration has also been given to the fact that even in systems which provide for only one administrative organ, a de facto distinction is often made between executive members who manage the business of the company, and non-executive members who confine themselves to supervision.

As was stated above, the two-tier system has been influenced considerably by German company law. It has a management board appointed, supervised and removed by a supervisory board. The supervisory board must receive quarterly reports on the development of the business and is able to call for information on any company matters at any time.

The single-tier system is similar to the French société anonyme and has the advantage of strong collective responsibility amongst the board members. It has an administrative board consisting of at least three members. Non-executive members are to be in the majority and will supervise the executive members, with the same powers to receive quarterly reports and call for other information on the business. Employee representatives may be appointed to the board in the same proportions as to the supervisory board in the two-tier structure.

No person may at the same time be a member of the management board and the supervisory board of the same European Company. However, no limit is imposed on the number of boards on which a member may serve. But his general duties may influence the decision on which boards to serve.

The general meeting is responsible for, inter alia, the appointment and removal of members of the administrative or supervisory boards and the institution of proceedings on the company's behalf for negligence or misconduct by board

31 Rules particular to the two-tier system are contained in arts 62-65, whereas arts 66-67 provide for the one-tier system. Articles 68-80 set out the rules common to both board systems.

32 Preamble to the Fifth Directive 1983. See also note 22 above.

33 "Dual boards" and worker participation have been two of Germany's most important contributions to company law: Conard "Supervision of Management" 1484; Conlon "Draft Fifth Directive" 350; Dine "EC Fifth Directive" 547. See also page 261 above. On management in German company law generally, see chapter 7 par 2 above.

34 Articles 62-64.

35 De Bruycker "European Company" 206. With regard to the management of companies in France generally, see also chapter 6 par 2 above.

36 Article 66.

37 Article 62(3).

38 In this regard, see par 2.3.2 below.
members. In certain instances, neither a shareholder nor his representative at a general meeting may exercise the right to vote attached to his shares or to shares belonging to third persons. This will be the position where the subject matter of the resolution relates to the assertion of claims by the company against that shareholder; if legal proceedings are commenced to establish the shareholder’s liability to the company in accordance with article 78; or if the right to bring proceedings to establish the liability of that shareholder to the company in accordance with article 79 is waived.

2.3.2 Rights and Obligations of Board Members

Each board member of a European Company shall have the same rights and obligations. There is therefore no differentiation in respect of the duties of employee directors. All board members must carry out their functions in the company’s interests, having particular regard to the interests of shareholders and employees.

There is no indication of what standard of care and skill is required of a director. This will accordingly be left to national law. In practice this may be problematic in view of the varying standards expected from directors in member states.

39 Article 81.
40 See page 267 below.
41 See page 269 below.
42 Article 74(1). The article specifically provides that this is without prejudice to any internal allocation of responsibilities between the members of the board, and the provisions of the board’s rules of procedure governing the taking of decisions in the event of a tied vote, and also without prejudice to the provisions concerning the delegation of management responsibilities to executive members.
43 This could imply a serious conflict of interests for employee directors who are, with the other directors, obliged to act in the interests of the company: Dine "EC Fifth Directive" 556; Welch "Fifth Draft Directive" 101. In practice they therefore do not have the absolute freedom enjoyed by members of a works council to negotiate with management on equal terms. It is submitted that this problem affects all nominee directors (see, for example, Gower Company Law 556 in respect of nominee directors in English law), as well as members of the mandatory supervisory board under German law (see chapter 7 par 2.2.2 above). On employee involvement in the European Company, see De Bruycker "European Company" 206ff; Conard "Supervision of Management" 1483ff; Dine "EC Fifth Directive" 55ff. This aspect is foreign to some company law systems, and especially English commentators are sceptical about the wisdom of regulating it to the extent proposed in EEC legislation. See, in general, Dine "EC Fifth Directive" 559, Schmitthoff "Fifth Directive" 457; Welch "Fifth Draft Directive" 100.
44 Article 74(2).
45 See page 263 above.
46 English and South African company law, for example, set a very low standard (see chapter 9 par 3.1.2 below) in comparison to that imposed by German law (see chapter 7 par 3.1 above).
No mention is made of fiduciary duties owed by directors to the company. This is to be expected, in view of the fact that such a fiduciary obligation is not recognised by all member states.47 No separate doctrine of corporate opportunities, which is regarded as a particular aspect of the fiduciary obligation, is therefore acknowledged. Board members' liability for alleged breaches of duty, including wrongful appropriation of corporate opportunities, will be determined with reference to the specific provisions of the proposed Statute, and applicable national law.48 The provisions in respect of disclosure of interest and confidential information are of particular relevance in this regard.

Article 73 provides that any transaction in which a board member has an interest conflicting with the interests of the company shall require the prior authorisation of the supervisory board or the administrative board.49 The statutes may, however, provide that this does not apply to routine transactions. A routine transaction is simply described as having been concluded on normal terms and conditions.50 The corresponding provision in the Draft Fifth Directive requires authorisation of any transaction not within the "normal business" of the company if it is one in which a member of either board has an interest, even if it is only indirectly.51 A board member to whom the above applies, is entitled to be heard before a decision on the authorisation is made, but may not take part in the deliberations of the relevant board when it makes its decision.52 Authorisations given under the article during any financial year must be communicated to the shareholders not later than at the first general meeting following the end of that particular financial year.53 Failure to obtain due authorisation may not be relied upon against third parties, unless the European Company can prove that the third party was aware of the need for, and lack of, such authorisation.54

47 French company law, for example, does not recognise a fiduciary obligation. In this regard, see chapter 6 par 2 above.

48 Article 7. See also page 263 above.

49 Article 73(1). In the case of a single-tier system, this provides less of a safeguard than in the two-tier system, where the authorisation of the supervisory board is required when the interested party is a member of the management organ.

50 Article 73(2).


52 Article 73(3).

53 Article 73(4).

54 Article 73(5). This provision is similar to the position under German law. In this regard, see chapter 7 par 3.1 above. The Draft Fifth Directive contains two alternative drafts for this situation. The first draft provides for this exception, whereas the second draft prevents lack of authorisation being pleaded against third parties in any event (art 10).
In addition, board members are obliged to exercise a proper discretion in respect of information of a confidential nature concerning the company. The duty applies even after they have ceased to hold office. It has been suggested that this duty poses specific problems for employee directors, because it will prevent any regular reporting back without approval by management.

If it is alleged that an opportunity of the European Company has been appropriated, it will have to be determined whether the board member has wrongfully disclosed confidential information. The board member will, in any event, incur liability if he has not obtained the prior authorisation of the supervisory or administrative boards, where his interests and those of the company coincide. The "interests of the European Company" will, accordingly, be an important concept to establish liability. Directors will have to obtain prior approval in respect of any business activity which falls within the sphere of interests of the company.

It is submitted that the requirement of authorisation imposed by article 73, is not in principle different from the requirement that a director must not put himself into a situation where his duties and interests conflict. For example, the directors in Regal (Hastings) Ltd v Gulliver, would, it is submitted, have escaped liability if they had obtained the prior authorisation of the company to the transaction they concluded. Had the same circumstances arisen in a European Company, they would have had to obtain prior approval from the supervisory or the administrative board in terms of article 73. But, if factors such as ratification and the inability of the company to pursue a particular opportunity absolve the director from liability for a breach of fiduciary duty, the application of fiduciary principles might prove to be more flexible. There would then be no liability in terms of the fiduciary obligations

55 Article 74(3) provides that all board members shall exercise a proper discretion in respect of information of a confidential nature concerning the company.

56 Article 74(3).

57 Dine "EC Fifth Directive" 550. Welch "Fifth Draft Directive" suggests that this is likely to breed distrust and criticism of the employee directors on the part of the workforce. The author opines that it can also lead to a frequent turnover of employee directors at elections if they are unable to satisfy their electorate. The same criticism could, it is submitted, be levelled at all nominee directors. See also note 43 above.

58 See page 266 above.

59 This formulation is accepted in Anglo-American law as part of the wider fiduciary obligation between a director and the company he serves and is discussed elsewhere: chapter 4 par 3.2 above, chapter 5 par 3.2.3 above, par 3.3 below and chapter 9 par 3.2.4 below.

60 [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) (see chapter 4 par 3.2.1 above). From the facts it appeared that the directors had taken up and then resold shares in a company because their initial plan to finance a particular transaction on behalf of the company proved unfeasible. Although they applied different tests, their lordships confirmed a director's fundamental duty not to let their own interests conflict with those of the company.

61 Dine "EC Fifth Directive" 549. In respect of these factors, see chapter 4 par 4.8 above, chapter 5 par 4.8 above and chapter 9 pars 4.5 and 4.8 below.
between a director and his company, but he would still be liable for non-disclosure under article 73 of the European Company Statute.62

2.3.3 Liability of Board Members

Article 77 imposes civil liability upon members of the administrative board, the management board or the supervisory board. These members are liable to the company for any damage suffered by the company as a result of wrongful acts committed while carrying out their duties.63 No definition of "wrongful acts" is supplied.64 However, in its amended version, the 1991 proposal no longer mentions fault. It has been suggested that this indicates a preference for a more objective standard of liability.65

Where the board consists of more than one member, the members are jointly and severally liable without any limitation on their liability.66 Where a loss has been established the burden of proof is reversed. The director must then prove that he was without personal fault.67

Proceedings to establish liability may be instituted on behalf of the company by the administrative board or the supervisory board.68 Whether the founders of the company have opted for the one-tier or the two-tier system, it is always the general meeting which decides whether to initiate proceedings against the directors.69 The statutes may not prescribe a majority greater than an absolute majority of the votes attached to the capital represented for such a decision.70 Proceedings on behalf of the company may also be brought by one or more shareholders who together hold

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62 Unless the 'interests of the company' are then considered not to include the particular transaction, the determination of which will have to take place in accordance with article 7 (see page 263 above).

63 Article 77(1). This article provides for more restricted liability than the Fifth Directive, which imposes liability for all damage sustained by the company as a result of breaches of duty by the members in carrying out their functions (art 14).

64 This is left to national legislation: Welch "Fifth Draft Directive" 91.

65 Campbell Liability of Corporate Directors 722.

66 Article 77(2). A member may be relieved from liability if he can prove that no fault is attributable to him personally, but such relief may not be claimed by a member on the sole ground that the act giving rise to liability did not come within the sphere of responsibilities delegated to him.

67 This is similar to the position under German law. See chapter 7 par 3 above.

68 Article 78(1).

69 Campbell Liability of Corporate Directors 733.

70 Article 78(2).
five percent of the company's capital,71 or by any creditor of the European Company who can show that he cannot obtain satisfaction of his claim on the company.72 Minority shareholder claims are, therefore, permissible in certain circumstances. Thus shareholders are afforded more protection than under the English rule in Foss v Harbottle, under which liability may only be enforced by the company.73 Unnecessary and trivial lawsuits will, it is submitted, be avoided by the difficulty of persuading five per cent of the scattered shareholders of a European Company to agree.

The company may waive its right to institute proceedings on the company's behalf in order to establish liability.74 The waiver requires an express resolution of the general meeting taken in the knowledge of the wrongful act which gave rise to damage to the company.75 There does not seem to be any fraud on the minority exception. However, the resolution may not be passed if it is opposed by shareholders whose shareholdings amount to five percent of the capital of the company.76 Consequently shareholders who form a minority of less than five per cent may be severely prejudiced. No proceedings to establish liability may be instituted on behalf of the company more than five years after the act giving rise to the damage.77

It is not clear whether member states will be permitted to enact or retain a provision which would allow a court to excuse a director in respect of negligence, default, breach of duty or breach of trust where the director acted honestly and reasonably and ought fairly to be excused.78

71 Article 78(3). The previous version of the SE-Statute followed the Draft Fifth Directive where the limit is fixed at ten per cent.

72 Article 78(4).

73 Even wrongful actions taken by the managing body may be subject to subsequent approval. The effect of the rule in Foss v Harbottle is somewhat tempered by the attitude of English courts to considerably restrict this right of subsequent approval. See chapter 4 page 3.3.2 above.

74 Article 79(1).

75 Article 79(1). The interested party or parties are apparently not excluded from the decision as in Cook v GC Deeks and Others [1916] 1 AC 554 (PC) (see chapter 4 par 4.8 above).

76 Dine 'European Company' 211.

77 Article 80.

78 Such as s 727 of the English Companies Act 1985 and s 248 of the South African Companies Act 61 of 1973. Under the Draft Fifth Directive exoneration is admitted where the director establishes that no fault is attributable to him: article 77(2). The fact that the act giving rise to the damage does not fall within his field of competence will as such not be sufficient to exonerate him: Campbell Liability of Corporate Directors 722.
The Draft Fifth Directive contains provisions which prevent the authorisation of actions in breach of directors' duties and which forbid ratification.\textsuperscript{79} It has been suggested that these provisions are rigid and will lead to extreme uncertainty.\textsuperscript{80} The proposed Statute does not contain similar provisions. In fact, the provisions of paragraphs (a) and (b) of article 93 that neither a shareholder nor his representative shall exercise the right to vote attached to his shares or to shares which belong to third persons where the subject matter of the resolution relates to the assertion of claims by the company against that shareholder, or to the commencement of legal proceedings to establish the liability of that shareholder to the company in accordance with article 78,\textsuperscript{81} seem to suggest that ratification is possible.

2.4 Conclusions

The Draft Fifth Directive and proposed European Company Statute show considerable German influence. But, since companies are free to keep a single-tier board and involve employees only by providing information and consultation, the implementation of this European Union legislation is unlikely to cause a big upheaval on states with different systems of company law.

The provision that board members must carry out their management functions in the interests of the company\textsuperscript{82} recognises that any "duty" is to the company. The rights of specific interest groups, particularly shareholders and employees, may be indicative of whether the interests of the company have, in the circumstances, been properly served.

The requirement of authorisation by the supervisory board of any transaction in which a member and the company have conflicting interests, is not in principle different from the requirement that a director must not put himself into a situation where his duty and interest are in conflict. But the latter method of dealing with such situations is probably more flexible.\textsuperscript{83}

Actions by minority shareholders of a European Company are permissible in certain circumstances.\textsuperscript{84} This is not reconcilable with the English rule in \textit{Foss v Har-}

\textsuperscript{79} Article 14(4) of the Fifth Directive 1983 provides that the authorisation given by the supervisory organ shall not have the effect of exempting the members of the management organ from civil liability. Furthermore, art 14(5) states that any discharge, instruction or authorisation given by the general meeting shall not have the effect of exempting the members of the management organ or of the supervisory organ from civil liability.

\textsuperscript{80} Dine "EC Fifth Directive" 558.

\textsuperscript{81} See page 262 above.

\textsuperscript{82} Article 74(2). See page 265 above.

\textsuperscript{83} See page 267 above.

\textsuperscript{84} See page 268 above.
bottle.\(^{85}\) It is submitted that unnecessary and trivial lawsuits will probably be avoided by the difficulty of persuading five per cent of the shareholders of a large SE to agree.

It was seen that members of the administrative, supervisory and management boards are liable to the company for any damage sustained by the company as a result of wrongful acts committed in the course of their duties.\(^{86}\) Board members are jointly and severally liable. The precise ambit of "wrongful acts" is uncertain. Liability of board members is not determined with regard to the existence of fiduciary duties between themselves and their company. Accordingly, there is no separate doctrine which determines liability for wrongful appropriation of corporate opportunities. It is submitted that the provisions concerning information of a confidential nature and conflicts of interest will be decisive in this regard.\(^{87}\)

It is uncertain when the Draft Fifth Directive and Proposed Statute for a European Company will be implemented. Indications are that implementation may be a few years away.\(^{88}\) Some commentators doubt whether a European Company is actually needed in practice.\(^{89}\) However, the provisions discussed above indicate how codification, as an option to resolve issues pertaining to corporate opportunities, will probably approach the matter. In addition, they show how principles deriving from different sources, and, at times, differing considerably, can effectively be reconciled.

### 3 DEVELOPMENTS IN SELECTED COMMONWEALTH COUNTRIES

#### 3.1 Introduction

English company law developments have always played an important role in the South African law.\(^{90}\) But of late the English company law has been greatly influenced by events in the European Union and it is expected that the English influence on our company law may decrease.\(^{91}\) In fact, in Australia, New Zealand and Canada, where company law is also based on English law, the influence of the

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85 See page 269 above.
86 See page 268 above.
87 See page 267 above.
88 Campbell *Liability of Corporate Directors* 720.
89 Kolvenbach "Worker Participation" 709; Wehlau "Societas Europea" 502.
90 Cilliers & Benade *Corporate Law* 15-16; Du Plessis "Internasionale Ontwikkelings" 562; Naudé *Maatskappydirekteur* 8-9; *Ex parte NBSA Centre Ltd* (1987) 2 SA 783 (T) at 786E-I; *Ex parte Russlyn Construction (Pty) Ltd* (1987) 1 SA 33 (D) at 35F-36D.
91 Cilliers & Benade *Corporate Law* 16 note 16; Du Plessis "Internasionale Ontwikkelings" 564. In respect of developments in the European Union, see par 2 above.
European Union on that system has been used as motivation to deviate from it. The future development of company law in these countries can therefore be expected to be of increasing comparative value for South African law.

In the following discussion, it is indicated how courts in Australia, Canada and New Zealand have dealt with situations involving the appropriation of corporate opportunities. Selected cases are examined more closely. Since the three systems under discussion share the same basic approach to the issue, they are not discussed separately.

3.2 Company Law in Australia, Canada and New Zealand

Companies and securities legislation has, in recent times, been substantially reviewed and amended in all three the above countries. In Australia new legislation and a new scheme of national corporate regulation came into being on 1 January 1991. Further reforms are expected in the near future. The New Zealand company legislation has also recently been the subject of reform. The New Zealand Companies Act 1993 came into effect on 1 July 1994. The Companies Act 1955 will be repealed on 30 June 1997 in terms of the Companies Act Repeal Act 1993. All companies that are at that time still governed by the 1955 Act will then become

92 Du Plessis "Internasionale Ontwikkelings" 561; Welling Corporate Law 38; Ford Company Law 9.

93 Where appropriate a case reference includes an indication in brackets of the country where it was decided.

94 On the background to the new legislation, see Australia Law Reform Commission "Company Law" 3; Australia Law Reform Commission "Directors" 173; Ford "Legislation" 15. See also Baxt "Reform" 294; Du Plessis "Internasionale Ontwikkelings" 566. The Senate Standing Committee on Legal and Constitutional Affairs Australia Company Directors' Duties - Report on the Social and Fiduciary Duties and Obligations of Company Directors (1989) (hereafter referred to as the "Cooney Report") is of particular relevance. In this regard, see Baxt "Proposals" 139 and 205. An important aspect noted by Du Plessis "Internasionale Ontwikkelings" 567 is that developments in Australian company law were mostly based on preceding investigations, and that, in this respect, the Australian amendments are probably better founded than is the case under English law. On the new companies legislation in Australia generally, see Ford "Legislation" 15ff; Simmonds "Law Reform" 57.

governed by the 1993 Act.®7 Canadian company law has benefited from the influence of both English and American law.®8 The Canada Business Corporations Act®9 is generally regarded as well-drafted and very flexible.®0

The current approach to corporate governance is similar in New Zealand and Canada.®1 The focus in reforms has been on the civil duties of directors and controlling shareholders, as well as investors' remedies. The Australian approach is different, and emphasises bureaucratic enforcement through the criminal law.®2

None of the statutes is comprehensive in the sense that recognised common law principles, originally derived from the English law, are excluded. One of the areas in which these principles remain of paramount importance, relates to the sphere of directors' fiduciary duties.

3.3 Directors' Fiduciary Duties

A fiduciary obligation between company directors and the companies they serve, is recognised under all three legal systems.®3 It is generally recognised that

®7 In order to align the 1955 and 1993 Acts certain provisions of the 1955 Act, notably those pertaining to directors' duties and liquidations, were amended by the Companies Amendment Act 1993. See, in general, Beck New Zealand Company Law and Practice 3-070; Gilbertson "New Zealand Company Law Reform" 86.

®8 Weinrib "Fiduciary Obligation" 3, who, in his discussion of the Canadian experience in dealing with fiduciaries, comments that, for better or worse, the common law jurisdictions of Canada have provided an interesting laboratory for observing how a doctrine originating in the English law of trusts interplays with innovative United States forms of commercial enterprise.

®9 Canada Business Corporations Act, RSC 1985 c C-44 ("CBCA"). Since each of the ten provinces in Canada, as well as the federal Parliament, has legislative power in the area of corporate law, there are eleven different corporate law jurisdictions. The corporate statutes of all the provinces, except British Columbia and Nova Scotia, are very similar to the CBCA. Reference to Canadian law is, unless indicated otherwise, to the law as accepted in the majority of provinces. For an excellent account of the evolution of modern Canadian corporate constitutions, see Welling Corporate Law 37-51.

®10 Beck "Constraints" 152; Dine "European Company" 209.

®11 Campbell Liability of Corporate Directors 542.

®12 Farrar "Harmonisation" 452. This difference in approach is illustrated by the fact that the Australian Corporations Act 1989 consists of one thousand three hundred and sixty two sections, supplemented by the Corporations Legislation Amendment Act 1991. By contrast, the New Zealand Companies Act 1993 comprises only two hundred and eighty five sections.

®13 Campbell Liability of Corporate Directors 16, 117, 547; Welling Corporate Law 381. Tomasic, Jackson & Woellner Corporation Law 370 summarise the fiduciary duty as follows: "The most fundamental implication of the fact that directors owe fiduciary duties is that they must act in good faith for the benefit of the company as a whole. This in turn suggests that they must use powers given to them for proper purposes and avoid actual and potential conflicts of duty and interest. It follows that directors must not make undisclosed gains from their office, or through personal contracts with the company, or compete with the company. Nor can they make improper use of property or confidential information of the company or misuse company funds."
the fiduciary obligation arises in equity and requires that directors should act at all times in the best interests of the company they serve. The obligation may be entrenched by statute. Enforcement of these duties occurs by similar means.

### 3.4 Appropriation of Corporate Opportunities

#### 3.4.1 The Traditional Approach

Commonwealth courts have traditionally applied the general fiduciary principles to determine whether directors are accountable to the company for appropriation of corporate opportunities. Although the decision in *Regal (Hastings) v Gulliver* has been criticised for the inequities and hardship it can cause, the decision has been followed in a number of Commonwealth cases. But courts have shown that they are prepared to interpret the principles expounded in that decision in the light of modern commercial practice and the realities of corporate activity,

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104 See, for example, Ford *Company Law* 446ff (Aust); Gillies *New Company Law* 148 (Aust); Welling *Corporate Law* 378ff (Can). Of the many authorities in case law, mention can be made of *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592 (Aust); *Richard Brady Franks Limited v Price* (1937) 58 CLR 112 per Latham CJ at 135 (Aust); *Mills and Others v Mills and Others* (1938) 60 CLR 150 (Aust); *GE Smith Limited v Smith* [1952] NZLR 471 (NZ); *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371 (Can); *Walker v Wimborne and Others* (1976) 137 CLR 1 at 7 and 15, (1976) 50 ALJR 446 (Aust); *Queensland Mines Ltd v Hudson and Others* (1978) 52 ALJR 399 (PC) at 400 (Aust); *Grove v Flavel* (1986) 11 ACLR 161 at 166 (Aust); Carlson *v Trans-Pac Industries Corp et al* (1989) 43 BLR 192 (Can).

105 In eight of the ten provincial legislatures in Canada, the directors and officers are statutorily obliged to exercise their powers in the best interests of the corporation: Welling *Corporate Law* 437. This is also the case under CBCA, s 122(1)(a). Section 101 of the New Zealand Companies Act 1993 provides that the fundamental duty of every director of a company, when exercising powers or performing duties as a director, is to act in good faith and in a manner that he or she believes on reasonable grounds is in the best interests of the company. The New Zealand Companies Act 1955 did not contain these duties, which consequently had to be gleaned from a large volume of complex case law.

106 In this regard, see generally Beck "Derivative Action" 159 (Can); Cheffins & Dine "Shareholder Remedies" 89 (Can); Diethelm "Impugned Share Allotments" 262 (Aust); Ford *Company Law* 562ff (Aust); Leigh Ffrench "Minority Shareholder Actions" 192 (Aust); Welling *Corporate Law* 455ff (Can).

107 [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL). See chapter 4 par 3.2.4 above.

108 See, for example, *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295 (Can); *GE Smith Limited v Smith* [1952] NZLR 471 (NZ); *Charles Baker Ltd v Charles Baker Sr and Charles Baker Jr* [1954] 3 DLR 432 (Can); *Fine Industrial Commodities Limited v Powling* (1954) LXXI RPC 253 (Eng); *Zwicker v Stanbury* [1953] 2 SCR 438, [1954] 1 DLR 257 (Can); *Midcon Oil & Gas Ltd v New British Dominion Oil Co Ltd* (1958) 12 DLR (2d) 705 (Can); *Boardman and Another v Phipps* [1967] 2 AC 46 (HL) (Eng).
complicated as it is with subsidiaries and associate corporations and interlocking directorates.\textsuperscript{109} It is accepted that directors may not divert to themselves opportunities which properly belong to the company. A corporate opportunity in this sense is an existing business advantage, or an opportunity for which the company is actually negotiating, or for which it could negotiate.\textsuperscript{110} It is regarded as a corporate asset which the directors cannot therefore appropriate to their own use.\textsuperscript{111}

Under this approach, accountability for alleged wrongful appropriation of a business opportunity is based on the rule against the making of undisclosed profits and the prohibition against conflicts of duty and interest.\textsuperscript{112} The fiduciary is accountable for profits derived in breach of these rules, irrespective of whether or not the principal has suffered any injury or loss.\textsuperscript{113} Generally, the fact that this produces a

\textsuperscript{109} LFH "Fiduciary Agents" 78; \textit{Peso-Silver Mines Ltd v Cropper} (1966) 58 DLR (2d) 1 (Can). The need to continually update the equitable obligations of corporate fiduciaries was confirmed by the Canadian Supreme Court in \textit{Canadian Aero Service Ltd v O'Malley} [1974] SCR 592 at 610, (1973) 40 DLR (3d) 371 at 384, where Laskin J stated that the equitable obligations of corporate fiduciaries constitute "a necessary supplement, in the public interest, of statutory regulation and accountability which themselves are, at one and the same time, an acknowledgement of the importance of the corporation in the life of the community and of the need to compel obedience by it and by its promoters, directors and managers to norms of exemplary behaviour." Ziegel "Contributions" 418 regards this aspect of the judgment in \textit{O'Malley} as possibly the most important contribution by the learned judge in the field of Canadian company law. See also Shepherd "Unified Concept" 51-52, who stresses the need for a theoretical framework for fiduciary situations. The author submits that the problem of determining the extent and scope of easily recognisable fiduciary duties has created a maze of rules, none of which are satisfactory, without any central or unifying rationale.

\textsuperscript{110} Borrowdale \textit{Duties} 609 (NZ); Campbell \textit{Liability of Corporate Directors} 117 (Can), 565 (NZ); \textit{Pacifica Shipping Co Ltd v Andersen} (1985) 2 NZCLC 99,306 at 99,312 (NZ); \textit{SSC&B: Lintas New Zealand Ltd v Murphy} (1986) 3 NZCLC 99,546 (NZ).

\textsuperscript{111} Farrar \textit{Company Law} 422. See, however, the warning issued by Welling \textit{Corporate Law} 419-420 (Can) about the dangers of not distinguishing between proprietary claims and actions for fiduciary accounting.

\textsuperscript{112} McLay "Corporate Opportunity" 439 (Aust) submits that these rules have sufficient vitality to deal with cases as they arise without needing to resort to the American corporate opportunity doctrine, or the doctrine of unjust enrichment.

\textsuperscript{113} Austin "Accountability" 175; Fridman "Ratification" 262; \textit{Parker v McKenna} (1874) 10 Ch App 96; \textit{James Brichtnell and Another v The Equity Trustees, Executors and Agency Company Limited and Another} (1929) 42 CLR 384 at 409 (Aust); \textit{Furs Ltd v Tomkies} (1936) 54 CLR 583 at 592 (Aust); \textit{HL Misener & Son Ltd v Misener} (1977) 77 DLR (3d) 428 at 431 per MacKeigan CJNS (Can); \textit{Green and Clara Pty Ltd v Bestobell Industries Pty Ltd} [1982] WAR 1 at 20, (1982) 1 ACLC 1 (Aust). But in \textit{Misener} MacDonald JA expressed his doubts in this regard. The learned judge held that he had been unable to find any reported case wherein a director was found to be in accountable breach of his fiduciary duty when there was no evidence that he had made a profit or benefit, actual or potential, as a result of an alleged conflict between personal interest and his fiduciary duty and where the company was not shown to have suffered any actual or potential loss as a result of the directors' actions. He was, however, in any event of the opinion that, on the circumstances of the case, such an actionable breach of duty had not been established.
windfall gain to the principal is of no consequence to the question of liability.\textsuperscript{114} In \textit{Furs v Tomkies},\textsuperscript{115} for example, the defendant had been the managing director of the plaintiff company. As such, he had been authorised to negotiate for the sale of a part of its business concerned with tanning, dressing and dyeing. The company had secret formulae concerned with these matters. The defendant found a buyer, who was a company to be incorporated. While negotiations were pending the defendant was informed that he would be hired by the new company. The plaintiff's chairman was informed of this by the defendant, who was told to make the best arrangements that he could. He subsequently, but before the sale was completed, contracted with the purchaser to serve the new company and to reveal his knowledge about the industrial processes in question. The defendant was to receive shares in the company as well as a salary. This transaction, which when executed would mean that the plaintiff's formulae were valueless to it, was not disclosed to the plaintiff company. The Australian High Court held that there had been a breach of fiduciary duty, because there had not been a disclosure of the benefits which had been received by the defendant while working as a director of the plaintiff company. He was therefore under a duty to account for these benefits, notwithstanding that the plaintiff company had not suffered any proven loss.\textsuperscript{116}

### 3.4.2 Selected Corporate Opportunity Cases

In \textit{Peso-Silver Mines Ltd v Cropper}\textsuperscript{117} the problems surrounding corporate opportunities were illustrated in the Supreme Court of Canada. This case is of par-

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\textsuperscript{114} Austin "Accountability" 175.
\textsuperscript{115} (1936) 54 CLR 583 (Aust).
\textsuperscript{116} Per Latham CJ at 590.
\textsuperscript{117} \textit{Peso-Silver Mines Ltd v Cropper} (1966) 56 DLR (2d) 117, (1966) 58 DLR (2d) 1, discussed by Beck "Peso Mines" 80; Hahlo "Opportunity" 71; LFH "Fiduciary Agents" 78 and Prentice "Peso" 450. From the facts, it appeared that Peso Silver Mines Ltd (Peso) was incorporated to take over a particular group of silver mining claims held by Tanar Gold Mines Ltd. The defendant, Cropper, was instrumental in incorporating both companies. He was also the managing director of Peso. This company was later converted to a public company and shares were sold to the public. The proceeds were used to finance development of the claims. Subsequent purchase and development of further claims had considerably strained the finances of Peso. When the company was offered further claims (the Dickson claims), the offer was not accepted because of financial problems and also because it was of the opinion that Peso had enough ground under its control. Cropper, together with other persons, then formed a private company (Cross Bow) to take up the offer of the Dickson claims. The Tanar-Peso cycle was repeated and Cross Bow sold its shares to a new private company incorporated by the same group (Mayo Silver Mines). When control of Peso was subsequently acquired by Charter Oil, the president of this company demanded that Cropper and his associates turn over their interests in Cross Bow and Mayo Silver Mines to Peso. Cropper refused. Peso then instituted action against Cropper for an accounting and declaration of trust, and dismissed him as managing director. The company's claim was dismissed because of a finding that all the directors, including the defendant, had acted in good faith toward Peso in rejecting the offer made to the company. The appeal \textit{in casu} was from the affirmation by the British Columbia Court of Appeal of the decision by the trial court (see \textit{Peso-Silver Mines Ltd v Cropper} (1966) 56 DLR (2d) 117). The Supreme Court of Canada unanimously affirmed the decision.
\end{flushleft}
ticular interest because it attempts to resolve a problem left unanswered in *Regal*, namely, whether a director should be held accountable for profits which accrue from the exploitation of a business opportunity specifically rejected by the company.118

Both the decisions of the British Columbia Court of Appeal and the Canadian Supreme Court were reported.119 The decision of the Court of Appeal was based on the existence of two separate grounds for liability. Bull J stated that *Regal* laid down two rules, namely that a fiduciary cannot put himself in a position where his interest and duty conflict and, second, that a fiduciary cannot retain a profit made by reason of his fiduciary position.120 In respect of the conflict principle, the learned judge distinguished *Regal* on the basis that in *Peso* the company no longer had an interest in the property once the board had rejected the offer.121 In *Regal*, the property was wanted, but could not be obtained.122 The interests of the fiduciary were, therefore, in conflict with those to whom the duty of loyalty was owed. In respect of the profit rule, the court found that the judgment of Lord Russell in *Regal*123 required that the particular transaction should be entered into only by reason of the fact that the alleged wrongdoers were directors, and in the course of the execution of their office. This was not the case *in casu*, although the purchase was based on knowledge obtained as directors.124

In his dissent, Norris JA opined that the director should be made to account as he had acquired the information relating to the claims in the course of the execution of his duties as a director. Underlying the legal basis for disagreement was a basic policy disagreement as to the advisability of making the fiduciary principles which regulate the activities of directors more stringent. Furthermore, it was contended on behalf of the defendants that because of the complexity of modern business, modern practice and the modern way of life, the strict rule laid down in *Regal* and other cases should not be applied. Norris JA disagreed. The above-mentioned factors

118 See note 117 above, where it is indicated that the company had refused the offer to purchase further claims because of their financial problems, and also because it was of the opinion that it had enough property under its control.


120 (1956) 56 DLR (2d) at 154. Both these rules have been approved by the Canadian Supreme Court. The conflict rule was approved in *Zwicker v Stanbury* [1953] 2 SCR 438, [1954] 1 DLR 257, and the profit rule in *Midcon Oil & Gas Ltd v New British Dominion Oil Co Ltd* (1958) 12 DLR (2d) 705 at 726-727.

121 *Peso-Silver Mines Ltd v Cropper* (1966) 56 DLR (2d) 117 at 155.

122 [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) at 145-146. As was pointed out in chapter 4 par 3.2.4 above, the court accepted that the directors had acted in good faith and in order to facilitate a transaction for the company which the company was unable to finance from its own sources.

123 See chapter 4 par 3.2.4 above.

124 *Peso-Silver Mines Ltd v Cropper* (1966) 56 DLR (2d) 117 at 157-158.
seemed to his lordship a very good reason why the rule should be enforced strictly. He suggested that:

[i]t is to be remembered, however, that the Regal case is not an ancient decision and indicates a complex state of facts similar to the set of facts on the present appeal. ... [I]t seems to me that the complexities of modern business are a very good reason why the rule should be enforced strictly in order that such complexities may not be used as a smoke screen or shield behind which fraud might be perpetuated.

... The history today of the activities of many corporate bodies has disclosed scandals and loss to the public due to failure of the directors to recognize the requirements of their fiduciary position. No great hardship is imposed on directors by the enforcement of the rule, as a very simple course is available to them which they may follow.

The unanimous judgment of the Canadian Supreme Court dealt only with the profit rule and not with the wider conflict rule. Since there had been a rejection in good faith of the claims by the company, their subsequent purchase by the director was held not to have been in the course of the execution of his office.

Corporate opportunities were extensively discussed in another Canadian case. In Canadian Aero Service Ltd v O'Malley, the Canadian Supreme Court relied not only on a number of American authorities pertaining to the corporate opportunity doctrine, but also on the leading English cases dealing with the content and scope of a fiduciary's duty of loyalty. In O'Malley the plaintiff company offered mapping and geophysical exploration services. Its principal clients were governments who either required the services directly, or sponsored the services for other governments as part of foreign aid programmes. The two defendants had been directors of the plaintiff company and had been involved in carrying out preparatory work for the plaintiff in connection with a project in Guyana. Subsequently the Canadian government invited the plaintiff company and others to submit tenders for this project. At this time, the defendants resigned their offices with the plaintiff company, and formed their own surveying company. This company sought, and was awarded, the contract with the Canadian government. The defendants were held liable to the

125 (1966) 56 DLR (2d) 117 at 139. The course open to the directors is that of obtaining the shareholders' approval to a particular transaction: Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 389 per Lord Russell and at 394 per Lord Wright, [1967] 2 AC 134 (HL).

126 See, however, Prentice "Cooley" 631, where it is submitted that the argument of bona fides should go to the measure of corporate recovery or to the issue of ratification, but has no bearing on the threshold question of whether or not a director has breached his fiduciary duty.

127 [1974] SCR 592, (1973) 40 DLR (3d) 371, discussed by Beck "O'Malley" 771; Prentice "Doctrine" 464; Ziegel "Contributions" 418-419. This case is probably the most important decision in Canadian company law. Its importance is succinctly summarised by Beck "O'Malley" 772-773: "the judgment ... breaks the boundaries of fiduciary duty out of the rigid lines that had been drawn from the judgment ... in Regal (Hastings) v Gulliver, casts a shadow over the Supreme Court's decision in Peso Silver Mines v Cropper, raises doubts about the accepted dicta of the House of Lords in Bell v Lever Bros that a director is free to compete with his company and puts into a hazardous position any person who acts as a director of interlocking firms."
plaintiff company for their loss of the contract. Laskin J warned that the strict approach followed in *Regal* straitjacketed the development of the law in this area. The Canadian Supreme Court was sceptical about the "imprecise ethical standard" which it concluded emerges from American case law and preferred to, with regard to a number of factors, consider whether or not, in the light of all the circumstances, the fiduciary was in breach of his fiduciary duties. The factors to be considered would include the office or position held, the nature of the corporate opportunity, the relationship of the director or officer to it and the amount of knowledge possessed. Also decisive would be the circumstances in which the knowledge was acquired; whether the particular information was special or private; the factor of time in the continuation of fiduciary duty where the alleged breach occurs after termination of the relationship with the company; and the circumstances under which the relationship was terminated, that is whether by retirement or resignation or discharge. It would be fair to say that the decision in *O'Malley* represents a move to something approximating the American corporate opportunity doctrine on the basis of Commonwealth authorities. The test used by the court resembles the "expectancy test" applied in that system, since liability would only arise where the company has developed an interest in or is actively pursuing the particular opportunity.

In another Canadian decision, *Abbey Glen Property Corp v Stumborg*, the court confirmed that the decision in *O'Malley* was the point of departure for any dis-

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128 The strict approach concentrates on the capacity of the profiteers, rather than to engage in any examination of the nature of the opportunity. It entails that the profit or opportunity must have been acquired by reason of the position as director and in the course of the fiduciary relationship. For criticisms of this approach, see Weinrib "Fiduciary Obligation" 1; Beck "O'Malley" 771.

129 *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592 at 612, (1973) 40 DLR (3d) 371 at 385. See also chapter 5 par 6.4.3 above. The leading American cases are discussed in the same chapter.

130 *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592 at 620, (1973) 40 DLR (3d) 371 at 391. Beck "Constraints" 152 regards this as a useful approach. The author does not regard this as an area of the law where a single test is helpful, or even useful, given the nature of the problem. He also contends that the factors set out by Laskin J are not vague or difficult to apply. By contrast, Ziegel "Contributions" 419 criticises the approach of Laskin J on the ground of uncertainty. Austin "Accountability" 165 submits that the approach is no different from the "fairness approach" sometimes used in the United States, and should be rejected for the same reasons. In respect of fairness as a determinant for liability, see also par 3.4.8 below.

131 Austin "Accountability" 159. See, however, Welling *Corporate Law* 407-419 for convincing criticism of a separate corporate opportunity doctrine. In this regard, see further chapter 9 par 4 below.

132 Prentice "Windfall Profits" 216. On the "expectancy test", see chapter 5 par 6.4.1 above.

133 (1976) 65 DLR (3d) 235; (1978) 85 DLR (3d) 35, discussed by Prentice "Windfall Profits" 215. The defendants were directors and shareholders of an investment company with primary activity the investment in real estate in the city of Edmonton, from the time of its incorporation until 1969. By a series of name changes and amalgamations this company became the plaintiff company. The defendants approached another company with the object of entering into a joint venture to acquire and develop land in the vicinity of Edmonton. The latter company indicated that it was unwilling to deal with the defendants' company, and would only deal with the defendants personally. Another company was then set up by the defendants, which company acquired land in the vicinity of Edmonton for development
discussion of corporate opportunities in Canadian law. The liability of the defendants turned on two aspects. The first issue was whether the corporate opportunity doctrine could be applied to the particular facts. The second question which arose was whether, even if the defendants were liable, the court should order them to disgorge their profits considering that there had been a complete change in the composition of the shareholders of the plaintiff company between the time of the breach of duty and the time of the action.

Both the judge at first instance and the Alberta Supreme Court found that liability would only arise where the company had developed an interest in or was actively pursuing the particular business opportunity. This was so in the present case, since the defendants had learnt of the particular opportunity while representing their company in investigating the possibility of acquiring the particular property as a joint venture.

The defendants relied upon the fact that the partner in the joint venture would not have entered into the business arrangement with the plaintiff company. As had been the case in Cooley, this defence failed. The court held that a director could not put himself in a position where he was advancing his own interest at a time when he should have been advancing the interest of the company he directed. McDermid JA deduced the following principles from the decision in O'Malley:

In general:
1. The fiduciary relationship "betokens loyalty, good faith and avoidance of a conflict of duty and self-interest".

In particular:
(a) A person in a fiduciary position "is precluded from obtaining for himself, either secretly without approval of the company (which would have to be properly manifested upon full disclosure of the facts) any property or business advantage either belonging to the company or for which it has been negotiating".
(b) "The general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interest of those whom he is bound to protect" (quotation from Viscount Sankey in Regal (Hastings) Ltd. v Gulliver et al. [1942] 1 All ER 378 at p. 381).

purposes. This transaction formed the principal grounds of the plaintiff company's allegation that the defendants had breached their fiduciary duty.

134 Abbey Glen Property Corp v Stumborg (1976) 65 DLR (3d) 235 at 250.

135 The company of which the defendants had been directors had been taken over in 1969, a few years after the impugned transactions.

136 Abbey Glen Property Corp v Stumborg (1976) 65 DLR (3d) 235 at 259; Abbey Glen Property Corp v Stumborg (1978) 85 DLR (3d) 35 at 60ff. This reflects the requirements of the "expectancy test" under American law (see chapter 5 page 6.4.1 above).


The second defence put forward by the defendants, that the plaintiff company did not have sufficient resources to exploit the opportunity, was not proved. In the third instance, the defendants argued that they had made disclosure. After they had entered into the arrangement with their partner in the joint venture, they informed the plaintiff company's board of directors of this fact. It was argued that despite this disclosure, the plaintiff's directors entered into a management agreement with the defendants. The court held that this did not constitute a valid waiver by a company of its rights against an errant director. The implication is that this type of breach is ratifiable provided full disclosure has been made.

The court also considered whether it should order corporate recovery in view of the fact that none of the shareholders who owned shares in the plaintiff company at the time when the breaches occurred, had remained shareholders. The result would be that present shareholders of the plaintiff company would receive a "windfall" profit by having the value of their shares increased as a result of any moneys recovered. A majority of the Court of Appeal found that the windfall to the new controllers produced by corporate recovery was not a sufficient reason for not ordering the defendants to account. Support for the finding was found in Regal (Hastings) Ltd v Gulliver. In that case Lord Porter indicated:

This [the enhancement in the value of the plaintiff company's shares], it seems, may be an unexpected windfall, but whether it be so or not, the principle that a person occupying a fiduciary relationship shall not make a profit by reason thereof is of such vital importance.

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139 It was accepted that the company's cash position was weak. Nevertheless, it was considered a matter of speculation whether, if the various proposals had been put to the shareholders, they would not have found some way to finance them (Abbey Glen Property Corp v Stumborg (1976) 65 DLR (3d) 235 at 265-266).

140 Abbey Glen Property Corp v Stumborg (1976) 65 DLR (3d) 235 at 279-280. McDonald J also stated that it does not lie within the power of the board of directors to waive the right of the company or its shareholders to complain of a breach of fiduciary duty.

141 Prentice "Windfall Profits" 217. In Hawrelak v City of Edmonton (1975) 54 DLR (3d) 45 Laskin CJC stated that it was so ratifiable. Prentice "Windfall Profits" 217 also argues that there is no policy reason why ratification should not constitute a good defence, provided any dissenting shareholder is given the means to seek redress by way of a suitably drafted minority oppression remedy. On ratification generally, see par 3.4.9 below.

142 McDermid JA delivered a dissenting judgment.

143 (1978) 85 DLR (3d) 35 at 49-52, 63.

144 [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL). See also chapter 4 par 3.2.4 above.

145 [1942] 1 All ER 378 (HL) at 394.
that the possible consequence in the present case is in fact as it is in law an immaterial consideration.146

The decision in O'Malley was also applied, inter alia, in Martin v Columbia Metals Corporation Ltd147 and, in New Zealand, in SSC&B: Lintas New Zealand Ltd v Murphy.148 In an application for an interim injunction in Lintas,149 the plaintiff company relied, inter alia, upon an alleged breach of fiduciary duty by the first defendant based on his failure, as director, to work in the interests of the company and on his wrongful use of confidential information.150 Holland J restated that the defendant, as director, owed the company a fiduciary duty. The court confirmed that, in the absence of any contractual stipulation to that effect, the company had no proprietary right to continued support and patronage by specific customers. However, it did have the benefit of a continuing relationship which placed it in a

146 Accountability for windfall profits has been criticised. See, for example, Austin "Accountability" 175. Turnbull "Doctrine of Corporate Opportunity" 185 suggests that the application of a "market value test" to determine property rights over business opportunities, will allow for identification of windfall gains and a determination whether different legal remedies would unduly restrict competition. This test embraces the interest or expectancy test, the 'line of business' test, the fairness test and the procedure followed in Miller v Miller 222 NW2d 71 (Minn 1974) (in respect of these tests, see chapter 5 page 173ff above). It provides that if an executive appropriates a business opportunity, which had been anticipated as belonging to the company, for private account, and the appropriation affects or could be expected to affect the market value of the firm, then the opportunity is a corporate one.

147 Martin v Columbia Metals Corporation Ltd (1981) 12 BLR 72. The plaintiffs sued in the Ontario Supreme Court for payment of a debenture assigned to them. The defendants alleged that the plaintiffs had acquired the debenture by virtue of their knowledge, as directors, that the defendant was insolvent, and that they were therefore in breach of their fiduciary duty to the company. Parker ACJHC referred to the factors mentioned in O'Malley and found that it was common knowledge that the defendant was insolvent and that the bank was prepared to discount the debenture to anyone prepared to buy it. The court further found that the information had not been acquired by the directors only by reason of their office and that there had been a bona fide rejection by the corporation of the opportunity to purchase the debenture. Under the circumstances, there was no breach of any fiduciary relationship. For other applications of O'Malley in Canadian law, see also The Jiffy People Sales (1966) Ltd et al v Eliason et at (1975) 58 DLR (3d) 439; Weber Feeds Ltd v Weber (1979) 24 OR (2d) 754.

148 (1981-1983) 1 NZCLC 98,384, discussed by Shapira "Corporate Opportunity Doctrine" 496. From the facts it appeared that the creative director of a company (Lintas) that operated as an advertising agency, resigned and immediately set up a competing agency. Seventeen employees of Lintas resigned from that company and joined the competition. Several former customers of Lintas also transferred their advertising business to the new agency, or indicated that they proposed to do so.

149 Historically, the remedy of injunction was peculiar to the Court of Chancery of England. By the Judicature Act 1873 (UK), which became the law of New Zealand, the Supreme Court, now the High Court, was given the jurisdiction to grant an injunction in all cases in which it appeared to the court that such an order would be just or convenient. The court has a wide discretion, but an injunction can only be granted according to legal principles and for the protection of rights or the prevention of injury. The right which is protected must be a legal right, or one created by the rules of equity. This remedy is also available under Australian and Canadian law.

150 The claim against the other defendants was based upon their duties as employees, and is not considered further.
position of advantage over its competitors for as long as that relationship con-
tinued. The defendant had obtained the benefit of that continuing relationship. It
was clear to the court that, had the defendants not previously worked for the
plaintiff and acquired a relationship with the customers in that capacity, they would
not have obtained the business of some of the customers with the speed and ease
which had been established. The personal relationships between the defendant
and the customers were regarded as matters in respect of which the defendant was
accountable to the company to whom he owed a fiduciary obligation. The
termination of the defendant’s office as director did not absolve him from liability.

The decision in *Lintas* shows that patronage of customers and the preliminary
work surrounding it, may be regarded as a corporate opportunity. In *O’Malley* the
corporate opportunity entailed work done in preparation of a specific project by the
officers on behalf of the company. In *Lintas* the concept has been extended to gen-
eral preliminary work to secure continuous patronage and support of established
customers. The importance of the decision further lies therein that it places the
use of confidential information in perspective.

Varying approaches have been favoured in Australia. In *Queensland Mines Ltd
v Hudson* a company had been formed to exploit mining licences. Hudson, the
managing director of the company, was negotiating with the government for the
licences when the company met with severe financial difficulties. Hudson took the
licence in his own name, subsequently resigned as director, and later made con-
siderable profits. The Privy Council held that he was not liable to account to the
company as he had fully discussed the situation and his actions with the company’s
board, who had resolved not to pursue the licences further. The court held that the
issue to be decided was whether the director had acted in a way in which there was a
“real sensible possibility of conflict” between his interests and those of the com-

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152 At 98,392. The court further held that “[i]n order to obtain the business of the customers so
speedily they [the defendants] have used and are using the property of the plaintiff in that continuing
personal relationship and preliminary work ... That relationship and preliminary work was not the
property of the defendants.”

153 In reaching this decision, the court relied upon the decisions in *O’Malley* (see page 278 above)
and *Thomas Marshall (Exporters) Ltd v Guinle* [1979] Ch 227, [1978] 3 All ER 193 (see chapter 4 par
4.6 above).

154 See page 275 above, where it is indicated that a “corporate opportunity” includes an existing busi-
tness advantage.

155 Shapira “Corporate Opportunity Doctrine” 501.

156 At 98,393. This aspect is discussed in par 2.4.3 below.

157 (1978) 52 ALJR 399 (PC) discussed by RB “Queensland” 574 and Sullivan “Queensland Mines”
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Directors' Fiduciary Duties and Corporate Opportunities

pany. Furthermore, it had to be ascertained whether in exploiting for himself the opportunity which had come to his attention while he was managing director, he did so with the informed consent of the company. The first question was answered in the negative, the latter in the affirmative. The facts that the company had declared that it did not have the financial resources to pursue the opportunity, and that the director had never sought to hide anything that he did, were considered important. A stricter rule was applied by the Western Australian Court of Appeal in *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd.* Although the company had not suffered any damages, the fiduciary was held accountable.

3.4.3 Corporate Opportunities and Confidential Information

Liability for usurpation of corporate opportunities is frequently motivated by wrongful use of confidential information. Indeed, these two aspects often overlap.

158 At 401. According to the judgment by their Lordships (delivered by Lord Scarman), the position after the date of the defendant's resignation could be put in either of two ways: (a) It could be said that from that date the venture was beyond the scope of the trust and agency created by the relationship of company and director; or (b) it could be said that on that date the company had given its fully informed consent to the matter not being pursued further, leaving the defendant to do what he wished or could do in his own name in respect of the venture (at 403-404).

159 At 402.

160 [1982] WAR 1, (1982) 1 ACLC 1. The divisional manager (Green) of a company (Bestobell) was a shareholder of another company. The latter company submitted a tender for construction work in competition with Bestobell. Green's company was awarded the contract. Action was instituted against Green for recovery of the profits he had made.

161 From the facts it appeared that Bestobell would not have successfully tendered for the construction work even if Green's company had not tendered. Kennedy J referred to *Parker v McKenna* (1874) 10 Ch App 96; *Furs Ltd v Tomkies* (1936) 54 CLR 583 and *Reading v Attorney-General* [1951] AC 507, [1951] 1 All ER 617 (at 20), and found that, since the rule which prohibits a conflict between a director's own interests and those of the company is prophylactic and not restitutionary, neither damage nor absence of profit need be proved.

162 Burt CJ clearly stated ([1982] WAR 1 at 4) that the obligation to account did not depend upon whether the profit gained by the defendant was a profit which would not otherwise have been obtained. Neither was it to be denied by showing that the plaintiff company had not suffered loss or damage, nor necessary to establish fraud or personal dishonesty. The court relied upon the statement by Gibbs J in *Consul Development Pty Limited v DPC Estates Pty Limited* (1975) 132 CLR 373 at 393, (1975) 5 ALR 231 at 248 that "the rule that a person in a fiduciary position is not entitled to make a profit without the knowledge and assent of the person to whom [the] fiduciary duty is owed is not limited to cases where the profit arises from the use of the fiduciary position or the opportunity or knowledge gained from it. The basis of the rule is that a person in a fiduciary position may not place himself in a situation where his duty and interest conflict". The strict approach followed in *Boardman and Another v Phipps* [1967] 2 AC 46; [1966] 3 All ER 721 (HL); *New Zealand Netherlands Society 'Oranje' Incorporated v Kays and Another* [1973] 1 WLR 1127 (PC) at 1129, [1973] 2 All ER 1222 and *Consul Development*, was favoured by the court (per Wickham J at 10 and Kennedy J at 19).

163 See, in general, Roberts "Corporate Opportunity and Confidential Information" 68ff; Stuckey "Breach of Confidence" 402; New Zealand Companies Act 1993, ss 112-113.
as is illustrated by the New Zealand decision in Pacifica Shipping Co Ltd v Andersen. A shipping company planned to introduce a new ship on a particular route. When it appeared that the preferred ship, Seadrake, was available for charter, the board deferred their decision for a month pending a feasibility study. During this month, one of the directors resigned and incorporated a company which itself chartered Seadrake for use on substantially the same route. The court found that the director had usurped a business opportunity which belonged to the company, had applied the company's property (in the form of information) for his own personal benefit, and had made unauthorised use of confidential information gained from the company without its consent. An injunction was granted, preventing the director from using the information acquired by him in his capacity as director, and from participating in the charter or use of Seadrake in New Zealand coastal waters.

Confidential information includes trade secrets, technical know-how, customer lists, internal financial reports and feasibility studies, and specific information concerning ongoing transactions between the company and its clients. A general prohibition on reliance on "company information" is not feasible, since it would restrict competition unfairly. This information is, in any event, often common knowledge and cannot be regarded as confidential information.


165 For further examples, see CCH Australia Limited Corporations Law Guide 716.

166 Cranleigh Precision Engineering Ltd v Bryant and Another [1965] 1 WLR 1293, [1964] 3 All ER 289.


168 Borrowdale Duties 610. The particular facts will, however, be decisive. In Westminster Chemical NZ Limited v McKinley and Tasman Machinery & Services Limited [1973] 1 NZLR 659 the New Zealand Supreme Court found that a director could not be debarred forever from doing business with the former clients of his company. An injunction was refused in respect of customer names about which it was not shown that the company had any special relationship which would have been unknown to the defendant but for his confidential position. This "special relationship" was the distinguishing feature in Lintas. See page 282 above.


170 SSC&B: Lintas New Zealand Ltd v Murphy (1986) 3 NZCLC 99,546 (NZ).

171 Turnbull "Doctrine of Corporate Opportunity" 188. According to Khan "Fiduciary Obligations and Confidential Information" 99 no special relationship between parties is required for liability to be imposed for wrongful use of confidential information. The plaintiff must establish three basic elements: the information must have the necessary quality of confidence about it, it must have been communicated in such a way that an obligation of confidence arises, and the information must have been used for an unauthorised purpose to the detriment of the plaintiff. On this aspect, see in general Saltman Engineering Co Ltd v Campbell Engineering Co Ltd (1984) [1963] 3 All ER 413n, 65 RPC 203; Speed Steel Products Ltd v Paddington [1986] 1 All ER 91; International Corona Resources Ltd v Lac Minerals Ltd (1987) 44 DLR (4th) 592.
The circumstances are sometimes such that it is difficult to classify the relevant information as "confidential" or as belonging to the company. This was the case in *Lintas*,\(^{172}\) where Holland J found an arguable case of wrongful information. The information, namely knowledge of the customers' advertising requirements, though freely available to advertisers, gave the defendants a head start over other firms competing for the business. It was considered confidential because it had been obtained by the defendant directors while they were employed by the plaintiff company, and was not meant to be used to the disadvantage of the company.\(^{173}\) A further problem which arises is that a principle which limits recovery to benefits derived from office is sometimes inadequate. For example, a director may make personal use of information that could be utilised by the company, but which the director has acquired in a personal capacity rather than by virtue of his position in the company.\(^{174}\) In such an instance, the benefit cannot be regarded as having been derived from the director's office. Yet the director should not, in all circumstances, escape liability for using the information for his personal benefit. These are some of the problematic aspects which have obliged courts to look at alternative approaches to the resolution of corporate opportunity issues.

The approach followed in *O'Malley*\(^ {175}\) does not limit liability to information acquired while acting as a director. According to one commentator,\(^ {176}\) this is realistic, because information that directors and officers receive does not come marked for them in their different capacities. They are men who are engaged in a particular business and they receive information relevant to the business because of that fact. Whether the information is received in their offices, in the boardroom or on the golf course, is immaterial.\(^ {177}\) The corporate opportunity "doctrine", according to this approach, requires that if the company has a present interest in the opportunity, or an expectancy in it,\(^ {178}\) then the fiduciary must present it to the company for consideration prior to exploiting it himself.\(^ {179}\)

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172 See page 282 above.

173 Shapira "Corporate Opportunity Doctrine" 497.

174 This was the situation in *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162 (see chapter 4 par 4.3 above), where it was clear that the opportunity had been offered to the defendant in his private capacity.

175 See page 278 above.

176 Beck 'O'Malley' 782.

177 In this regard, Prentice "Peso" 453 also states that "Information does not come neatly packaged designating the capacity of the recipient."

178 An "expectancy" in this sense denotes an opportunity which the company has begun to look for, or an opportunity in which it has no present interest or expectancy, but in which it might reasonably be expected to be interested given its present line of business.

179 In this regard, see also Prentice "Cooley" 632, who submits that it is "because a company cannot know of information, whether it be confidential or otherwise, unless it is informed of it by its directors, that directors should feel themselves under some compulsion to relay potentially useful information to their companies."
The confidentiality of the information is thus not the important issue in the corporate opportunity context. Even if the specific information is not confidential, the fiduciary obligation requires that the director may not, without the company's consent, disclose or make personal use of it if it was acquired in the course of his office as director. The test is whether the information is valuable to the company which has a vested interest in it. It is the use that is made of the information that comes to a director in his capacity as such that is conclusive, whether it is confidential or not. In *O'Malley* the court confirmed that the fact that breach of confidence may itself afford a ground of relief does not make it a necessary ingredient of a successful claim for breach of fiduciary duty. It may be an element to prove liability on other grounds, for example, in delict. This, it is submitted, is one of the factors which distinguish liability for breaches of fiduciary duty from other forms of liability such as delictual liability.

180 Beck "O'Malley" 779 suggests that the idea that the information that a director makes use of must be confidential to the company for liability to attach is one which has bedeviled the Anglo-Canadian cases. The duty not to disclose confidential information is also not dependent upon the existence of any fiduciary duty: Ford *Company Law* 458. This was confirmed in *International Corona Resources Ltd v Lac Minerals Ltd* (1987) 44 DLR (4th) 592 (Can) where it was recognised (at 638) that "the law regarding obligations imposed by the delivery of confidential information is distinct from the law imposing fiduciary duties and ... does not depend upon any special relationship between the parties."

181 This is one aspect of the rule that directors may not apply company property for their own purposes.

182 Borrowdale *Duties* 610.

183 Beck "Peso Mines" 112. This was also the indication in *Lintas* (see page 282 above), where the court stated: 'The important issue appears to me to be that it is not so much a matter that the information itself is confidential but that the information was acquired in circumstances whereby the recipient of the information is expected to keep it confidential and not to use the information to the detriment of the person or persons conveying the information to him.' (at 98,393). In *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295 (Can) it was clear that the information which the defendant director exploited could have been acquired by him even if he had not held the position of director. The relevant points, however, were that he had obtained the information when actively searching for investment outlets for his company, and had also made use of corporate facilities to evaluate the economic potential of the information.

184 *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371 at 388. See also Beck "Peso Mines" 109-112.

185 See chapter 9 par 3.1 below, where it is argued that liability for breaches of directors' fiduciary duties should not be based on delict.
3.4.4 Corporate Opportunities and Former Directors

It has been suggested that company directors' fiduciary duties may extend past resignation from office. For example, in *O'Malley*, Laskin J held that the breach of duty had survived the defendant's resignation. The precise extent of the continuing fiduciary duties will depend upon the circumstances of each case. In the corporate opportunity context, a director is precluded from diverting a business opportunity where his resignation may fairly be said to have been prompted or influenced by a wish to acquire it for himself. It has also been held that the fiduciary duty will continue where it was the director's position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.

It is submitted that circumstances such as these are not indicative of a duty which continues after the resignation of the fiduciary. Rather, they reflect an instance of liability which is imposed for profits acquired after the fiduciary's resignation, but where the breach of duty actually occurred before that time. Where the fiduciary starts negotiations during his term of office, or specifically resigns to take up an opportunity, the breach of duty has already occurred. But the consequences of that breach are perpetuated or come to fruition after the resignation. This was confirmed by Ormiston J in the Australian decision in *Sali v SPC Ltd and Another*. The court confirmed that the special duties imposed upon directors arise because of the powers directors have in relation to the company's affairs. This special influence ceases upon termination of office. Once that relationship ceases there is no reason to require a former director to account as a fiduciary except in respect of that which he obtained while a director, or in consequence of his acts as a director.

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188 *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592 at 607, (1973) 40 DLR (3d) 371 at 382. On this point the decision is similar to that given in *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162 (see chapter 4, par 4.3 above). This part of the decision in *O'Malley* was applied in England in *Island Export Finance Ltd v Umunna and Another* [1986] BCLC 460 and *Balsdon Limited and Another v Headline Filters Limited and Another* (1990) 17 FSR 385. See also *WJ Christie & Co Ltd v Greer and Sussex Realty & Insurance Agency Ltd* [1981] 4 WWR 34 (Can); *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd* [1982] WAR 1, (1982) 1 ACLC 1 (Aust).


190 Welling "Fiduciary Obligations" 1121.


192 At 1527.
3.4.5 Fiduciary Duties of Non-Directors

In addition to directors, some levels of senior, non-directorate management may also owe fiduciary duties to the company. This was emphasised by Laskin J in O'Malley:194

It follows that ... stood in a fiduciary relationship ... which in its generality betokens loyalty, good faith and avoidance of a conflict of duty and self-interest. Descending from the generality, the fiduciary relationship goes at least this far: a director or a senior officer ... is precluded from obtaining for himself, either secretly or without the approval of the company (which would have to be properly manifested upon full disclosure of the facts), any property or business advantage either belonging to the company or for which it has been negotiating; and especially is this so where the director or officer is a participant in the negotiations on behalf of the company.

The level of responsibility borne by the manager may be indicative of such a duty. In Green and Clara Pty Ltd v Bestobell Industries Pty Ltd196 the fact that different State branches of a company did not operate entirely as separate entities, but co-operated with each other and shared information was considered as a factor which indicated that the branch manager stood in a fiduciary relationship to the company.

The Canada Business Corporations Act entrenches this principle, by prescribing the same fiduciary standard for directors and officers.197

3.4.6 Rejection of the Opportunity by the Company or Inability to Pursue It

There is British authority for the requirement that directors should account for all profits made where corporate opportunities have been appropriated personally. Rejection of the particular opportunity by the company, or inability to

193 Campbell Liability of Corporate Directors 16, 113. Welling Corporate Law 381; Canadian Aero Service Ltd v O'Malley [1974] SCR 592 at 605-606, (1973) 40 DLR (3d) 371 at 381-382 (Can); Consul Development Pty Ltd v DPC Estates Pty Ltd (1975) 132 CLR 373 at 394, (1975) 5 ALR 231 (Aust) per Gibbs J (with reference to irregular appointments); Green and Clara Pty Ltd v Bestobell Industries Pty Ltd [1982] WAR 1, (1982) 1 ACLC 1 (Aust). See, however, Austin "Accountability" 173, where it is submitted that a business opportunity doctrine should not apply to directors who are not employees.


197 Canada Business Corporations Act, s 117; Campbell Liability of Corporate Directors 113.

198 Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL); Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162. See chapter 4 par 4.3 above.
pursue it, has accordingly been considered irrelevant in several Commonwealth cases. This aspect formed the distinguishing feature of the Canadian decision in *Peso-Silver Mines Ltd v Cropper.* The particular opportunity had been offered to the company and was found to have been rejected in good faith before the purchase by the directors occurred. Both the British Columbia Court of Appeal and the Supreme Court of Canada held that subsequent dealing with the property by a director was not by reason of, and in the course of, the execution of his office. The rejection of the opportunity by the company therefore had the consequence of removing the conflict of interest problem. Thus rejection operated in the same way as disclosure does with respect to directors' contracts with the company. This approach has been followed in New Zealand and there are indications that Australian courts may follow suit.

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199 *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592 (Aust); *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL); *Boardman and Another v Phipps* [1967] 2 AC 46; [1966] 3 All ER 721 (HL); *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162; *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 395, (1975) 5 ALR 231 per Gibbs J (Aust); *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd* [1982] WAR 1, (1982) 1 ACLC 1 (Aust).

200 See page 276 above. Many of the cases before *Peso* fairly clearly involved the appropriation of corporate assets or the taking of property by directors in which the company was or would have been interested without first offering it, and making full disclosure, to the company. See, in particular, *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350 (Can); *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC); *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL); *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295 (Can); *Zwicker v Stanbury* [1953] 2 SCR 438, [1954] 1 DLR 257 (Can); *GE Smith Limited v Smith* [1952] NZLR 471 (NZ); *Fine Industrial Commodities Limited v Powling* (1954) LXXI RPC 253 (Can).

201 See note 117 above; Beck "Peso Mines" 95.

202 Hadden, Forbes & Simmonds *Canadian Business Organizations Law* 219; *Peso-Silver Mines Ltd v Cropper* (1966) 56 DLR (2d) 117 at 156 (per Bull JA); *Peso-Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1 at 8 (per Cartwright J).

203 Prentice "Peso" 453, who mentions another possible approach, namely to interpret the rejection as being tantamount to condonation or authorisation of the director's conduct.


205 Ford *Company Law* 462 is of the opinion that the matter might depend on whether the impediment is one which the director could possibly assist to remove. The author (at 464) cites *Kak Loui Chan v Zacharia* (1984) 154 CLR 178, 53 ALR 417 as an indication that there are signs of relaxation in Australian law. In *Chan* Deane J indicated that liability to account might not arise in circumstances where it would be unconscientious to assert or in which there is no possible conflict between personal interest and fiduciary duty ((1984) 154 CLR 178 at 204-205, 53 ALR 417 at 437-438). Not all commentators agree. Austin "Accountability" 180 suggests the development of a business opportunity doctrine in Australian law. The author maintains that the doctrine should not depend on corporate damage or allow corporate inability as a defence, but that windfall gains to the new controllers of a company are not justifiable. The author further opines that liability is not justified where there is only a theoretical risk of harm. Bastin "Secret Profits" 529 maintains that a director who has taken personal advantage of a business opportunity rejected in good faith by the board, should be liable to account for any profit thereby made, unless the general meeting has consented to the making or retention of the profit.
The major criticism of the approach in *Peso* is that it requires a determination by the court as to whether the board's rejection of the opportunity was *bona fide* or not. Furthermore, it has been submitted that the 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 the business opportunity, but also of facilitating its subsequent exploitation by the directors, the very persons who made the decision to reject on behalf of the company. This was the case in *Queensland Mines*, where decisions relating to the mining licenses clearly fell within the managerial competence of the board of directors. The argument is that merely for a board to decide on behalf of a company that a particular venture is unsuitable or non-feasible, does not release it for exploitation by the directors, because the directors' legal management powers are subject to the equitable obligations imposed by their fiduciary role. Should this argument be accepted, it could be maintained that no conflict of interest arises where it would be illegal for the company to exploit the business opportunity. Where there is any other impediment to the company exploiting the business opportunity, such as financial inability, the doctrine of *ultra vires*, or a specific decision to reject the opportunity, a conflict of interest exists.

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206 Farrar *Company Law* 425; Rajak "Managing Director" 658. The courts themselves are sceptical about their ability to make such determinations: *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL) at 392 (per Lord Wright), [1967] 2 AC 134n (HL) at 154. Beck "Peso Mines" 102 is of the opinion that the conclusion by the court on the facts in *Peso* show how wise Equity was in refusing to delve into the *bona fides* of directors' actions. The author contends that once a conflict of interest is found, a finding of prior *bona fide* rejection of the property becomes irrelevant, and Equity's rigid rule that a fiduciary must not use his position to appropriate for himself benefits which he ought to have acquired, if at all, for his principal, should be applied.

207 Prentice "Peso" 454. In *Peso* the rejection was by the board of directors. This criticism will probably fall away if the rejection is by the company in general meeting.

208 *Queensland Mines Ltd v Hudson and Others* (1978) 52 ALJR 399 (PC) (see page 283 above).

209 Sullivan "Queensland Mines" 714. The directors could, therefore, have disposed of the company's interest in the licences to the defendant if they were acting in good faith and at arm's length, and were receiving value.

210 The decisions in cases such as *Boardman and Another v Phipps* [1967] 2 AC 46 (HL) and *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) do not permit fiduciaries to exploit opportunities which have arisen in the course and execution of their office even when those with the requisite authority have turned down the venture on behalf of the principal.

211 According to Sullivan "Queensland Mines" 714 the orthodoxy of *Queensland* is that this principle is overridden by permitting a managerial decision to delineate the scope of a fiduciary obligation.

212 Prentice "Peso" 454, who maintains that "[t]hese hurdles are surmountable and accordingly the director who makes use of the business opportunity in the above circumstances should be made to account in order to guarantee his disinterested advice." In *Abbey Glen Property Corp v Stumborg* (1976) 65 DLR (3d) 235, (1978) 85 DLR (3d) 35 (Can) (see page above), however, the implication was that clearly established commercial inability would provide a sound defence.
Both the issues of corporate damage and corporate inability lead to a fundamental question about the principles which are at the root of fiduciary duties. If the idea of unjust enrichment is paramount, it follows that corporate damage should be an ingredient of liability and corporate inability a defence. The reason is that in neither case will the director's enrichment have been at the expense of the company in any significant sense. If the primary concern is to set a strict prophylactic standard, it has been suggested that the general approach by the Commonwealth authorities is correct. The justification of this argument is that questions of risk of improper advantage and difficulty of factual determination sweep aside the issue of honesty on the facts, concentrating instead on the potential for dishonesty created by the fiduciary's situation. For this reason, the courts are right in principle when they insist that it is immaterial that the fiduciary was honest.

3.4.7 Competing Ventures

There is no general principle prohibiting a director being a director in another company which conducts a similar business, unless the articles of association expressly provide otherwise. The dangers of the director using confidential information acquired in his capacity as director to assist him in the competing business are, nonetheless, regarded as considerable. In the case of an executive direc-

213 Jones "Unjust Enrichment" 472 suggests that this is the case where the fiduciary has acted with proven dishonesty or has otherwise manifestly acted contrary to his principal's interests.

214 Austin "Accountability" 176.

215 Austin "Accountability" 180.

216 Austin "Accountability" 179.

217 Ford Company Law 466; Aubanel & Alabaster Ltd v Aubanel (1949) 66 RPC 343 at 346 per Danckwerts J; Trounce and Wakefield v NCF Kaiapoi Ltd (1986) 2 NZCLC 99,422 (NZ); On the Street Pty Ltd v Cott (1990) 3 ACSR 54 at 61 (Can). See also Riteway Express Pty Ltd v Clayton and Others (1987) 10 NSWR 238 (Aust), discussed by Pascoe 'Director's Right to Compete' 205. The defendant, by agreement with the plaintiff, formed a company which was in effect the incorporation of the plaintiff's sales department. The defendant remained a director of the plaintiff. When the agreement between the parties was terminated following disputes between them, the plaintiff applied for an interlocutory injunction preventing the disclosure of confidential information relating to the plaintiff's business operations. McLelland J confirmed that the duties of a director (albeit a non-executive director) fall to be determined by no less an onerous standard than that applicable to former employees (at 241). The closeness of connection between the two companies was a factor taken into consideration by the court.

218 Smith Directors' Rights and Responsibilities 60-61; Abbey Glen Property Corp v Stumborg (1976) 65 DLR (3d) 235 at 278 per McDonald J (Can); London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd (1891) WN 165; Berlei Hestia (NZ) Ltd v Femylough [1891] WN 165; Trounce and Wakefield v NCF Kaiapoi Ltd (1986) 2 NZCLC 99,422 (NZ); Riteway Express Pty Ltd v Clayton and Others (1987) 10 NSWR 238 at 240-241 per McLelland J (Aust); ZBB (Australia) Ltd v Allen (1991) 4 ACSR 495 (Aust). For comprehensive discussions of multiple directorships, see Boros "Nominee and Multiple Directors II"; McLay 440ff; Thomson "Nominee and Multiple Directors" 161. See also chapter 9 par 2.2 below.
tor such as a managing director it may be that, even in the absence of an express
term in any employment contract requiring the director to serve the company exclu­
sively, some such term would be implied.219

The Cooney Committee did not recommend any changes to the Australian law
in this respect.220 It considered it not useful for the law to set limits on the number of
directorships a person may hold.221 However, the commissioners suggested that the
law should clearly set down the required standards of conduct. Directors should
then judge for themselves whether their commitments allow them to meet the
standards.222

There is also no general prohibition against competition between a director
and his company.223 But, in many instances, the director may find himself in breach
of his fiduciary duty concerning a conflict of interests. In particular, such a breach
may occur where the director encounters an opportunity for profit-making during
his directorship, which is then exploited by starting another, independent, busi­
ness.224 Solicitation of the company's customers is not permissible.225 The situation
of the particular director may also be relevant.226 In the event of breach of a specific
contractual stipulation,227 the usual contractual remedies, such as damages or an
injunction, will be attracted.

219 Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162; Thomas
Marshall (Exporters) Ltd v Guinle [1979] Ch 227, [1978] 3 All ER 193; On the Street Pty Ltd v Cott
(1990) 3 ACSR 54 at 61 (Aust).

220 Cooney Report, par 4.40-4.49. Section 231(6) of the Australian Corporations Act 1989 already
provides for disclosure of any conflicts of interest which the director may experience.

221 In fact, the Committee was of the opinion that the wide differences in the capacity of directors and
in the work required to direct different companies, make it pointless to do so (Cooney Report par 4.49).

222 Cooney Report par 4.49.

223 Ford Company Law 460.

224 The circumstances of each case will determine whether a breach of duty has occurred or not: Gil­
lies New Company Law 175; Cook v GC Deeks and Others [1916] 1 AC 554 (PC) (breach did occur);
Peso-Silver Mines Ltd v Cropper (1966) 56 DLR (2d) 117 (Can) (no breach); The Jiffy People Sales
(1966) Ltd v Eliason (1975) 58 DLR (3d) 439 (Can) (breach did occur); Queensland Mines Ltd v Hudson
(1978) 52 ALJR 399 (PC) (Aust) (no breach).


that a director actively involved in the day to day running of the business may be in a different position
from a director who does no more than attend board meetings. It may also be that the position differs
where the company is not, as was the position in casu, in substance an incorporated partnership.

227 For example, one which prohibits the director's involvement in another business venture, irrespec­
tive of whether it is a rival one, without the consent of the company, as in Thomas Marshall (Exporters)
Ltd v Guinle [1979] Ch 227, [1978] 3 All ER 193 (see chapter 4 par 4.6 above).
3.4.8 Fairness as Determinant for Liability

Traditionally, if a court finds a real possibility of conflict, or a director has made use of his position in a particular transaction, fairness to the company will not be examined.\(^{228}\) There are two reasons for this strict view. First, once there is a possibility of conflict of interest and duty, the director's duty is considered to be to avoid any personal involvement, and not merely to avoid taking advantage of the company. The director is under a duty not to disable himself from making impartial decisions for the benefit of the company. A second reason is that courts are hesitant to become involved in assessing whether the fiduciary has not taken advantage of the company.\(^{229}\)

Many American jurisdictions no longer hold this view.\(^{230}\) In some decisions interested directors are considered to have fulfilled their duty to the company if there was full disclosure to disinterested directors who authorised the transaction and the transaction is fair to the company. In the determination of fairness, factors such as the degree of pressure exerted on the disinterested directors, how the transaction was initiated, and any objective indicators of fairness of price are considered.\(^{231}\)

In some instances, Australian and New Zealand courts have taken cognisance of the tension between the strict equitable principle against extraneous loyalty and commercial practicality. For example, nominee directors have been permitted to consider the interests of a person outside the company, provided the director believed in good faith that those interests were compatible with the company's interests.\(^{232}\) Dual loyalty is therefore sometimes allowed. But it seems that in instances where it is difficult to know whether there has been actual impropriety, the potentiality of conflict of duties will be sufficient to establish liability.\(^{233}\)

In Canada, there has also been a shift towards the fairness approach. Buckley suggests that the effect of the decision in \textit{O'Malley} is that Canadian courts will be

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\(^{228}\) Ford \textit{Company Law} 464; \textit{Regal (Hastings) Ltd v Gulliver} [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL); \textit{Furs Ltd v Tomkies} (1936) 54 CLR 583. In \textit{Parker v McKenna} (1874) 10 Ch App 96 James LJ stated that the rule that no agent can be allowed to keep secret profits was inflexible and should be applied inexorably by the court (at 124-125).

\(^{229}\) Ford \textit{Company Law} 465.

\(^{230}\) Marsh "Trustees" 43ff.

\(^{231}\) See chapter 5 par 6.4.3 above.


\(^{233}\) Ford \textit{Company Law} 425. At 466 the author comments, in respect of Australian law, that the courts do allow the merits of the particular transaction to be considered and even go so far as not to review an apparently honest assessment of the merits by the director.
more willing to consider general standards of loyalty and good faith to the exclusion of rigid measures and literal terms. The opinion to the contrary, expressed in Australia, is that a "fairness approach" may lead to uncertainty. A test of fairness may, in any event, arise when the court is requested to exercise its statutory discretion to excuse a breach. It is submitted that, in practice, this has not caused too many problems in respect of legal uncertainty.

3.4.9 Ratification and Authorisation in Advance

The question as to what extent a company may relieve a director of breaches of duty he may have committed, or may commit in the future, has been the topic of considerable debate. In the opinion of some commentators, there is little distinction in principle between directors rejecting an opportunity and directors approving the taking of the opportunity ex post facto.

In Canada, the matter is regulated by statute. Eight of the ten provincial legislatures permit any shareholder (mostly referred to as "complainant") to bring an action on behalf of the corporation to seek judicial intervention whenever the Act or the corporate constitution is violated. Majority shareholder "ratification" is not a

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234 Buckley "Ratification" 201. The author's expectation is that "the judicial leitmotif, whether articulated or not, will be increasingly one of fairness". This does not imply laxity, because regard will still be had to the pervasiveness of a strict ethic in this area of the law. In particular cases, the new duty may in fact prove more exacting than the old rules: Buckley "Ratification" 202.

235 Austin "Accountability" 161. The author advances two other points to support preference for an expanded "line of business" test over the fairness approach. First, he submits that the fairness approach makes too many factors, such as the riskiness of the development of the opportunity, the amount of personal effort required of the director, and the extent to which he has committed his own financial resources to the project, relevant to the evaluation. These factors should probably be considered when determining the remedy, but should not necessarily be ingredients to be used in establishing liability. In the second instance, the fairness approach fails to set a standard of behaviour. It is interesting to note that in respect of self-interested transactions, a fairness-test has been introduced in both Canada and New Zealand: New Zealand Companies Act 1993, s 112; Ontario Business Corporations Act s 132(7).

236 Ford Company Law 466. Statutes which provide for relief from liability if a director or officer can prove that, with regard to all relevant circumstances, he has acted honestly, may therefore alter the outcome of corporate opportunity cases: Smith Directors' Rights and Responsibilities 56 (in respect of s 1318 of the Australian Corporations Act).

237 See, for example, Baxt "Ratification" 16; Beck "Derivative Action" 198ff; Buckley "Ratification" 167; Mason "Ratification" 161; Prentice "Jurisdiction" 587. See also chapter 9 par 4.8 below.

238 Fridman "Ratification" 264. See, however, Austin "Accountability" 183, who regards this as a potentially sensible and perhaps even a necessary distinction. The decision to reject is a business decision for the directors, whereas the decision to authorise or ratify might be regarded as a decision to waive rights, more appropriately to be vested in the shareholders who would be the indirect beneficiaries of the exercise of those rights. The author warns of the risk that this distinction may become frozen into a rigid rule productive of further anomalies.

239 See, for example, CBCA, s 395.
sufficient reason to deny the shareholder's claim. In fact, some statutes specifically note the possibility of majority shareholder approval, and determine that such majority votes are not to be taken as determinative of the issues before the court. This is confirmed in case law.

In most Canadian jurisdictions, therefore, majority shareholder approval of a breach of managerial obligations cannot be taken as corporate "ratification" of the breach. It has been suggested that Canadian judges should follow the spirit of statutory reform in other instances than only statutory representative actions, recognise that the Judicial Committee's reasoning in *North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty* was misguided, and simply delete the useless concept of "ratification" from the field of corporate law.

Elsewhere in the Commonwealth the cases indicate several contentious aspects. It is accepted that certain breaches of duty are condonable by a company after full disclosure. The condonation should, however, be given by fully informed shareholders voting in general meeting. One reason to permit ratification is that the transaction which is tainted by the breach of duty is voidable at the option of the company and not void from the outset. In *Furs Ltd v Tomkies* it was held that

240 Welling *Corporate Law* 438.

241 See, for example, CBCA, s 242(1).

242 See, for example, *Bellman et al v Western Approaches Ltd* (1981) 17 BLR 117, where Pace JA stated: "Presumably it was the intention of the drafters [of the CBCA] to remove the common law barriers which I have described. Section 235(1) [now s 242(1)] clearly eliminates the ratification procedure. An alleged breach of duty, ratification of which is approved by the shareholders, no longer provides a sole reason to dismiss an application for leave to proceed derivatively" (at 133).

243 (1887) 12 App Cas 589 (PC). See chapter 4 par 4.8 above.

244 Welling *Corporate Law* 438.

245 Ratification is not permitted if it would amount to an oppression of the minority shareholders, if it would defeat a personal right of the member, or when an act is *ultra vires* the company: Gillies *New Company Law* 201 (Aust).

246 Gillies *New Company Law* 199; *Imperial Mercantile Credit Association v Coleman* (1871) 6 Ch App 558 at 567; *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 599 (Aust); *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) at 150 and 154; *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295 at 318 (Can). Smith *Directors' Rights and Responsibilities* 55 (Aust), however, opines that a director cannot, in a business opportunity situation, defend his actions by showing that they were subsequently approved of at a general meeting.

247 Gillies *New Company Law* 200.

248 (1936) 54 CLR 583 (Aust). The defendant (Tomkies) was the managing director of the plaintiff company and had particular expertise in dyeing and tanning processes. The company wished to sell that part of its business, and instructed Tomkies to obtain the best possible price for it. The directors also suggested that he look after his own interests in whatever way he could. Tomkies found a purchaser for the business, who was only prepared to purchase if Tomkies would come with it. The company received less from the transaction because of the fact that the managing director was also to receive a contract of employment. Payment to the defendant was satisfied by promissory notes and shares. The company claimed that Tomkies held the shares and promissory notes on its behalf.
the board of directors could not permit the defendant to conclude a contract in his
own name if this would result in the company receiving less for its assets. However,
it was considered that he could have been absolved from liability had he obtained
ratification by the shareholders.249 The implication is that ratification could have
taken place even though the company would have sustained a loss on the deal.250

In Queensland Mines Ltd v Hudson251 the court inferred that the company had
given its fully informed consent to pursue the matter.252 The implication is that the
board has the authority to grant a waiver to a colleague.253 On the facts this did not
make much difference, since both shareholders were controlled by two of the three
directors.254 This may have been an implied reason for disregarding the decision in
Furs v Tomkies that disclosure to the board of directors is inadequate in corporate
opportunity matters.255

A company's power to ratify in general meeting directors' acts done in breach
of duty was discussed in Winthrop Investments Ltd and Another v Winns Ltd and
Others256 Here the issue pertained to the issue of shares.257 All three judges agreed
that a general meeting of the shareholders of a company to whom full disclosure
of all relevant facts had been made, may ratify an exercise of power by the directors of
that company which would otherwise constitute a breach of their fiduciary duty to
the company. The court was further in agreement that advance authority for such an
exercise of power could be given by shareholders, again provided that full disclosure

249 At 599.

250 Baxt "Ratification" 46, who indicates that this is inconsistent with cases such as Cook v GC Deeks
and Others [1916] 1 AC 554 (PC) and Canada Safeway Ltd v Thompson [1951] 3 DLR 295.

251 (1978) 52 ALJR 399 (PC). For the facts, see page 283 above.

252 per Lord Scarman at 403-404.

253 The matter had never been put before the shareholders. Sullivan "Queensland Mines" 713 points
out that the defendant in this case was a person who had great influence on and participated in the very
decision which absolved him. It should further be noted that, in fact, the board never formally decided
that the director could take the licences. Fridman "Ratification" 265 also suggests that a dangerous
precedent is set by this implication.

254 The company was in the nature of a joint venture. One shareholder was a company which held fifty
one per cent of the shares in the company. That company was controlled by a fellow-director of the
defendant, who had agreed to finance the venture. The defendant was the managing director of the
remaining shareholder company. Thus the defendant and his co-director effectively controlled the two
shareholders in the plaintiff company.

255 Afterman & Baxt Cases on Corporations 589; Sullivan "Queensland Mines" 713.

256 [1975] 2 NSWLR 666, discussed by Baxt "Winthrop" 315 and Conway & Manuell "Duties of Direc-
tors and Ratification" 493.

257 The decision confirmed Bamford v Bamford [1970] Ch 212 (CA), [1969] 2 WLR 1107 (see chapter
4, par 4.8 above).
Directors' Fiduciary Duties and Corporate Opportunities

had been made. The Lavarch Committee has endorsed this opinion in its recommendations on shareholder rights in Australia.\textsuperscript{258}

It has been suggested that some constraints should apply to ratification by the shareholders.\textsuperscript{259} These include an independent vote and the imposition of certain percentages which may be required at meetings where ratification is sought.\textsuperscript{260} The whole issue surrounding ratification is therefore still clearly in some disarray.

3.5 Conclusions

The developments in company law in Australia, Canada and New Zealand are of particular value to South African company law for two reasons. First, the common law principles derive from the English law and thus have the same basis. In the second instance, recent English law has been greatly influenced by events in the European Union, to which South Africa and the other Commonwealth countries under discussion are not parties. It is therefore to be expected that the company laws of England and the other four countries will, to a greater or lesser extent, part ways.

Company legislation has been the subject of recent reform in Australia, New Zealand and Canada. But the law relating to fiduciary duties of company directors is still generally recognised as an application of common law principles which derive from equity, and which may be entrenched by statute. The equitable fiduciary obligation of a company director requires that he shall, at all times, act in the best interests of the company he serves.\textsuperscript{261} This implies a number of "sub-rules".

An existing business advantage, or an opportunity for which the company is negotiating, or for which it could negotiate, is described as a "corporate" or "business" opportunity. Accountability of a director for the wrongful appropriation of such an opportunity is traditionally based on the application of the general fiduciary principles, especially the prohibition against conflicts of duty and interest and the rule against the making of undisclosed profits. Liability is imposed upon the director, irrespective of whether he has made any profit, and irrespective of whether the company has suffered any loss. The fact that the current shareholders of the company may make a windfall profit, is also regarded as immaterial. The decision of the

\textsuperscript{258} See Report by the House of Representatives Standing Committee on Legal and Constitutional Affairs Corporate Practices and the Rights of Shareholders (1991) par 5.4.45.

\textsuperscript{259} Baxt "Ratification" 50.

\textsuperscript{260} Baxt "Ratification" 51 suggests that these percentages could range from a simple independent majority in cases involving a \textit{bona fide} breach of duty and negligence, to an unanimous vote of shareholders in a situation such as \textit{Cook v Deeks} (see chapter 4 par 4.3 above), with a special resolution being required in other cases.

\textsuperscript{261} A number of more recent decisions favour an obligation to consider the interests of other interest groups. But the obligation still remains in favour of the company. In this regard, see chapter 3 above.
House of Lords in *Regal Hastings v Gulliver* remains the leading case in this regard.\(^{262}\)

The decision in *Regal* has been followed in a vast number of other Commonwealth decisions. But strict application of its rules, although carrying the advantage of legal certainty, can have harsh consequences. Furthermore, the decision does not address all the issues pertaining to corporate opportunities.\(^{263}\) Commonwealth courts have recently indicated their preparedness to interpret the principles expounded in that decision in the light of modern commercial practice and the realities of corporate activity. Arguably, this will still not lead to acceptable results in all corporate opportunity cases.

Perhaps not unsurprisingly, because of its proximity to America, where the existence of a separate "corporate opportunity doctrine" is well-established,\(^{264}\) Canada was the first Commonwealth country to expressly acknowledge such a doctrine, in the noteworthy decision of *Canadian Aero Service Ltd v O'Malley*.\(^{265}\) Various factors are, according to this doctrine, considered in order to establish whether a director should incur liability for the appropriation of a corporate opportunity. They include the office or position held, the nature of the particular opportunity, the relationship of the director or officer to that opportunity, and the amount of knowledge possessed by the fiduciary. However, the decision warns against the "imprecise ethical standard" which it suggests has emerged from American case law. The decision leaves no doubt that in addition to directors, some levels of senior, non-directorate management may also owe fiduciary obligations to their company.\(^{266}\) New Zealand courts have followed the decision in *O'Malley* in a number of cases.\(^{267}\) In Australia too, there have been indications that the content of fiduciary duties will not necessarily be the same for all cases,\(^{268}\) thereby allowing for the possibility of the development of a separate doctrine.\(^{269}\)

A number of contentious issues has emerged from the case law in the field of corporate opportunities. They include the inter-relationship between corporate

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\(^{262}\) See chapter 4, par 3.2.1 above.

\(^{263}\) For example, the question whether a director could make use of an opportunity which had been rejected by the company, was left unanswered. See par 3.4.6 above.

\(^{264}\) See chapter 5 par 6 above.


\(^{266}\) See par 3.4.5 above.

\(^{267}\) For example, *SSC&B: Lintas New Zealand Ltd v Murphy* (1981-1983) 1 NZCLC 98,384; *Pacifica Shipping Co Ltd v Andersen* (1985) 2 NZCLC 99,306.

\(^{268}\) Austin "Accountability" 159; *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 60 ALR 741, discussed by Austin "Fiduciary Duty" 444. In this case a commercial arrangement was held to give rise to fiduciary duties.

\(^{269}\) Austin "Accountability" 159.
opportunities and confidential information, when the fiduciary duty not to appropriate a business opportunity for personal use lapses, the assessment of liability where the company has rejected the particular opportunity, or is unable to pursue it for financial or other reasons, and the position of a director in competing ventures. It was apparent that the wrongful use of confidential information may overlap with the appropriation of corporate opportunities.270 But the confidentiality of the information is not the important issue when considering the taking of corporate opportunities. Here the real test is whether the information is valuable to the company which has a vested interest in it. It is thus the use of the information in the particular circumstances which is predominant.

It was concluded that the fiduciary obligation does not continue after termination of a director's office.271 Accountability may, however, extend beyond his resignation where it has been prompted or influenced by the desire to do something which would breach the fiduciary obligation should he not resign. The special duties imposed upon directors arise because of their powers in relation to the company's affairs. It is submitted that it is illogical to hold that these obligations continue when the directorship terminates.

The effect of rejection of, or inability to pursue, a particular opportunity proved to be particularly problematic.272 The Canadian decision in *Peso-Silver Mines v Cropper* allowed the purchase of property by a director where the particular opportunity had been offered to and rejected in good faith by the company before the purchase occurred.273 Although the decision has found support in Australia and New Zealand, it has been criticised on the basis that it requires a determination by the court regarding the *bona fides* of the rejection of the opportunity.

It was seen above that there is no general prohibition on the number of directorships any person may hold, nor on competition between a director and his company.274 But in many instances the basic fiduciary obligation to act in the company's best interests will intervene. In particular, the director may breach this duty if he exploits an opportunity for profit-making which was first encountered during his term of office.

The effect of ratification by the company is uncertain, except in Canada, where the matter is regulated by statute.275 In that country the ratification procedure has

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270 See par 3.4.3 above.
271 See par 3.4.4 above.
272 See par 3.4.6 above.
273 See par 3.4.2 above.
274 See par 3.4.7 above.
275 See par 3.4.9 above.
been effectively abolished.\textsuperscript{276} The role of fairness as a determinant for liability has yet to be established, but appears to be becoming increasingly important.\textsuperscript{277}

Certain developments in the field of corporate opportunities in the countries discussed in this section are commendable.\textsuperscript{278} The need sometimes to deviate from the English common law has, furthermore, been accentuated. It is submitted that the developments in the European Union may cause this need to arise more frequently, under South African law as well as in the other Commonwealth countries. Whether or not the application of a specific doctrine is considered necessary, it is submitted that case law indicates that much depends upon the facts and circumstances of every individual situation.

\textsuperscript{276} See page 295 above.

\textsuperscript{277} See par 3.4.8 above.

\textsuperscript{278} These are discussed in the evaluation of the South African law (see chapter 9 par 4 below).
CHAPTER 9
SOUTH AFRICAN LAW

1 INTRODUCTION

The Companies Act 1973 applies to every company incorporated under this Act. In addition, it is applicable to every external company with a place of business in the Republic and to every company which had been a company in terms of any Act which was repealed on the commencement of the Act. The Act is, however, not a complete codification of the company law applicable to companies regulated by it, and common law principles should always be seen as the wider backdrop. In this respect, English law plays an important role, since the incorporated company of our law is modelled after its English counterpart. Many of the English company law rules have been readily accepted in South African law. This is particularly true in respect of directors' fiduciary duties, which are discussed in more detail below. But, where English principles conflict with our law, South African courts have indicated that they should not be followed. English company law thus has merely persuasive, and not binding, authority in South African law.

In this chapter, a company director is identified. The positions of nominee, de facto and non-executive directors are briefly investigated. The fiduciary obligation

1 Act 61 of 1973. Sections cited hereafter refer to this Act, unless expressly indicated otherwise.

2 Section 2(2) read with the definition of “existing company” and “external company” in s 1. The repealed acts are listed in Schedule 5 of the Act. Certain sections of the Companies Act also apply to other associations and bodies corporate, but they are, for present purposes, not relevant.

3 Cilliers & Benade Corporate Law 14.

4 De la Rey “Vroeë Maatskappyereg” 18ff; Naudé Maatskappydirekteur 9; Hahlo Cases 1-3; Ex parte Provisional Liquidator Hugo Franco (Pty) Ltd 1958 (4) SA 397 (W) at 399H-400D.

5 Even where the wording of a statute follows the wording of a statute of another country, the interpretation of the local statute will not necessarily be the same as that given to similar wording in another country: Ex parte Adair Properties (Pty) Ltd 1967 (2) SA 622 (R). In Roodepoort United Main Reef GM Co Ltd (in Liquidation) and Another v Du Toit NO 1928 AD 66 Solomon CJ warned: “Although, therefore, there is force in the argument that as our Companies Act is taken over from the English Act, we should be guided in our interpretation of it by decisions of English courts on identical sections, the argument cannot be pressed too far, and does not justify us in adopting any English decision which is based upon legal principles which are foreign to our system of law” (at 71-72). See also Naudé Maatskappydirekteur 9, who states: "Dat hierdie situasie egter nie 'n paspoort bied aan iets wat met ons eie regsbeginnels nie te verseen is nie, spreek vanself.”

6 Hahlo Cases 2-3; Van Dorsten Directors 10; Jonker v Ackerman en Andere 1979 (3) SA 575 (O) at 588F-G and authorities cited; Wolhuter Steel (Welkom) (Pty) Ltd v Jatu Construction (Pty) Ltd (in provisional liquidation) 1983 (3) SA 815 (O) at 821A.
which accompanies the office of director and the basis of liability for breaches of this duty are considered. Thereafter the content of the fiduciary obligation of company directors, as applied in South African law, is discussed. The discussion then focuses on the appropriation of corporate opportunities, which is regarded as one aspect of the general fiduciary obligation. Where appropriate, developments in the legal systems discussed above, are referred to. Finally, certain conclusions are drawn.

2 COMPANY DIRECTORS

All companies must necessarily act through individuals. The Companies Act provides that every public company must have at least two directors, every private company one. Anyone who occupies the office of director is regarded as a director. The legislature places no obligation on companies to assign any particular task to the board of directors. However, the board exists conceptually to undertake the management of the company, or, at the least, to assume responsibility for it.

7 Since South Africa derives its company law from the English law, many of the authorities referred to inevitably belong to that system. On the origin and development of South African company law generally, see Cilliers & Benade Corporate Law 18ff; De la Rey "Vroeë Maatskappyeereg" 4; Hahlo Cases 1-3; Hahlo "Progeniturs" 139; LAWSA Companies pars 3-8.

8 See chapters 4, 5, 6, 7 and 8 above in respect of developments in England, America, France, Germany, Australia, Canada and New Zealand.

9 Section 208(1); Table A art 53 and Table B art 54. For recent interesting discussions of various aspects of a directorship, see Du Plessis "Besturende Direkteure" 577; Du Plessis "Status" 267; Du Plessis "Status II" 453; Du Plessis "Vergoeding" 243. See further, generally, Du Plessis Grondslae 1-200; Naudé Maatskappydirekteur; Hahlo Cases 327ff; Henochsberg 392ff; Van Dorsten Directors.

10 Hahlo Cases 327; Naudé Maatskappydirekteur 68. In Re Lo-Line Electric Motors Ltd [1988] BCLC 698 it was stated (at 706) that the provision of s 741(1) of the English Companies Act 1985 that the expression "director" includes "any person occupying the office of director by whatever name called" is intended merely to cover the situation where the management of a company is conducted by persons who are described other than as directors. A similar provision exists under South African law. Section 2 of the Companies Act 61 of 1973 defines a director as "any person occupying the position of director or alternate director irrespective of the name by which he may be designated." The definition in the Companies Act is only an application in connection with that Act. Other acts, for example the Criminal Procedure Act 51 of 1977, have their own definitions for the purpose of their own provisions: Beuthin & Luiz Basic Company Law 203; Hahlo Cases 327. As to the term "director", see Du Plessis "Director" 153.

11 See, in general, Cilliers & Benade Corporate Law 133; LAWSA Companies par 161; McLennan "Misapplications" 408. Generally speaking the directors of a company have two functions at law. They administer the assets of the company and they represent the company in transactions with third parties. The reason for the analogies with the positions of trustees and agents is, therefore, obvious. In this regard, see chapter 2 par 3.1 and par 3.2 above. See also, generally, Blackman Fiduciary Doctrine 275ff.
powers are usually stated in terms of article 59 of Table A and article 60 of Table B of the Companies Act.\textsuperscript{12}

The Act does not uniformly prescribe the manner of appointment, the qualifications or the right to remuneration of all directors.\textsuperscript{13} Whether a particular person occupies the office of director depends in principle upon whether he was properly qualified\textsuperscript{14} and appointed in terms of the Act and the relevant articles of association.\textsuperscript{15} Notwithstanding any defect that may afterwards be discovered in his appointment or qualification, the acts of a director are valid.\textsuperscript{16} Once the defect is discovered, it must be corrected before any action may be continued by the director whose appointment is defective.\textsuperscript{17}

The number of directors and their appointment are usually regulated by the articles.\textsuperscript{18} If the articles do not provide otherwise, the first directors are appointed by the subscribers to the memorandum.\textsuperscript{19} Until directors have been appointed, every subscriber is deemed to be a director.\textsuperscript{20} Subsequent directors are usually elected by

\textsuperscript{12} These articles read: "The business of the company shall be managed by the directors who may pay all expenses incurred in promoting and incorporating the company, and may exercise all such powers of the company as are not by the Act, or by these articles, required to be exercised by the company in general meeting, subject to these articles, to the provisions of the Act, and to such regulations, not inconsistent with the aforesaid articles or provisions, as may be prescribed by the company in general meeting, but no regulation prescribed by the company in general meeting shall invalidate any prior act of the directors which would have been invalid if such regulation had not been prescribed."

\textsuperscript{13} Larkin "Duties" E-2-3; Naudé \textit{Maatskappydirekteur} 68.

\textsuperscript{14} Section 218 of the Companies Act disqualifies certain persons from being appointed or acting as directors of a company. A company may, in terms of s 218(3), in its articles provide for further disqualifications in respect of the appointment of or the retention of office by any person as a director of such company. For a comprehensive discussion of this aspect, see Du Plessis \textit{Ontslag} 165ff. See, further, Du Plessis "Ontwikkelinge" 435; Hahlo \textit{Cases} 330-344. On the discretion of the court in this regard, see McLennan "Discretion" 4; \textit{Ex parte Tayob and Another} 1990 (3) SA 715 (T) at 722-724.

\textsuperscript{15} Larkin "Duties" E-2; Naudé \textit{Maatskappydirekteur} 68; Gohike & Schneider \textit{v Westies Minerale (Edms) Bpk} 1970 (2) SA 685 (A), discussed by Beuthin "Articles" 395. The articles may prescribe the holding of a specified number of qualification shares: s 211(1)(b).

\textsuperscript{16} Section 214; Beuthin & Luiz \textit{Basic Company Law} 213; Marrok Plase (Pty) \textit{v Advance Seed Co (Pty) Ltd} 1975 (3) SA 403 (A) at 412.

\textsuperscript{17} Henochsberg 408-409; Dowjee \textit{Co Ltd v Waja} 1929 TPD 66; \textit{Carbonic Gas Company Ltd v Ziman} 1938 TPD 102.

\textsuperscript{18} On the appointment of company directors generally, see Cilliers & Benade \textit{Corporate Law} 114ff; Hahlo \textit{Cases} 330ff; Naudé \textit{Maatskappydirekteur} 70-80.

\textsuperscript{19} Section 209.

\textsuperscript{20} Section 208(2); Table A art 53; Table B art 54.
the company in general meeting. 21 A third party may have the right to appoint one
or more directors to the board. 22

There are two components to an appointment as director. The nomination
must be accepted by the nominee before he can be considered to be properly
appointed. 23 By contrast, resignation is a unilateral act. The concurrence or accept­
ance of the company is not required to terminate the appointment. 24

In terms of the Companies Act no appointment of a person as director of a
company shall be valid unless he has signed and lodged with the registrar his written
consent to act as director of the company. 25

It is fairly common practice for the articles to provide for the representation of
a director who will be absent from board meetings for a lengthy period by enabling
him to appoint an "alternate" or "substitute" director. 26 The alternate director enjoys
the powers of a director only to the extent that his exercise of power does not
derrogate from the appointing director's exercise of power. 27 However, he is subject
to all duties and liabilities of honesty, good faith, skill, care and diligence imposed

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21 Table A arts 66-69; Table B art 67.

22 Gohlke & Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A); Fisheries Development
Corporation of SA Ltd v Jorgensen 1980 (4) SA 156 (W); De Kock v Davidsen 1971 (1) SA 428 (T).

23 In Gohlke & Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A) at 690-691 it was sug­
gested that mere appointment would suffice. However, as is indicated by Naudé Maatskappydirekteur
71, this would lead to the undesirable result that persons could be on directorates without their con­
sent, or even their knowledge. It is submitted that the result in Gohlke can probably be explained by the
fact that acceptance of office may occur before the actual appointment as director.

24 Cilliers & Benade Corporate Law 119; Rosebank Television & Appliance Co (Pty) Ltd v Orbit Sales
Corporation (Pty) Ltd (1969) 1 SA 300 (T) at 302. If any director or officer has vacated his office, the
company must, however, enter a statement to that effect in the register of officers and directors: s
216(1)(b).

25 Section 211. Appointments made before the issue of a certificate to commence business and those
made thereafter, are distinguished. See, in general, Oosthuizen "Toestemming" 247. Section 210
provides that where more than one director is to be elected at a meeting, a separate resolution must be
moved for each person to be appointed unless the meeting without dissent agrees to make the appoint­
ment by a single resolution. In respect of the corresponding s 69bis of the Companies Act 1926, see
Schachat v Trans-Africa Credit & Savings Bank Ltd 1963 (4) SA 523 (C) at 525-526; Atchison v Dench
1964 (2) SA 515 (T) at 517.

26 Gore-Browne on Companies par 25.10. See, in general, Baxt "Alternate Directors I" 194; Baxt
"Alternate Directors II" 326; Gower Company Law 143; Pennington Company Law 552-553; Petkovic
"Alternate Directors" 36043; Williams "Alternate Directors" 263. In England, the Jenkins Committee
was of the opinion that it was unnecessary for the Companies Act to regulate the position of an alter­
nate director. The Committee was satisfied that "an alternate director is, in the eyes of the law, in the
same position as any other director, though his powers may of course be restricted by the company's
articles" (Cmd 1749 par 83).

27 It would therefore be too simplistic to regard the alternate director as being in the position of an
ordinary director in all respects: Cilliers & Benade Corporate Law 117; Hahlo Cases 378, 430 and 459.
on other directors. An alternate director is a director in his own right and is not prevented from voting on a matter in which the director to whom he is an alternate, is interested.

2.1 Nominee and De Facto Directors

The practice of appointing a director as nominee representing certain shareholders or other interests within the company is legally recognised. Management of companies through nominees is not objectionable per se. There is, however, little doubt that the practice is open to abuse. The nominees, who are de iure directors, occupy a fiduciary position in respect of their companies. It is no defence to possible liability that they were merely carrying out instructions. The nominee director may, however, observe the wishes of his nominator provided that this accords with the interests of the company.

The question arises to what extent the real controllers, or de facto directors, are subject to the same fiduciary duties as are ordinary directors. This issue does not only arise in connection with nominee directors. Two categories of de facto directors may be distinguished. In the first instance, there are persons who act as

28 Markwell Bros Pty Ltd v CPN Diesels (Qld) Pty Ltd (1982) 7 ACLR 425.
29 Hahlo Cases 430.
30 Cilliers & Benade Corporate Law 141. See also the authorities cited in chapter 4 note 24 above.
31 A nominee director can be described as a person who, independently of the method of his appointment, but in relation to his office, is expected to act in accordance with some understanding or arrangement which creates an obligation or mutual expectation of loyalty to some person, or persons other than the company as a whole. On the position of nominee directors generally, see Hahlo Cases 378; Fisheries Development Corporation of SA Ltd v Jorgensen 1980 (4) SA 156 (W) at 163 and authorities cited in chapter 4 note 24 above.
32 Botha Groups 238-249. But the warning expressed in Boulting and Another v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606 (CA) that the director should remain free to exercise his best judgment in the interests of the company which he serves should be heeded (see chapter 4 note 26 above).
33 McLennan "Misapplications" 401; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 196.
34 S v Shaban 1965 (4) SA 646 (W) at 651; S v De Jager and Another 1965 (2) SA 616 (A) at 623. See also chapter 4 par 2.1 above.
35 For a general discussion of relevant authorities, see Botha Groups 238-249.
36 A concise definition of a de facto director is as difficult as the definition of a director generally. McLennan "Misapplications" 408 suggests as guideline that a de facto director is someone who enters the directorial sphere, that is, who actually carries out and performs those functions which are customarily performed by directors.
37 Naudé Maatskoppydirekteur 69-70.
directors without having been appointed as such in the manner prescribed by the 
articles. The controllers behind nominee directors may be included in this category. 
Internally, these persons are clearly not regarded as directors. They are not entitled 
to directors' remuneration and, should the articles permit an ordinary director to 
convene an extraordinary general meeting, they will not be entitled to do so.38 

The second category of *de facto* directors concerns persons who are in fact 
appointed to the office, but where there is some defect in their appointments or 
qualifications. These persons are, legally, also not directors, although they are 
treated as such.39 Their actions prior to the defect being discovered are, nonetheless, 
valid.40 

Conflicting opinions have been expressed on the issue of fiduciary duties owed 
by *de facto* directors. Naudé argues that these persons do not owe duties of care and 
skill or fiduciary duties to the company.41 The contrary opinion has also been 
expressed.42 It has been argued that it would be more satisfactory to apply the "no

\[38 \text{ Naudé } \text{*Maatskappydirekteur* 69 note 1.} \]
\[39 \text{ Larkin "Duties" E-3; Naudé } \text{*Maatskappydirekteur* 69.} \]
\[40 \text{ Section 214. See also note 16 above. However, once the defect is discovered it must be remedied for} \]
\[\text{the further actions of the director to be valid. See note 17 above.} \]
\[41 \text{ Naudé } \text{*Maatskappydirekteur* 69. The author opines that one would normally be able to construe a} \]
\[\text{contract of mandate between the first category of *de facto* directors referred to above and the company,} \]
\[\text{so that they would owe the company the normal duties connected with this type of contract. Companies} \]
\[\text{could also, in appropriate circumstances, incur liability for the acts of these persons in terms of the} \]
\[\text{principle of estoppel. See, however, McLennan "Misapplications" 403, where the submission that a *de} \]
\[\text{facto* director may incur liability in the capacity of mandatory, is regarded as unconvincing. The author} \]
\[\text{convincingly indicates that there are situations where it would not be easy to discern the agency rela­} \]
\[\text{tionship. An example would be where the puppeteer-manipulator simply issues instructions that are} \]
\[\text{blindly obeyed.} \]
\[42 \text{ Larkin "Duties" E-3 refers to } \text{Palmer's Company Law 59-15, where it is stated that a *de facto* directo­} \]
\[\text{r is as much in a fiduciary position as a *de iure* director (in respect of English company law, see also Pennington} \]
\[\text{Personal Liability 26). The decision in } \text{In re Canadian Land Reclaming and Colonizing Company,} \]
\[\text{Coventry and Dixon's Case (1880) 14 ChD 660 is cited as authority. The court considered} \]
\[\text{whether persons who had acted as directors for some time without holding the required qualification} \]
\[\text{shares, were directors or officers. Jessel MR considered that a person who had acted as *de facto* director} \]
\[\text{could not afterwards be allowed to deny that he was a director. See also } \text{Morris v Kanssen and} \]
\[\text{Others [1946] AC 459, [1946] 1 All ER 586. In that case Lord Simonds stated that the correspondent} \]
\[\text{section of the English law to s 214 could not be invoked to validate certain actions, since there had not} \]
\[\text{been a valid appointment. Larkin "Duties" E-3-4 regards Coventry and Dixon's Case as "perhaps a good} \]
\[\text{instance of an English decision which is based upon legal principles which are foreign to our system of} \]
\[\text{law and, accordingly, of little assistance". The author also indicates (at E-4) that decisions such as those} \]
\[\text{in } \text{R v Mall 1959 (4) SA 607 (N) and } \text{S v Vandenberg 1979 (1) SA 208 (D) in respect of the interpreta­} \]
\[\text{tion of the term "director" in particular contexts, are based on a definition contained in the Companies} \]
\[\text{Act and, as such, are not significant for the purpose of identifying a director who is, at common law,} \]
\[\text{subject to fiduciary duties. In Mall it was held that a person who, without semblance of authority, func­} \]
\[\text{tions as a director, was not a director within the meaning of s 185 of the Companies Act 46 of 1926} \]
\[\text{(now s 425). In } \text{L Suzman (Rand) Ltd v Yamayani (2) 1972 (1) SA 109 (W) the court suggested,} \]
\[\text{however, that the restricted definition in Mall may apply only to the penal provisions of the Act.} \]
power without responsibility" principle and simply to hold a person who occupies a position of trust responsible to the duty which inevitably attaches to that trust. This argument is, it is submitted, sound. A de facto director has placed himself in a fiduciary position and, therefore, should bear the consequences and responsibilities of that position. In addition, the appointment as director by an outside party of a puppet or mere tool who has no idea what he is doing is illegal and punishable as fraud. In S v De Jager it was confirmed that a director who had resigned and secured the appointment of a puppet in his place was still bound by the fiduciary and other duties of a director.

2.2 Executive and Non-Executive Directors

This classification of directors is not found in statutes. The term "non-executive director" has been described as a "vogue description of a director who does not perform any executive functions in a company". But the importance of the non-executive director in modern company structures is illustrated by the fact that the status of the non-executive director was comprehensively considered in recent investigations of company law. As a rule, executive directors attend and vote at meetings of the board, but do not work full-time for the company and have no service contract, whereas non-executive directors have a service contract under which they work full-time for the company.

43 Larkin "Duties" E-6. In this respect, McLennan "Misapplications" 403 states: "If a person enters into the directorial sphere, if he functions as a director by actually directing and controlling the company's affairs, his relationship with the company should be no less fiduciary than if he had been de jure appointed to the board." For support of this view (albeit by reference to Laskin in lieu of McLennan) see also Sibex Construction (SA) (Pty) Ltd v Injectaseal CC 1988 (2) SA 54 (T) at 65 per Goldstone J.

44 The categories of fiduciary duties are not closed: see chapter 2 par 2 above. There is therefore not, in principle, an objection against a de facto director being regarded as a fiduciary.

45 Cilliers & Benade Corporate Law 141; S v Shaban 1965 (4) SA 646 (W); Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W).

46 S v De Jager and Another 1965 (2) SA 616 (A) at 622-623.

47 Du Plessis "Wanopvatting" 137.

48 Davis "Duties" 567.

49 See chapter 4 par 2.2.1 above in respect of the Cadbury Report in England, and par 4.9 above on the King Report in South Africa.

50 Hahlo Cases 327. See further, in general, Brusser "Non-Executive Directors" 9; Davis "Duties" 567; Dillon "Non-Executive Directors" 67, 123 and 153. In respect of non-executive directors in Australia, see Baxt "Sleeping Directors" 78. See also chapter 4 par 2.2 above, where it is indicated that recommendations by the Cadbury Committee in England are likely to lead to specific recognition of and a much more important role for non-executive directors, especially with regard to their duties of care and skill.
tant functions as part of non-executive directors' duties. They need to bring their special expertise and knowledge to bear on the strategy, enterprise, innovative ideas and business planning of the company. Secondly, they can monitor and review the performance of the non-executive management more objectively than the executive directors. Thirdly, they can play a role in resolving conflict of interest situations, for example the remuneration of executives, succession and hostile take-overs. Fourthly, they can act as a check and balance against the executive directors. In view of the importance of their role, the committee recommends that, whilst recognising the shortage of trained and experienced people to be appointed directors in South Africa and even if the chair is an independent non-executive director, no board should have less than two non-executive directors of sufficient calibre that their views will carry weight in board decisions.

The distinction between executive and non-executive directors in South African company law was comprehensively considered in two cases. In *Fisheries Development Corporation of SA Ltd v Jorgensen* the court made the distinction in respect of a director's duty of care and skill. Margo J confirmed that the extent of this duty depends to a considerable degree on the nature of the company's business and on any particular obligations assumed by or assigned to him. In that regard, the court held, there is a difference between the full-time or executive director, who participates in the day-to-day management of the company's affairs or of a portion thereof, and the non-executive director who has not undertaken any special obligation. The latter would not be required to give continuous attention to the affairs of his company.

It has been pointed out that the distinction drawn in the *Fisheries* case is based on the fact that the executive director is obliged to give his full attention to the company's affairs and is liable for damage suffered by the company as a result of his absence and consequent dereliction of duty, whereas the non-executive director is not so obliged. The non-executive director should therefore not assume that his duties will always be less onerous. Since the modern non-executive director is likely

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51 On the Report by the King Committee on Corporate Governance (hereafter referred to as the "King Report", see par 4.9 below.

52 King Report 6, par 4.8.

53 King Report 27, par 19.6.3. See also chapter 6 of the report on the position of the non-executive director in general.

54 1980 (4) SA 156 (W).

55 At 165. See also Soderquist "Outside Directors" 1341. But Davis "Duties" 576 points out that the duty of care and skill remains the same for executive and non-executive directors. Both must exercise the highest degree of care and skill of which they are capable. It is the degree that may vary. It may even be, in appropriate circumstances, that the liability of a non-executive director may be greater than that of an executive director (for example, a non-executive director who is an attorney, where the relevant issue pertains to a question of law).

56 Davis "Duties" 576.
to be professionally qualified, or at least endowed with a particular expertise, the
degree of skill demanded of him is likely to be greater than that required of his
counterpart some years ago.\footnote{57}{Dillon "Non-Executive Director" 156.}
That it may, furthermore, vary depending upon the role and function of the particular
non-executive director in the company is apparent from the recent \textit{Cadbury Report}
in England.\footnote{58}{See chapter 4 par 2.2.1 above. On the report and its influence on South
African company law, see Du Plessis "Cadbury" 81ff.}

More recently, in \textit{Howard v Herrigel and Another}\footnote{59}{1991 (2) SA 660 (A). Application
was made under s 424 of the Companies Act to declare a non-executive director personally
liable for the debts of a company.} the Appellate Division considered a distinction between
executive and non-executive directors in respect of their fiduciary duties. Goldstone
JA regarded it as unhelpful, and even misleading, to use this classification to establish
the duties of directors to the company or when any specific or positive action is required
from them.\footnote{60}{At 678.}
The court confirmed that once a person accepts office as director, he becomes a fiduciary in relation to the
company and is obliged to display the utmost good faith towards the company and in
his dealings on its behalf. Application of the general rule will, of necessity, depend
upon the facts and circumstances of each case. It would be a factor to be considered
in the assessment of the director’s liability that he is not involved in the manage­
ment of the company on a full-time basis.\footnote{61}{This factor was considered in \textit{Cronjé NO v Stone en ’n Ander 1985 (3) SA 597 (T)},
discussed by Luiz "Extending Liability" 788. The application before the court was also in terms of s 424.}
The fact that the director was classified as "non-executive" would not, however, generally indicate that he has less onerous
duties than would otherwise have been the case.\footnote{62}{See also Brusser "Non-Executive Directors" 11; Havenga "Personal Liability" 67; Larkin "Annual
Survey 1991" 226.}

It is submitted that the distinction between executive and non-executive direc­
tors may serve as a useful point of departure is assessing whether a particular duty
has been complied with. The fact that the director has executive or non-executive
functions does not, however, determine the extent of his duty.\footnote{63}{The view of the King Committee that all directors, both
executive and non-executive, are bound by fiduciary duties and duties of care and skill is
endorsed. The committee recommends that non-executive directors will, in the assessment of their duties of care and skill,
obtain recognition for the fact that such duties are only performed on an intermittent basis and that they enjoy lesser access to the
books and records of the company than executive directors: \textit{King Report} 6, par 4.5. By implication, executive and non-executive
directors are to be treated equally in respect of the assessment of their fiduciary duties.}
ries with it a fair share of the concealed danger of extensive personal liability. Furthermore, whether their functions be executive or non-executive, they may not be exempted from personal liability, except, in exceptional circumstances, by the court. This threat of extensive personal liability may lead to the disappearance of the non-professional, non-executive director.

3 DIRECTORS' FIDUCIARY DUTIES

In accordance with the common law principles derived from the English law, it is accepted that directors stand in a fiduciary relationship to the company they serve. The holding of the office of director carries with it the burden of fiduciary duties. These duties exist in addition to the various statutory duties contained in the Companies Act. Furthermore, fiduciary duties do not in any sense replace the other duties of directors.

The fiduciary position of a director only arises once the appointment as director takes effect. Thus a prospective director or "director-elect" does not occupy a fiduciary position. If the director has not formally been appointed, the fiduciary relationship commences when he starts to act as director.

It is sometimes stated that former corporate directors continue to owe fiduciary obligations to their companies after they resign. It is respectfully submitted that this is wrong. A director's resignation from, or termination of, office should release

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64 Du Plessis "Cadbury" 87; Du Plessis "Wanopvattinge" 142.
65 Section 247. See par 3.3 below.
66 Section 248. See par 3.3 below.
67 Du Plessis "Wanopvattinge" 142.
68 Blackman Fiduciary Doctrine 239ff. South African sources also recognise that one person can stand in a fiduciary relationship towards another: Naudé Maatskappydirekteur 108. On the origin and basis of the fiduciary obligation, see chapter 2 above. The beneficiary of the fiduciary obligation is discussed in chapter 3 above. On the application of the fiduciary doctrine to company directors in South Africa generally, see Blackman Fiduciary Doctrine, especially 275ff; Henochsberg 464ff; Naudé Maatskappydirekteur 106ff. See also par 3.2 below.
69 Du Plessis "Grondslag van Aanspreeklikheid" 11; Fourie "Vertrouenspligte" 127 and authorities cited in note 57. Certain sections of the Companies Act, such as ss 37, 38, 226 and 228 enforce some aspects of the overriding fiduciary duty. In this regard, see McLennan "Directors" 417. For a comprehensive list of directors' statutory duties, see Van Dorsten Directors 233ff.
70 Larkin "Duties" E-2; Naudé Maatskappydirekteur 48; Van Dorsten Directors 180. This was confirmed in respect of English law in Lindgren v L & P Estates Ltd [1968] Ch 572 (CA) at 596 (see chapter 4 note 51 above).
71 LAWSA Companies par 218.
72 Cilliers & Benade Corporate Law 119 note 5; Canadian Aero Service Ltd v O'Malley [1974] SCR 592, (1973) 40 DLR (3d) 371 at 391 (see chapter 8 par 3.4.4 above).
him from his fiduciary obligation. But it is submitted that, in certain instances, a for­
mer director may still be accountable on the basis of his prior fiduciary obligation
for certain competitive activities which occurred after his resignation.73 For example,
where a director's resignation is influenced by a wish to acquire for himself an
opportunity, or where his position with the company, rather than a fresh initiative,
led him to the opportunity, he remains precluded from taking it.74 A former director
may also be restrained from using confidential information acquired by him when he
was a director to the prejudice of the company.75 As a general statement, former
directors can be accountable for profit made when either a conflict between self-
interest and fiduciary duty led to the situation in which the profit was made, or if the
opportunity to make the profit can be attributed to the fiduciary position formerly
occupied.76

In principle a director owes his fiduciary duties only to the company on whose
board he serves and not to other companies even if they are in the same group.77
However, due to the power exercisable by a holding company over a subsidiary, a
fiduciary duty by directors of the holding company towards the subsidiary company
may be construed in certain circumstances.78

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73 Welling "Fiduciary Obligations" 1106.

74 Henochsberg 472; Cranleigh Precision Engineering Ltd v Bryant and Another [1965] 1 WLR 1293,
[1964] 3 All ER 289; Magnus Diamond Mining Syndicate v MacDonald 1909 ORC 65 at 81-82; 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 382; Sibex Construction (SA) (Pty)
Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T) at 65-66. In Magnus Diamond Mining Syndicate v
MacDonald and Hawthorne 1909 ORC 65 at 81 Maasdorp CJ confirmed that the purported resignation
by two directors was merely an attempt to divest themselves of the responsibilities and obligations
of their office, from which they could not in law free themselves without the consent of the corporation.
See also Island Export Finance Ltd v Umunna and Another [1986] BCLC 460, discussed in chapter 4 par
4.4 above, where 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" (at
460). It is submitted that this statement applies to all directors and that the terms "employer" and
"employment" are used somewhat loosely.

75 In this regard, see par 4.7 below.

76 Welling "Fiduciary Obligations" 1109. The author submits that public policy should set an upper
limit on this liability.

77 Henochsberg 395; LAWSA Companies par 220.

78 Botha Groups 225ff; Cilliers & Benade Corporate Law 136; Robinson v Randfontein Estates Gold
Mining Co Ltd 1921 AD 168 at 197-198. The authors of Cilliers & Benade Corporate Law provide as
example the duty not to use the controlling power of the holding company to destroy the subsidiary's
ability to act in its own best interests: Cilliers & Benade Corporate Law 136. Section 37, which entrenc
ches aspects of the director's fiduciary obligation (see note 69 above), also provides an example of an
exception to the general rule. It provides for disclosure of loans made or security given to any holding
company or subsidiary of the holding company which is not a subsidiary of the lending company. On
this section generally, see Naudé "Section 37".
It is only when a director acts in his capacity as such that he owes fiduciary duties to the company. When exercising his powers as a member of the company, the director is free from any fiduciary obligation. However, in order to curb the power of directors who are also shareholders, it is recognised that courts will protect minorities if what is resolved at a general meeting of shareholders amounts to a "fraud on the minority".

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 authorised to act on its behalf and, in particular, to those acting in a managerial capacity. For the purposes of the Companies Act, the term "officer" includes, unless the context indicates otherwise, any managing director, manager or secretary, but excludes a secretary which is a body corporate.

3.1 The Basis of Liability for Breaches of Directors' Fiduciary Duties

The theoretical basis of the fiduciary office is somewhat obscure. The uncertainty has the undesirable consequence that doubt may arise about the available remedies for breaches of fiduciary duties. This in turn may hamper their enforcement.

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79 Beuthin & Luiz Basic Company Law 224; Hahlo Cases 308; Larkin "Duties" E-2; North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty (1887) 12 App Cas 589 (PC) at 600.

80 This aspect is discussed under par 4.8 below.

81 Gower Company Law 553. This statement, in an earlier edition of this work, was approved in Canadian Aero Service Ltd v O'Malley [1974] SCR 592, (1973) 40 DLR (3d) 371 at 381. See also Farrar Company Law 379; Henochsberg 395; LAWSA Companies par 219; Sibex Construction (SA) (Pty) Ltd v Infectious C.C and Others 1988 (2) SA 54 (T) at 65-66. In respect of officers who are authorised to act on behalf of the company, as opposed to those who are merely its servants, see Bell and Another v Lever Brothers Limited and Others [1932] AC 161 (HL). Servants, too, may owe duties of fidelity, which depend on the law of master and servant and which may be similar to the fiduciary duties owed by company directors: Reading v Attorney-General [1951] AC 507, [1951] 1 All ER 617 (HL).

82 Section 1(1). In Lipschitz and Another NNO v Wolpert and Abrahams 1977 (2) SA 732 (A) the court accepted the following definition of "officer": "a person holding office and taking part in the management or direction of a society or institute especially one holding the office of president, treasurer or secretary; an office-bearer". See also Re a Company [1980] 1 Ch 138 (CA), where it was held that the meaning of the word "officer" may depend on the context in which it is used.

83 Sometimes it rests on property, sometimes on reliance on a dominant position, sometimes on an unequal relationship, sometimes on contract, sometimes on unjust enrichment: Farrar 'Controlling Shareholders' 189. See also chapter 3 par 3 above.

84 Du Plessis 'Grondslag van Aanspreeklikheid' 11 and 23-26; Fourie "Vertrouenspligte" 124; Havenga "Opportunities" 131; Shepherd Law of Fiduciaries 5. Du Plessis Grondslae 100 suggests that before fiduciary duties can effectively control a director's powers, more certainty about this aspect is necessary: "Ten einde te verseker dat die gemeenregtelike vertrouenspligte as deeglike grondslag dien vir die geregelte kontrole-funksie wat daarmee beoog word, moet daar sekerheid bestaan oor beide wat bedoel word met vertrouenspligte en wat die remedies is as hierdie pligte verbreek word." Sealy 'Problems' 177 confirms that a supposed legal duty which is not matched by a remedy is a nonsense.
The comparative legal survey undertaken above confirmed the *sui generis* basis of a director's fiduciary duties.\(^85\) It has thus far been accepted that the basis of his liability for breaches of fiduciary duties is similarly unique.\(^86\) It is clearly not contractual, since the mere fact of holding office as director creates no contractual relationship between the director and his company.\(^87\) Neither does a contractual relationship arise by virtue of the articles of association.\(^88\) Furthermore, as was seen above, it is not necessary for persons to enter into a contract or agreement in order to establish a fiduciary relationship.\(^89\)

However, some commentators have recently expressed the opinion that the *actio legis Aquiliae* is the proper basis for liability in respect of directors' breaches of their fiduciary duty.\(^90\) The proposition is based upon two main arguments. First, it is argued that principles derived from English law are unnecessarily relied upon. In the second instance, it is submitted that acceptance of the *actio legis Aquiliae* as basis of liability will lead to legal certainty. The argument is that *sui generis* liability is so wide that the duty it seeks to enforce becomes too uncertain to be adequately protected. In this respect it is also alleged that it will be unnecessary to distinguish between the duties of care and skill and the fiduciary obligation if both are based on aquilian liability. These arguments are investigated below. Thereafter, some problems in respect of the application of the elements of delict are pointed out.

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\(^85\) See chapter 2 par 3.3, and chapter 5 par 2 above.

\(^86\) Beuthin & Luiz *Basic Company Law* 218; Cilliers & Benade *Corporate Law* 136; Du Plessis *Grondslae* 101; Hahlo *Cases* 366; *Henochsberg* 464; Naudé *Maatskappydirekteur* 142-143; Oosthuizen *Handelsreg* 449; Van Dorsten *Directors* 184; Robinson *v* Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 199 (per Innes CJ) and 242 (per Solomon JA); *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706G. See also chapter 2, par 2.2 above. In addition to the liability for breach of duty the director may incur criminal liability: Beuthin *Theft* 479; Cilliers & Benade *Corporate Law* 136; Smukler *Theft*; Van Dorsten *Directors* 184; *R v Herholdt and Others* 1957 (3) SA 236 (A); *S v De Jager and Another* 1965 (2) SA 616 (A).

\(^87\) Beuthin *Articles* 276; Cilliers & Benade *Corporate Law* 114; Naudé *Maatskappydirekteur* 80, 142.

\(^88\) Cilliers & Benade *Corporate Law* 75, 114; Naudé *Maatskappydirekteur* 80ff; Gower *Company Law* 156, 282ff; *De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873 (O) at 877; *Gohike & Schneider v Westies Minerale (Edms) Bpk and Another* 1970 (2) SA 685 (A) at 692F-G; *Rosslare (Pty) Ltd and Another v Registrar of Companies* 1972 (2) SA 524 (D) at 528B. The director can, of course, enter into a contractual relationship with his company in various ways: Cilliers & Benade *Corporate Law* 114; Naudé *Maatskappydirekteur* 80ff.

\(^89\) See chapter 2 par 2 above.

\(^90\) Du Plessis *Grondslae* 101-103; Du Plessis "Grondslag van Aanspreeklikheid" 100-103; Fourie "Perspektiewe" 350.
3.1.1 Reliance on Principles Derived from English Law

As was indicated above, any investigation into directors' fiduciary duties relies heavily on the common law rules developed by English courts of equity.91

Chancery courts had particular characteristics. The rules laid down were deliberately vague to ensure that legal aid could be given in a variety of circumstances.92 Some of them were, however, applied strictly. This obviated the need to delve too deeply into the factual merits of a case, which the court was unable to do.93 The strict application of fiduciary rules can also be explained by reference to the uncertainty which existed in connection with the concept of fiduciary relationships.94 Furthermore, courts of equity often made use of principles derived from the law of trust.95 In this regard it has been suggested that there is no reason for English principles of trust, which were developed for their own historic reasons, and about which there is not agreement even in English law, to continue to influence South African law.96 The opinion has also been expressed that recognition of liability without fault on the part of company directors in respect of breaches of their fiduciary obligation amounts to a negation of the historical context of the development of fiduciary duties under English law, and that the principles of the English trust law have a detrimental influence on this area of the law.97

The views that one should have regard for the historical basis of the equitable rules and that certain English principles are not applicable in South African law, are supported. As was stated above, English company law in any event has only pur-

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91 See chapter 2 pars 1 and 2 above. For a comprehensive account of courts of equity and the philosophy behind them, see also Blackman Fiduciary Doctrine 78ff.

92 Du Plessis "Grondslag van Aanspreeklikheid" 16. See also chapter 2 par 1 and authorities cited in note 1; chapter 4 par 3 above.

93 The early courts of chancery had very inadequate means for hearing evidence and getting at the facts: Sealy Commercial Reality 38. The author suggests that this was one reason for strict application of rules. See also Du Plessis "Grondslag van Aanspreeklikheid" 16-17; Ford Company Law 465; Ex parte James (1803) 8 Ves 337, 32 ER 385 at 388.


95 See chapter 2 par 3.1 above.

96 Du Plessis Grondslae 103; Du Plessis "Grondslag van Aanspreeklikheid" 30; Fourie "Perspektiewe" 350. See also chapter 2 par 3 above.

97 Fourie "Perspektiewe" 350. The author suggests that sui generis liability is not supported by the South African law of trusts, where the actio legis Aquiliae serves as basis for trustees' liability for breach of trust. But in this respect see Honoré & Cameron Honoré's Trusts 298. The authors of this work explain the basis of the Aquilian action for breach of trust as "based on the duty owed by one who deals or meddles with the property of another to exercise due care in doing so" (at 299). They also state: "Not all breaches of trust are delictual. ... Ordinarily it matters little whether the trustee's 'debt' in such cases is regarded as contractual, or quasi-contractual or as arising from an obligation of its own special sort (sui generis)" (at 302).
suasive authority in South African law. However, it is submitted that it does not necessarily follow that the basis of liability of breaches of fiduciary duty should be Aquilian.

The South African common law itself provides a *sui generis* action for breach of fiduciary duties. Obligations can arise from contracts, delicts or other grounds. The other sources of obligations are many and varied. It is submitted that breaches of fiduciary duty form one of these "various other causes". South African courts have acknowledged this in respect of directors' duties. In *Robinson v Randfontein Estates Gold Mining Co Ltd*, Innes CJ, referring to the no profit rule, held:

The test is expressed, for the most part, in terms peculiar to the English law; but the principle which underlies it is not foreign to our own. For it rests upon the broad doctrine that a man, who stands in a position of trust towards another, cannot, in matters affected by that position, advance his own interests ... at that other's expense.

The learned judge then confirmed that:

the action with which we have to do falls under none of the specified classes suggested.

In the same decision, Salomon JA too, confirmed that:

the action is one *sui generis*.

This view is in accordance with the general trend reflected in the comparative legal survey undertaken, which indicated a general acceptance of the *sui generis*

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98 See page 303 above.

99 These other grounds are described in D 44.7.1 pr as obligations *ex variis causarum figuris*. See also chapter 2 par 3.3 above; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706G.

100 De Wet & Van Wyk *Kontraktereg en Handelsreg* 4; Van der Merwe, Van Huyssteen ao *Contract* 4ff.

101 1921 AD 168 at 179.

102 At 199.

103 At 242. See also Naudé *Maatskappydirekteur* 142; *Cohen NO v Segal* 1970 (3) SA 702 (W). In *Cohen Boshoff J* stated: "In our law the action based on breach of trust is *sui generis*" (at 706H). For a comprehensive account of the fiduciary relationship in Roman-Dutch law, see Blackman *Fiduciary Doctrine* 239-273. *Contra* Du Plessis *Grondslae* 101 who opines that *sui generis* liability has never been critically evaluated in South African law.
nature of a director’s position. It therefore does not necessarily follow as a consequence of non-reliance upon English trust principles that the claim for breaches of fiduciary duty should be delictual in nature.

3.1.2 Legal Certainty

It has been argued that the application of delictual principles will bring about more legal certainty in connection with the determination of liability for breaches of directors’ fiduciary duties. Two reasons are given. First, it is suggested that more restricted liability would result, because the elements of delict will impose a reasonable limit on liability. The argument is that sui generis liability is so wide that the duty it seeks to enforce becomes too uncertain to be adequately protected. The second argument is that delictual principles also form the basis of liability for breaches of the duty of care and skill which a director owes his company. Should the same principles be at the root of fiduciary duties, it would therefore be unnecessary to retain the distinction between the two types of duty. This would result in more legal certainty about directors’ duties in general. Two questions arise. The first is to what extent one wishes to limit the fiduciary duty owed by a company director to his company. Second, it should be asked whether the actio legis Aquiliae is the best means of achieving any restriction which may be deemed necessary. These issues are investigated below.

3.1.2.1 Restriction of Liability

It is evident that, should it be accepted that the basis of liability for breaches of directors’ fiduciary duties is sui generis, the risk of liability is very wide. It is

104 See chapter 2 par 3.3 and authorities cited in note 116; chapter 4 par 3 (England); chapter 5 par 2 (America); chapter 7 par 3.2 (Germany) and chapter 8 par 3.3 (Australia, Canada and New Zealand) above. Under French law, where directors’ liability is based upon statutory provisions rather than on a fiduciary relationship, liability is not based only upon the application of general principles of tort law: Campbell Liability of Corporate Directors 275. German law too imposes duties extending beyond delictual liability: see chapter 7 par 3 above.

105 Du Plessis Grondstae 108. On the law of delict in general, see Boberg Delict; Neethling, Potgieter & Visser Law of Delict; Van der Merwe & Olivier Onregmatige Daad; Van der Walt Delict. See also Du Plessis Grondstae 106-107 for an application of delictual principles to a breach of duty by company directors (on the assumption that the actio legis Aquiliae is accepted as basis for liability in instances of breach of duty).

106 Du Plessis Grondstae 108.

107 It was, for example, seen above (see chapter 4 par 3.2.1 above) that the result of the decision in Regal (Hastings) Ltd v Gulliver can, on the particular facts, be regarded as inequitable. Similarly, the result of some of the decisions on corporate opportunities has been that shareholders who were not shareholders at the time when the breach of duty occurred, would receive a ‘windfall’ profit by having the value of their shares increased as a result of the moneys recovered. See, for example Abbey Glen Property Corp v Stamburg (1978) 85 DLR (3d) 35 (chapter 8 par 3.4.2 above).
equally apparent that application of the elements of delict, on the other hand, limit liability.\textsuperscript{108}

The need for a strict fiduciary rule has been recognised in South African law since the beginning of the century.\textsuperscript{109} The legal systems of the other countries investigated in this thesis also acknowledge the need for strict enforcement of directors' duties, whether it be done by means of the imposition of a fiduciary responsibility,\textsuperscript{110} or by statutory provisions,\textsuperscript{111} or by means of a combination of the two approaches.\textsuperscript{112} Restricted liability might indeed bring about increased legal certainty. But there is the danger that, if too confined, the enforcement of directors' fiduciary obligations may become ineffective.\textsuperscript{113} It is therefore submitted that the strict rule regarding the duties of fiduciaries should be preserved as a deterrent for possible abuse of that position. Legal certainty and a reasonable limit to liability remain important considerations. It is, however, suggested that these aims can be achieved by the development of flexible rules in respect of the particular position of a company director. Existing decisions already, to some extent, indicate the parameters of liability.

\textbf{3.1.2.2 The Duty of Care and Skill}

The delictual basis of liability for breaches of a director's duty of care and skill is generally recognised.\textsuperscript{114} Should it be accepted that the basis of liability for

\begin{itemize}
\item \textsuperscript{108} Neethling, Potgieter & Visser \textit{Law of Delict} 2, 154-155; Pretorius "Aanspreeklikheid" 66; Van der Merwe & Olivier \textit{Onregmatige Daad} 15-16, 314 and 316; \textit{Administrateur, Naal v Trust Bank van Afrika Bpk} 1979 (3) SA 824 (A) at 832H-833B.
\item \textsuperscript{109} \textit{Transvaal Cold Storage Co Ltd v Palmer} 1904 TS 4 at 23-24 per Innes CJ; \textit{S v Heller} 1971 (2) SA 29 (A) at 44A-B; \textit{Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others} 1988 (2) SA 54 (T) at 67E.
\item \textsuperscript{110} As in England, America, Australia, Canada and New Zealand (see chapters 4 par 3, 5 par 3 and 8 par 3.3 above).
\item \textsuperscript{111} See chapter 6 par 3 above in respect of the French legal system.
\item \textsuperscript{112} As is done under German law (see chapter 7 par 3 above).
\item \textsuperscript{113} \textit{Contra Du Plessis Grondslae} 109, who submits that the \textit{sui generis} nature of a director's position will still be taken into account in the application of delictual principles, especially in the determination of unlawfulness and negligence. The author further suggests that Aquilian liability could also serve as basis for control over the powers of other officers and employees. It is submitted that the fiduciary doctrine could also cover these situations, since it is not restricted to directors. Even if that were not the case, in view of the long development of the law of a director as a particular type of fiduciary, it is submitted that it is not essential to have the same basis for liability of directors and other functionaries.
\item \textsuperscript{114} On the duty of care and skill generally, see Cilliers & Benade \textit{Corporate Law} 142ff; Farrar \textit{Company Law} 396-402; Gower \textit{Company Law} 585-589; Naude \textit{Maatskappydirekteur} 155-156, 161ff; Pennington \textit{Company Law} 600-603; \textit{In re Brazilian Rubber Plantations and Estates Ltd} [1911] 1 Ch 425; \textit{In re City Equitable Fire Insurance Co Ltd} [1925] 1 Ch 407; \textit{Fisheries Development Corporation of SA Ltd v Jorgensen} 1980 (4) SA 156 (W); \textit{Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd and Others} [1983] Ch 258, [1983] 3 WLR 492 (CA), [1983] 2 All ER 563 (CA); \textit{Cronjé NO v Stone en 'n Ander} 1985 (3) SA 597 (T), discussed by Luiz "Extending Liability" 788.
\end{itemize}
breaches of a director's duty is delictual in nature, the same principles would there-
fore be fundamental to both types of duty.115

The implication is that it would be unnecessary to retain the distinction 
between breaches of these duties. Thus Du Plessis submits:

'n Verdere gevolg van hierdie voorstel [that the basis of liability for breach of fiduciary
duty is delictual] is derhalwe dat dit onnodig raak om steeds 'n streng onderskeid te hand-
haaf tussen enersyds die skending van sorgsaamheids- en vaardigheidspligte en andersyds
die skending van vertrouenspligte.116

Traditionally, systems that distinguish between directors' fiduciary duties and 
their obligations of care and skill acknowledge that the former duties are much 
more onerous than the latter ones.117 In France, where the distinction is not made, 
the grounds for civil and criminal liability are numerous and varied, and include ele-
ments of both obligations.118 This is also the case in Germany, where the concept of 
directors' fiduciary obligations is less developed than in Anglo-American law.119 In 
that system, the obligation imposed upon a director to exercise the diligence and 
care of a prudent and conscientious manager is interpreted widely and implies that 
he should, in all circumstances, act to the advantage of the company and should 
avoid anything which may cause it harm.120 But both these systems, as was seen 
above, rely to a great extent on the codification of general legal principles and com-
pany law, which is not the position in South African law. It is submitted that this 
consideration should be borne in mind before abolishing the traditional distinction 
between duties of care and skill and fiduciary obligations.

It is suggested that another reason why the distinction between directors' 
duties of care and skill and their fiduciary duties should be retained is that the 
extent of a director's duty of care and skill depends to a considerable degree on the 
nature of the company's business and on any particular obligations assumed by or 
assigned to the director.121 Fiduciary obligations are not dependent upon any such 
considerations.122

115 Du Plessis Grondsle 108.
117 Menzies "Company Directors" 156. According to Gower Company Law 585, English law recog-
nises "... a striking contrast between the directors' heavy duties of loyalty and good faith and their light 
obligations of skill and diligence". Baxt "Ratification" 19-20 points out in respect of the Australian law 
that the nature of the skill and care that is expected has never been placed at a very high level.
118 See chapter 6 par 3.2 above.
119 See chapter 7 par 3.2 above.
120 See chapter 7 par 3.1 above.
121 Cilliers & Benade Corporate Law 143; In re City Equitable Fire Insurance Co Ltd [1925] 1 Ch 407 at 
427; Wolpert v Uitzigt Properties (Pty) Ltd & Others 1961 (2) SA 257 (W) at 267.
122 See par 3.2 below.
It is, furthermore, submitted that what is required of a cautious fiduciary differs from that which an enterprising director needs to display. It may be argued that the distinction in degree of the respective duties will be maintained by application of the delictual element of wrongfulness. As is indicated below, this poses problems of its own.\textsuperscript{123}

3.1.3 \textit{The Elements of Delict}

In this paragraph the elements of delict are briefly discussed. The aim of the analysis is to indicate that the application of delictual principles may pose problems in respect of the recognised fiduciary obligations in South African company law. It is submitted that such application will not necessarily lead to legal certainty. And, even if it should be accepted that liability of company directors should be restricted, it is attempted to show why the application of delictual principles will not succeed in this aim. A comprehensive discussion of delictual principles is obviously not possible in this thesis. The analysis is restricted to an attempt to highlight specific problems which may be encountered if these principles are enforced upon all situations where liability arises for breaches of a director's fiduciary obligation. It is, at the same time, acknowledged that a plaintiff may elect to base his claim upon delictual principles in certain circumstances.

3.1.3.1 \textit{Conduct}

An act or conduct may be described as a general prerequisite for delictual liability.\textsuperscript{124} It is assumed that this requirement is complied with when it is sought to impose liability for breach of a director's fiduciary duty.\textsuperscript{125}

3.1.3.2 \textit{Wrongfulness}

An act which causes harm to another is in itself insufficient to give rise to delictual liability. For liability to follow, prejudice must be caused in a wrongful, that is, a legally reprehensible or unreasonable manner.\textsuperscript{126} The general norm or criterion to be employed in determining whether a particular infringement of interests is

\textsuperscript{123} See par 3.1.3.2 below.

\textsuperscript{124} Boberg \textit{Delict} 41; Neethling, Potgieter & Visser \textit{Law of Delict} 21; Van der Merwe & Olivier \textit{Onregmatige Daad} 24ff; Van der Walt \textit{Delict} 57.

\textsuperscript{125} Burchell \textit{Delict} 29 regards capacity as an additional element of delict. Neethling, Potgieter & Visser \textit{Law of Delict} 104-105 regard it as an aspect of accountability, not as a separate delictual element. It is assumed for purposes of this discussion that the company director complies with this requirement.

\textsuperscript{126} Boberg \textit{Delict} 30ff; Neethling, Potgieter & Visser \textit{Law of Delict} 145ff, 155ff; Van der Merwe & Olivier \textit{Onregmatige Daad} 49ff; Van der Walt \textit{Delict} 20ff; Van Heerden "Onregmatigheidsonorme" 151; Visser "Onregmatige Mededinging" 118-120.
unlawful, is the legal convictions of the community, or the boni-mores test. The legal convictions of the community is an objective test based on reasonableness, that is, the question is whether society condemns the particular conduct as unreasonable and improper. Reasonableness entails a balancing process between the interest which the defendant promoted and those rights which he actually infringed. The test for wrongfulness is thus open-ended.

It is submitted that it may prove difficult to establish this requirement. Various criteria are applied in order to determine wrongfulness. One criterion is the infringement of a subjective right. A company director must, therefore, infringe a subjective right of the beneficiary of his fiduciary duty to comply with the delictual requirement of wrongfulness. It was concluded above that the beneficiary of the fiduciary obligation is the company itself. Thus a subjective right of the company must be infringed to establish wrongfulness in term of the doctrine of subjective rights.

The classes or categories of rights distinguished on this basis, are real rights, personality rights, personal rights and immaterial property rights. Personal immaterial property rights have been identified as a possible fifth category of rights. Earning capacity and creditworthiness of the individual are examples of the fifth category of rights. It is unnecessary, for purposes of this discussion, to enter into this debate, since these rights will resort under either immaterial property rights, or personal immaterial property rights. In instances of unfair competition, it

127 Neethling, Potgieter & Visser *Law of Delict* 31ff and authorities cited. The authors point out that in applying the boni-mores criterion in the law of delict, we are not concerned with what the community regards as socially, morally, ethically or religiously right or wrong, but whether or not the community regards a particular act or form of conduct as delictually wrongful (at 35). Legal convictions are, however, naturally influenced by ethical, moral and religious convictions: *Clarke v Hurst NO and Others* 1992 (4) SA 630 (D) at 652G-H.

128 Boberg *Delict* 33; Van der Walt *Delict* par 21.


130 In *Universiteit van Pretoria v Tommie Meyer Films (Edms)* Bpk 1977 (4) SA 376 (T) at 387, the court accepted the doctrine of subjective rights. The fundamental premise of this doctrine is that wrongfulness consists of the infringement of a subjective right. On this doctrine, see in general Neethling, Potgieter & Visser *Law of Delict* 43ff.

131 Du Plessis *Grondslae* 106-107. On the dual relationship that characterises every right, namely the subject-object relationship and the subject-subject relationship, see Neethling, Potgieter & Visser *Law of Delict* 43-44.

132 See chapter 3 par 4 above.

133 Van der Merwe & Olivier *Onregnatige Daad* 55; Van der Walt *Delict* 22; *Universiteit van Pretoria v Tommie Meyer Films (Edms)* Bpk 1977 (4) SA 376 (T) at 382.

134 Neethling 'Persoonlike Immaterieelgoedereregte' 316ff.

135 Neethling 'Persoonlike Immaterieelgoedereregte' 317.
therefore seems, at first glance, fairly easy for a company to establish the element of wrongfulness. But unfair competition, in any event, allows the company a separate delictual remedy, without detracting from the possibility of a claim for breach of the director’s fiduciary obligation.\textsuperscript{136} And, furthermore, where the contracting party would not have contracted with the company itself, it could be argued that no right of the company was in fact infringed. Nonetheless, the comparative legal survey undertaken above showed that in such circumstances liability has frequently been imposed upon company directors.\textsuperscript{137} It is submitted that circumstances such as the financial inability of a company to pursue a particular opportunity, or ratification, may cause similar problems.

The infringement of a subjective right is only one criterion for the determination of wrongfulness.\textsuperscript{138} There are circumstances in which it more appropriate to determine wrongfulness by inquiring whether a legal duty has been breached.\textsuperscript{139} Cases of liability for an omission or the causing of pure economic loss are recognised as such circumstances.\textsuperscript{140} Here too, it is envisaged that the application in respect of company directors will prove problematic. Directors’ fiduciary duties are traditionally expressed in terms of positive obligations and not omissions.\textsuperscript{141} Liability has, furthermore, frequently been imposed in circumstances when no loss has been suffered by the company.\textsuperscript{142}

In certain instances the existence of a special relationship between the parties may be an indication that the one party has a legal duty towards the other to prevent harm.\textsuperscript{143} There is no indication that the fiduciary relationship between a director and his company constitutes such a relationship. Furthermore, there is some doubt

\textsuperscript{136} See par 4.6 below.

\textsuperscript{137} Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162 (see chapter 4 par 4.3 above); Energy Resources Corporation, Inc v Porter 438 NE2d 391 (Mass 1982) (see chapter 5 note 449 above).

\textsuperscript{138} See page 322 above.

\textsuperscript{139} Neethling, Potgieter & Visser Law of Delict 49.

\textsuperscript{140} Neethling, Potgieter & Visser Law of Delict 49ff. The authors point out that there is, however, neither a general duty to prevent loss to others by positive conduct, nor a general duty to prevent pure economic loss. The imposition of such duties would probably place too heavy a burden on individuals in the community.

\textsuperscript{141} See chapter 4 par 3 above; chapter 5 par 3 above; par 3.2 below.

\textsuperscript{142} See par 3.1.3.5 below.

\textsuperscript{143} Neethling, Potgieter & Visser Law of Delict 60. The existence of a contractual relationship may indicate such a duty. Other examples are the relationship between a policeman and a citizen (\textit{Minister van Polisie v Ewels} 1975 (3) SA 590 (A)), an officer of the law and a prisoner (\textit{Mati v Minister of Justice} 1958 (1) SA 223 (A)) and an employer and his employee (Silva’s Fishing Corporation (Pty) Ltd v Maweta 1957 (2) SA 256 (A)).
whether the relationship is in itself sufficient to give rise to a legal duty. Therefore, to determine whether a legal duty to prevent damage exists, not only must the relationship between the parties concerned be investigated, but also each case must be measured against the *boni-mores* criterion in the light of all the circumstances.

In view of the above, it is suggested that the application of the element of wrongfulness to effectively enforce directors' fiduciary obligations is fraught with uncertainties. Moreover, the *boni-mores* criterion may in certain circumstances lead to very comprehensive liability. The application of this delictual element will, it is submitted, not contribute to the aims of legal certainty or restricted liability mentioned above.

### 3.1.3.3 Causation

The causing of damage through conduct is required for a delict. A person can therefore not be liable in delict if he has not caused any damage. The question whether there is a causal *nexus* in a particular context, is a question of fact which must be answered in the light of the available evidence.

In order to establish delictual liability for breach of a director's fiduciary duty, it will thus have to be ascertained whether the director's act was the factual and juridical cause of the loss or damage suffered by the plaintiff. Various theories exist in respect of the existence of legal causation. The most recent Appellate Division cases show that a flexible approach is preferred. The most important question is whether there is a sufficiently close relationship between cause and consequence so that the consequence may be imputed to the wrongdoer with reference to reasonableness, fairness and justice.

The element of causality should, it is submitted, not on its own pose a problem in respect of the enforcement of directors' fiduciary duties. However, it is suggested that the requirement of a causal link between the conduct of the director and the ensuing *damage* will prove problematic.

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144 Neethling, Potgieter & Visser *Law of Delict* 60; Van der Merwe & Olivier *Onregmatige Daad* 46; Van der Walt *Delict* 33; *Bedford v Suid-Kaapse Voogdy Bpk* 1968 (1) SA 226 (C) at 230.

145 See par 3.1.2 above.

146 Neethling, Potgieter & Visser *Law of Delict* 159.

147 On the element of causality generally, see Neethling, Potgieter & Visser *Deliktereg* 146ff, 159ff. The factors to be considered are succinctly set out in *International Shipping Co (Pty) Ltd v Bentley* 1990 (1) SA 680 (A) at 700-704.


149 Neethling, Potgieter & Visser *Law of Delict* 193; *S v Mokgethi* 1990 (1) SA 32 (A) at 39ff; *International Shipping Co (Pty) Ltd v Bentley* 1990 (1) SA 680 (A), especially 700-704.

150 On the delictual requirement of damages, see par 3.1.3.5 below.
3.1.3.4 Fault

It is accepted that fault (culpa in a wide sense) is a general requirement for delictual liability.\(^{151}\) The existence of either intent or negligence on the part of the defendant is sufficient to blame him. Intent will be established if the wrongdoer's will is directed at the result which he causes while he is conscious of the wrongfulness of his conduct.\(^{152}\) However, in the field of delictual liability for patrimonial loss within the *actio legis Aquiliae* intention is seldom encountered as the relevant form of fault since negligence is considered to be sufficient.\(^{153}\)

In the case of negligence, a person is blamed for an attitude or conduct of carelessness, thoughtlessness or imprudence, because, by giving insufficient attention to his actions, he failed to adhere to the standard of care legally required of him.\(^{154}\) The criterion of the reasonable man thus takes the central place in the determination of negligence.\(^{155}\) The test to determine whether a person's conduct complies with that of a reasonable person is to enquire whether a reasonable person in the position of the defendant (a) would foresee the possibility of his conduct causing harm; (b) take reasonable steps to guard against such harm; and (c) the defendant failed to take such steps.\(^{156}\) In the case of experts such as dentists, surgeons or electricians the test for negligence in respect of the expert activity is the test of the so-called "reasonable expert". It is also possible to establish the standard of, for example, a reasonable angler or a reasonable attorney.\(^{157}\) Once it has been estab-

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\(^{151}\) Boberg *Delict* 268ff; Van der Walt *Delict* 60ff; Neethling, Potgieter & Visser *Law of Delict* 103, 113ff; Van der Merwe en Olivier *Deliktereg* 110ff. Our common law acknowledges certain exceptional instances where a defendant would be liable for compensation when the elements of delict have not been satisfied (the so-called "strict" or "risk" liability): Neethling, Potgieter & Visser *Law of Delict* 341ff; Van der Merwe & Olivier *Onregmatige Daad* 456. Van der Walt *Delict* 3 submits that these cases are still considered to be exceptions to the "fault" principle or "specialties". They do not detract from the fact that fault is a general requirement for delictual liability.

\(^{152}\) Neethling, Potgieter & Visser *Law of Delict* 116.


\(^{154}\) Boberg *Delict* 274; Neethling, Potgieter & Visser *Law of Delict* 122; Van der Walt *Delict* 65. An authoritative statement in respect of the test for negligence is found in Kruger *v Coetzee* 1966 (2) SA 428 (A) at 430 (per Holmes JA): "For the purposes of liability culpa arises if - (a) a *diligens paterfamilias* in the position of the defendant - (i) would foresee the reasonable possibility of his conduct injuring another in his person or his property and causing him patrimonial loss; and (ii) would take reasonable steps to guard against such occurrence; and (b) the defendant failed to take such steps." See also Botes *v Van Deventer* 1966 (3) SA 182 (A); Santam Insurance Co Ltd *v Nikosi* 1978 (2) SA 784 (A) at 791-792; Santam Versekeringsmaatskappy Bpk *v Swart* 1987 (4) SA 816 (A) at 819-820.


\(^{156}\) Kruger *v Coetzee* 1966 (2) SA 428 (A) at 430E-F; Nguibane *v South African Transport Services* 1991 (1) SA 756 (A) at 776E-F.

\(^{157}\) Sursathi *v Elliott* 1963 (3) SA 233 (D); Mouton *v Die Mynwerkersunie* 1977 (1) SA 119 (A) at 142ff. For further examples from the case law, see Neethling, Potgieter & Visser *Law of Delict* 129 note 87.
lished that the conduct of a particular person should be measured against a certain category of experts, the "reasonable expert" should be taken as yardstick.\textsuperscript{158} But it is submitted that the "reasonable company director" does not exist, because the skill and experience, and, accordingly, a director's duties vary from company to company.\textsuperscript{159} The difficulty of establishing a uniform test for a director's negligence was underlined in \textit{Ex parte Lebowa Development Corporation Ltd},\textsuperscript{160} where Stegmann J stated:

The liability of a director for negligence in the conduct of a company's affairs depends upon a number of factors that require investigation. They include the part which each director in fact played in the conduct of the company's business and the manner in which he played his part.

Du Plessis contends that, as is done in respect of the duty of care and skill, the issue of fault should be seen as a \textit{species} of the problem of determining the liability of specialists.\textsuperscript{161} He relies upon the statements in \textit{Robinson v Randfontein Estates Gold Mining Co Ltd}\textsuperscript{162} as authority for the requirement of \textit{dolus} before liability can be imposed in cases of breach of duty.\textsuperscript{163} In that case the court had to decide whether a commission should be interpreted \textit{de bene esse}. Wessels J stated:

It is alleged that the defendant abused his fiduciary position as chairman and director of the Randfontein Estate, and that he acquired for himself property that he ought to have acquired for the company ... A charge of that kind involves dolus undoubtedly ...

... In this case the inquiry appears to turn on the question of an abuse of a fiduciary relationship. Such an abuse may be the result of deliberate dishonesty or it may be that the defendant thought he was entitled to do what he actually did.\textsuperscript{164}

It is submitted that these statements should be considered in their context. In the above matter, the plaintiffs relied upon \textit{dolus} and it was unnecessary to consider

\textsuperscript{158} Scott "Nalatigheidstoets vir Deskundiges" 156; \textit{Tonkwane Sawmill Co Ltd v Filmalter} 1975 (2) SA 453 (W) at 455A.

\textsuperscript{159} Naudé \textit{Maatskappydirekteur} 162ff; Pretorius "Aanspreeklikheid" 67 note 90.

\textsuperscript{160} (1989) 3 SA 71 (T) at 108A.

\textsuperscript{161} Du Plessis \textit{Grondslae} 107; Du Plessis "Grondslag van Aanspreeklikheid" 34.

\textsuperscript{162} 1918 TPD 420.

\textsuperscript{163} Du Plessis \textit{Grondslae} 102; Du Plessis "Grondslag van Aanspreeklikheid" 30.

\textsuperscript{164} At 423 per Wessels J. The case was heard by the same judges who would later hear the \textit{a quo} case of \textit{Robinson v Randfontein Estates Gold Mining Co Ltd} 1921 AD 168, namely Wessels, Mason and Gregorowski JJ.
if liability could have arisen even without its presence. In the later decision in Robinson v Randfontein Estates Gold Mining Co Ltd, the court pertinently considered the basis of a director's liability for breach of fiduciary duty before concluding that it is sui generis.

Fault has never been considered as a prerequisite for directors' liability in instances where they have breached their fiduciary duties.

A further argument against the requirement of fault as a precondition for liability relates, it is submitted, to the specific rules which have been developed over the years in connection with the enforcement of directors' fiduciary duties. One example is the "proper purpose rule". Under this rule, a director will be liable if he has abused his powers by acting for an improper purpose. Often the improper purpose will be the director's own financial gain, or to ensure the continued control of the company. But it is accepted that where directors have acted honestly in what they believe to be the benefit of the company, they may still be liable if they have exercised their powers for a purpose different from that for which the powers were conferred upon them. The application of the proper purpose rule thus often occurs in circumstances when it is accepted that fault cannot be ascribed to the directors. It is submitted that the enforcement of this well-established rule will become ineffective if it is attempted to force the basis of fiduciary liability of direc-

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165 The reference by Du Plessis "Grondslag van Aanspreeklikheid" 30 note 139 to Meyerson v Health Beverages (Pty) Ltd 1989 (4) SA 667 (C) at 6751 does not, it is submitted, take the matter any further. Thring AJ, in that excerpt, merely refers to the Robinson-case (1918 TPD 420 at 422-423) as an example of a situation where allegations were made of dolus and dishonesty and the evidence of the witness concerned is of cardinal importance to the case.

166 1921 AD 168.

167 Naude Maatskappydirekteur 143; Van Rooyen Thesis 543; Cohen NO v Segal 1970 (3) SA 702 (W) at 706G. In Australia, this is also the position: Ffrench Company Law 170. In respect of the South African law, Naude Maatskappydirekteur 142 note 6 refers to s 217 of the Companies Act, which was repealed by s 16(1) of Act 59 of 1978. Section 217 permitted the court to release a director from liability if he had acted honestly and reasonably, and if the circumstances indicated that he should not be held liable. The same discretion now vests in the court by virtue of s 248 of the Companies Act 61 of 1973. The implication of the article is that the director could otherwise have been liable. But see Fourie "Perspektiewe" 345, who traces the historical background of this section to s 3 of the English Judicial Trustees Act 1896, which applied to trustees, and concludes that it has no place in South African law. On section 248, see par 3.3 below.

168 See, in general, Farrar Company Law 391ff; Gower Company Law 556ff; chapter 4 par 3.1.2 above (in respect of English law). See also par 3.2.3 below.


170 Other elements of delict, such as causation and damages may, in the circumstances, prove even more difficult to establish.
3.1.3.5 Damage

For the purpose of founding Aquilian liability, the plaintiff must be able to prove a calculable pecuniary loss or diminution in his estate. In company law, however, there are many instances of liability for breaches of fiduciary duty when no damage have been suffered. For example, it is recognised that the strict limitation to benefit from the office of director serves to diminish possible conflicts of interest between a director and his company. This principle led to the decision in *Regal (Hastings) Ltd v Gulliver*, where the plaintiffs had not suffered any damage. When corporate opportunities are usurped, it is also accepted that the company need not have suffered any damage for liability to attach to the director. Other examples are where a director obtains a profit by concluding a contract which the company is legally incapable of concluding, or which it is prohibited from entering into, such as dealing in its own shares; and where the other party would not have transacted the
transacted the business in question with the company because of an objection to its character. The specific statutory provisions in respect of insider trading also apply irrespective of whether the company has suffered any loss.

**Evaluation**

Legal certainty about the basis of liability for breaches of directors' fiduciary duties is desirable in view of the fact that it should promote their enforcement. Thus far, it has been generally accepted that liability for breaches of these duties is *sui generis*. English common law, which is derived from the trust principles as evolved in courts of equity, is largely relied upon in this regard. The fiduciary principle is, however, also clearly recognised by South African law and has traditionally not been based on contract or delict.

It is respectfully submitted that attempts to base the fiduciary liability of directors on the *actio legis Aquiliae* do not succeed. Whilst the view that there is no reason for English principles of trust to continue to unduly influence the South African law is supported, it does not follow that claims for breaches of fiduciary duty should be delictual in nature. South African law provides for *sui generis* liability. It is submitted that this action is the proper basis for liability in respect of breaches of directors' fiduciary duties.

It was seen above that the acceptance of Aquilian liability as the basis for breaches of fiduciary duties by directors would place these duties on a par and probably merge them with the duties of care and skill. This, it is submitted, is not expedient. Traditionally the fiduciary duties are much more onerous, as a result of the particular position of the fiduciary. The need to observe a strict fiduciary rule has been recognised for many years, and is in accordance with other Anglo-American legal systems. It is suggested that the strict rule regarding the duties of fiduciaries should be preserved as a deterrent for possible abuse of that position.

178 *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162 (see also chapter 4 par 3.2.1 above).

179 On insider trading generally, see s 440F; Botha "Control of Insider Trading" 1ff; Botha "Insider Trading" 145ff; Cilliers & Benade *Corporate Law* 145ff; Du Plessis 'Binnekennistransaksies' 46ff; *Henochsberg* 974ff; Luiz 'Transplant' 59ff; Luiz 'Saga' 328ff; Van Zyl 'Binnekennistransaksies' 77ff. See also note 283 below.

180 See page 315 above.

181 See par 3.1.1 above.

182 See page 317 above.

183 See par 3.1.2.2 above.

184 See page 320 above.

185 See chapter 4 par 3 (England); chapter 5 par 3 (America); chapter 8 par 3.3 (Australia, Canada and New Zealand) above.
Legal certainty and a reasonable limit to liability remain important goals. They can, however, be achieved by other means. It is submitted that useful guidelines have, in this regard, already emerged in respect of the particular position of a company director from the case law.

The investigation into the possible application of delictual principles to breaches of directors’ fiduciary duties revealed some uncertainties. It is therefore respectfully submitted that the aim of legal certainty in respect of the enforcement of directors’ duties will not be achieved by such application. Neither will more restricted liability necessarily result, since the application of the *boni-mores* criterion in the determination of wrongfulness may, in fact, serve to establish comprehensive liability.  

The elements of delict, for example fault and damages, are, furthermore, not traditionally considered as prerequisite to establish directors’ liability when they are in breach of their fiduciary duties. It is submitted that to require their compliance in the interest of legal certainty will result in established principles being ignored. This will lead to even greater uncertainty in respect of the enforcement of directors’ duties than presently exist.

It is, therefore, submitted that liability for breaches of a director’s fiduciary duty should continue to be regarded as *sui generis* in nature. This is the position in the other Anglo-American systems investigated above, and is also in accordance with the enforcement of the duties of other fiduciaries. It is suggested that it is unnecessary to enforce directors’ duties differently from the duties of other fiduciaries.

The plaintiff retains the option to institute a delictual action in appropriate circumstances. A claim in respect of unlawful competition, for example, may be delictual and may, at the same time, concern the appropriation of a corporate opportunity. If it is decided to proceed by way of a claim in delict, the normal principles will, naturally, apply. It is therefore submitted that a director’s liability

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186 See page 324 above.
187 See pars 3.1.3.4 and 3.1.3.5 above.
188 *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others* 1981 (2) SA 173 (T). See also par 3.4 below. In this regard, see also *Henochsberg* 472, where an action for damages under the actio legis Aquiliae is mentioned as an additional possibility in respect of the appropriation of corporate opportunities if in the circumstances there has also been unlawful competition. The authors clearly do not regard the usual remedies for appropriation of corporate opportunities as based on delictual principles.
189 See, for example, *Cohen NO v Segal* 1970 (3) SA 702 (W) where this choice was made. Boshoff J stated (at 706H): “An application of a company’s money *ultra vires* the company is in fact a breach of trust on the part of the directors. In the case of such misapplication the directors are not only liable for what they put into their own pockets but also for what they, in breach of trust, pay to others. They have to account to the company for such moneys and their liability need not necessarily be based on fraud or delict. If it is sought to base their liability on fraud or delict it is necessary to prove the fault and blameworthiness which is essential for actions of that kind. In our law the action based on breach of trust is *sui generis*. See also *McLelland v Hulett* (1992) 1 SA 456 (D), discussed by Van der Merwe “Minderheidsaandeelhouers” 216, where it was held, on the basis of policy considerations, that after dissolution of the company the shareholders may sue the directors in delict for an omission which caused pure economic loss.
for a breach of his fiduciary obligation arises neither contractually nor delictually. It is *sui generis* and, as such, may arise irrespective of the existence of fault or damages.¹⁹⁰

### 3.2 The Scope of a Director’s Fiduciary Obligation

#### 3.2.1 Introduction

A company directorship is generally regarded as one of the most complex fiduciary offices.¹⁹¹ The fiduciary relationship arises from the purpose for which the director’s office and powers are entrusted to him, namely the benefit of the company. It therefore seeks to ensure that the powers are used and exercised for only that purpose.¹⁹² This aim is achieved by imposing two basic duties upon directors. First, the director must use his office and exercise his powers *bona fide* in the interests of the company.¹⁹³ In the second instance, he must not place himself in a position where his personal interests conflict, or may possibly conflict, with his duties to the company.¹⁹⁴

Compliance with the fiduciary obligation depends largely upon the circumstances of each case.¹⁹⁵ In order to facilitate evaluation, it is often attempted to identify different categories of fiduciary duties.¹⁹⁶ This is not objectionable *per se*.

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¹⁹⁰ The similar view expressed by Naudé *Maatskappydirekteur* 142-143 is thus endorsed.

¹⁹¹ Finn *Fiduciary Obligations* 64. Shepherd *Law of Fiduciaries* agrees: “Nowhere are fiduciary principles applied in a more difficult or complex context than the modern corporation - any attempt to build tiny little cubbyholes in the corporate context is doomed to failure” (at 347-348). As stated by Du Plessis “Deposit-taking Institutions” 57, the problem in company law in South Africa too, is that no specific meaning can be attributed to the term ‘fiduciary duty’. This leads to vagueness and gives rise to uncertainty which in turn leads to ineffectiveness of the prophylactic aim of strict fiduciary duties imposed upon directors: Du Plessis *Grondslae* 88-93 and 100-109.

¹⁹² LAWSA *Companies* par 218.

¹⁹³ See par 3.2.2 below.

¹⁹⁴ See par 3.2.3 below. See, generally, Cilliers & Benade *Corporate Law* 235; Hahlo *Cases* 376ff; Larkin “Duties” E-6; LAWSA *Companies* par 218ff; Naudé *Maatskappydirekteur* 110ff. The last mentioned author is of the opinion that “[t]logies behoort die reëls van die positiewe reg, wat die vertrouensposisie van direkteure betref ... niks anders te wees as uitgekristaliseerde toepassings van [die] twee basiese beginsels nie”: Naudé *Maatskappydirekteur* 110.

¹⁹⁵ British precedents play an important role in this regard: Du Plessis “Deposit-taking Institutions” 57; Fourie “Vertrouenspligte” 122; Naudé *Maatskappydirekteur* 109.

¹⁹⁶ For categorisations by leading English commentators, see chapter 4 note 56 above.
However, the underlying principle should not be lost sight of. The categories of directors’ fiduciary duties are, in any event, not exclusive and, to some extent, overlap. What is clear, however, is that a number of particular duties result from these two basic obligations.

The company’s two primary remedies for breach of duty are, first, a right to claim any benefit or profit acquired by the director as a result of the breach, and, in certain circumstances, the right to set aside contracts entered into by the company. In addition, the company may claim damages in respect of any loss it has suffered as a result of the breach and obtain an interdict to restrain the commission of any threatening breach.

3.2.2 Exercise of Powers in Good Faith

It is generally accepted that the paramount duty of directors, individually and collectively, is to exercise their powers bona fide in the best interests of the company. The position under South African law is therefore similar to that under English law. In South Africa too, a concise definition of the "interests of the com-

197 Fourie "Vertrouenspligte" 124. Du Plessis "Grondslag van Aanspreeklikheid" 27 also warns that the historical perspective of the English classifications should be borne in mind.

198 Farrar Company Law 380 note 12; Hahlo Cases 376. The authors of Corporate Law distinguish four categories, namely that directors (a) should prevent a conflict of interest; (b) may not exceed the limitations of their power; (c) must maintain an unfettered discretion; and (d) should exercise their powers for the purpose for which they were conferred: Cilliers & Benade Corporate Law 137.

199 Henochsberg 465; LAWSA Companies pars 218 and 226-227; Imperial Mercantile Credit Association v Coleman (1873) LR 6 Ch 558; Costa Rica Railway Co Ltd v Forwood [1901] 1 Ch 746 (CA) at 761; Cohen v Directors of Rand Collieries Ltd 1906 TS 197 at 201-202; Gray v New Augarita Porcupine Mines Ltd [1952] 3 DLR 1 (PC) at 15; Hely-Hutchinson v Brayhead Ltd and Another [1968] 1 QB 549 at 573 and 585, [1967] 3 All ER 98 at 103.


201 Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T).

202 Blackman Fiduciary Doctrine 285; Blackman "Authorised Purpose" 6; Cilliers & Benade Corporate Law 135; Farrar Company Law 383; Hahlo Cases 376; Gower Company Law 551ff; Pennington Company Law 584; Van Rooyen Thesis 325, 377; Magnus Diamond Mining Syndicate v MacDonald and Hawihome 1909 ORC 65 at 76; Treasure Trove Diamonds Ltd v Hyman 1928 AD 464 at 479; Levin v Felt & Tweeds Ltd 1951 (2) SA 401 (A); R v Herholdt and Others 1957 (3) SA 236 (A); In re Smith and Fawcett, Limited [1942] 1 Ch 304 (CA); Parke v Daily News Ltd [1962] Ch 927, [1962] 2 All ER 929; SA Fabrics Ltd v Millman 1972 (4) SA 592 (A) at 596; Novick and Another v Comair Holdings Ltd and Others 1979 (2) SA 116 (W) at 130; Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Gwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 197.

203 See chapter 4 par 3.1 above.
pany" remains elusive. One point of view is that the interests of the company are the interests of the present and future shareholders in their capacities as shareholders. However, it was indicated above that in other systems modern management often takes the view that company directors should consider not only the interests of present and future shareholders, but also those of other interest groups and, possibly those of the State and the general public. It was concluded that directors' fiduciary duties remain owed to the company. But directors' compliance with fiduciary obligations cannot be evaluated without taking cognisance of all surrounding circumstances. When indicated by the facts of a particular case, it is therefore logical to expect that the interests of certain definable groups, which include creditors and employees of the company will merit careful scrutiny. Often this will imply a balancing of the interests of different groups.

In the assessment of this duty, the court will determine the propriety of the motive upon which the directors acted. It will therefore establish whether or not the directors have behaved as honest men of business might be expected to act. The court will, however, not usurp the function of the directors and consider what is best for the company from a business viewpoint. On the face of it, this duty is therefore simply to display subjective good faith. However, notwithstanding that it is for the directors and not the courts to consider what is in the interests of the company, they may breach the duty of good faith if they have not acted with conscious dishonesty, but have failed to direct their minds to the question whether a transaction was in fact in the interests of the company. Certain objective standards are thus also

204 See also chapter 3 above. Van Rooyen Thesis 337 formulates the problem crisply: "Wat word bedoel met die uitdrukking 'die maatskappy as geheel'? Slaan die begrip 'maatskappy' in hierdie verband op die maatskappy as regsentiteit of op die lede van die maatskappy? Welke rol speel die belange van die werknemers, skuldeisers, verbruikers en die gemeenskap wanneer 'n hof moet uitmaak of daar in belang van die maatskappy (of lede) opgetree is?" See also Beuthin "Range of Interests" 158.


206 See chapter 3 par 1 above. The debate has not yet been considered in South African case law. But see the comprehensive investigations by Botha "Bondholders" 287ff (bondholders as beneficiaries of the fiduciary obligation) Fourie "Skuldeisers" 25ff (in respect of a possible duty to creditors) and Du Plessis "Pligte" 378ff.

207 See chapter 3 par 4 above.

208 Gower Company Law 553; LAWSA Companies par 221; Richard Brady Franks Limited v Price (1937) 58 CLR 112 at 135 and 138; Levin v Felt & Tweeds Ltd 1951 (2) SA 401 (A) at 414. In Levin, for example, it was held that the court would not interfere with the directors' exercise of their discretion where the objection to a scheme of reconstruction was based on the ground that there were better ways of raising money.

209 Naude Maatskappydirekteur 111; Gower Company Law 553.

210 Naude Maatskappydirekteur 111; Gower Company Law 553-554.
imposed. They entail that the directors must exercise their powers themselves, for the purposes for which they were conferred and for the benefit of the company.\textsuperscript{211}

3.2.2.1 Unfettered Discretion

A director must be able to manage the affairs of a company objectively. His discretion may, therefore, not be curtailed.\textsuperscript{212} It may, however, be necessary to distinguish the situation where the directors have in the \textit{bona fide} exercise of their discretion entered into a contract which requires them for its effectuation to vote in a certain way at future board meetings.\textsuperscript{213} For example, in \textit{Thorby v Goldberg},\textsuperscript{214} the Australian High Court upheld the validity of a contract between directors, who were also shareholders, and prospective shareholders. The directors had undertaken to alter the articles to allot certain shares and to resign as directors. Kitto J confirmed that in some transactions the exercise of the directors' discretion is called for at the time of the negotiation and not at the time when the contract is to be performed. If at the former time they are \textit{bona fide} of the opinion that it is in the best interests of the company that the transaction should be entered into, there is no reason why they should not bind themselves to do whatever is to be done by the board.\textsuperscript{215}

In their capacities as shareholders, directors may conclude voting agreements.\textsuperscript{216} Delegation of powers is only permissible if authorised by the articles of

\textsuperscript{211} Hahlo \textit{Cases} 376 and authorities cited on 399-400. In respect of the beneficiary of the fiduciary obligation, see chapter 3 above.

\textsuperscript{212} Cilliers & Benade \textit{Corporate Law} 140; Gower \textit{Company Law} 558-559; LAWSA \textit{Companies par} 222; Hahlo "Voting Agreement" 281; McLennan "Duty" 86. In \textit{Coronation Syndicate, Limited v Lilienfeld and the New Fortuna Co, Limited} 1903 TS 489 a contract in which directors had bound themselves to convene a general meeting of shareholders, was considered unenforceable. Solomon J stated: "[T]he directors are in a fiduciary position, and it is their duty to do what they consider will best serve the interests of shareholders. If, therefore, they have bound themselves by contract to do a certain thing, and thereafter have \textit{bona fide} come to the conclusion that it is not in the interests of the shareholders that they should carry out their undertaking, I do not think that the Court would be justified in interfering with their discretion and compelling them to do what they honestly believe would be detrimental to the interests of the shareholders" (at 497).

\textsuperscript{213} See also chapter 4 par 3.1.1 above.

\textsuperscript{214} (1965) 112 CLR 597.

\textsuperscript{215} At 605-606. Cilliers & Benade \textit{Corporate Law} 141 note 25 confirm that such contracts do occur and are essential in practice. See also \textit{Fulham Football Club Ltd v Cobra Estates plc} [1992] BCC 863 (CA) (chapter 4 page 68 above).

\textsuperscript{216} Cilliers & Benade \textit{Corporate Law} 103; Hahlo "Voting Agreement" 282; \textit{Stewart v Schwab} 1956 (4) SA 791 (T) at 793, applied in \textit{Amoils v Fuel Transport (Pty) Ltd} 1978 (4) SA 343 (W). See, in general, Hahlo \textit{Cases} 364 and authorities cited. In \textit{Clemens v Clemens Bros Ltd} [1976] 2 All ER 268 (Ch) the court concluded that a shareholder's freedom to use his vote as he pleases is limited. However, the opinion expressed by Cilliers & Benade \textit{Corporate Law} 103 note 16, that if some qualifying principle is to be adopted, it will have to be formulated with greater precision, is endorsed.
3.2.2.2 Excursus: The Constitution of the Republic of South Africa, 1993

a) Introduction

Chapter three of the interim Constitution contains the present constitutional provisions concerning the protection of fundamental rights and thus constitutes a bill of rights for South Africa. Such an instrument will also be incorporated in a future constitutional dispensation. The precise scope, effect and interpretation of the provisions of chapter three are still uncertain. However, any discussion of the future legal dispensation should consider the influence of a bill of rights on existing and future legal rules.

A bill of rights is traditionally regarded as a constitutional instrument entrenching, and thus guaranteeing and protecting, the basic rights of citizens against unwarranted interference by the state and its institutions. Its provisions are thus in principle directly applicable only to state action. In other words, a bill of rights therefore primarily has vertical application to relations between the state and its citizens. The possible horizontal application of the provisions of a bill of rights to private-law relations between individuals is, however, recognised in most jurisdictions where basic human rights are protected in a bill of rights. It is therefore necessary to consider the possible implications of the Constitution, and the Bill of Rights in particular, on company law.

In this excursus, provisions of the Bill of Rights which may affect companies are mentioned. The possible horizontal application of the provisions of the Bill of Rights is considered. The effect of the Constitution on the determination of good faith is then considered in the light of the requirement referred to above that a company director should exercise his powers in good faith.

b) Provisions of the Bill of Rights

Section 7(3) of the Constitution provides that juristic persons shall be entitled to the rights contained in chapter three where, and to the extent that, the nature of the rights permits. In other words, the fundamental rights entrenched in chapter

217 See also chapter 4 par 3.1.1 above.


219 Van Aswegen Contract Law 450; Van der Vyver Constitutional Options 771-773, 795.

220 See, generally, Van der Vyver Constitutional Options 795-801. This aspect is discussed on page 338 below.

221 See par 3.3.2 above.
three, to the extent that they are capable of application to bodies corporate, extend, *inter alia* to companies and close corporations.\(^{222}\) Juristic persons will most often be affected by the provisions mentioned below.\(^{223}\)

The provisions pertaining to equality are contained in section 8. Every person shall have the right to equality before the law and to equal protection of the law.\(^{224}\) No person shall, directly or indirectly, be unfairly discriminated against.\(^{225}\) A company may, therefore, not be discriminated against on the basis of the business that it conducts.\(^{226}\)

Section 13 protects the personal privacy of every person, including the right not to be subject to searches of property or to the seizure of private possessions.

Access to court and to information held by the state or any of its organs at any level of government in so far as such information is required for the exercise or protection of any of his or her rights, are protected in terms of sections 22 and 23. Section 24 protects the right of any person to lawful and procedurally fair administrative action.

Section 26 deals specifically with economic activity. Every person shall have the right freely to engage in economic activity and to pursue a livelihood anywhere in the national territory.\(^{227}\) This is qualified by the stipulation that measures designed to promote, amongst others, economic growth, basic conditions of employment, fair labour practices or equal opportunity for all, are not precluded, provided that such measures are justifiable in an open and democratic society based on freedom and equality.\(^{228}\) Hence a measure of balance and restraint is brought to the degree to which economic freedom may be carried.\(^{229}\) The task of determining the boundaries of the criterion of what is justifiable in an open and democratic society

\(^{222}\) According to Du Plessis "Constitution" 714 some of the negotiators involved in drafting the interim Constitution feared that, on the strength of s 7(3), corporations may overburden the Bill of Rights by constitutionalising issues which are best adjudicated on a different basis. It could, for example, be asked whether a company has a constitutionally recognisable "dignity", or a "privacy" of its own. And should it be possible for companies, whose activities are restricted by environmental legislation, to claim that they are being discriminated against? In view of these concerns the technical committee was of the opinion that a wording which requires an analysis of the nature of the right in question is more restrictive than one requiring an analysis of the *nature of the juristic person* itself: an entity can more readily be "humanised" or "personalised" than a right.

\(^{223}\) On the interpretation of the Bill of Rights generally, see Dugard "Bill of Rights" 208.

\(^{224}\) Section 8(1).

\(^{225}\) Section 8 (2). This applies to corporations and natural persons: *AK Entertainment CC v Minister of Safety and Security and Others* 1995 (1) SA 783 (E) at 790A-C.

\(^{226}\) On the effect of s 8 on corporations, see Albertyn & Kentridge "Equality" 170-172.

\(^{227}\) Section 26(1). On the effect of s 26 on restraints of trade, see Woker "Restraints of Trade" 329.

\(^{228}\) Section 26(2).

\(^{229}\) Knoll "Constitution" 376.
will no doubt soon fall upon our courts, including the Constitutional Court as the court of final instance.

Labour relations are regulated by section 27,230 and the protection of property rights (including movable property in the form of, for example, shares in companies) by section 28. This section provides that every person shall have the right to acquire and hold rights in property and, to the extent that the nature of the rights permits, to dispose of such rights.231 No deprivation of any rights in property shall be permitted otherwise than in accordance with a law.232 Where any rights in property are expropriated pursuant to such a law, the expropriation shall be permissible for public purposes only and subject to the payment of compensation.233 The interpretation of "public purposes" for purposes of this provision will, again, fall upon the courts in disputed cases.

With regard to the dispossession of land, section 8(3)(b) entitles any person or community dispossessed of rights in land before the commencement of the Constitution under any law that would have been inconsistent with subsection (2),234 had that subsection been in operation at the time of the dispossession, to claim restitution of such rights.235 Companies owning land may, naturally, be affected by these provisions.

Section 29 entrenches environmental rights. It gives every person the right to an environment which is not detrimental to his or her health or well-being. Therefore, where the government has permitted a company to conduct, on or under land, operations which are proved to be detrimental to the health or well-being of individuals, the individual or a class of individuals would be able to obtain an appropriate interdict against the company.236

The rights entrenched in chapter three may, according to section 33, be limited by law of general application, provided and only to the extent that the limitation is reasonable and justifiable in an open and democratic society based on freedom and equality, and that it does not negate the essential content of the right in question.237

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230 The effect of the Constitution on labour law is cogently discussed by Basson "Labour Law" 498ff.
231 Section 28(1).
232 Section 28(2).
233 Section 28(3).
234 This section prohibits unfair discrimination. See page 336 above. A law that would have been inconsistent with it is the now repealed Group Areas Act 36 of 1966.
235 Sections 121, 122 and 123 provide for a Commission on Restitution of Land Rights to investigate the merits of claims and for a court of law to deal with these matters.
236 Knoll "Constitution" 377.
237 On this section, see also Diamond "Grondwet" 383.
c) Horizontal Application of the Bill of Rights

The recognition of the possible horizontal application of the provisions of a bill of rights to private-law relations between individuals by most jurisdictions where basic human rights are protected in a bill of rights, was referred to above. There are different approaches to the issue of horizontal application. One is found in the German doctrine of *Drittwirkung*, or indirect horizontal application, which entails that unless specifically provided otherwise, the provisions of the *Grundgesetz* have no direct application to private-law relations. These relations are regulated by the provisions of the German Civil Code (*BGB*) and other legislation. Indirect horizontal application can, however, arise because the so-called general clauses in the *BGB*, embodying the principles of good faith and good morals, have to be interpreted and applied to reflect the standards set by the basic rights protected in the *Grundgesetz*. Furthermore, the interpretation by the courts of all legislation, including that governing private-law relations, has to be undertaken to give maximum effect to an objective system of values extracted from the provisions of the *Grundgesetz*, in effect indirectly subjecting all private-law rules and principles to the basic values of the *Bill of Rights*.

Indirect horizontal application can also arise by other means. The legislature can be subjected as an organ of state, and thus of all new legislation affecting private-law relations, to the provisions of the *Bill of Rights*. New legislation regulating private relations will not infringe or conflict with the fundamental rights protected in such a bill beyond the limitation of fundamental rights specifically permitted, usually in a general limitation clause contained in the *Bill of Rights*. Moreover, a bill of rights can specifically provide for legislative or other state measures to promote or protect specific fundamental rights or to enable affirmative action programmes. In as far as such measures affect private-law relations they constitute a form of indirect horizontal application.

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238 See page 335 above.

239 The provision of s 35(3) of the South African Constitution that in the interpretation of any law and the application and development of the common law and customary law, a court should have due regard to the spirit, purport and objects of chapter three, is in effect an express adoption of the model of *Drittwirkung*: Van Aswegen "Implications" 6.

240 *BGB*, pars 242; 138; 836.

241 Nörr "Codification to Constitution" 37; Van Aswegen "Implications" 3; *BVerfGE* 7.198.

242 On *Drittwirkung* in German law, see Foster *German Law and Legal System* 116; Nörr "Codification to Constitution" 37-38; Van der Vyver "Constitutional Options" 796-798.


244 Van Aswegen "Contract Law" 451. For another model of horizontal application, as found in the United States of America, see Van der Vyver "Constitutional Options" 796-798.
Direct horizontal application, on the other hand, means that the regulation of private relations is automatically subjected to the provisions of the Bill of Rights and can never result in any infringement or limitation of any fundamental right. Contracts concluded by the legislative and executive organs of state will evidently be directly subjected to the provisions of the Bill of Rights. It is doubtful whether direct horizontal application was intended in the Constitution, especially since its wording expressly restricts the application of chapter three to the vertical relationship between state and individual.245

The debate regarding the operation of the Bill of Rights will ultimately have to be resolved by courts with constitutional jurisdiction.246 However, various provisions in the Constitution indicate that the Bill of Rights has both horizontal and vertical application. Section 7(2) provides that chapter three shall apply to "all law in force during the period of operation of the Constitution". The reference to "all law" as opposed to "all laws" leads to the inference that the intention of the legislator was to include not only statute law, but also common and customary law.247 Moreover, section 35(3) specifically provides that in the interpretation of any law and the application and development of common and customary law, a court shall have due regard to the spirit, purport and objects of chapter three. And section 33(2) provides that, save as provided for in the Constitution, no law, whether a rule of the common law, customary law or legislation, shall limit any right entrenched in chapter three of the Constitution. This must influence all applications of the common law which governs private-law relationships, since courts must therefore consider the Bill of Rights when adjudicating upon matters between third parties.248 In the final instance, section 33(3) provides that the entrenchment of the rights in terms of chapter three shall not be construed as denying the existence of any other rights or freedoms recognised or conferred by common law, customary law or legislation to the extent that they are not inconsistent with that chapter. The conclusion must be drawn that both common and customary law are expressly subjected to the application of the Bill of Rights.

Courts are, therefore, obliged when applying the common law which applies to matters between third parties (including legal persons) to have due regard to the fundamental rights and freedoms contained in the Bill of Rights. Any determination of whether a company director has complied with his basic obligation to exercise his powers in good faith must henceforth be measured against these criteria.249 Further-

245 Chapter three binds all legislative and executive organs of state at all levels of government, including any statutory body or functionary: s 7(1); s 233(1)(ix). See also Du Plessis "Constitution" 709.

246 The first indication of the Bill's horizontal applicability in our case law is in the decision in Mandela v Falati 1995 (1) SA 251 (W) at 257B-258E per Van Schalkwyk J.

247 Basson "Labour Law" 501; Du Plessis "Constitution" 713.

248 See also Basson "Labour Law" 501; Du Plessis "Constitution" 713.

249 This issue is discussed under par d) below.
more, the conclusion that the Bill of Rights has horizontal application as described above, is of fundamental significance for the common laws of contract and delict, which will, in appropriate circumstances, affect company law.

d) The Determination of "Good Faith"

When legal rules do not provide a clear resolution of a dispute, judges have to rely on substantive justifications for their decisions, reflecting values accepted by society and comprising a balancing of competing values. The values can be ethical, with some moral content, such as fairness, justice, or good faith. Alternatively, they can be goal-based, reflecting a desirable outcome in the interests of society, such as effective loss-spreading or free economic competition. Such substantive reasons for judgments are called policy considerations, and the legal rules governed by them are the so-called open-ended standards or principles. They furnish the most effective method of incorporating the values underlying the protection of fundamental rights in a bill of rights into private-law rules. Since a bill of rights reflects the fundamental legal values accepted in a society, the policy considerations determining the contents and application of open-ended rules can, to a considerable extent, be extracted from the provisions of the Bill of Rights.

The implication for company law is apparent from the consideration of the accepted principle that a company director must exercise his powers in good faith. Compliance with this open-ended standard will henceforth have to be measured in the light of the *boni mores* or legal convictions of the community as reflected in the Bill of Rights. The possible overlap with existing rights, for example the right to economic activity, must also be taken into account. It is to be hoped that future decisions will indicate the courts' approach in this regard.

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250 See, generally, Van Aswegen "Contract Law" 448ff.

251 Policy considerations are applied in instances where the traditional area of application of an established rule has to be expanded to meet changed social, scientific or technological circumstances, or where settled rules have to be altered to accommodate novel factual circumstances. In addition, they apply where legal rules expressly or by implication incorporate them in their application. See in general, Van Aswegen "Implications" 13-14; Van Aswegen "Policy Considerations" 173-174, 180-188; Payen Components SA Ltd v Bovic Gaskets CC and Others 1994 (2) SA 464 (W) at 474-476.

252 See par 3.2.2 above.

253 Section 35(3) provides that a court shall have due regard to the spirit, purport and objects of chapter three.

254 See page 336 above.
3.2.3 Exercise of Powers for the Purpose for which They were Conferred

Directors must exercise their powers for the purpose for which they were conferred, namely, an authorised business purpose. The powers that directors must exercise for the purposes of the company's business are those corporate powers derived from the objects clause of the memorandum, namely, the powers to do whatever is necessary for, or reasonably incidental to, the achievement of the object or objects stated in the company's memorandum. This duty to act for the company's business is distinguishable from directors' duty to act in what they in good faith believe to be in the interests of the company as a whole. Directors can, while acting to advance or benefit the interests of their company, further an unauthorised object by engaging in a line of business not authorised by the objects clause in the company's memorandum. In such an instance they will not be in breach of their duty to act bona fide in the interests of the company. They will, however, breach their duty to act for the purposes of the company's business. Alternatively, directors could act for the purposes of their company's business, but do so for their own benefit or for the benefit of others and not for the benefit of the company.

Directors' powers may, furthermore, not be exercised for an ulterior or improper purpose even if such act falls within the scope of the directors' powers. Where the directors act for more than one purpose, the court will establish what the primary or substantial purpose of their action was. If that purpose is improper, the action is in breach of duty despite the fact that the directors may also have acted for other proper purposes.

255 Blackman "Authorised Purpose" 6ff; Cilliers & Benade Corporate Law 141ff; Hahlo Cases 393ff; Van Dorsten Directors 188. In respect of the English law, see chapter 4 par 3.1.2 above.

256 Blackman "Authorised Purpose" 6. In this regard s 33 of the Companies Act 61 of 1973 includes in the company's main object as stated in the memorandum unlimited ancillary objects, except such specific ancillary objects as are expressly excluded in its memorandum. Section 34 provides that, except for those powers excluded or qualified in its memorandum, every company shall, furthermore, have plenary powers to enable it to realize its main and ancillary objects.

257 Blackman "Authorised Purpose" 6-7; In re Jon Beauforte (London) Ltd [1953] Ch 131, [1953] 1 All ER 634 (Ch); Re Introductions Ltd [1968] 2 All ER 1221, affirmed [1970] Ch 199 (CA), [1969] 1 All ER 887 (CA).

258 Blackman "Authorised Purpose" 7ff; Mears v African Platinum Mines 1922 WLD 57 at 60-61; French Hairdressing Saloons Ltd v National Employers Mutual General Insurance Association 1931 AD 60 at 67-68; S v Berliner 1966 (4) SA 535 (W) at 536.

259 LAWSA Companies par 221; Mills and Others v Mills and Others (1938) 60 CLR 150 at 163-165; Teck Corp Ltd v Millar (1973) 33 DLR (3d) 288 at 327.

There are many instances of improper purpose. In practice the duty to act for a proper purpose is often connected to control of a company. This results from judgments dealing with a board of directors which used its power to issue unissued shares to ensure the board's continued control over the company instead of using it for its proper purpose, namely to acquire additional capital for the company. The limitation is also relevant when the board of directors exercises its powers to prevent a take-over bid for members' shares. Similarly, the directors will not be allowed to use their powers to allot shares in the company with the object of defeating the pre-existing majority.

Directors may incur liability even if they have acted honestly in what they believe to be the benefit of the company, but have exercised their powers for a purpose which is different from that for which the powers were conferred upon them. Courts are reluctant to interfere with a power which a director bona fide believed he was exercising for a proper purpose. But if the question arises whether something was done for a particular purpose or not, the court will look at the matter objectively to estimate how pressing that problem was.

261 They include defeating or injuring the interests of the company (Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Gwano (Pty) Ltd and Others 1981 (2) SA 173 (T)), the exercise of powers for the purpose of preserving the directors' control of management (Punt v Symons & Co Ltd [1903] 2 Ch 506; Piercy v S Mills & Co [1920] 1 Ch 77) and entering into a service agreement with the company for the sole purpose of securing a pension for the director's wife in the event of his dying before her (In re W & M Roith Ltd (1967) 1 WLR 432). For further examples, see LAWSA Companies par 221.

262 Cilliers & Benade Corporate Law 141; Punt v Symons & Co Ltd [1903] 2 Ch 506 (shares issued to effect amendment of articles whereby certain shareholders would lose their right to appoint and remove directors); Piercy v S Mills & Co [1920] 1 Ch 77 (shares issued to prevent election of additional directors). See also Meats v African Platinum Mines 1922 WLD 57 where the directors made a sudden call on partly paid shares because they hoped that a certain member would not succeed in finding the amount in time and so would lose his voting rights at a particular meeting. The call was prevented by the court.

263 See Cilliers & Benade Corporate Law 141: "The directors act in breach of their fiduciary duties if they exercise their powers in such a way that they can outvote the majority, whether that majority lies with a take-over bidder or not, merely because of their belief that the party staging the take-over will not serve the interests of the company in the way they would like to see it being done" (at 140-141).

264 Cilliers & Benade Corporate Law 142; Howard Smith Ltd v Ampol Petroleum Ltd and Others [1974] AC 821, [1974] 2 WLR 689, [1974] 1 All ER 1126 (PC), [1974] 1 NSWLR 68. In this regard s 221(1) provides that, notwithstanding anything contained in its memorandum or articles, the directors of a company shall not have the power to allot or issue shares of the company without the prior approval of the company in general meeting. By contrast, the corresponding s 80(1) of the English Companies Act 1985 permits authorisation in the company's articles.

Where directors have exercised a power for an improper purpose, the transaction is voidable at the instance of the company.266 The company may ratify the particular exercise of power if it was bona fide.267 If the transaction has been concluded with a third party, it is voidable against that party if he was aware that the directors were acting for an improper purpose.268

### 3.2.4 Avoidance of Conflicts of Interest and Duty

A fiduciary may not place himself in a situation where his own interests conflict with those of the beneficiary of his fiduciary obligation.269 Therefore, a director may not place himself in a position in which he has or can have a personal interest which conflicts, or which may possibly conflict, with his duty to act in the interests of the company.270 "Possibly may conflict" means that the reasonable man considering the relevant facts and circumstances of the particular case would think that there was a real possibility of conflict, not that some situation can be imagined as arising which might conceivably result in a conflict.271 The matter must be approached on a common sense basis.272

The rule that a fiduciary should not place himself in a position where his interests and duties conflict has become clouded because the principle has many applications.273 The first is where the fiduciary purports to act on behalf of his beneficiary in a particular matter in which he has an interest conflicting with that interest of his

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266 Lindgren v L & P Estates Ltd [1968] Ch 572 (CA); Bamford v Bamford [1970] Ch 212 (CA) at 238, [1969] 2 WLR 1107; SA Fabrics Ltd v Millman 1972 (4) SA 592 (A) at 596.

267 Naudé Maatskappydirekteur 188; Hogg v Cramphom Ltd and Others [1967] Ch 254, [1966] 3 All ER 420; Bamford v Bamford [1970] Ch 212 (CA), [1969] 2 WLR 1107. See chapter 4 par 3.1.2.1 above in respect of the English law. The approach followed in Hogg v Cramphom was approved in Sammel v President Brand Gold Mining Co Ltd 1969 (3) SA 629 (A) at 682.


269 Magnus Diamond Mining Syndicate v MacDonald and Hawthorne 1909 ORC 65 at 76. The term "interests" is usually interpreted by the courts as meaning financial interests: Finn Fiduciary Obligations 203.

270 Aberdeen Rail Co v Blaikie Bros (1854) 1 Macq 461 at 473, (1854) 2 Eq Rep 1281 (HL) at 1286; Bray v Ford [1896] AC 44 at 51; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168; Boardman and Another v Phipps [1967] 2 AC 46 (HL) at 123-124. See also chapter 4 par 3.2 above.

271 LAWSA Companies par 223; Boardman and Another v Phipps [1967] 2 AC 46 at 124, [1966] 3 All ER 721 (HL); Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162 at 172.

272 Atlas Organic Fertilizers (Pty) Ltd v Piekewyn Gwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 198H.

273 Blackman Fiduciary Doctrine 191.
beneficiary which he has undertaken to advance. Here it may undoubtedly be said that the fiduciary has entered into a transaction in which his interests conflicted with his duty, whether or not the terms of the transaction are more or less advantageous than the beneficiary would have obtained had he transacted with an outsider. In this instance the most important reason for the rule is that no matter how honestly the fiduciary may act, the fact is that he could hardly but be biased. There will always be some doubt as to the propriety of the transaction.

The second situation concerns circumstances where the fiduciary acts on behalf of the beneficiary in a matter in which he has an interest but where the interest does not conflict with his duty. A wide interpretation of the *Aberdeen*-case implies that the rule covers such situations because, although the fiduciary acted in good faith, his interests could have conflicted with his duty. This approach is, it is submitted, untenable. The fiduciary is either in breach of his fiduciary duty or not. He cannot be made accountable where it is thought that he might conceivably breach his fiduciary duty.

Thirdly, where the fiduciary acts in his own interests instead of acting in the interests of the beneficiary, he breaches his duty by acting contrary to it. This is also a case where the fiduciary has permitted his interests to conflict with his duty.

Where the fiduciary breaches his duty even though he has not acted for himself instead of for the beneficiary, it appears erroneous to say that his interests conflicted with his duty. The act may be purely for the benefit of a third party, for example where confidential information is disclosed purely for the benefit of a third party. Similarly, it seems incorrect to treat incidental profits made during the course of the fiduciary’s administration of the beneficiary’s affairs as a “conflict of interest and duty”.

A director should not make any profit from his position, other than that specified in the articles or any separate contract which may exist between himself and himself.

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274 For example, where the fiduciary purports to enter into a transaction on behalf of his beneficiary with himself.

275 *Blackman Fiduciary Doctrine* 193.

276 See *Blackman Fiduciary Doctrine* 193 for the example of an agent who has been instructed to purchase property for a maximum price putting up the balance of the purchase price himself and subsequently taking a proportionate share of the profit upon resale.

277 *Aberdeen Rail Co v Blaikie Bros* (1854) 1 Macq 461, (1854) 2 Eq Rep 1281 (HL) at 471. See chapter 4 par 3.2 above.

278 *Blackman Fiduciary Doctrine* 195 suggests that the fiduciary may still be accountable for profits made, but on the basis of having turned the particular transaction into a joint venture.

279 *Blackman Fiduciary Doctrine* 195.

and the company. The receipt of payments, benefits or gratuities by directors as compensation for loss of office is specifically regulated in the Companies Act. 282 Other circumstances in which a conflict of interest and duty may arise include where a director is personally interested in a particular contract, concludes a contract with his own company, holds directorships in competing companies, or acquires the profit or gain in instances of "insider-trading". The acquisition of a "corporate opportunity" is also a specific instance of profit-making by a director, although the profit is not necessarily made by virtue of his position.

3.2.4.1 "Secret Profits"

A company director has no right to remuneration unless such right is given to him by the articles or contractually. Any other pecuniary gain received by a direc

281 See par 3.2.4.1 below.

282 Section 297 provides that the annual financial statements of a company shall contain particulars showing the aggregate amounts of the directors' emoluments, directors' or past directors' pensions and any compensation to directors or past directors in respect of loss of office. Section 227 specifically provides for disclosure to the members of a company of payments to directors for loss of office or in connection with arrangements and take-over schemes. These sections are examples of statutory provisions which supplement aspects of the fiduciary duties of a company director. See note 69 above.

283 LAWSA Companies par 224; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 178; S v Heller 1971 (2) SA 29 (A); Bellairs v Hodnett 1978 (1) SA 1109 (A); Novick and Another v Comair Holdings Ltd and Others 1979 (2) SA 116 (W) at 152-153.

284 Novick and Another v Comair Holdings Ltd and Others 1979 (2) SA 116 (W).

285 Premier Medical and Industrial Equipment (Pty) Ltd v Winkler 1971 (3) SA 866 (W) (here the matter was dealt with by reference to the fiduciary duties of an employee to his employer rather than to directors' fiduciary duties); Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Glwano (Pty) Ltd 1981 (2) SA 173 (T); Sibex Construction (SA) (Pty) Ltd v Injectaseal CC 1988 (2) SA 54 (T) (where the director resigned to form a competing close corporation).

286 This entails the use by an "insider" of price-sensitive information (known to him, but not generally, which he has acquired by virtue of his position) to trade to his advantage in the securities of a company. Farrar Company Law 364. See, in general, Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W). This aspect is currently regulated by a Securities Regulation Panel, instituted and provided for by the Companies Amendment Act 78 of 1989 and Companies Second Amendment Act 69 of 1990. See, in general, Hahlo Cases 441-442; Larkin "Securities Regulation Code" 209; Luiz "Transplant" 59; Luiz "Saga" 328. See further note 179 above.

287 See par 4 below.

288 Hahlo Cases 369; Naudé Maatskappydirekteur 98, 116; Phillips v Base Metals Exploration Syndicate Ltd (in liquidation) 1911 TPD 403 at 406. As a rule the articles leave it to the company in general meeting to determine directors' fees: Brown v Nanco (Pty) Ltd 1976 (3) SA 832 (W) at 832. See also Blackman Fiduciary Doctrine 349, where three situations of profit-making are distinguished, namely the misappropriation of property entrusted to the director, advantages obtained by him as the result of his having done something for himself which he ought to have done for the company and those advantages obtained by the director in the course of his administration of the company's affairs but which he was under no obligation to obtain for it.
The director may also incur criminal liability. This includes commissions or bribes: Naudé *Maatskappydirekteur* 117. For other examples, see chapter 4 page 77 above.

For example, the Appropriation of company assets may constitute the crime of theft. Beuthin "Theft" 479 regards the ultimate justification for a conviction on a charge of theft from a company as not simply the fact that a juristic person has been unlawfully deprived of its property, but also the prejudice to members and creditors. See also *R v Milne & Erleigh* 1951 (1) SA 791 (A); *R v Herholdt* 1957 (3) SA 236 (A); *S v De Jager* 1965 (2) SA 616 (A); *S v Heller* 1971 (2) SA 29 (A) at 46. In *R v Jona* 1961 (2) SA 301 (W) it was held that the sole beneficial shareholder and director of a private company, who had used various amounts of the company's funds for his own purposes, was not guilty of theft. One of the grounds for acquittal was that in law there was no theft because the owner of the funds was the company, who had, through its sole beneficial owner and shareholder, consented to the abstractions of funds. This approach does not take sufficient account of the fact that the company's powers to deal with its assets are limited, and was not followed in *De Jager*. For a comprehensive analysis of theft by company controllers, see Smukler Theft.

In respect of this rule generally, see chapter 4 par 3.2.1 above. On the no profit rule and its historical development generally, see Blackman *Fiduciary Doctrine* 161ff, 207ff, 262ff and 349ff.

*Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 177 per Innes CJ; *S v Berliner* 1966 (4) SA 535 (W) at 536; *Bellairs v Hodnett* 1978 (1) SA 1109 A at 1126; *S v Heller* 1971 (2) SA 29 (A) at 44; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981 (2) SA 173 (T) at 198; *Sibex Construction (SA) (Pty) Ltd v Infectaseal CC* 1988 (2) SA 54 (T) at 64F-65B. The general principle on which accountability of agents for secret profits is based in South African law, was succinctly summed up in the headnote to *Transvaal Cold Storage Co Ltd v Palmer* 1904 TS 4: "Whenever an agent in the course or by means of the agency acquires any profit or benefit without the consent of the principal, such profit or benefit is deemed to be received for the principal's use, and the amount must be accounted for and paid over to the principal. In order to render the agent liable to account for such profit it is not essential that it should arise from transactions falling within the scope of the principal's business; for the agent's inability is based not on the fact that he has prevented the principal from earning the profits, but on his duty in good faith to hand over to his employer every advantage directly or indirectly connected with the agency, save the remuneration agreed upon." This summary was quoted with approval in *Uni-Erections v Continental Engineering Co Ltd* 1981 (1) SA 240 (W) at 253B-C. In that case Nestadt J held that an employee was not liable to account because the profits made had not been directly or indirectly connected with the employee's employment or earned by virtue of his position as employee. Larkin "Annual Survey 1981" 313 warns that a conflict of interests can arise outside the "Palmer-principle" and that the duty to avoid such a conflict is the basic duty of any fiduciary.

See chapter 4 par 3.2.1 above. See also Blackman *Fiduciary Doctrine* 207, where it is shown that the term "profits" has a very wide meaning in Equity. It includes pecuniary advantages obtained by the fiduciary at the expense of his beneficiary as the result of a breach of his duty as well as incidental profits accruing to him as the result of his position.

Naudé *Maatskappydirekteur* 116. Larkin "Duties" E-35 therefore suggests the use of the term "improper gains". In *Robinson v Randfontein Estates Gold Mining Co Ltd* 1923 AD 155 at 159 Innes CJ confirmed that "profit", in this context, covers every gain or advantage made by a wrongdoer. The principle is not restricted to profits arising from the relationship between director and company, but applies equally to other agents, including servants, and partners. In *Jones v East Rand Extension Gold Mining Co Ltd* 1903 TH 325 Bristow J confirmed that the principle is that an agent (including a servant) cannot
arises from the mere fact of a profit having been made. Liability has been incurred under this rule in a variety of circumstances. Directors have been held accountable for profits made as a result of their use of the company's property or facilities, and for profits made by them on the resale of shares which they acquired by using their positions or issued to themselves. Liability has been imposed for commissions or bribes received in the course of transacting on behalf of the company. The question whether the company itself would have received the commission was treated as irrelevant. Accountability has, furthermore, arisen for profits acquired in the course of take-over, amalgamation or reconstruction. In Regal (Hastings) Ltd v Gulliver, directors were held liable for the profits they made on the resale of shares purchased by them from a subsidiary which had been formed for the purpose of acquiring certain property. Liability arose notwithstanding the fact that the directors purchased the shares in order to save the scheme which would otherwise have failed because of the company's inability to furnish all the capital needed by the subsidiary. Directors have been held accountable for profits made as a result of their use of information acquired by them through their office and which was of a confidential nature or in the nature of a trade secret, or which was of value to the company or which would or could not otherwise have been obtained. They have also been held liable for benefits given to them by promoters, usually consisting of a gift of their qualification shares given to them for consenting to be appointed to the board or to acquire their co-operation in the sale of assets to the company.

make a secret profit out of anything (including information which can be used for the purposes of the principal's business) which belongs to his principal and which the agent possesses merely in a fiduciary capacity (at 335). This dictum was approved in Peacock v Marley 1934 AD 1 at 5, and the principle approved in Robinson; Durand v Louw 1935 TPD 47. See also Trimble and Bennett v Goldberg 1906 TS 1002 (PC) on appeal from Goldberg v Trimble and Bennett 1905 TS 255 in respect of the right of a partner to share in profits made in similar circumstances.

295 See LAWSA Companies par 227 and notes 14-21.

296 Transvaal Cold Storage Co Ltd v Palmer 1904 TS 4. Where the use of the company's facilities are of a small degree liability will not follow: Bellairs v Hodnett 1978 (1) SA 1109 (A) (see also par 4.3 below).

297 Parker v McKenna (1874) 10 Ch App 96; Shaw v Holland [1900] 2 Ch 305 (CA).

298 Imperial Mercantile Credit Association v Coleman (1873) LR 6 HL 189; Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339.


300 Fine Industrial Commodities Limited v Fowling (1954) LXXI RPC 253; Cranleigh Precision Engineering Ltd v Bryant and Another [1965] 1 WLR 1293, [1964] 3 All ER 289. See also chapter 4 par 4.6 above.

301 Magnus Diamond Mining Syndicate v MacDonald and Hawthorne 1909 ORC 65

302 In re Carriage Co-Operative Supply Association (1884) 27 ChD 322.
The philosophy behind the principle of liability for secret profits has been succinctly stated as follows:303

This strict limitation to benefit from the office of director serves to diminish possible conflicts of interest between a director and his company. While such additional advantages are frequently referred to as secret profits, the rule applies equally even if the advantage was obtained openly, in good faith and in no way at the expense of the company. The decisive factor is whether the advantage arose from the director's occupation of his office; whether or not the company itself has been deprived of any advantage is immaterial.

Should such gains constitute a "secret profit" as discussed above, recovery depends on which of the two tests laid down in Regal is followed. It was seen above that the test preferred by Lord MacMillan requires that it be established that what the directors did was so related to the affairs of the company that it could properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors, and that this had also resulted in a profit to themselves.304 Lord Porter took a broader view and held that anyone who occupies a position of trust and makes a profit which he could only have acquired by use of his fiduciary position, is liable to account for such profit.305 According to this view, liability can arise even if the profit was not acquired in the exercise of the office of director. This liability for all profits made from the director's position as such is said to arise from the conflict of interest and duty principle.306 In Regal, their Lordships were of the opinion that such a conflict existed.307

Both of the above tests have found support from South African commentators. One suggestion has been that any pecuniary gain acquired by a director as a "secret profit" will be recoverable by the company only if it was not acquired as part of the agreed compensation in respect of the directorship, was acquired only by virtue of and during the course of the exercise of the office and was acquired in circum-

303 Cilliers & Benade Corporate Law 137.

304 Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 391-392, [1967] 2 AC 134 (HL) at 153. See also chapter 4 page 73 above. The decision in Regal was followed in South Africa in, inter alia, Peacock NO v Peacock NO 1956 (1) SA 413 (T) and Peffers NO and Another v Attorneys, Notaries and Conveyancers Fidelity Guarantee Fund Board of Control 1965 (2) SA 53 (C) at 57-58. See also Naudé Maatskappydirekteur 116ff; Havenga "Profit" 104.

305 Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 395, [1967] 2 AC 134 (HL) at 158. See also Parker v McKenna (1874) 10 Ch App 96 at 124, where James LJ stressed that the no profit rule should be regarded as inflexible and that it should be applied inexorably.

306 See, for example, the dictum of Lord Russell of Killowen in Regal.

307 Their reasoning is that the directors would have purchased the shares for their company if this had been possible. They were, however, not able to do so, and therefore, acting in the interests of the company, purchased the shares themselves. By doing this they placed themselves in a position where their interests may have conflicted with their duty. Blackman Fiduciary Doctrine 356.
stances where the interests of the director potentially conflicted with those of the company.308

But the wider test has also been supported, based upon the premise that

in the field of company law this uncompromising attitude is rendered even more necessary in consequence of the rather special relationship which the director has with the company and its shareholders, and because of the complexities of the modern company organization, which tends to obscure any abuse of their position.309

It is submitted that the decision in Canadian Aero Service Ltd v O'Malley indicates that this is the correct approach.310

Irrespective of which of the two tests is applied, the profit must have been made by virtue of the fiduciary position of the director in order to be recoverable as a "secret profit". All profits acquired by a director during the course and execution of his office,311 or by his use of office are recoverable.312 The question of bona fides is irrelevant in these instances. In fact, incidental profits are usually made because the administrator acted bona fide in the interests of the beneficiary.313

A contract concluded where directors have placed themselves in a position of conflict with their company, is voidable at the option of the company.314 But the right to avoid the contract will be lost if the company delays unduly before rescinding, restitutio in integrum becomes impossible, the rights of bona fide third parties intervene315 or the company affirms the contract. Affirmation may occur by an exclusion clause in the articles,316 or by ratification subsequent to the particular

308 Naude Maatskappydirekteur 122. This view is supported by Larkin "Duties" E-39.
309 Beuthin "No-profit Rule" 467.
310 Canadian Aero Service Ltd v O'Malley [1974] SCR 592, (1973) 40 DLR (3d) 371, discussed in chapter 8 par 3.4.2 above.
311 Parker v McKenna (1874) 10 Ch App 96 at 118; Transvaal Cold Storage Co Ltd v Palmer 1904 TS 4 at 33; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL) at 153; Harris v Fisher 1960 (4) SA 855 (A) at 862 (in respect of the executor and administrator of an estate).
312 Boston Deep Sea Fishing and Ice Co v Ansell (1888) 39 ChD 339; Boardman and Another v Phipps [1967] 2 AC 46; [1966] 3 All ER 721 (HL); Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL).
313 Blackman Fiduciary Doctrine 356.
314 Cilliers & Benade Corporate Law 138; Larkin "Duties" E-19-30; Naude Maatskappydirekteur 127ff.
316 For the wording of a typical exclusion clause, see Cilliers & Benade Corporate Law 138-139 note 16. See also Du Plessis Grondslae 152-154; Movitex Ltd v Buifield 1988 BCLC 104 (Ch).
The director may exercise his vote as shareholder in favour of the ratification, provided that he does not commit a fraud on the minority. Unless permitted by the articles, disclosure cannot be made to the directors. Neither may the board sanction the retention of the profit. The reason is that the director seeking to retain the profit cannot, qua director, act in the matter and that the company cannot, by reason of a director’s personal interest in a matter, be deprived of its right to the voice of all its directors in matters entrusted to their decision.

If the articles contain provisions which render the common law requirement of approval by the general meeting unnecessary, the director must nevertheless declare the nature and extent of his interest to the board of directors in terms of sections 234 et seq.

### 3.3 Exemption From or Indemnification Against Breaches of Duty

A director cannot be relieved of his fiduciary duty in the company’s articles or contractually. Section 247(1) provides that, subject to the provisions of subsection (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, or the auditor of the company, from any liability which by

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317 See par 4.8 below.

318 *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC); *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257, [1980] 2 All ER 841 at 862. In respect of ratification, see also par 4.8 below.

319 *Benson v Heathom* (1842) 1 Y&CCC 326, 63 ER 748; *Imperial Mercantile Credit Association v Coleman* (1871) 6 Ch App 558 at 567-568.

320 *LAWSA Companies* par 227; *Benson v Heathom* (1842) 1 Y&CCC 326, 63 ER 748; *Imperial Mercantile Credit Association v Coleman* (1871) 6 Ch App 558 at 567-568; *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 (PC) at 13.

321 Section 234(1) requires a director who is in any way materially interested in a contract or proposed contract of a more important kind with the company, or who becomes so interested in any such contract after it has been entered into, to declare his interest and full particulars thereof at a board meeting. Section 234(5) provides that nothing contained in § 234 shall be taken to prejudice the operation of any rule of law restricting the directors of a company from having any interest in contracts with the company. On ss 234-241 generally, see *Beuthin & Luiz Basic Company Law* 211-213; *Cilliers & Benade Corporate Law* 151ff; *Hahlo Cases* 377; *Henochsberg* 444ff.

322 *Timmers and Another v Spansteel (Pty) Ltd* 1979 (3) SA 242 (T) at 252A-D. In respect of English law, see also chapter 4 par 3.4 above.

323 This subsection permits a company to indemnify any director, officer or auditor in respect of any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour, or in which he is acquitted, or in respect of any such proceedings which are abandoned, or in connection with any application under § 248 in which relief is granted to him by the Court. On § 248, see page 353 below.
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 any such liability, shall be void. In Barlows Manufacturing Co Ltd and others v RN Barrie (Pty) Ltd and Others, Conradie J recently confirmed this principle. The decision concerned the validity of an agreement entered into between two companies, the second applicant and the first respondent. The contract involved the sale of a certain business together with "tangible assets" to the respondent. It conferred upon the applicant the right to appoint, in certain circumstances, a manager to run the business sold. The powers conferred upon the manager were vast. The applicants had obtained a rule nisi for an order of specific performance. On the return date, it was argued on behalf of the applicants that certain clauses in the company's articles of association empowered the directors to delegate their authority in the manner they had done. The court accepted that the articles contained wide powers of delegation, but held that they could not be construed as permitting the board to divest itself of its control of the company:

A director owes a fiduciary duty to his company. He cannot, while he is a director, divest himself of that duty. It is something which is inextricably tied to the office. In the exercise of this duty the director may delegate some or even all of his powers of controlling the company but he cannot, without violating what I regard as a fundamental principle of company law, delegate his duty and hence his power to control the controller. He may delegate but he may not abdicate. The board must retain ultimate control.

Any act which amounts to an evasion of the fiduciary duty is seen in the same light as a breach of that duty itself.

The exact ambit of section 247 is uncertain. In particular, difficulty arises from the lack of clarity of the words "any liability". It is certain that provisions that pur -

324 On s 247 generally, see Blackman "Exemption" 538ff. The King Committee has recommended that because of the onerous duties placed on directors the question of companies indemnifying directors be revisited: King Report 31, par 19.24.7.

325 1990 (4) SA 608 (C), discussed by McLennan "Duty" 86.

326 McLennan "Duty" 86. The court held that the powers were so extensive that the directors of the respondent company in fact purported to relinquish all effective control, at any rate, over that part of the first respondent's affairs which concerns the business (at 611D-E).

327 At 6101-611A. Even if the relevant articles could have been construed in the manner contended for, it is submitted that they would have been unlawful and of no effect. Articles may not contravene the Companies Act or any other imperative statutory or common-law rule: Hahlo Cases 110; McLennan "Duty" 88. No article can, therefore, validly relieve a director of his fiduciary duty.

328 S v Ressel 1968 (4) SA 224 (A) at 232A-C; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 197; S v De Jager and Another 1965 (2) SA 616 (A) at 625; S v Shaban 1965 (4) SA 646 (W). For this reason, courts will pierce the corporate veil of a company which has been incorporated so as to make it appear that it is that company and not a director himself which is entering into a particular transaction. Conversely, no one can persuade the court to lift the corporate veil in order to enable him to escape the consequences of what was clearly a fraudulent use of the company's separate legal identity: Beuthin & Luiz Basic Company Law 14-15.
port to relieve directors from liability for breaches of duty are rendered void by the section. But it is not clear whether the section also renders void provisions that purport to release directors from duties. The uncertainty results from the frequent practice of inserting a provision similar to article 85 of the English Companies Act 1985 in the articles of South African companies. These provisions appear to release directors from certain fiduciary duties, and their validity is mostly unquestioned. It is submitted that directors cannot be released from their common law duties by provisions contained in the articles. However, the decision in *Movitex Ltd v Bulfield*, indicates the confusion which results from the co-existence of exclusions by articles similar to article 85 and provisions to the effect of section 247. A decisive solution to the problem would be to insert sections with provisions similar to those contained in the articles in the Companies Act and to amend section 247 so as to exclude from its ambit any transactions permitted under those sections.

Section 248 grants directors and officers of a company a limited measure of protection from personal liability. It permits a court, in its discretion, to relieve a director from liability in respect of negligence, default, breach of duty or breach of trust. A director may also apply to court for this relief. The protection afforded

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329 Blackman "Exemption" 539.

330 This article, similar to articles 78 and 84 of the English 1948 Act, provides: "Subject to the provisions of the Act, and provided that he has disclosed to the directors the nature and extent of any material interest of his, a director notwithstanding his office - (a) may be a party to, or otherwise interested in, any transaction or arrangement with the company or in which the company is otherwise interested; (b) may be a director or other officer of, or employed by, or a party to any transaction or arrangement with, or otherwise interested in, any body corporate promoted by the company or in which the company is otherwise interested; and (c) shall not, by reason of his office, be accountable to the company for any benefit that he derives from any such office or employment or from any such transaction or arrangement or from any interest in such body corporate and no transaction or arrangement shall be liable to be avoided on the ground of any such interest or benefit."

331 Blackman "Exemption" 539; *African Claim and Land Co Ltd v Langermann* 1905 TS 494 at 523; *Mendonides v Mendonides* 1962 (2) SA 190 (D); *Novick and Another v Comair Holdings Ltd and Others* 1979 (2) SA 116 (W) at 152-153.

332 This point is cogently argued by Blackman "Exemption" 537ff.

333 1988 BCLC 104 (Ch). See chapter 4 par 3.4.1 above.

334 See chapter 4 par 3.4.1 above in respect of the corresponding English s 310.

335 This was proposed by Gower in respect of s 310 of the English Companies Act: see chapter 4 par 3.4.1 above.

336 Section 248(1) provides that, if in any proceedings for negligence, default, breach of duty or breach of trust against any director, officer or auditor of a company it appears to the court that the person concerned is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably and that, in the circumstances, he ought fairly to be excused, the court may relieve him, either wholly or partly, from his liability on such terms as the court deems appropriate. The provisions of s 247(1) do not prohibit a company from indemnifying any director, officer or auditor in respect of any liability incurred by him in connection with any application under s 248 in which relief is granted to him by the Court: s 247(2).
by this section is relief from liability to the company itself, not to outsiders, and from criminal accountability.\(^{338}\) It has been suggested that there is no need for a statutory provision such as section 248, because it wrongly creates the impression that a director can incur liability without fault.\(^{339}\) But, as was argued above, it is submitted that fault is not a necessary prerequisite for directors' liability for breaches of their fiduciary duties.\(^{340}\)

4 CORPORATE OPPORTUNITIES

4.1 Introduction

A director's fiduciary obligation to act in the best interests of his company,\(^{341}\) obliges him sometimes to acquire economic opportunities for his company, if he acquires them at all. If he acquires these opportunities for himself it is said that he has appropriated a "corporate opportunity". The law then refuses to give effect to his intention and treats the acquisition as having been made on behalf of the company.\(^{342}\) Accordingly, the company may claim the property from the delinquent director.\(^{343}\) In addition,\(^{344}\) or where such a claim is no longer possible,\(^{345}\) the company may claim any profit the director may have made as a result of his breach of duty, or damages in respect of any loss thereby caused to the company.\(^{346}\) In appropriate circumstances, where the breach of fiduciary duty is about to take place,

\(^{337}\) Section 248(2).

\(^{338}\) *Ex parte Lebowa Development Corporation Ltd* (1989) 3 SA 71 (T) at 107H-J.

\(^{339}\) Fourie "Perspektiewe" 349-351.

\(^{340}\) See par 3.1.3.4 above.

\(^{341}\) See par 3.2 above.

\(^{342}\) *Hahlo Cases* 423; *African Claim and Land Co Ltd v WJ Langemann* 1905 TS 494 at 505; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 179-180, 200.

\(^{343}\) *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* 1909 ORC 65; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 241; *Cook v GC Deeks and others* [1916] 1 AC 554 (PC).

\(^{344}\) It is submitted that this claim is not alternative, as is suggested in *LAWSA Companies* par 228.

\(^{345}\) *Henochsberg* 470 cites as example where the director has already sold the opportunity to a third party. In this regard, see *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

\(^{346}\) *Henochsberg* 470; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *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 392. Action may be instituted under the *actio legis Aquiliae*. 
a court order may be obtained to prohibit the impending action.\textsuperscript{347} The director may also be dismissed, and will have no claim for damages on the ground of breach of contract.\textsuperscript{348}

The relevant rules in English law are based almost exclusively upon principles peculiar to Equity.\textsuperscript{349} Some other Anglo-American countries have developed a special corporate opportunity doctrine to deal with the situation.\textsuperscript{350} By contrast, in South Africa many of the cases dealing with so-called "corporate opportunity" situations, do not even mention that term.

Before reviewing the cases concerned with this issue, it is important to define the concept "corporate opportunity".

\section*{4.2 Definition of a Corporate Opportunity}

Defining a corporate opportunity has proved to be an elusive issue.\textsuperscript{351} In certain instances, however, it may be of cardinal importance to establish whether a particular advantage may be regarded as such an opportunity. The validity of a decision to ratify and of the \textit{locus standi} of members to institute derivative actions may depend on this definition.\textsuperscript{352}

The word "opportunity" denotes a chance, occasion, happening or suitable circumstance.\textsuperscript{353} It is therefore submitted that the concept of the appropriation of a corporate "opportunity" is wider than the acquisition of a particular asset, for example where the director has a mandate to purchase a particular asset. Should the director acquire the asset for himself rather than for the company, he will be accountable in terms of the secret profit rule.\textsuperscript{354} It is unnecessary to treat such cases as instances of the appropriation of corporate opportunities.\textsuperscript{355}

\textsuperscript{347} Naude \textit{Maatskappydirekteur} 142 note 3 mentions the example of a director who is about to exercise his power for another purpose than that for which it was conferred upon him.

\textsuperscript{348} \textit{Nourse v Farmers' Co-operative Co Ltd} (1905) 19 EDC 291 at 317. If no contract exists between the director and the company, the issue of a claim for damages does not arise. See, in general, Du Plessis \textit{Ontslag} 54ff; Naude \textit{Maatskappydirekteur} 80ff, 136 note 1.

\textsuperscript{349} See chapter 4 par 4 above.

\textsuperscript{350} See chapter 5 par 6 (American law) and chapter 8 par 3.4 (Australia, Canada and New Zealand) above.

\textsuperscript{351} Brews "Defining Corporate Opportunity" 4.

\textsuperscript{352} Van Rooyen \textit{Thesis} 507 note 89.

\textsuperscript{353} Collins 424. In \textit{Webster} an "opportunity" is defined as "an appropriate or convenient time or occasion, a favorable position or chance": \textit{Webster} 664.

\textsuperscript{354} Beck "O'Malley" 787 indicates that the Canadian corporate opportunity doctrine is not circumscribed by any notion of "commission or mandate to purchase". See also page 371 below.

\textsuperscript{355} This distinction is important where ratification is concerned. In this regard, see par 4.8 below.
Generally, it can be stated that this term indicates any economic or business opportunity, whether property or rights, which rightfully "belongs" to the company or to which the company has some kind of claim. The duty not to appropriate such an opportunity arises from the particular relationship which exists either between the director concerned and his company or between the company and the particular opportunity. The opportunity can pertain to material or immaterial property.

Various tests have been suggested to determine whether a particular opportunity is corporate in nature. The widest approach is to demand that directors should pass on to the company any and all opportunities of which they become aware, irrespective of the nature of the opportunity and its affinity to company interests, and irrespective of the manner in which knowledge of such an opportunity was acquired. Every opportunity would therefore prima facie constitute a corporate opportunity. The relevant issue, according to this approach, would be to determine the mechanism by which a company could properly decline the opportunity, which would allow the director to pursue it. The narrowest approach is to state that only those opportunities in which a company has an existing legal right is a corporate opportunity. The directors would then be free to appropriate almost every opportunity for their personal use. In between these two poles, a number of tests have been applied:

The "position test" is based upon the proposition that an agent (or trustee) should not benefit from an opportunity acquired by virtue of his office. In this respect it resembles the secret profit rule. The existence or non-existence of a corporate opportunity is made dependent on the circumstances surrounding the manner in which knowledge of such an opportunity was acquired. The director may not use such information to his personal advantage if, in the circumstances, he ought to have conveyed it to the company: Henochsberg; Cranleigh Precision Engineering Ltd v Bryant and Another [1965] 1 WLR 1293, [1964] 3 All ER 289; Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162. See also Olifants Tin "B" Syndicate v De Jager 1912 TPD 305 for corresponding authority in respect of partnerships.

The law is further illustrated by the decision of Cranleigh Precision Engineering Ltd v Bryant and Another [1965] 1 WLR 1293, [1964] 3 All ER 289; Fine Industrial Commodities Limited v Powling (1954) LXXI RPC 253. See also chapter 4 par 4.2 above.

According to Brews "Defining Corporate Opportunity" 9 such an approach would be based on the view that "directors, being employed, inter alia, to ferret out new opportunities for their companies, are bound to give their companies first bite at any potential new apple."

Brews "Defining Corporate Opportunity" 9.

Brews "Defining Corporate Opportunity" 9ff; Hahlo Cases 423.
in which the director became aware of the opportunity. If it was by virtue of his position as director, the opportunity is regarded as corporate in nature. The court must therefore determine in each case whether the director was acting as a fiduciary or in a personal capacity.362

The "conflict test" rests upon the principle that a fiduciary should not place himself in a position where his private interests and his duty to the company conflict. Under this test, the existence of conflict per se turns an ordinary opportunity into one of a corporate nature.363 An opportunity will, accordingly, be deemed corporate in nature if it causes either a conflict of interest, or the possibility of such a conflict, between the director's personal interests and his duties to the company.364 The application of this test indicates a deviation by the courts from the narrower approach of the position test.365

The "expectancy test" derives from the American decision in Lagarde v Anniston Lime and Stone Co.366 The court followed a narrow approach, holding that a corporate opportunity was an opportunity in which the company had an expectancy growing out of an existing right. In later applications of the test liability is incurred when the company has developed an interest in or is actively pursuing the particular opportunity.367 No existing right is required. This test is representative of the approach followed by American courts, which emphasise the proprietary rights of a company to opportunities which are considered corporate in nature.368 It places the emphasis on whether the company expected to acquire the particular opportunity, in the sense that the company was either interested in or actively pursuing the opportunity when the director diverted it. A criticism which has been levelled at this test is that it enunciates the obvious - that which the corporation is interested in, or actively pursuing, will obviously constitute a corporate opportunity. It is the opportunities which the company may be interested in pursuing or acquiring

362 Brews "Defining Corporate Opportunity" 10; Beuthin "No-profit Rule" 458; Brusser "Corporate Opportunities" 72; Beck "O'Malley" 782; Prentice "Peso" 453; Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162 at 173-174 (see also chapter 4 par 4.3 above).


364 Boardman and Another v Phipps [1967] 2 AC 46 (HL) esp at 86; Queensland Mines Ltd v Hudson and Others (1978) 52 ALJR 399 (PC) (see chapter 8 par 3.4.2 above).

365 Brews "Defining Corporate Opportunity" 6. See also Bellairs v Hodnett 1978 (1) SA 1109 (A) at 1126-1127 where the court referred to the unreported finding by the court a quo that the element of potential conflict was conclusive when the fundamental principle prohibiting conflicts between the fiduciary's personal interests and his fiduciary duties is applied.

366 126 Ala 26 (1900). See chapter 5 page 164 above.

367 Prentice "Windfall Profits" 215.

368 Brews "Defining Corporate Opportunity" 7. See also chapter 5 par 6 above.
that present the actual problems. But these opportunities fall outside the expectancy test.369

The "present interest test", also formulated in the Lagarde-decision, deems any opportunity a corporate opportunity if the company concerned has an existing interest in it. In that decision, the court held that the legal restrictions which rest upon directors in their acquisitions are generally limited to property wherein the corporation has an already existing interest, or in which it has an expectancy growing out of an existing right, or to cases where the directors' interference will in some degree balk the corporation in effecting the purposes of its creation. It was seen above that modern American decisions consider the first two alternatives together to form the "interest or expectancy" test.370 The third alternative formulated in Lagarde, "where the directors' interference will in some degree balk the corporation in effecting the purposes of its creation", has, however, not been applied as an additional test.371 The present interest test too, emphasises the American approach to rely on proprietary rights.372

The essence of the "line of business test" is that an opportunity, to be corporate in nature, must correspond with the existing and prospective interests or activities of the corporation concerned.373 The present and potential business of a company must therefore be established, whereafter it can be determined whether the particular opportunity fell within its ambit.

According to the "fairness test", ethical standards of what is fair and equitable in the particular circumstances are applied.374 If the circumstances indicate that it would be unfair for the fiduciary to take advantage of a particular opportunity, the opportunity will be deemed to be corporate. Brews suggests that this test embraces a fairly broad and undefinable approach to the matter.375

Under English law it is usually attempted to define a corporate opportunity by looking at the source of the opportunity.376 In Menier v Hooper's Telegraph Works,377

369 Brews "Defining Corporate Opportunity" 11.
370 See chapter 5 par 6.4.1 above.
371 Brews "Defining Corporate Opportunity" 7.
372 Ibid.
373 Brews "Defining Corporate Opportunity" 7; Menzies "Corporate Opportunity" 768. See also chapter 5 par 6.4.2 above.
374 See chapter 5 par 6.4.3 above.
375 Brews "Defining Corporate Opportunity" 8.
376 Farrar Company Law 422ff; Burland and Others v Earle and Others [1902] AC 83 (PC); Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162 at 173-174. See also, generally, chapter 5 par 4 above.
377 (1874) LR 9 Ch App 350. See also chapter 4 page 73 above.
the suggestion was that an opportunity would be corporate in nature when, taking account of the circumstances, it could in conscience be said that the opportunity actually belonged to the company. This is in accordance with the approach to regard directors as trustees of company property which is in their hands or under their control. In *Cook v Deeks*, the court adopted the view that an opportunity would be corporate in nature when the company was justifiably relying on the director to acquire the opportunity for it.

American courts prefer to emphasise the proprietary rights of the company to opportunities which are considered corporate in nature, rather than viewing the issue as one of conflict, or dependant upon the source of the opportunity. In this regard the line of business test has the broadest scope, since it includes both existing interests or activities of the company, as well as those to which the company may expand. The determination of potential expansion areas or prospective activities of a company may, however, prove difficult. The fairness test, which concentrates on what is fair and equitable in the circumstances is somewhat uncertain, because of the subjectivity of the concepts of fairness and equity. Its main advantage is that it harmonises English and American law.

South African courts have not yet laid down concisive guidelines in this respect. However, an analysis of decisions here and in the other Commonwealth countries investigated indicates that in general the test that should be applied in determining whether a particular opportunity is corporate in nature is whether in all

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378 See chapter 4 par 3.2.2 above. For an exposition of other early English cases, where Chancery also looked upon the opportunity as "belonging" to the company, see Blackman *Fiduciary Doctrine* 362-376. This reasoning was rejected in *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162, discussed in chapter 4 page 94 above. See also Blackman *Fiduciary Doctrine* 360.

379 [1916] 1 AC 554 (PC) (see chapter 4 page 93 above).

380 The various tests applied in American decisions are discussed in chapter 5 par 6.4 above.

381 See page 357 above.


384 This is understandable in view of the fact that corporate opportunity issues are usually resolved by application of the general fiduciary principles applicable to company directors. In *Bellairs v Hodnett* 1978 (1) SA 1109 (A) at 1129 (see page 362 below), the court relied on "the actual business at the time" of the company. By implication the line of business test is favoured: *Ibid.* "Defining Corporate Opportunity" 14. See also Beuthin "No-profit Rule" 464 who states that the opportunity must be in the line of business of the company, or at least closely associated with it, or one which the company is actively pursuing, or one the acquisition of which is vital to the company. It is submitted that the last three possibilities mentioned by the author also concern opportunities that fall "in the line of business" of a company.
the circumstances it can be said that it actually belonged to the company, or that the company was justifiably relying upon the director either to acquire the opportunity for it, or to give the company the chance of acquiring it, or at least of attempting to acquire it. The opportunity should therefore not only be in the line of business of the company, but in all 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.

The consequence of the appropriation of a corporate opportunity is that its acquisition by a director is deemed to have taken place at the expense of the company. The fundamental distinction between taking a corporate opportunity and making a secret profit is that in the latter instance the profit is not necessarily made at the expense of the company, but it was obtained in some way as a result of the director's office. When a corporate opportunity is appropriated, it is deemed to be at the expense of the company, but the opportunity was not necessarily acquired by virtue of the director's position as such. There are other differences. The secret profit rule extends beyond the taking of corporate opportunities. It extends to all kinds of fiduciary relationships, including non-commercial ones. Furthermore, the secret profit rule extends to all kinds of collateral profits, whereas corporate opportunity matters are restricted to the exploitation of business opportunities.

If, for some reason, a director acquires the right to appropriate for his own benefit an opportunity, which would otherwise have constituted a corporate opportunity, such opportunity ceases to be "corporate".

385 In *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350 the court found that the directors had "obtained certain advantages by dealing with something which was the property of the whole company" (at 353). See also chapter 4 page 73 above, and page 357 above.

386 *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC) (see chapter 4 page 93 above); *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 (see page 360 below).

387 *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295 (see chapter 8 pages 274 note 108 and 296 note 248 above).


389 Beuthin & Luiz *Basic Company Law* 227.

390 Beuthin "No-profit Rule" 462. See also page 353 and authorities cited in notes 339-343 above.

391 See also chapter 4 page 96 above.

392 See, for example, *Boardman and Another v Phipps* [1967] 2 AC 46 (HL), discussed in chapter 4 page 72 above.

393 See also chapter 4 page 92; chapter 5 par 3.2.3.1 above.
A director may be accountable on the basis of his previous fiduciary obligation for activities which occurred after his resignation. It is submitted below that this does not imply that his fiduciary duties extend beyond his resignation from office.\textsuperscript{394}

\subsection*{4.3 Case Law}

The general principles regarding the accountability of agents for secret profits under South African law are set out in \textit{Transvaal Cold Storage Co Ltd v Palmer}.\textsuperscript{395} The plaintiff was a company formed with the object of erecting and exploiting cold storage chambers and of doing all such business as could be carried on in connection therewith. It appointed the defendant to act as its manager and representative in Durban. While acting as manager of the plaintiff company, the defendant contracted privately with a client of the plaintiff to receive all frozen meat on its behalf, including meat which was stored in the plaintiff's cold chambers, and to supervise its due conveyance into the buildings or into trucks for transport into the country. In carrying out this contract, the defendant made use of the plaintiff's staff, but paid them an allowance for their extra work. The plaintiff succeeded in an action to compel the defendant to account for profits made under the contract with the client. The court confirmed that the defendant was a fiduciary of the plaintiff company.\textsuperscript{396} Innes CJ also found that the private contract entailed work which fell within the scope of business of the plaintiff, although the company had not actually been doing that type of work when the particular contract was concluded.\textsuperscript{397} The learned judge held that although this was an important element, it was not essential, since the doctrine of an agent's liability to account for profits is not based upon the fact that he has prevented the principal from earning those profits. Rather, it is founded on his duty in good faith to hand over to his employer every advantage directly or indirectly connected with the agency, except for the remuneration agreed upon.\textsuperscript{398} The defendant in this case was the manager, and not a director, of the plaintiff company, but the principles apply equally to company directors.

The decision in \textit{Robinson v Randfontein Estates Gold Mining Co Ltd} dealt specifically with company directors.\textsuperscript{399} The facts are, briefly, as follows: By the beginning of the century large mineral interests in certain farms were held by a number of associated companies, all members of the Robinson group. Randfontein Estates Gold Mining Co Ltd was the parent company of this group. The defendant

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{394} See par 4.4 below.
\item \textsuperscript{395} 1904 TS 4. See also page 346 note 292 above.
\item \textsuperscript{396} At 17.
\item \textsuperscript{397} At 18.
\item \textsuperscript{398} At 21.
\item \textsuperscript{399} 1921 AD 168.
\end{enumerate}
\end{footnotesize}
was the chairman of the board of directors of this, the plaintiff company. The plaintiff company’s interest in the farm Waterval took the form of a lease of the mineral rights. The defendant would have preferred to purchase the farm for the company, but he could not come to an agreement with its owner. Subsequently, the defendant, through an agent, bought an undivided half-share of the farm for sixty thousand pounds and sold it soon afterwards for two hundred and seventy five thousand pounds to the Waterval Trust Company. This concern had been formed by the plaintiff company for the purpose of acquiring and holding, for a limited period, the farm Waterval. All its shares were held by the plaintiff company. The purchase price of two hundred and seventy five thousand pounds was paid to the defendant by a draft drawn on the plaintiff company. The court held that the plaintiff company was entitled to claim from the defendant the profit of two hundred and fifteen thousand pounds made by him on the transaction. The defendant’s argument that the claim was either a *condictio indebiti* or a delictual claim for damages, or contractual in nature, and that it had therefore prescribed, was rejected.

The Appellate Division confirmed 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 make a secret profit at the other’s expense or to place himself in a position where his interests conflict with his duty. Innes CJ held that a transaction which falls within this sphere can only be validated by the free consent of the principal following upon full disclosure by the agent. The *(de facto)* director was ordered, in his capacity as mandatory, to account for profits made from the sale of the asset to the company.

The court took a narrow view of the profit rule. It held that the general rule determined that if a director learned of a business opportunity in any sphere, he was under no obligation to put his company first unless it could be shown that there was a fiduciary relationship which “directly affected” the acquisition.

In *Robinson*, it was clearly the duty of the board of directors to acquire the particular asset. The fact that the seller had a predilection in favour of the defendant and would only have offered the property to any other party if the defendant refused it, did not alter this fact. It can be inferred that its chairman, the defendant, had at least an implied mandate to purchase the asset for the company.

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400 At 177.

401 At 178.

402 At 179. See also Brusser “Corporate Opportunities” 76.

403 Per Solomon JA at 229.

404 At 239-240 Solomon JA referred to this aspect and stated: “If ... the defendant stood in a fiduciary relationship to the plaintiff company, in regard to the acquisition of the farm, this fact cannot affect the legal position. Any right which he had actually acquired before he was brought into such relationship he was entitled to make full use of, but a mere personal preference in his favour ... is something to which his principal was entitled, and which it was his duty to have utilised on behalf of the plaintiff company.”
Although the company was certainly given the opportunity to acquire the farm, the actual problem lay in the fact that the company acquired an asset from its chairman, who made a substantial profit on the transaction. The case is therefore not strictly speaking an example of the appropriation of a corporate opportunity, but an application of the no profit rule.\(^{405}\) Application of the principles in respect of secret profits sufficed to resolve the issue.\(^{406}\)

In *Bellairs v Hodnett*,\(^{407}\) the court was presented with an ideal opportunity to deal with the issue of corporate opportunities. The decision of the court *a quo* was not reported, but large extracts of it appear in the decision by the Appeal Court. From the facts, it appeared that Northcliff Townships (Pty) Ltd owned a portion of land (N15). Its sole shareholder and *de facto* managing director, Bellairs, who was an experienced property developer, agreed with Hodnett to develop this property. Hodnett then acquired one third of the shareholding of the company. Subsequently, Bellairs and Hodnett acquired a further adjacent portion (N19) for Northcliff Townships for development. When another lot (N20), adjacent to N19, became available, Bellairs acquired it for himself and not for the company. He then formed another company, Picked Properties (Pty) Ltd, with the object of using it as a holding company for four township development companies, of which Northcliff Townships would be one. Hodnett refused the opportunity to participate in this venture. Bellairs sold his shares in Northcliff to Picked Properties at cost price, without first offering them to Hodnett "at the price he was willing to accept" as he was obliged to do under their shareholders' agreement. Some three years later, Hodnett acquired the remaining shares in Northcliff. Thereafter, Northcliff, now owned and controlled by Hodnett, sued Bellairs for the profits he had made out of the purchase of N20. It was alleged on behalf of Northcliff that Bellairs had been under a fiduciary duty to acquire the property for Northcliff and not for himself. The claim succeeded in the trial court, but on appeal the Appellate Division reversed, dismissing the claim. The second aspect of the company's claim related to a property known as Uhlenhorst. The company contended that Uhlenhorst was offered to the company and that Bellairs advised against its purchase. The company therefore did not buy it although it was suitable for township development and the company had the required financial resources to purchase the property. It was alleged that, since Bellairs had subsequently purchased the property for himself, he was in breach of his fiduciary duty to the company, and was liable to account for the profit derived from the acquisition. The court *a quo* found that it was not established that the property had first been offered to the company. However, the Appellate Division found that the acquisition and development of Uhlenhorst was beyond the actual scope of the

\(^{405}\) Brews "Defining Corporate Opportunity" 13. On the differences between the secret profit rule and appropriation of corporate opportunities, see also chapter 4 page 96 above, and page 359 above.

\(^{406}\) It is submitted that the importance of drawing this distinction lies in the issue of ratification, which is discussed in par 4.8 below.

\(^{407}\) 1978 (1) SA 1109 (A), noted by Beuthin "No-profit Rule" 458, Brews "Defining Corporate Opportunity" 13-14; Cartoon "Bellairs" 67; Larkin "Duties" E-39-40 and Van Rooyen "Bellairs" 160.
company's business. Bellairs was therefore considered entitled to refuse the offer on behalf of the company and later to accept it on his own behalf.

Botha J in the Witwatersrand Local Division was convinced that the defendant had placed himself in a position where his own interests conflicted with those of the company. He was, therefore, in breach of the fiduciary duty which he owed the company. The court held that the acquisition of the additional property was something that could have fitted in naturally, conveniently and economically with the company's existing business. The element of potential competition was considered conclusive.408

But the Appellate Division held that the business of the company was limited to the development of the first two properties. Since the company, represented by the minds of the directors, never contemplated further developments, no duty existed which made it incumbent upon Bellairs to pass on the opportunity409. The fact that the company was, in its memorandum, empowered to acquire further property was not regarded as of any consequence by the court. Their lordships held that the practice to endow a company with wide powers in its memorandum existed in case these powers might be needed in future. On this particular aspect the court was not concerned with the cold print of the memorandum but with what business the company was actually carrying on or intended to carry on.410

In regard to the Uhlenhorst transaction,411 the fact that the transaction was beyond the actual scope of the company's operations, was considered the decisive factor. The fact that Bellairs had advised against the acquisition of the property and had acquired it for himself at a profit, was therefore not considered relevant. It is submitted that this is incorrect. A director who acquires knowledge of a profit-making venture at a board meeting and recommends that the company does not accept the opportunity, places himself in a position where his personal interests con-

408 At 1126G. His lordship made it clear, however, that he was not suggesting that a director, even a managing director, stands under a fiduciary duty in relation to the acquisition of a property, simply because its acquisition by his company would be within the company's power and the property might be useful or prospectively beneficial to the company (at 1127E). Brews "Defining Corporate Opportunity" 14 suggests that this is an application of the conflict test, discussed on page 356 above.

409 At 1129C and 1132F. This is in accordance with the "line of business" approach, discussed on page 357 above.

410 At 1128F-G. Cartoon "Bellairs" 70 submits that this approach is incorrect when dealing with the problem of fiduciary duties and that the court should not have ignored the company's objects clause as it did. The author suggests that, if every time further property was offered to the company, Bellairs merely bought it for himself without offering it to the company, it is difficult to see how the scope of the company's operations would ever have been extended. He reasons further that all Bellairs would have had to do to ensure that he never be called upon to account, would have been to consistently refuse to extend the company's operations beyond its initial acquisitions. It is suggested that this would have to be resolved similarly to all deadlock situations. It is submitted further that effect should be given to the memorandum because the company is accepted as a separate legal entity. The implications which arise therefrom should therefore be given full effect. In this regard, see also note 416 below.

411 See page 362 above.
conflict with those of the company if he subsequently acquires the opportunity for himself.412 It was seen above that systems not based upon, or not based exclusively upon, fiduciary accountability also impose liability in similar circumstances.413 Under German law the director would have incurred liability under the general provision that members of the management board may not, without the consent of the supervisory board, conduct any business undertaking of any nature nor enter into business undertakings within the field of the company’s activities.414

As had been the case in the court a quo, the issue was regarded as one concerning competition between a director and his company.415 Therefore, no principles were enunciated in respect of corporate opportunities. It is submitted that, in view of the particular facts and circumstances of the case, the court found no need to consider this aspect. The relationship between Bellairs and Hodnett, likened to that between partners, was emphasised.416 It is submitted that general principles relating to corporate opportunity matters should, therefore, not be derived from the decision.417

412 On the conflict between a director’s personal interests and those of the company generally, see chapter 4 par 3.2; chapter 5 par 3.2.3 above. See also Cartoon “Bellairs” 71, who concludes, it is submitted correctly, that the decisive factor should have been the actual conduct of the director, who acquired for himself a profit which, as director, he had deliberately refused on behalf of the company.

413 See chapter 6 par 3; chapter 7 par 3 above.

414 See chapter 7 page 250 above.

415 The approaches of the courts differed. The court a quo was largely influenced in determining the scope of the company’s business by the fact that the company was a separate legal persona, distinct from the only two directors and shareholders. The Appellate Division held that in a case such as the present the business of the company, although it is a separate legal persona, does not transcend the contemplation of the persons embarking on a joint venture and employing the company as the means to achieve their object (at 1131H).

416 At 1130D-1131H. In view of the unique circumstances under which the company had been formed and under which its business was conducted, the application of partnership principles can, it is submitted, be justified. See also Brews “Defining Corporate Opportunity” 13-14; Van Rowjen “Bellairs” 164; Du Plessis “Deposit-taking Institutions” 59. However, the statement by the court (at 1130F) that the fact that the company was a separate, legal persona was of no great importance seems incorrect. The court should, it is submitted, either accept the separate legal entity of the company and give full effect to the legal implications which arise therefrom, or reject the company as a separate legal entity entirely. In this regard, see also note 410 above; Brusser “Corporate Opportunities” 78.

417 Contra Beuthin “No-profit Rule” 466 who suggests that it can be inferred from the decision that the court found no corporate opportunity. An interesting aspect of the decision is that the court did not find it necessary to consider how Bellairs obtained the property. This is explained by Larkin “Duties” E-40 on the basis that once there is no competition it is irrelevant that the director may have obtained a profit by reason of holding office. Beuthin “No-profit Rule” 466-467 submits that the court’s finding that Bellairs was not liable to account to the company for the profit he had made could have been based on a finding either that the opportunity or the knowledge of it had not come to him “by reason of his office”, or else that the shareholders had agreed (either by prior approval or by subsequent ratification) to his appropriating the profit for himself. The author stresses the importance of the agreement between the particular shareholders and contends that it would be wrong in principle to assume that simply because parties in the positions of the directors in Bellairs have agreed that it will not be necessary for the company to be given a chance of acquiring certain opportunities, they have in addition thereby agreed that each of them is free to acquire those opportunities for himself. This view is
The outcome of this case seems fair in the circumstances. But unfortunately the court did not make use of the opportunity to lay down considered guidelines in respect of corporate opportunities. The approach indicated by the court is, furthermore, opposite to that of the law in England and other Commonwealth countries, where an attempt is being made to modernise the law of corporate opportunity by widening the ambit of the director's duty of loyalty. It is suggested that courts should confine the approach taken in *Bellairs* to companies which are analogous to partnerships. In respect of larger companies, the Commonwealth approach should be adhered to.

In *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others* a claim for certain interdicts and damages was based on unlawful competition in relation to the manufacture and sale of various guano-based fertilisers. One of the defendants had been the managing director of the company (Atlas). Claims against him were, in part, based on alleged breaches of his duty of good faith. Besides the comprehensive discussion of unlawful competition, the court commented on the fiduciary duties of company directors and officers, as well as on the appropriation of corporate opportunities. The managing director of the plaintiff company had resigned his office. While serving the period of notice under his service contract, he took steps to create the defendant company. He also sabotaged the plaintiff company's chances to obtain long-term favourable raw material contracts, concluded these contracts for his own benefit and persuaded certain employees (inter alia the sales manager) of the plaintiff company to resign with a view to joining the defendant company. Van Dijkhorst J held that the managing director had acted in breach of his fiduciary duties in diverting the contracts to himself and in inducing the employees to join his company. The setting up of a competitive company *per se* was, however, not regarded as an unlawful act.

endorsed.

418 Cartoon "Bellairs" 71; Du Plessis "Deposit-taking Institutions" 59.

419 See, for example, *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162, discussed in chapter 4 page 98ff above; *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371, discussed in chapter 8 page 282ff and *Abbey Glen Property Corp v Stumborg* (1978) 85 DLR (3d) 35, discussed in chapter 8 page 283 above. These cases indicate that, although the facts and circumstances of each particular case remain important, a director is under a strict obligation not to place himself in a position where his own interests conflict with those of the company, including those opportunities in which the company might be interested. Brusser "Corporate Opportunities" 76ff regards the decision in *Bellairs* as a regressive step by the Appellate Division.


421 In this regard, see also par 4.6 below.

422 At 197F.

423 At 199B.
In respect of the position of trust occupied by a director in relation to his company, the court agreed with the exposition in *Cook v Deeks*\(^ {424}\) that

... men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.\(^ {425}\)

It is therefore a director's duty to act for the company's, rather than his own, benefit.\(^ {426}\) Accordingly, the plaintiff was entitled to damages which were proved to have resulted from the appropriation of the corporate opportunity, namely the conclusion of the raw-material contracts.\(^ {427}\)

The court next considered whether the setting up of the competing company amounted to an act of unfair competition.\(^ {428}\) Since this was a delictual claim, the element of unlawfulness had to be proved. The pertinent question, held the learned judge, was whether the managing director of a company when he has resigned and is serving his period of notice, may take any steps to create a competitor of that company. The court affirmed the principle stated in *Robinson*,\(^ {429}\) 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. But in the field of company law Van Dijkhorst J considered that an individual director is not, as such, an agent of the company and is therefore usually free to transact business on his own account even in competition with the company of which he is a director.\(^ {430}\)

\(^{424}\) *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC), discussed in chapter 4 par 4.3 above, at 563.

\(^{425}\) *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others* 1981 (2) SA 173 (T) at 197G-H.

\(^{426}\) *Atlas* at 197-198. In this regard, see also *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 177-180; *R v Herholdt and Others* 1957 (3) SA 236 (A) at 258; *S v De Jager and Another* 1965 (2) SA 616 (A) at 625. In *Atlas* the position of trust and fiduciary duty of a director were connected to his position as "agent" of the company. It is submitted that the fiduciary duty owed by a company director should not be linked to his acting as agent of the company, but rather stems from his position of power in relation to the company: Havenga "Opportunities" 123.

\(^{427}\) At 197F-H. The term "corporate opportunity" was not used by Van Dijkhorst J.

\(^{428}\) See also par 4.6 below.

\(^{429}\) See page 360 above.

\(^{430}\) At 198H. This does not, however, pertain to the divulging or use of confidential information accessible to him as director. See also Naudé *Maatskappydirekteur* 135ff; Naudé "Mededinging" 193; *Bell and Another v Lever Brothers Limited and Others* [1932] AC 161 (HL). Contra the opinions of McLennan "Misapplications" 403 and Goldstone J in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others* 1988 (2) SA 54 (T), discussed on page 369 below. See also note 426 above, where it is submitted that the fiduciary duty owed by a company director should not be linked to his acting as agent of the company, but rather stems from his position of power in the company.
The court was of the opinion that it is inconceivable that this freedom to hold directorships in competing companies can exist in the case of a managing director who is actively so employed. The reason is that it is impossible for one person to advance the conflicting interests of two actively competing businesses as managing director of both.\textsuperscript{431} On the other hand, stated the learned judge

\begin{quote}
... common sense dictates that the mere creation by a managing director, whose services have been terminated and who is serving his month's notice, of a future alternative means of employment, albeit in competition with his present company, need not necessarily create a conflict of interest greater than that of an ordinary director serving on the boards of two competing companies.\textsuperscript{432}
\end{quote}

However, the mere incorporation of the competing company on the initiative of the managing director, whilst serving his month's notice, was not regarded as a breach of his fiduciary duty to the company. This part of the judgment can, with respect, not be endorsed. It is not clear why a lesser duty should be required from a managing director when he is serving notice than at other times. This is precisely the time when his loyalty to the company is likely to be at its lowest point and when breaches of duty are most likely to occur.\textsuperscript{433} It is suggested that the principles apparent from the comparative survey still apply, namely that where a director's resignation is influenced by a desire to acquire an opportunity for himself, or if his position in the company rather than a fresh initiative led to the opportunity, he remains precluded from taking it personally.\textsuperscript{434}

The court further found that the incorporation of the competing company did not constitute an act of unfair competition, since the managing director was entitled to take up other employment, even with a competitor of the company.\textsuperscript{435}

With regard to the enticement of staff, Van Dijkhorst J pointed out that it did not constitute unfair competition to induce an employee to terminate his contract of employment lawfully.\textsuperscript{436} Such enticement could be actionable if done systematically.

\textsuperscript{431} At 198H-199A. In respect of competing directorships, see also par 4.7 below.
\textsuperscript{432} At 198-199. This aspect is returned to in par 4.7 below.
\textsuperscript{433} Larkin "M/D under Notice" E-32 and Larkin "Annual Survey 1981" 314, suggests, it is submitted correctly, that the judgment lacks a thorough examination of the managing director's basic fiduciary obligation not to place himself in a position where his duty and his self-interest may conflict.
\textsuperscript{434} See chapter 4 page 103 and \textit{Scottish Co-operative Wholesale Society Ltd v Meyer and Another} [1959] AC 324, [1958] 3 All ER 66 (HL) discussed on page 110 above (English law); chapter 5 page 144 above (American law) and chapter 8 par 3.4.4 above (Australia, Canada and New Zealand).
\textsuperscript{435} At 199B. The court considered that the planning of his future and the preparatory steps taken to enable the director to obtain alternative employment to earn a living was not against public policy and therefore unlawful, even if taken during his month of notice.
\textsuperscript{436} The court confirmed (at 200E) that as long as the employee is free to leave, others are entitled to offer him better terms of employment. The fact that the loss of the employee might cause damage to the employer was considered incidental and irrelevant.
to cripple or eliminate the business competitor, rather than to have the benefit of the employee’s services. *In casu* the company had certainly suffered a devastating blow by the defection of its most important employees, but it had been the incidental result of the competing company’s aim to obtain the services of those employees to corner the market. Its actions therefore did not amount to unlawful competition. It is submitted that this is incorrect. The requirement of fault is not restricted to intent (*dolus*) in the determination of unfair competition.\(^{437}\) In principle, negligence should always suffice to establish Aquillian liability.\(^{438}\) Neither is intent an element of wrongfulness, since wrongfulness must be established before intent can be determined.\(^{439}\) The views that even an innocent act of competition justifies an interdict based on unlawful competition, and that negligence suffices to establish liability *ex lege Aquilia*, are therefore supported.\(^{440}\)

Van Dijkhorst J held that the position of the managing director was different. He had canvassed employees of Atlas while serving his notice month at the same company. This constituted a breach of his fiduciary duties to that company.\(^{441}\) The sales manager had breached his service contract by enticing certain other employees. Since they had both acted on behalf of the competing company within the scope of their authority, the company was also liable.\(^{442}\) The judgment emphasises, it is submitted correctly, that however “lawful” it may be for an outsider to persuade an employee of a company to terminate his employment with the company to join a

\(^{437}\) Neethling & Potgieter “Opset by Onregmatige Mededinging” 34-35; Neethling “Onregmatige Mededinging” 209; *Link Estates (Pty) Ltd v Rink Estates (Pty) Ltd* 1979 (2) SA 276 (EC) at 281; *William Grant & Sons Ltd v Cape Wine & Distillers Ltd and Others* 1990 (3) SA 897 (C) at 915E-I.

\(^{438}\) Van Heerden & Neethling *Unlawful Competition* 68.

\(^{439}\) It is generally recognised that wrongfulness and fault are two separate delictual elements: Boberg *Delict* 30ff; Neethling, Potgieter & Visser *Law of Delict* 29ff, 113ff; Neethling & Potgieter “Opset by Onregmatige Mededinging” 36; Van der Merwe & Olivier *Onregmatige Daad* 49ff, 110ff; Van der Walt *Delict* 20ff, 60ff. Should fault qualify wrongfulness, the distinction between these two elements of delict would disappear. Van Heerden “Onregmatigheidsnorme” 154 therefore states: ‘’n [M]ededingingshandeling [kan] onregmatig ... wees selfs in die afwesigheid van ’n verwytybare gesindheid by die dader. ... Regsnorme, as norme van regmatige gedrag, stel eise aan die uitwendige gedrag van die mens. Daarom is die gesindheid van die dader in die reël nie ter sprake nie wanneer besin word oor die vraag of sy handeling strydig met die norm is.’’ See also Neethling “Onregmatige Mededinging” 220-222.

\(^{440}\) Neethling & Potgieter “Opset by Onregmatige Mededinging” 38; Neethling “Onregmatige Mededinging” 220. Contra Boberg “Lawfulness of Competition” 43 (but the author apparently concedes the point in Neethling *Onregmatige Mededinging* 151).

\(^{441}\) At 201A.

\(^{442}\) At 201A-B.
rival, such conduct on the part of any director of the company itself amounts to a breach of the fiduciary duty of good faith.

Since Atlas had proved an unlawful selling campaign the court ordered the defendants to pay damages on the basis of the actual instances of unlawful sales in terms of the unlawful selling campaign. The amount awarded was computed by multiplication of a profit figure per ton. Van Dijkhorst J held that the damages, if any, caused by the premature canvassing of staff during the defendants last weeks of employment was impossible to determine or quantify, and made no award in respect thereof.

In conclusion, the decision in Atlas confirms that a company director must act in the best interests of his company and points out the difficulties underlying the issue of competing directorships. Whilst it is submitted that the court's conclusion in respect of the setting up of a competing business, and linking the director's fiduciary obligation to agency, are incorrect, the judgment gives a useful indication of the approach of South African courts to corporate opportunity matters.

The decision in Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others confirms the duty of a director 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. Goldstone J distinguished two distinct

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443 See, however, the doubts expressed on this aspect of the judgment on page 368 above.

444 In this regard, see also Larkin "M/D under Notice" E-33.

445 At 204F and 206A.

446 At 205G. It is submitted that this illustrates the type of problem that may be encountered if it is insisted that claims based on breaches of directors' fiduciary duties must be delictual: see par 3.1 above.

447 See also par 4.6 below.

448 See page 366 above.

449 1988 (2) SA 54 (T), discussed by Havenga "Opportunities" 122.

450 From the facts it appeared that the first applicant (Sibex), a wholly owned subsidiary of the second applicant, conducted on-line maintenance sealing as its sole business. This entails a unique process whereby on-line leaks in a plant or equipment are sealed without the necessity of shutting down the plant or equipment. The first respondent, Injectaseal CC, had as its founding members B and C. Both these members of the close corporation had previously been involved in the management of Sibex. B had been the managing director and C the general manager of the company. It was common cause that the business conducted by Injectaseal CC was in direct competition with that of Sibex (at 58A). It was apparent from the facts that the founding statement of the close corporation had been signed only five days after B had left the employ of Sibex and during C's notice month. The majority of skilled technicians in the employ of Sibex had also left the company within a month from B's departure from the company. During his notice month, C 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 an interdict preventing Injectaseal CC from benefiting from the current quotations to Sasol and Natref pendente lite. The court 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 quotations pending the determination of an action by the applicants for a final interdict.
causes of action, namely unfair competition and breach of fiduciary duty. In respect of 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. The court was of the opinion that a very substantial probability existed that the information had been used as aforesaid.

With regard to the possible breach of fiduciary duties owed to the company, the court indicated that the fiduciary duties of a director extend beyond instances where he acts as an agent of the company. However, because of the urgency of the matter before him his lordship assumed that the fiduciary duties of a director and of a member of its top management arise only when they act as agents of the company.

The court agreed with the statement by McLennan that

It is 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.

On the particular facts, there was little doubt that an individual director would not be able to serve on the board of a rival company.

**Evaluation of South African Case Law**

From the cases discussed above it appears that corporate opportunity issues are often resolved on the basis of the secret profit rule, namely that a director may not obtain any advantages in the course and execution of his office other than that

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451 At 64D-F and 67G. The learned judge relied on the criteria of "fairness and honesty". Wrongfulness is, however, determined in the light of the *boni mores*: Knobel "Handelsgeheime" 496; Neethling "Onregmatige Mededinging" 559-561. See also par 4.7 below.

452 At 67G.

453 At 65B-G. See page 366 above, where it is indicated that, in *Atlas*, Van Dijkhorst J linked the fiduciary duties of a director to his "agency". It is submitted that the approach taken by Goldstone J in *Sibex* is sounder.

454 At 67A. It is therefore submitted that the court's description of the director as a trustee is obiter. In this regard, see also Havenga "Opportunities" 123-124.

455 Albeit by reference to Laskin: McLennan "Misapplications" 403.

456 *Sibex* at 65F-G.

457 Goldstone J held that it would be a most unusual situation which allowed directors or senior officers or managers of one company to act in the same or similar capacity for a rival without actual or potential conflict situations arising with frequent regularity (at 67D-E).
to which he is entitled by virtue of his holding office.\textsuperscript{458} In many instances, South African courts do not mention corporate opportunities as such, and possible competition between the director and his company is the crucial issue.\textsuperscript{459}

However, the secret profit rule can also be applied in circumstances unrelated to the appropriation of corporate opportunities.\textsuperscript{460} A director may, furthermore, learn of a corporate opportunity in other circumstances than by virtue of his office. In \textit{Industrial Development Consultants Ltd v Cooley},\textsuperscript{461} for example, the opportunity was offered to the director in his private capacity.\textsuperscript{462} It is therefore submitted that the secret profit rule will not always adequately resolve corporate opportunity matters.

The reported decisions show that there are at least three situations in which a director has a duty to acquire an opportunity for his company.\textsuperscript{463} First, the director is under this duty if he has been given, expressly or impliedly, a specific mandate either to acquire the particular opportunity for the company,\textsuperscript{464} or to inform the company as to its suitability.\textsuperscript{465} In appropriate circumstances, for example, if a director has a mandate to purchase a particular asset for the company, the secret profit rule will suffice.\textsuperscript{466} But a corporate "opportunity" also extends beyond the purchase of assets. The survey of Anglo-American law undertaken above, showed that it denotes any chance, occasion, happening or suitable circumstance.\textsuperscript{467} It was also seen that the provisions under German law extend beyond the purchase of an asset in which the company would be interested for the director's personal gain. Besides

\textsuperscript{458} Naudé \textit{Maatskappydirekteur} 116 (translation by Larkin 'Duties' E-31). On the application of this rule in England, see chapter 4 par 3.2.1 above. See also par 3.2.3.1 above and Blackman \textit{Fiduciary Doctrine} 384 where it is pointed out that since our law is largely English law, it is hardly surprising that, in the few cases in South African law dealing with these situations, our courts have relied almost exclusively upon English authority.

\textsuperscript{459} For example, \textit{Bellairs v Hodnett} 1978 (1) SA 1109 (A), discussed on page 362 above; \textit{Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others} 1981 (2) SA 173 (T), discussed on page 365 above.

\textsuperscript{460} On the differences between the application of the secret profit rule and appropriation of corporate opportunities, see chapter 4 page 96 above; page 359 above.

\textsuperscript{461} [1972] 1 WLR 443, [1972] 2 All ER 162, discussed in chapter 4 page 94ff above.

\textsuperscript{462} For the facts of the case, see chapter 4 note 273 above. See also Beck "O'Malley" 782 and Prentice "Peso" 453, who indicate that opportunities do not come to directors in any particular capacity.

\textsuperscript{463} See, generally, LAWSA \textit{Companies} par 228.

\textsuperscript{464} \textit{Burland and Others v Earle and Others} [1902] AC 83 (PC) at 98-99 (see also chapter 4 page 79 above); \textit{Robinson v Randfontein Estates Gold Mining Co Ltd} 1921 AD 168 (see page 360 above).

\textsuperscript{465} \textit{Olifants Tin "B" Syndicate v De Jager} 1912 TPD 305.

\textsuperscript{466} See also page 354 above; Beck "O'Malley" 787.

\textsuperscript{467} See chapter 4 par 4.2 above; chapter 5 par 6 above.
this situation, members of the German management board may also not, without the consent of the supervisory board, conduct any business undertaking of any nature, nor enter into business transactions within the field of the company's activities on their own account or on behalf of others. When it comes to the issue of ratification, however, the distinction between making of secret profits and appropriation of a corporate opportunity may be vital.

In the second place, a director must acquire an opportunity for his company if he, alone or together with other directors, is given a general mandate to acquire particular types of opportunities for the company or to pass information regarding such opportunities to it. The mandate may be express or implied. A mandate will be inferred where the management of the company's business, or its business in regard to transactions of the kind in question, has been entrusted to the director, or he assumes control over the management with the acquiescence of the other directors. A managing director will normally resort under this category. A director is also under this duty if he in fact so controls the company or those empowered to manage its affairs that the company cannot acquire opportunities, or that particular opportunity, without his consent. Usually a mandate will be inferred in these circumstances. But the duty may arise otherwise than by mandate. Even where a mandate cannot be inferred a director will in these circumstances be deemed to have been the agent of the company, or, at least, to have placed himself in such a position that if he takes at all, he must take the opportunity for his company. Where the company is in substance a partnership, the court will look to the underlying agreement or understanding which exists between its members in order to determine the company's scope of business.

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468 See chapter 7 page 239 above.

469 See par 4.8 below.

470 *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC) (see chapter 4 page 93 above); *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 (see page 360 above); *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162 (see chapter 4 page 94 above).

471 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

472 LAWSA *Companies* par 128 note 12. In the case of a one man company such a mandate will inevitably be inferred: *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 180-181, 195-196, 218-223 and 228-229.

473 LAWSA *Companies* par 228; *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* 1909 ORC 65; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162; *Bellairs v Hodnett* 1978 (1) SA 1109 (A) (see page 362 above).

474 *Cook v GC Deeks and others* [1916] 1 AC 554 (PC) (see chapter 4 page 93 above); *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

475 LAWSA *Companies* par 228 note 16; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 196-197 and 233; *Cook v GC Deeks and Others* [1916] 1 AC 554 (PC).

476 *Bellairs v Hodnett* 1978 (1) SA 1109 (A) at 1130-1132 (see page 362 above).
In these circumstances, the director's duty concerns opportunities which fall within the company's scope of business and which an ordinarily prudent board of directors would decide that the company should acquire.\(^{477}\) The duty extends to all assets and opportunities which fall within the scope of the company's operations and are so manifestly of advantage to it that it would have been the duty of the board to acquire it.\(^{478}\) Obviously included are those opportunities which the company is already actively pursuing.\(^{479}\) The decision in *Bellairs* indicates that the fact that the company has the power to purchase the particular property is of less relevance than the actual or intended business of the company.\(^{480}\) The approach thus far adopted by South African courts, indicates that the "line of business" test will be applied.\(^{481}\) This is also confirmed by the approach of the King Committee.\(^{482}\) In the "Code of Ethics for Enterprises" compiled by this committee it is a stated obligation of the manager of any enterprise to acquire for the benefit of the enterprise any economic opportunity which is in the same line of business as the enterprise he represents.\(^{483}\)

In the third instance, a director may not usurp an opportunity which the company is actively pursuing or an opportunity which may as far as the company's directors are concerned, be said to belong to the company.\(^{484}\) In *Canadian Aero Service Ltd v O'Malley*,\(^{485}\) for example, the defendant had actively been seeking the same contracts on behalf of his company which he subsequently entered into on his own behalf. And in *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne*\(^{486}\) it was clear that the company would have been interested in purchasing the particular property.

\(^{477}\) *Bellairs v Hodnett* 1978 (1) SA 1109 (A) at 1126-1128 (judgment in the court *a quo* per Botha J); *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 221.

\(^{478}\) LAWSA Companies par 228 note 118; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 210-211.

\(^{479}\) For example, in *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* 1909 ORC 65 directors and managers of the company acquired information as to the value of certain diamondiferous property and subsequently purchased it in competition with the company.

\(^{480}\) See page 362 above.

\(^{481}\) On this test, see page 357 above.

\(^{482}\) See par 4.9 below.

\(^{483}\) *Code of Ethics for Enterprises and All who Deal with Enterprises* par 7.3.4.

\(^{484}\) LAWSA Companies par 228; *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* 1909 ORC 65 (company seeking property); *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371 at 382.

\(^{485}\) See chapter 8 page 288 above.

\(^{486}\) 1909 ORC 65.
Once the duty has arisen, it is irrelevant that the person from whom the opportunity has to be acquired will not part with it to the company. It is also immaterial that the opportunity does not fall within the objects of the company as set out in the memorandum.

It is submitted that a determination should be made of what the director's duty entails in the particular circumstances of each case. A fiduciary must not use his position for his personal advantage. He cannot appropriate for himself property or opportunities which should have been acquired for the company. It is submitted that it is immaterial whether the chance for the property or opportunity came to him because of the position he occupied. All the relevant factors of the specific situation should be considered. No court can supply a comprehensive list of these factors, since the circumstances are so variable. It is submitted that the relevant factors include the particular office or position held in the company; the nature of the corporate opportunity; and the circumstances which led to its acquisition. The amount of knowledge possessed by the director; how he came to acquire that knowledge; and whether it can be regarded as confidential information will also be decisive. If the office has been resigned, it is submitted that the director will only be in breach of his duty if his resignation was prompted by the desire to acquire the opportunity for himself. It should be determined whether in all the circumstances the company was justifiably relying upon the director either to acquire the opportunity for it, or to give the company the chance of acquiring it, or at least of attempting to acquire it.

487 In Magnus Diamond Mining Syndicate v MacDonald and Hawthorne 1909 ORC 65 the court accepted that the seller would have preferred to sell his property to the directors. They were nevertheless obliged to transfer the property to the company and to account for profits made. See also Industrial Development Consultants Ltd v Cooley [1972] 1 WLR 443, [1972] 2 All ER 162, discussed in chapter 4 page 98 above).

488 LAWSA Companies par 228; Fine Industrial Commodities Limited v Powling (1954) LXXI RPC 253.

489 According to Beuthin "No-profit Rule" 468 this includes the precise relationship in which the director stands to the company, and the nature of the economic opportunity in question.

490 A useful exposition of factors was supplied in Canadian Aero Service Ltd v O'Malley [1974] SCR 592, (1973) 40 DLR (3d) 371 (see chapter 8 page 280 above), but Laskin J took care to point out that the list was not exhaustive.

491 See par 4.4 below.

492 Cook v GC Deeks and others [1916] 1 AC 554 (PC) (see chapter 4 page 97 above); Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 (see page 360 above).


It is, finally, suggested that the crucial issue remains whether what the director has done has placed him in a position where his own interests and his duty are in conflict, in other words, whether he has complied with his basic fiduciary duty not to act in conflict with the interests of the company. The position occupied by the director in the company will not necessarily be decisive. An ordinary director may, in a smaller private company, play a more vital role in the day-to-day management of the company than will a managing director in a large public company.

### 4.4 Corporate Opportunities and Former Directors

It was seen above that a director's fiduciary duties arise once his appointment takes effect. The leading authorities suggest that they may extend beyond his resignation from office, holding a director accountable for the appropriation of corporate opportunities which occurred after his resignation. Yet a former director is not a fiduciary, since he no longer holds the position from which he derived his fiduciary obligation.

Where a director's resignation is influenced by a wish to acquire for himself an opportunity, or where his position with the company, rather than a fresh initiative, led him to the opportunity, he remains precluded from taking it. In Island Export Finance Ltd v Umunna and Another, it was explained that otherwise

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495 See par 3.2.1 above.

496 See par 3 above.

497 *Cranleigh Precision Engineering Ltd v Bryant and 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; *Island Export Finance Ltd v Umunna and Another* [1986] BCLC 460. See also chapter 4 par 4.4 and chapter 8 par 3.4.4 above.

498 "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": Welling "Fiduciary Obligations" 1121. See also chapter 2 above on the basis of the fiduciary position.


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.\footnote{At 460. It is submitted that this statement applies to all directors and that the terms "employer" and "employment" are used somewhat loosely.}

This principle was confirmed in \textit{Roper v Murdoch et al}, where the corporate asset at issue was the right of opportunity to produce and distribute a certain television show.\footnote{Roper v Murdoch (1987) 39 DLR (4th) 684 (BCSC).} When an agreement had been practically 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 by him when he was a director to the prejudice of the company.\footnote{Gower \textit{Company Law} 553; \textit{Thomas Marshall (Exports) Ltd v Guinle} [1979] Ch 227, [1978] 3 All ER 193 (see also chapter 4 page 108 above). In respect of confidential information, see also par 4.7 below.}

It is submitted that the abovementioned cases were decided correctly. Nevertheless, a former director is no longer a fiduciary. Accountability can be explained on the basis that, in certain instances, a former director may be accountable for certain competitive activities which occurred after his resignation.\footnote{See page 313 above. See also par 4.6 below on competition between a director and his company.} In terms of section 26 of the Constitution a director may in appropriate circumstances rely on his right freely to engage in economic activity and to pursue a livelihood anywhere in the national territory. His former company will then have to prove that any limitation of that right is reasonable, justifiable, and that it does not negate the essential content of the right in question.\footnote{See par 3.2.2.2 above.} It is suggested that former directors should be accountable for profit made when either a conflict between self-interest and fiduciary duty led to the situation in which the profit was made, or if the opportunity to make the profit can be attributed to the fiduciary position formerly occupied.\footnote{Section 33(1)(a) of the Constitution.} But limitless accountability would set too harsh a standard.\footnote{Welling "Fiduciary Obligations" 1109.} 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 resignation by the director. 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. Furthermore, if the director was unlawfully dismissed by the company it cannot reasonably be expected of him to abstain from using business contacts or information acquired by him during his term of office in order to establish alternative employment for himself. The director may, moreover, be indemnified, in the articles or a separate contract with the company, from liability which would otherwise arise from competition with the company after the termination of his office.\(^509\)

This would, it is suggested, not fall under the prohibition of section 247,\(^510\) since it does not divest the director of any fiduciary obligation owed to the company during his term of office.

### 3.3 Rejection of the Opportunity or Inability to Pursue It

The comparative survey pointed out that the effect of rejection of an opportunity by the company, or the company's inability to pursue that opportunity remains a problematic issue.\(^511\)

American decisions indicate a variety of causes for a company's inability to pursue an opportunity. There may be 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, or unwillingness of the party offering the opportunity to deal with the corporation.\(^512\) The uncertainty surrounding the effect of the inability\(^513\) and the exact nature of financial inability\(^514\) lead to the conclusion that a director or senior executive should only appropriate an opportunity for his personal use if that opportunity has been rejected by the corporation and customer connection require that damages be assessed rather than calculated.\(^509\) The defendant was ordered to pay five years of estimated lost revenue and four months of projected future losses to the plaintiff.

\(^509\) On unfair competition, see par 4.6 below.

\(^510\) See par 3.3 above.

\(^511\) See, in general, chapter 4 par 4.5, chapter 5 par 7.3 and chapter 8 par 3.4.6 above. See also *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443 at 484, [1972] 2 All ER 162 at 176 (defence rejected); *Island Export Finance Ltd v Umunna and Another* [1986] BCLC 460 (defence allowed).

\(^512\) Austin "Accountability" 176.

\(^513\) See chapter 5 par 7.3.2 above.

\(^514\) See chapter 5 page 187ff above.
ration after proper disclosure. This corresponds with the proposal by the American Law Institute.\(^{515}\) The commentary on the proposal clearly states that the rejection may be based on the financial inability of the corporation to pursue the opportunity.\(^{516}\) Only after a disinterested majority of the board of directors has, on the basis of informed consent, declined the opportunity, should the fiduciary pursue it.\(^{517}\)

This leads to the matter of rejection by the company. American decisions show 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 domination.\(^{518}\) The rejection by the corporation must be by a disinterested vote of the board of directors after full disclosure to it.

Most Commonwealth cases have refused corporate inability as a defence to a claim based on the conflict or profit rules.\(^{519}\) But the director in *Peso-Silver Mines Ltd v Cropper*\(^{520}\) was allowed to retain a profit acquired after the board of directors had decided in good faith that the company did not have the financial resources to take the opportunity itself. The company's rejection of the property was found to have removed any conflict of interest. It therefore operated in the same way as disclosure does with respect to directors' contracts with the company. There have been indications that New Zealand and Australian courts will follow this approach.\(^{521}\)

The effect of inability to pursue an opportunity and its rejection have not yet received pertinent attention in South African decisions.\(^{522}\) Three main arguments should be considered: \(^{523}\) 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 it encourages flexibility in the enforcement of directors'

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516 The principle was approved in *Klinicki v Lundgren* 678 P2d 1250 (Or 1984): see page 191 note 479 above.

517 See chapter 5 page 191 above.

518 See chapter 5 par 7.4 above and authorities cited.

519 Austin "Accountability" 176. See also chapter 4 par 4.5 and chapter 8 par 3.4.6 above.

520 (1966) 58 DLR (2d) 1 (see chapter 8 page 290 above).

521 See chapter 8 page 289ff.

522 In *LAWSA Companies* par 228 it is suggested that where the board of directors has *bona fide* 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.

523 Van Rooyen Thesis 533-537.
duties. It has also been suggested that it may be unwise to place honest and diligent directors in the same category as the dishonest ones. The major criticism of the 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. 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. The problem is augmented 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. Furthermore, 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.

According to the second argument, an opportunity is 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 the opportunity. As soon as the board has decided no longer to pursue the opportunity, it can no longer be regarded as a corporate opportunity. The director will therefore be able to pursue it for his 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, since there is no expropriation of company assets. This viewpoint 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

524 See chapter 4 page 102 above.

525 Bastin "Secret Profits" 528; Beck "Peso Mines" 102; Bishop & Prentice "Fiduciary Remuneration" 303; Farrar Company Law 425; Prentice "Peso" 451ff. The courts themselves have expressed doubts about their ability to make such decisions: Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL) at 392, [1967] 2 AC 134 (HL) at 154. See also chapter 8 page 291 above and authorities cited.

526 The board of directors is generally entrusted with management of the company and will, therefore, be the appropriate organ to decide whether or not to pursue the opportunity (see page 304 above). To require the general meeting to decide on such matters would not resolve the matter, since the directors are often able to control this meeting: Van Rooyen Thesis 636 note 145.

527 See also chapter 4 page 102 above.

528 Prentice "Peso" 454. See also chapter 8 page 276-277 above.

529 For example, by trying to obtain the required capital, or by amending the constitution of the company if it prevents the acquisition of the opportunity: Van Rooyen Thesis 535.

530 Bastin "Secret Profits" 527ff; Beuthin "No-profit Rule" 465; Hahlo "Opportunity" 71ff; Van Rooyen Thesis 535-536.
taken in good faith. If *mala fides* cannot be proved, the opportunity will not be regarded as corporate and the general meeting will, consequently, be able to authorise the director to retain the benefit derived from it. Often the directors themselves exercise the majority vote at such meetings.

The third 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 authorised to appropriate such an opportunity.531

It is submitted that the principles at the root of fiduciary obligations suggest the answer. The fiduciary duties of company directors serve primarily to prevent abuse of the director's privileged position in his company.532 Directors are, furthermore, normally handsomely compensated, although they have no right to compensation merely because of their appointment.533 Therefore a director should not be placed in a position where he is tempted to abuse his office. It is submitted that if a conflict of interest situation is found to exist, rejection of the opportunity or the company's financial inability does not permit its appropriation by the directors personally.534 This approach is admittedly strict, but, it is submitted, is warranted by the need to balance and protect the various interests involved.535 And the director is not prejudiced, because he retains the option of obtaining the prior approval of the shareholders before taking up the opportunity. Prior authorisation will be ineffective if the directors do not make adequate disclosure, or if the general meeting's consent is invalid, either because it lacks the power to give the consent, or because it gives it for improper purposes.536 The suggested approach also does away with the problems of proof in respect of financial inability, the effect of 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

531 Beck "Corporate Opportunity" 236; Van Rooyen Thesis 536-537.

532 See par 3.2.1 above. See also *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371 at 382, where Laskin J referred to the "pervasiveness of a strict ethic in this area of the law." But Jones "Unjust Enrichment" 472 suggests that the concept of unjust enrichment is paramount when a fiduciary has acted with proven dishonesty or has otherwise manifestly acted contrary to his principal's interests.

533 Cilliers & Benade *Corporate Law* 133-134; Hahlo *Cases* 369ff. See also chapter 5 par 2.4 above.

534 It is submitted that the fact of financial inability as such does 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 Thesis 545.

535 The same underlying policy is concerned in situations of 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 must receive some measure of protection when a take-over scheme is proposed and carried out: *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* 1982 (1) SA 65 (A) at 71G. On insider trading generally, see Henochsberg 961ff and the authorities cited in notes 179 and 283 above.

536 Worthington "Creditors' Rights" 148.
situations where there is no conflict of interest, for example if it is illegal for the company to pursue the particular opportunity. In such an instance it is submitted that the director should be permitted to take it up, since there is no breach of fiduciary duty.  

4.6 Corporate Opportunities and Competition

The general fiduciary principle leads to the question to what extent competition between a director and his company is permissible. The problem is clouded by the fact that both the nature of the competition and the position of the particular director may vary considerably.

The comparative legal survey revealed various approaches. Under English law, unless the articles provide otherwise, and subject to any contract between a director and his company, it has traditionally been accepted that competition between a director and his company is not prohibited per se. But since the decision in Hivac Limited v Park Royal Scientific Instruments Limited and Others restraining employees from working for a business competing with that of their employer, doubts have been expressed whether this view still holds true. Other Commonwealth countries have pointed out the considerable danger of misuse of confidential information. American law recognises that directors also have independent interests to advance. The general rule, therefore, is that directors may engage in independent business, but that if such business competes with that of the corporation, equitable limitations apply. In France, the delict of unfair trade allows the injured party a claim for

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537 Beck "Peso Mines" 102.

538 "So eenvoudig is die probleem egter nie, omdat die mededinging 'n variasie van vorms kan aanneem, en die posisie van die mededingende direkteur in die maatskappy kan varieer van die van 'n besturende direkteur tot die van 'n betitelde ornament wat weens sy prestige-waarde aangestel is": Naudé "Maatskappydirekteur 135. See also Naudé "Mededinging" 193.

539 Gower Company Law 571; Pennington Company Law 587; London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd [1891] WN 165, approved in Bell and Another v Lever Brothers Limited and Others [1932] AC 161 (HL) at 195. See also chapter 4 par 4.7 above. Gower Company Law 572 suggests that the decision in Thomas Marshall (Exports) Ltd v Guinle [1979] Ch 227, [1978] 3 All ER 193 (see chapter 4 page 104 above) provides a strong indication that competing per se is a breach of duty, and illustrates that it will almost inevitably lead to other breaches of duty.

540 [1946] Ch 169, [1946] 1 All ER 35. See chapter 4 page 106 above.

541 Gower Company Law 572; Sealy Cases 283.

542 Abbey Glen Property Corp v Stumberg (1976) 65 DLR (3d) 235 at 278; Berlei Hestia (NZ) Ltd v Fernyhough [1980] 2 NZLR 150 at 161. See also chapter 8 par 3.4.7 above. On misuse of confidential information, see par 4.7 below.

543 Henn & Alexander Laws of Corporations 628; Lincoln Stores, Inc v Grant 34 NE2d 704 (Mass 1941) at 709; Tovrea Land and Cattle Company v Linsenmeyer 412 P2d 47 (Ariz 1966) at 57. See also chapter 5 par 3.2.3.2 above.
damages against any individual who has engaged in damaging behaviour. Furthermore, competition by a director with his company is likely to contravene the fundamental principle that directors must actively supervise and diligently participate in management. All decisions must be taken in the best interest of the corporation and not in the director's personal interest. Failure to do so establishes an abuse of legal right, in respect of which both civil and criminal liabilities can be imposed. German law is even more specific. Members of the management board may not, without the consent of the supervisory board, conduct any other business undertaking of any nature nor enter into business transactions within the field of the company's activities on their own behalf or on behalf of others.

Under South African law the fiduciary obligation only applies when the director acts in his capacity as director. He may therefore be a member of a competing venture, and may purchase shares in a rival company. A director is not generally precluded from carrying on business with his company. But he remains obligated to comply with the basic fiduciary obligation not to place himself in a position where his interests and duties conflict. If he does not comply with this duty the contract is not void, but voidable at the instance of the company. The rule is the same when the company contracts with a company in which the director has an interest.

544 See chapter 6 par 4 above.
545 See chapter 6 par 3 above.
546 See chapter 7 pages 235 and 244 above.
547 See page 314 above.
548 Naude *Maatskappydirekteur* 135; Naude "Mededinging" 194; Sealy "Trustee" 97.
549 In special situations, it may be possible to deduce an implied prohibition. An example of such a "special situation" in which competition would not be permitted is where the type of business is highly competitive or the market is very restricted, so that damage to the company by the fiduciary's own trading would be inevitable: Sealy "Trustee" 97.
550 Cilliers & Benade *Corporate Law* 138; Henochsberg 472; LAWSA *Companies* par 229; Scottish Cooperative Wholesale Society Ltd v Meyer and Another [1959] AC 324, [1958] 3 All ER 66 (HL); Bellairs v Hodnett 1978 (1) SA 1109 (A) (no fiduciary duty was found in the circumstances); Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 198-201. The position in respect of partnerships is similar: Trinbile and Bennett v Goldberg 1906 TS 1002 (PC) at 1006; Truter v Hancke 1923 CPD 43 at 48-49.
551 Cilliers & Benade *Corporate Law* 138; Du Plessis *Grondslae* 132ff; Henochsberg 465; Van Rooyen Thesis 548; Hargreaves v Anderson 1915 AD 519 at 522; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 178; Cohen v Directors of Rand Collieries Ltd 1906 TS 197 at 201-202; African Claim and Land Co Ltd v Langermann 1905 TS 494 at 524. See also Blackman "Exemption" 555 who shows, it is submitted correctly, that there is no general rule that all contracts in which a director has an interest are voidable. Rather, a contract in which a director has an interest is voidable only when, and only because, the director has committed a breach of duty in connection with it.
552 Cilliers & Benade *Corporate Law* 138.
The contract will not be voidable if the directors are permitted in the articles to contract with the company by an "exclusion clause". Should the articles not contain such a provision, or if the provision has not been observed, the contract is voidable until the general meeting has ratified it pursuant to sections 234-240.

The position of a director who participates in rival companies is less certain. The traditional view is that, unless the articles provide otherwise, and subject to any contract between a director and his company, the director is not precluded from becoming a director, officer or employee of a rival company. The rule is subject to qualifications: the director may not subordinate the interests of the company to those of the other venture, or disclose confidential information to the rival company, and the corporate personality of the rival company may, in certain circumstances, be disregarded.

Where two or more companies are trade competitors, it is difficult to envisage one person being a director of more than one of the companies without subordinating the interests of one of the companies to his own interests, thereby breaching his fiduciary obligation. There is not only the real danger that the director might disclose confidential information, but withholding the information might also be held to be in contravention of the obligation to act in the best interests of the rival com-

553 Cilliers & Benade Corporate Law 138; Du Plessis Grondstae 152-154. See also the discussion of these clauses in par 3.3 above.

554 Cilliers & Benade Corporate Law 138; Sealy "Trustee" 97; London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd [1891] WN 165; approved in Bell and Another v Lever Brothers Limited and Others [1932] AC 161 (HL) at 195. See also Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 216; Abbey Glen Property Corp v Stumberg (1978) 85 DLR (3d) 35; Bertel Hestia (NZ) Ltd v Fernyhough [1980] 2 NZLR 150. The company's register of directors and officers, which has to be kept under ss 215 and 216 will facilitate any enquiry regarding simultaneous directorships held by any person. See, however, Re Thomson [1930] 1 Ch 203 where the court held that it was a breach of duty for a trustee to open a business which competed with that run by the trust.

555 LAWSA Companies par 229; Scottish Co-operative Wholesale Society Ltd v Meyer and Another [1959] AC 324 at 358 and 388, [1958] 3 All ER 66 (HL).

556 See par 4.7 below.

557 The court gave an unmistakable indication in Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 that it would disregard the legal personality of a company if it was being used to circumvent the fiduciary relationship between a director and his company. The transaction between the director and a subsidiary company of the company of which he was a director, was treated as if it was a breach of duty between the director and his own company. In this regard, see Naudé Maatskappydirekteur 136 note 2. Another instance where corporate personality may be disregarded, is where the director formed the competing venture himself with the purpose of competing with his company: Naudé "Mededinging" 194. On disregard of the corporate entity by the courts generally, see Cilliers & Benade Corporate Law 11ff; Botha v Van Niekerk 1983 (3) SA 513 (W), especially 521D-F.

558 Hence the warning by Goldstone J in Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T): "It would be a most unusual situation which allowed directors or senior officers or managers of one company to act in the same or similar capacity for a rival without actual or potential conflict situations arising with frequent regularity. Even in the case of a non-executive director a similar conflict of interests could arise in circumstances not difficult to imagine" (at 67D-E).
pany. In some instances competing directorships could, arguably, also form the basis of a member’s action for oppressive conduct under section 252.559 Furthermore, the director may be held to have committed the delict of unlawful competition, which may be broadly defined as any unlawful interference with, or infringement of, a trader’s right to attract custom.560 Directors’ appropriations of corporate opportunities frequently overlap with this delict.561 The objective norm of public policy is applied both in deciding whether the director has acted in good faith in the interests of the company,562 and in establishing unlawfulness as an essential element of the delict of unlawful competition.563 But the basis of liability for unlawful competition and misuse of confidential information is the actio legis Aquiliae.564 Accordingly, the plaintiff company must prove the elements of delict to succeed in its action. Its remedy lies in damages, whereas the sui generis basis for breaches of fiduciary duty allows the company to also claim an accounting for profits.565 Since the elements of delict do not have to be proved in an action based on breach of fiduciary duty, the company need not have suffered damages or fault. Moreover, where a director uses or conveys confidential information, he breaches his duty not to do so. It is then irrelevant whether or not the information was used to compete with the

559 This section provides that any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him or some part of the members of the company, may apply to court for appropriate relief.

560 Domanski “Unlawful Competition” 89. South African law has imposed Aquilian liability for economic loss caused by unlawful competition since early this century: see, in general, Neethling “Onregmatige Mededinging” 204ff, 554ff; Van Heerden & Neethling Unlawful Competition 56ff. Matthews v Young 1922 AD 492 is regarded as the locus classicus in this regard. Decisions such as Geary & Son (Pty) Ltd v Gove 1964 (1) SA 434 (A); Atlas and Schultz v Butt 1986 (3) SA 667 (A) at 678-679 confirm the actio legis Aquiliae as the basis of a general action in the case of unlawful competition.

561 See, for example, Bellairs v Hodnett 1978 (1) SA 1109 (A), discussed on page 362ff above and Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others 1981 (2) SA 173 (T), discussed on page 366ff above. Blackman Fiduciary Doctrine 397 suggests that where a director acts for himself or for another when he ought to have acted for his company we are concerned with a breach of his undertaking as such and the question of competition does not arise. That these two issues are, however, not mutually exclusive, is illustrated by the decision in Atlas.

562 See par 3.2.2.2 d) above.

563 Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 188H; Lorimar Productions Inc & Others v Sterling Clothing Manufacturers (Pty) Ltd 1981 (3) SA 1129 (A) at 1152-1153, approved in Schultz v Butt 1986 (3) SA 667 (A) at 678-679.

564 See also par 4.7 below. In Rectifier and Communication Systems (Pty) Ltd v Harrison and Others 1981 (2) SA 283 (C) at 286H-287A it was confirmed that where another person has benefited at the expense of the company, the actio legis Aquiliae is the only remedy available to the company in the absence of any fiduciary, contractual or statutory obligation.

565 Blackman Fiduciary Doctrine 399. See also par 3.1 above.
company. The distinction between unlawful competition, misuse of confidential information and a director's duty to act in the interests of the company therefore remains important.

Naude submits that a distinction should be drawn between those directors who are able to perform legal acts on behalf of the company individually, and all other directors. The first category includes the typical managing director, but may also include a dominant ordinary director. Any contract, irrespective of whether or not it involves the use of confidential information, concluded by such a director in which the company also has an interest, is, at the choice of the company, treated by the law as one made in the interests of the company, whether the director intended it to be in his own interests or not. The director must transfer property acquired in this manner to the company. If he has sold the property to the company at a profit without disclosure, the profit is recoverable by the company. In consequence, directors who resort under this category, are unable to compete with their companies, irrespective of whether there are other competitors or not, and further irrespective of whether or not the company has a monopoly in the market. The director will, moreover, not be able to be a managing director of a rival company.

An ordinary director who has no individual powers, but who, together with the other directors, functions as directorate, resorts under the second category suggested by Naude. This type of director is, provided he does not make use of confidential information which he has come to by virtue of his position as director, not prevented from competing with his company. The law gives effect to the intention

566 Blackman *Fiduciary Doctrine* 397.

567 Blackman *Fiduciary Doctrine* 394.

568 Naude *Maatskappydirekteur* 137.

569 In *Robinson*, for example, Robinson was an ordinary director. The court confirmed that, because the other directors had acquiesced in his arrogating to himself the management of the company, he was in the same position with regard to it as if express authority had been delegated to him by the other directors (at 228). See also *Dickson v Acrow Engineers (Pty) Ltd* 1954 (2) SA 63 (W), where implied authority to bind the company was inferred from a course of dealing inside the company itself (at 64). On contracts concluded by a managing director generally, see Rohan-Irwin "Contracts" 382; *The Mine Workers' Union v JJ Prinsloo* 1948 (3) SA 831 (A).

570 Naude *Maatskappydirekteur* 138; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 180, Per Innes CJ.

571 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 241, per Solomon JA.

572 Naude *Maatskappydirekteur* 137-138.

573 Naude *Maatskappydirekteur* 139; Naude "Mededinging" 200.

574 See par 4.7 below.

575 Cilliers & Benade *Corporate Law* 138; Pennington *Company Law* 587; *Bell and Another v Lever Brothers Limited and Others* [1932] AC 161 (HL) at 195.
of such a director to conclude a contract in his own name, even if the contract is also in the interests of the company. If the property is subsequently sold to the company at a profit, without the required declaration of interest, the contract is voidable, but his profit cannot be claimed. The director can also not be compelled to transfer the property to the company. Thus a director in this category is, according to this argument, free to transact business on his own account even in competition with the company of which he is a director and is permitted to be an ordinary director of the rival company. Any contract concluded by a director of two companies, both of whom are interested in the particular transaction, is according to Naudé, deemed to have been concluded on behalf of the company in respect of which he falls in the first category.

Naudé’s distinction, based on the level of activity and position of the director in the company, prohibits competition where the director may individually act on behalf of the company, but not otherwise. The director may, according to this approach, not compete with the company if he is empowered to act as its individual agent. The author similarly bases recovery of profits upon this division. But it was seen above that directors’ fiduciary duties are not based on the concept of agency. They are sui generis, and are not dependent on the position the director occupies in his company. A director’s liability in respect of competitive activities must be based either on his fiduciary obligation, in which case recovery of profits is permissible, or on the delict of unlawful competition, in which case the recovery is for damages. Naudé’s classification can therefore, with respect, not be endorsed.

576 In actual fact, the director does not possess the authority to conclude the contract in name of the company. If he purports to do so, he runs the risk of incurring personal liability, should the company not ratify the contract. On the contractual powers of directors generally, see Hahlo Cases 463ff.

577 The director has neither the authority, nor the duty, to conclude such a contract in the name of the company: Naudé Maatskappydirekteur 138-139; Burland and Others v Earle and Others [1902] AC 83 (PC) at 98-99; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 216, per Solomon JA.

578 Naudé Maatskappydirekteur 139. The author suggests that the director is in an awkward, but, nonetheless manageable, situation. The situation can be terminated by either of the companies by dismissal of the director: Naudé Maatskappydirekteur 139.

579 For example, A is the managing director of Company X and, simultaneously, an ordinary director of Company Y. He concludes a contract in which both companies have an interest. The contract will be deemed to have been concluded on behalf of Company X: Naudé Maatskappydirekteur 139. See also Naudé “Mededinging” 200.

580 See page 384 above.

581 See chapter 2 par 3.2 above.

582 See pars 2.1 and 2.2 above.

583 See page 353 above.

584 Blackman Fiduciary Doctrine 399. See also page 384 above.
One solution is the prohibition in the Companies Act of competing directorships.\(^{585}\) It is suggested that in view of the abovementioned difficulties facing a person who is director of competing companies, this alternative should be seriously considered.\(^{586}\) Such a measure should prohibit the holding of multiple directorships in companies who are trade competitors for the duration of the director's term of office.\(^{587}\) It should also prevent the director from disclosing confidential information.\(^{588}\) It is submitted that to permit competing directorships subject to disclosure of information regarding contracts in which a director is interested and shareholder approval of these contracts,\(^{589}\) still leaves the problem that vital information could be withheld from one of the companies, thereby influencing the decision to approve.\(^{590}\) Until the Companies Act is amended in this way it is suggested that the articles\(^{591}\) or separate service contracts\(^{592}\) should include a clause precluding directors from occupying directorships in competing companies.

In conclusion, a director who, either personally or on behalf of a rival enterprise, appropriates an opportunity which he knows his company would be interested in pursuing, acts in contravention of his fiduciary obligation to act in good faith in the best interests of his company. His action may also establish the delict of unlawful competition. Where one person holds directorships in rival companies, his position in respect of contracts in which both companies are interested is untenable. His duty to act in the best interests of both companies and the restriction on disclosure of confidential information makes it almost impossible for him to act. It is submitted that it is irrelevant what type of directorship is held in the various companies. Where one of the companies takes an opportunity in which the other is also interested, the action will, provided the requirements are satisfied, constitute unlawful competition, irrespective of whether or not the director was involved in the decision. In such circumstances the mutual director is not regarded as having usurped a corporate

\(^{585}\) Naudé *Maatskappydirekteur* 140 submits that this is the only other alternative that could be applied consequently in a community where economic and legal relations are becoming increasingly complex.

\(^{586}\) This opinion has also been expressed in respect of the Canadian company law: Beck "Peso Mines" 92. See also Finn *Fiduciary Obligation* 252ff.

\(^{587}\) See chapter 10 par 4 below. It is not suggested that the number of directorships should generally be restricted.

\(^{588}\) In this regard, see par 4.7 below.

\(^{589}\) This is the approach followed in the New Zealand Companies Act ss 108-112.

\(^{590}\) See page 383 above.

\(^{591}\) This is probably the easiest solution to the problem: Farrar *Company Law* 420.

\(^{592}\) *Hivac Limited v Park Royal Scientific Instruments Limited and Others* [1946] Ch 169, [1946] 1 All ER 350.
opportunity, since this concept denotes the taking of an opportunity for himself instead of for his company.593

4.7 Corporate Opportunities and Confidential Information

In all the legal systems investigated above a director can incur liability for the misuse of confidential information. The basis of liability differs in the various jurisdictions. Liability in English law is sometimes based upon a "breach of trust or confidence".594 The basis of this action is regarded as either contractual, or purely based upon principles of Equity.595 The recommendation by the Law Commission that breach of confidence should be made a specific tort, was never accepted in English law.596 The indication by existing South African case law is that no such action is needed in South African law, since the prejudiced competitor is adequately protected by existing contractual and delictual remedies.597 Liability for misuse of confidential information is sometimes based upon the fact that the information is regarded as a type of property.598 The director who misuses it is then held to be liable upon the same basis as his liability for profits which arise from the use of the company's property.599 It was pointed out above that a company which finds itself in the same situation as Regal600 would, under this approach, have two possible claims. It could claim that the directors were accountable because they had placed themselves in a position of conflict of duty and interest. Alternatively, it could claim that

593 See page 353 above.
594 Blackman Fiduciary Doctrine 438; Van Heerden & Neethling Unlawful Competition 271.
595 Van Heerden & Neethling Unlawful Competition 271.
597 Van Heerden & Neethling Unlawful Competition 271; Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg 1967 (1) SA 686 (W); Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd 1968 (1) SA 209 (C) at 221-222; Stellenbosch Wine Trust Ltd and Another v Oude Meester Group Ltd; Oude Meester Group Ltd v Stellenbosch Wine Trust Ltd and Another 1972 (3) SA 152 (C) at 160-161; Prok Africa (Pty) Ltd and Another v NTH (Pty) Ltd and Others 1980 (3) SA 687 (W) at 696; Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 190-191.
598 See chapter 4 par 3.2.2 above. In respect of insider information as property in Australian law, see Afterman Company Directors and Controllers 150.
599 Blackman Fiduciary Doctrine 438; Boardman and Another v Phipps [1967] 2 AC 46 (HL) (see chapter 4 page 76 above). On the uncertainty whether information can be regarded as property, see Beck "Peso Mines" 108ff, 117; Beck "Corporate Opportunity" 225ff; Blackman Fiduciary Doctrine 267ff; Gower Company Law 564ff; Jones "Unjust Enrichment" 484-485; Parkinson "Modification" 341-342; Stuckey "Breach of Confidence" 402; Wedderburn "Derivative Actions" 206, 211; Yoran "Director's Liability" 191.
600 See chapter 4 page 69ff above.
the directors, having used company property in the form of confidential information, became constructive trustees of any profit made thereby. American law recognises the same bases of liability. The trust was developed by English courts of Chancery. It was unknown to Roman and Roman-Dutch law. South African courts evolved an own law of trusts by adapting the trust idea to the principles of our own law. The constructive trust was not received, since South African law provides sufficient other remedies.

The new New Zealand Companies Act contains provisions aimed at the protection of confidential information. A director who has information in his or her capacity as a director or employee of the company, being information that would not otherwise be available to him or her, may not, subject to the Act, disclose that information to any other person, or use it, or act on its basis. The reality of the nominee director is acknowledged in the provision that a director may disclose any information to any person who is named in the interests register as a person in accordance with whose directions or instructions the director may be required or is accustomed to act in respect of his or her duties and powers as director. The section further provides that a director may disclose, use, or act on the basis of any information if particulars of such disclosure, use or act are entered in the interests register and the director is authorised to do so by the board. The company must, furthermore, receive fair value in respect of the disclosure, use or act.

Under French law, the misuse of confidential information is provided for under the general delictual principle of unfair trade. German law prohibits any competition between a director and his company, and imposes a duty of confidentiality in respect of any information which relates to the business conducted by the enterprise.

601 See chapter 4 page 101ff above. See also Smart "Confidential Information" 466ff. On constructive trusts, see chapter 4 par 3.2.2, chapter 5 par 4.1 above.

602 See chapter 5 page 146 above.

603 Braun v Blann and Botha NNO and Another 1984 (2) SA 850 (A) at 859F.

604 Honore & Cameron Honore's Trusts 108, 250-251; Estate Kemp v MacDonald's Trustee 1914 CPD 1084 at 1092; Verseput v De Gruchy NO 1977 (4) SA 440 (W).

605 See chapter 8 page 284 above.

606 Section 112(1).

607 Section 112(2).

608 Section 112(3).

609 See chapter 6 par 4 above.

610 See chapter 7 page 244 above.
It is accepted in South African law that directors may not use confidential information to compete with their company. There are various sources for protection of confidential information. In *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* the defendants, while directors and managers of a company, acquired information as to the value of certain diamondiferous property. They subsequently 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. The court based its decision on:

the general principle of our law, ... that a person, who occupies a fiduciary position, such as that of agent or partner or of a director or manager of a company, is bound to exercise ... good faith ... towards his principal or partner or the company in whose service he is employed as manager or director.

The unauthorised use of confidential information was similarly regarded as a breach of the existing fiduciary obligation between a director and his company in the *Sibex*-decision.

The misuse of confidential information is one of the established categories of unlawful competition. In order to constitute confidential information the information must be both confidential and of economic value. If these two requirements are met, the information is regarded as intellectual property belonging to the plaintiff.

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611 This is confirmed in par 2.14 of 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 par 7.3.1, which provides that managers shall not divulge confidential information of the enterprise to its competitors or otherwise make improper use of such information. See also par 4.9 below.

612 1909 ORC 65.

613 English law too acknowledges the remedy of an accounting for profits in exceptional cases when there has been a breach of confidence: *Peter Pan Manufacturing Corporation v Corsets Silhouette Ltd* [1964] 1 WLR 96 at 108.

614 At 76.

615 *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others* 1988 (2) SA 54 (T) (see page 373 above).

616 Knobel "Handelsgeheime" 488; Neethling "Onregmatige Mededinging" 559ff; Van Heerden & Neethling *Unlawful Competition* 229; *Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd* 1968 (1) SA 209 (K); *Stellenbosch Wine Trust Ltd and Another v Oude Meester Group Ltd, Oude Meester Group Ltd v Stellenbosch Wine Trust Ltd and Another* 1972 (3) SA 152 (C); *Prok Africa (Pty) Ltd and Another v NTH (Pty) Ltd and Others* 1980 (3) SA 687 (W) at 696-697; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) (Pty) Ltd and Others* 1981 (2) SA 173 (T) at 189-196; *Rectifier and Communication Systems (Pty) Ltd v Harrison and Others* 1981 (2) SA 283 (C). On unlawful competition, see also par 4.6 above.

617 *Harchris Heat Treatment (Pty) Ltd v Iscor* 1983 (1) SA 548 (T) at 554G-H.
and is protected by the Aquilian action. Whether the particular information meets these requirements, must be determined by the circumstances of each case.\textsuperscript{618} It is, however, clear that not only technical expertise is protected, but that confidential information also includes the "know-how" of an enterprise;\textsuperscript{619} customer lists;\textsuperscript{620} customer connections;\textsuperscript{621} business conversations;\textsuperscript{622} internal financial reports and feasibility studies; specific information concerning ongoing transactions between the company and its clients; and tender prices.\textsuperscript{623}

In certain circumstances the law of contract may be the basis of an action for misuse of confidential information. In \textit{Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg}\textsuperscript{624} a company relied on an implied term of a service contract to restrain an employer from using confidential information to its detriment.\textsuperscript{625} Should a director conclude a service contract with his company, he should be aware of the danger of such an implied term being inferred. In limited circumstances the protection afforded under copyright laws may protect confidential information.\textsuperscript{626}

The appropriation of corporate opportunities frequently overlaps with misuse of confidential information. However, it is submitted that, for various reasons, appropriation of a corporate opportunity and 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 seen above that South African courts favour the "line of business" test, the essence of which is that an opportunity, to be be corporate in nature, must correspond with the existing and

\textsuperscript{618} Van Heerden \& Neethling \textit{Unlawful Competition} 225ff.

\textsuperscript{619} \textit{Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd and Another} 1977 (1) SA 316 (T) at 324, 326; \textit{Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others} 1981 (2) SA 173 (T) at 189-192, 194-195; \textit{Harchris Heat Treatment (Pty) Ltd v Iscor} 1983 (1) SA 548 (T) at 551.

\textsuperscript{620} \textit{Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others} 1981 (2) SA 173 (T) at 195-196.

\textsuperscript{621} \textit{Knox D'Arcy Ltd and Others v Jamieson and Others} 1992 (3) SA 520 (W) at 527-528.

\textsuperscript{622} Van Heerden \& Neethling \textit{Unlawful Competition} 227; \textit{Sage Holdings Ltd and Another v Financial Mail (Pty) Ltd and Others} 1991 (2) SA 117 (W) at 132H-1.

\textsuperscript{623} \textit{Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others} 1988 (2) SA 54 (T) at 67-68 (see also page 363 above); \textit{Meter Systems Holdings Ltd v Venter and Another} 1993 (1) SA 409 (W) at 430D.

\textsuperscript{624} 1967 (1) SA 686 (W).

\textsuperscript{625} According to Marais J ",... 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." (at 691).

\textsuperscript{626} Knobel "Handelsgeheime" 489.
prospective interests or activities of the corporation concerned. Such an opportunity must be presented to the company, irrespective of how the director gained information regarding it, because of his obligation to advance the interests of the company above his own. 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 regarding an opportunity is received. It is submitted that this is not always possible, and also opens the door to abuse. It is, once again, important to bear in mind the strict rule underlying the fiduciary obligation.

Secondly, the bases of liability may differ. It was indicated above that liability for misuse of confidential information arises from various sources, only one of which is an existing fiduciary obligation. Liability for the appropriation of a corporate opportunity is necessarily based on a director's fiduciary obligation. Furthermore, where a director uses or conveys confidential information, he incurs liability because of that fact. It is then irrelevant whether or not he uses the information to compete with the company. 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, and possibly Anton Piller orders, but not an

627 See page 359 above.

628 Beck "O'Malley" 782; Borrowdale Duties 610; Prentice "Cooley" 632; Prentice "Peso" 453. Beck "Corporate Opportunity" 225 submits that such a standard does not place any great hardship on a fiduciary, who, presumably, is well rewarded, monetarily or otherwise. See also chapter 8 page 283-284 above; Canadian Aero Service Ltd v O'Malley [1974] SCR 592, (1973) 40 DLR (3d) 371, discussed in chapter 8 page 275ff above.

629 It is, for example, quite simple to stage a friendly game of golf for the purpose of inviting a director to personally do business instead of dealing through the company.

630 See page 390 above.

631 See page 357 above.

632 Blackman Fiduciary Doctrine 397.

633 On this remedy, see in general Kelbrick "Delivery Up" 12ff, who concludes that it is, in South African law, a form of mandatory interdict.

634 The validity and scope of these orders is uncertain: Knobel "Handelsgeheime" 501.
accounting of profits.635 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.636 Where a director has appropriated an economic opportunity for himself instead of for his company, the company may claim an accounting of profits.637

An issue which poses particular problems is when, after leaving his employment, an employee uses knowledge and skills which the previous employer alleges is confidential in nature either in his own enterprise or in someone else's employment. This issue may be of importance when a person ceases to be a director and thereafter takes an opportunity which, had he still been a director, would have been regarded as a corporate opportunity. The general rule is that the employee is free to use his own knowledge and skills, provided that he does not disclose confidential information.638 Information which is readily classifiable as not being of a confidential nature may be used in competition with the previous employer, even if acquired during the term of the previous employment,639 unless a restraint of trade has been agreed upon.640 Where the information can indeed be classified as confidential, because it is both confidential and of economic value,641 there may be factors indicating that the extent of the interest 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 may have obtained highly specialised knowledge and expertise. The knowledge and expertise may be an important asset which he could use in other employment. His own interest in using the confidential information to realise his full poten-

635 Knobel "Handelsgeheime" 501; Neethling "Onregmatige Mededinging" 562; Van Heerden & Neethling Unlawful Competition 73-74 (the authors suggest that this remedy should be included through legislation); 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 and Others 1981 (2) SA 283 (C) at 289.

636 Van Dorsten Directors 218; Van Heerden & Neethling Unlawful Competition 73; Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 190-191; Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others 1988 (2) SA 54 (T) at 64-68 (see also page 373 above). 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 and Others 1981 (2) SA 283 (C) at 286-287.

637 See page 353 above.

638 Knobel "Handelsgeheime" 497; Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd and Another 1977 (1) SA 316 (T) at 326-327; Northern Office Micro Computers (Pty) Ltd v Rosenstein 1981 (4) SA 123 (C) at 127-128; Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others 1981 (2) SA 173 (T) at 193; SA Historical Mint (Pty) Ltd v Sutcliffe 1983 (2) SA 84 (C) at 255-256.

639 Case law distinguishes between information which is generally known in the particular trade, and confidential information which is privy to the particular enterprise: Knobel "Handelsgeheime" 497; Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg 1967 (1) SA 686 (W) at 689.

640 In such an instance one is no longer concerned with the protection of confidential information.

641 See page 390 above.
tial 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 element of unlawfulness, and will be determined by application of the *boni-mores* criterion. Where a company bases its action against a former director on the breach of his fiduciary obligation, it is submitted that 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 to freely engage in economic activity.

The misuse of confidential information by a company director can take various forms and, as was stated above, frequently overlaps with the appropriation of corporate opportunities. The director may use the information acquired during his term of office to compete with the company, before or after his term of office expires. If he remains a director, the company may elect whether to base action on his fiduciary obligation or on misuse of confidential information, based on the causes referred to above. If he is no longer a director, he is no longer a fiduciary, and the company will have to make use of the other causes of action. Information regarding an economic opportunity may itself constitute confidential information. Where a director uses that information for his own benefit, the company may, likewise, base action on either of the causes. That is also the position where the director makes use of the information in order to resign and thereafter to compete with his previous company by making use of the opportunity.

In conclusion, it is submitted that the existing measures set out above adequately protect a company's confidential information in South African law.

### 4.8 Corporate Opportunities and Ratification

Ratification is well known in company law and is generally accepted in

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642 Knobel "Handelsgeheime" 497; *Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd and Another* 1977 (1) SA 316 (T) at 327; *Multi Tube Systems (Pty) Ltd v Ponting and Others* 1984 (3) SA 182 (D) at 187; *Northern Office Micro Computers (Pty) Ltd v Rosenstein* 1981 (4) SA 123 (C) at 136.

643 Section 26 of the Constitution: see page 336 above.

644 On competition and multiple directorships, see par 4.6 above.

645 See page 392 above.

646 See par 4.4 above.

647 See page 376 above where it was suggested that former directors should be accountable for profit made when either a conflict between self-interest and fiduciary duty led to the situation in which the profit was made, or if the opportunity to make the profit can be attributed to the fiduciary position formerly occupied.

648 In *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL), [1967] 2 AC 134 (HL), for example, Lord Russell indicated that the directors "could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of ... the shareholders in general meeting" (at 150). On ratification generally, see Baxt "Ratification" 16ff; Cranston "Limiting Liability" 198ff; Naudé *Maatskap­pydirekteur* 128ff; Partridge "Ratification" 122ff; Pennington *Company Law* 590; Van Rooyen *Thesis*; Worthington "Creditors' Rights" 142ff; *Cohen v Directors of Rand Collieries Ltd* 1906 TS 197; *Furs Ltd v*
England, America, Australia and New Zealand. It is also widely recognised as necessary in the context of modern commercial life. But in Canada, the many difficulties encountered in this area of the law led to the effective abolition of ratification. Ratification is also prohibited in the Draft Fifth Directive of the European Union, although similar provisions are not contained in the proposed Statute for a European Company.

The rule in *Foss v Harbottle* provides that it is the company that must institute action when it has suffered a wrong. Should the company fail to do so a member may, in certain instances, institute action on behalf of the company. Even so, a member cannot act if the wrong concerned is one which a simple majority could condone or ratify.

Thus minorities are bound by a majority resolution not to institute action against the wrongdoer or to release him from liability. If permitted by the articles

*Tomkies (1936) 54 CLR 583.*

649 See chapter 4 page 86, 107 and par 4.8 above.

650 See chapter 5 par 7.2 above.

651 See chapter 8 par 3.4.9 above.


653 In this regard, see chapter 8 page 293ff above.

654 See chapter 8 page 295 above.

655 Farrar *Company Law* 449; Gower *Company Law* 645ff; Naudé *Maatskippydirekteur* 168ff; Van Rooyen *Thesis* 7, 102; Wedderburn “Shareholders” 194; Wedderburn “Shareholders 2” 93. On the rule in *Foss v Harbottle* and its application in South African law generally, see Cilliers & Benade *Corporate Law* 288ff; Hahlo *Cases* 507ff and authorities cited; Strydom “Vakbonde” 157; *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189; *MacDougall v Gardiner* (1875) 1 ChD 13; *Shuttleworth v Cox Bros & Co (Maidenhead)* Ltd [1927] 2 KB 9 (CA); *Yende v Orlando Coal Distributors (Pty) Ltd* 1961 (3) SA 314 (W); *Samuel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A); *Makhuta and Others v Lukoto Bus Service (Pty) Ltd and Others* 1987 (3) SA 376 (VSC) at 394A; *James North (Zimbabwe) (Pty) Ltd and Others v Mattinson* 1990 (2) SA 228 (ZH) at 234E-F; *McLelland v Hulett* (1992) 1 SA 456 (D), discussed by Van der Merwe “Minderheidsaandeelhouers” 216.

656 It has been suggested that since the management of the company is entrusted to the directors, the task of ratification (of ratifiable wrongs) should also lie with this company organ: Cranston “Limiting Liability” 202; Sealy “Trustees” 102-103. The argument to the contrary is that ratification of breaches of directors’ duties cannot be regarded as managing the ordinary business of a company, which is the basic function of the board and that the general meeting of shareholders is the organ who should ratify wrongs done to the company: Baxt “Ratification” 49; Beck “Peso Mines” 119; Cilliers & Benade *Corporate Law* 139; Cranston “Limiting Liability” 202; Farrar *Company Law* 404; Hahlo *Cases* 285, 376; LAWSA *Companies* par 228; *Aberdeen Rail Co v Blaikie Bros* (1854) 1 Macq 461, (1854) 2 Eq Rep 1281 (HL); *Benson v Heathorn* (1842) 1 Y&C 326, 63 ER 748; *Imperial Mercantile Credit Association v Coleman* (1871) 6 Ch App 558; *Victors, Limited (in liquidation) v Lingard* [1927] 1 Ch 323; *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 (PC) at 13. The general meeting possesses the inherent capacity to ratify abuse of management powers in certain circumstances: Cilliers & Benade *Corporate Law* 83; Hahlo *Cases* 285; Naudé *Maatskippydirekteur* 91ff; Van Rooyen *Thesis* 464; Gohlke & Schneider *v Westies Minerale (Edms) Bpk and Another* 1970 (2) SA 685 (A).
the disclosure may be made to, and the sanction obtained from, the directors provided that they are independent. As shareholder a director remains free to vote in favour of the ratification of a contract in which he is interested. Admittedly there are practical problems with the requirement of a general meeting to effect the ratification. In large companies with widely distributed shareholders calling general meetings is costly. There is the further danger that the meeting and any resolutions at it may be invalid if any shareholder has not received notice of the meeting.

Certain wrongs cannot be ratified. Any attempt by the majority to ratify such acts is not binding on minorites who may institute action to assert their rights. Since directors owe their fiduciary duties to the company, it is the company that is wronged if a fiduciary obligation is breached. Therefore a member will institute a derivative action to assert the company’s right if the company will not institute

657 LAWSA Companies par 228; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 198.

658 In North-West Transportation Company, Limited and James Hughes Beatty v Henry Beatty (1887) 12 App Cas 589 (PC) Sir Richard Baggally confirmed that “Every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject matter opposed to or different from ‘the general or particular interests of the company’ (at 593). See also Alexander v Automatic Telephone Company [1900] 2 Ch 56 (CA); Northern Counties Securities Ltd v Jackson & Steeple Ltd [1974] 1 WLR 1133, [1974] 2 All ER 625 (Ch); Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257, [1980] 2 All ER 841.

659 On the calling and procedure at general meetings, see ss 180ff.

660 Hahlo Cases 290; Van Rooyen Thesis 43. The meeting will not be invalid for this reason if the shareholder to whom notice has not been given was not within reasonable reach: Majola Investments (Pty) Ltd v Uitzigt Properties (Pty) Ltd 1961 (4) SA 705 (T). A defect in giving notice can also be cured by the consent of all the members of the company: Gundelfinger v African Textile Manufacturers Ltd 1939 AD 314; Silver Garbus & Co (Pty) Ltd v Teichert 1954 (2) SA 98 (N); In re Bailey, Hay & Co Ltd [1971] 1 WLR 1357 at 1366, [1971] 3 All ER 693. Unanimity is usually required if the ratification is to occur other than at a general meeting: Cranston “Limiting Liability” 203; 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.

661 See page 397 below.

662 Beck “Corporate Opportunity” 233; Gore-Browne on Companies par 27.21.1; Van Rooyen Thesis 462ff; Kaye v Croydon Tramways Company [1898] 1 Ch 358 (CA) at 377 per Vaughan Williams LJ; Cook v GC Deeks and others [1916] 1 AC 554 (PC); Menier v Hooper’s Telegraph Works (1874) LR 9 Ch App 350.

663 See chapter 3 above.
action.\textsuperscript{664} The common law derivative action, based on the rule in \textit{Foss v Harbottle}, has fallen into virtual disuse in South Africa, both because of the uncertainty in England as to the exact scope of the rule,\textsuperscript{665} and also because a member has to conduct the case at personal risk.\textsuperscript{666} The benefits of a successful action accrue to the company, but the plaintiff personally bears the risk in respect of costs. The statutory derivative action, which overlaps with the common law action to a great extent, is usually preferred.\textsuperscript{667} Such an action is, furthermore, permitted even where the conduct has purportedly been ratified.\textsuperscript{668} The court is empowered in such an instance to set aside the ratification.\textsuperscript{669} In other words, the statutory derivative action obviates the necessity to distinguish between wrongs which can and those which cannot be ratified. The distinction remains of importance in instances where the company itself sues the wrongdoer.

Unratifiable wrongs may be classified under three headings.\textsuperscript{670} First, some acts are in breach of the company's rights as set out in the corporate constitution.\textsuperscript{671}

\textsuperscript{664} Naudé \textit{Maatskappydirekteur} 191. On derivative actions generally, see Cilliers & Benade \textit{Corporate Law} 295ff. A wrong to the company may have a detrimental effect on a member's shareholding and may thus indirectly breach the member's personal rights. Nevertheless, the member does not have a personal action for indirect breaches of this nature: Cilliers & Benade \textit{Corporate Law} 297; \textit{Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2) [1982] 1 Ch 204 (CA), [1982] 1 All ER 254 (CA)} (see chapter 4 page 80ff). Minority protection in England is regulated by ss 459-461 of the British Companies Act 1985. No provision is made for a separate statutory derivative action, and courts may therefore well authorise proceedings on behalf of the company against the wrongdoers: Cilliers & Benade \textit{Corporate Law} 311; Van Rooyen "Minderheidsbelange" 268ff. See also chapter 4 page 81ff.

\textsuperscript{665} See chapter 4 page 78ff.

\textsuperscript{666} The existence of the rule itself has frequently been accepted: Cilliers & Benade \textit{Corporate Law} 297; \textit{Moti v Moti and Hassim Moti Ltd 1934 TPD 428}; \textit{Gründling v Beyers 1967 (2) SA 131 (W) at 139F and 151}.

\textsuperscript{667} See, in general, Blackman "Majority Rule" 28ff; Cilliers & Benade \textit{Corporate Law} 298ff; Hablo \textit{Cases} 536ff.

\textsuperscript{668} Section 266(1) provides that where a company has suffered damages or loss or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by any director or officer of that company or by any past director or officer while he was a director or officer of that company and the company has not instituted proceedings for the recovery of such damages, loss or benefit, any member of the company may initiate proceedings on behalf of the company against such director or officer or past director or officer in the manner prescribed, notwithstanding that the company has in any way ratified or condoned any such wrong, breach of trust or breach of faith or any act or omission relating thereto.

\textsuperscript{669} Section 266(4).

\textsuperscript{670} Cilliers & Benade \textit{Corporate Law} 295.

\textsuperscript{671} For example, \textit{ultra vires} acts or acts which, in terms of the company's constitution, are beyond the authority of its agents. Ratification can, in these circumstances, only be effected once the constitution has been altered by special resolution: Cilliers & Benade \textit{Corporate Law} 295 note 2. The payment of dividends in contravention of the memorandum also falls under this heading. In this regard, see \textit{Quadrangle Investments (Pty) Ltd v Witind Holdings Ltd 1975 (1) SA 572 (A) at 581.}
Unlawful conduct and conduct in breach of the common law resort under the second heading. Directors' fiduciary duties are more directly affected by the third type of unratifiable wrong, namely those acts which are said to constitute a "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. 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. Its exact content is uncertain, but it is clear that the terms "fraud" and "minority" are not restricted to their usual meanings. The application of this exception is almost exclusively in areas where a director has committed a wrong against the company in his capacity as director. 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". In the first place a *mala fide* wrong done by a director to his company must amount to a wrong to the company which is not ratifiable by ordinary resolution. Examples of such conduct are an unlawful reduction of the capital of the company, conduct in contravention of s 38, or theft of company funds: Cilliers & Benade *Corporate Law* 296.

According to Gower "fraud" in this connotation implies an abuse of power analogous to its meaning in a court of equity to describe a misuse of a fiduciary position. There is no need for actual deceit: Cohen "Distribution of Powers" 284. Nor is it necessary that the injured parties should be a minority. The injured party may, in fact, often be the company itself. Sometimes those who have really suffered will be a class or section of members, not necessarily a numerical minority, who are outvoted by the controllers: Gower *Corporate Law* 593. See also Wedderburn "Shareholders 2" 93-94, where it is indicated that the actions constitute not so much a "fraud on the minority" as a "fraud on the company", and that the minority sues "to protect ... the company from the unlawful acts of the directors or other wrongdoers" (citing Cairns LJ in *Ferguson v Wilson* [1866] 2 Ch 77 at 90).

The authors of *Corporate Law* 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": Cilliers & Benade *Corporate Law* 293-294.

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Afterman *Company Directors and Controllers* 148ff; Birds "Making Directors do Duties" 69; Blackman "Majority Rule" 31; Cilliers & Benade *Corporate Law* 296; Cranston "Limiting Liability" 200; Mason "Ratification" 163-164; Naude *Maatskappydirekteur* 186; Van Rooyen *Thesis* 463.
may not be ratified. This concept entails more than what has been done fraudulently and dishonestly. It also includes actions by directors who have not complied with their subjective duty to act in the interests of the company, and have placed their own interests or those of another before the interests of the company. 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. This situation often overlaps with the appropriation of company assets, confirmation of which is generally regarded as invalid.

In the second instance, a wrong is 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. Van Rooyen regards it as unfortunate that the practice has developed to only distinguish between the abovementioned two instances of unratifiable wrongs. The learned author suggests, it is submitted correctly, that the real question remains that the directors had exceeded their powers, and not that they had acted otherwise than in good faith: Bax "Mala Fide Actions" 395; Beck "Peso Mines" 118-119; Cohen "Distribution of Powers" 285; Rider "Foss v Harbottle" 275 note 33; Van Rooyen Thesis 484-485. It is submitted that the decision in Bamford is at least confusing and, if meant to indicate that mala fide actions are ratifiable, also incorrect.

Other reasons have been suggested. Afterman Company Directors and Controllers 151 submits that to allow an ordinary resolution to waive the duty of good faith would destroy the foundations of the fiduciary relationship. The author also maintains that it would 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 section 247 of the Companies Act 61 of 1973). Wedderburn "Shareholders' Control" 569-570 submits that the ratification of a mala fide wrong amounts to expropriation of company assets and is therefore not allowed. For reasons that have been advanced by American authorities, see Van Rooyen Thesis 492ff and the discussion in chapter 5 par 5.1 above.

Naudé Maatskappydirekteur 189; Van Rooyen Thesis 471.

See, for example, Burland and Others v Earle and Others [1902] AC 83 (PC), where a decision by the general meeting was regarded as invalid and a "fraud on the minority" if "the majority are endeavouring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company, or in which the other shareholders are entitled to participate ..." (at 93 per Lord Davey). This dictum has been approved in several South African decisions. See, for example, Cohen v Directors of Rand Collieries Ltd 1906 TS 197 at 203; Moti v Moti and Hassim Moti Ltd 1934 TPD 428 at 441; Garment Workers' Union and Others v Smith 1935 CPD 249 at 257-258; Gundelfinger v African Textile Manufacturers Ltd 1939 AD 314 at 324-326. See also Cilliers & Benade Corporate Law 296; Farrar Company Law 426; Gower Company Law 593ff; Naudé Maatskappydirekteur 188-189; Van Rooyen Thesis 467-468; Montier v Hooper's Telegraph Works (1874) LR 9 Ch App 350 (see chapter 4 page 111 above); Cook v GC Deeks and Others [1916] 1 AC 554 (PC) (see chapter 4 page 97, 117 above); Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257, [1980] 2 All ER 841 (see chapter 4 page 79 above).

Van Rooyen "Stemreg" 613.
whether the majority has acted in accordance with the common law rule that it must act *bona fide* in the interests of the company.685 The test for compliance with this rule should be objective.686 Any decision by the majority which adversely affects members’ rights should be tested with regard to the interests or needs of the company.687 If it cannot be regarded as beneficial to the company, the decision is a fraud on the minority and is therefore 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.688 The type of conduct to which the majority’s resolution pertains is, according to Van Rooyen’s view, only a *factum probans*, as is the existence or not of an independent majority.689 It is therefore unnecessary to distinguish between ratifiable and unratifiable wrongs. All wrongs to a company may be condoned, provided that the condonation and the 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.690

Against this background it must be considered whether a director’s appropriation of an economic opportunity in which his company was interested, can be ratified. Some authorities indicate that ratification may be possible, either by ordinary resolution,691 or by a unanimous resolution692 and provided that the deci-

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685 Pennington *Company Law* 657; Van Rooyen “Stemreg” 602; Peters’ *American Delicacy Company Limited v Heath and Others* (1939) 61 CLR 457 at 480; Garden Province Investments v Aleph (Pty) Ltd 1979 (2) SA 525 (D) at 533-535; Sammel and Others v President Brand Gold Mining Co Ltd 1969 (3) SA 629 (A) at 686-687; Estmanco (Kiher 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 BCLR 11 at 18, 21; Smith and Others v Croft and Others (No 2) [1988] Ch 114, [1987] 3 All ER 909.

686 Van Rooyen “Stemreg” 604ff.

687 Van Rooyen “Stemreg” 607.

688 Van Rooyen *Thesis* 377ff; Van Rooyen “Stemreg” 606-607.

689 Van Rooyen “Stemreg” 613-614.

690 Van Rooyen “Stemreg” 613.

691 Cowling *v Stableford & Co Ltd* (1905) 22 SC 363 at 372; *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* 1909 ORC 65; Robinson *v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 197, 200 and 229; *Canadian Aero Service Ltd v O’Malley* [1974] SCR 592, (1973) 40 DLR (3d) 371. Cranston “Limiting Liability” 201 is of the opinion that it might be better doctrinally to treat a company’s *bona fide* approval of such a diversion as a rejection of the opportunity, which the directors are then able to pursue because it now falls beyond the scope of their trust. It is, however, submitted that a rejection of the opportunity should occur before it is taken by the director, if at all effective. See also par 4.5 above.

692 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 and 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
sion of the majority does not amount to a fraud on the minority. The problem with this approach is that it is almost impossible for frank and full disclosure to be made in such circumstances. Attempts to reconcile the different approaches to ratification are often forced.

Some differences between the appropriation of corporate opportunities and the secret profit rule were pointed out above. 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. However, the majority in general meeting may permit directors who have acted in good faith to retain their profits, provided the directors fully disclose the relevant facts. 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, in the first instance because it falls under the second category of unratifiable wrongs mentioned above, namely where the wrongdoer receives a benefit at the expense of the company, in the sense that the company is

opportunity and if he were to intend that such opportunity should be acquired by himself to the exclusion of the company there would exist (ordinarily) tacit consent to the acquisition. See also Henochsberg 471.

693 LAWSA Companies par 228. A director wishing to retain the opportunity who 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 and Others [1916] 1 AC 554 (PC); Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257, [1980] 2 All ER 841.

694 Baxt "Ratification" 18 points out 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 Partridge "Ratification" 142, where it is suggested 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. Therefore no question of ratification in relation to the director's personal liability arises. See further S v De Jager and Another 1965 (2) 616 (A) at 624-625, where it was indicated by Holmes JA 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 concept of limited liability.

695 Baxt "Ratification" 49 submits that the efforts at distinguishing the different cases "do not merit the painstaking analysis attempted." See also chapter 4 page 111ff above. No attempt is therefore made to reconcile the various decisions in this regard. Rather, it was attempted to formulate the general principles of South African company law. For a cogent discussion of the various approaches in case law, see Van Rooyen Thesis 495ff.

696 See page 359 above.

697 Beuthin & Luiz Basic Company Law 228; LAWSA Companies par 279; Rider "Foss v Harbottle" 275. See also pages 345ff above. It is submitted that this is why the transaction in Regal might have been ratifiable.
Directors' Fiduciary Duties and Corporate Opportunities

prejudiced so as to place assets in the hands of the wrongdoer. It may also be unratifiable because it constitutes a *mala fide* wrong done to the company. A large number of corporate opportunity cases 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.

It is submitted that the appropriation of corporate opportunities would also be unratifiable according to the approach recommended by Van Rooyen, because the majority's obligation to act in the best interests of the company would not permit the director to retain a profit made in these circumstances. The financial inability of the company to pursue an opportunity does not alter the fact that the director is contravening his obligation to act in the best interests of the company if he pursues such an opportunity for his own benefit.

In view of the above, it is submitted that the appropriation of an economic opportunity by a director for his own benefit in circumstances where he has contravened his obligation to act in the best interests of the company, is not ratifiable.

4.9 Codes of Conduct

The various legal systems investigated above all recognise the need for control of company management. One method of achieving this control is by means of a supervisory board as found in the German example. Other systems rely on common law principles, or extensive formal regulation. Formal regulation can be accomplished through statutory enactment, or by a Code of Conduct. In this paragraph codes of conduct are investigated. Statutory codification of directors' duties is considered below.

Both in England and South Africa proposals have been tabled that corporate governance be regulated by means of Codes of Conduct. The Cadbury Committee in

698 See page 399 above. Van Rooyen *Thesis* 495ff distinguishes three instances. First, the appropriation may concern assets which form part of the company's estate. Secondly, assets or advantages may be obtained in competition with the company and, finally, contracts may be concluded with the company. The appropriation of corporate opportunities concerns the second instance.

699 See page 398 above.

700 Naude *Maatskappydirekteur* 189. In *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162, for example, the director falsely represented ill health, obtained a release from his company and subsequently appropriated an opportunity on his own behalf (see chapter 4 page 98 note 272 above).

701 See par 4.5 above.

702 See chapter 7 pars 2.1.2 and 2.2.2 above.

703 For example, England (see chapter 4 above) and America (see chapter 5 above).

704 As in France (see chapter 6 above).

705 See par 4.10 below.
England recommended that listed companies comply with its Code of Best Practice or include a statement in their annual reports justifying their non-compliance.\textsuperscript{706} A Code of Conduct for company directors was also one of the issues investigated very recently in South Africa. The report by the King Committee on Corporate Governance, under chairmanship of Mervyn E King, was published on 29 November 1994. The committee’s recommendations are directed at all companies listed on the main board of the Johannesburg Stock Exchange, large public entities as defined in the Reporting by Public Entities Act 93 of 1992, banks, financial and insurance entities as defined in the various Financial Services Acts, large unlisted dependent companies, large \textit{quasi}-state entities such as control boards and co-operatives.\textsuperscript{707} A Code of Ethics directed at all business enterprises, and affirmative action guidelines were published simultaneously.

The purpose of the report is stated in the foreword as the promotion of the highest standards of governance in South Africa. It is acknowledged that corporate governance has, by virtue of the various interest groups or stakeholders which have an involvement in modern corporations, become more complicated.\textsuperscript{708} At the same time, it is appreciated that a corporate system which focusses on control on the basis that stifles enterprise is detrimental to any country’s economy.\textsuperscript{709} In the context of corporate governance, a proper balance therefore needs to be achieved between freedom to manage, accountability and the interests of the different stakeholders.\textsuperscript{710}

The committee’s terms of reference were wide. It investigated financial reporting and accountability, good practice concerning the responsibilities of executive and non-executive directors, the case for audit committees, the principle responsibilities of auditors and the links between shareholders, boards and auditors.\textsuperscript{711} In addition, the committee was charged with compiling a Code of Ethical Practice for business enterprises in South Africa, with due consideration of the special circumstances prevailing in South Africa, more particularly the emergence of a new class of entrepreneur being members of the disadvantaged communities.\textsuperscript{712}

\textsuperscript{706} On the report by this committee, see chapter 4 par 2.2.1 above.

\textsuperscript{707} \textit{King Report} 5, par 3.2. The Committee recommends that in the South African context “large” includes companies with shareholders’ equities of fifty million rand or more. It concedes that companies with an equity base of less than this amount may have very large turnovers and/or employ many people and that their successful functioning is important to the wider community. It suggests that these companies, which are difficult to define, should adhere to the recommendations: \textit{King Report} 5, par 3.4.

\textsuperscript{708} \textit{King Report} 1, par 1.2.

\textsuperscript{709} \textit{King Report} 2, par 1.13.

\textsuperscript{710} \textit{King Report} 3, par 1.16.

\textsuperscript{711} \textit{King Report} 3, par 2.1. These matters were also investigated by the Cadbury Committee in England: see chapter 4 par 2.2.1 above.

\textsuperscript{712} \textit{King Report} 3 par 2.4.
In considering the special circumstances prevailing in South Africa the task group on directors accepted the concept of not permitting the same individual to be the chairman and the executive head. However, it recognised that there are many instances in South Africa where the position of chair and chief executive are combined in the same individual by force of circumstances. There are, for example, "family companies" in South Africa, many of which are listed on the Johannesburg Stock Exchange. The task group further accepted the Cadbury recommendation that all companies should have a minimum of three independent non-executive directors as correct in principle. But it doubted whether there is, in South Africa, a sufficient pool of trained and experienced people available to serve as non-executive directors. It acknowledged that as a result of this limited pool of skilled people, conflicts of interest often arise. Whereas the Cadbury recommendations involved the financial aspects of corporate governance and focused on integrity and shareholder dominance, the King Committee was of the opinion that the emphasis should be on a participative entrepreneurial approach rather than a dominant one. Likewise, it considered that the participation process should not become so dominant that it stifles or obstructs the notion of business risk for reward in a free enterprise system.

The committee's recommendations are contained in chapter 19 of the report, and the "Code of Corporate Practices and Conduct" in chapter 20. Certain aspects relevant to this thesis have already been referred to where appropriate in preceding paragraphs.

With its recommended Code of Conduct, the King Committee recognised the need for independent supervision of larger companies. The adoption of the Code is, at present, voluntary. It will take some time for the Code to take effect and for affected corporations to prepare themselves for compliance. Consequently, the Committee recommends that the affected corporations reporting in respect of years commencing after 30 June 1995, should state in the report whether they comply with

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713 Cadbury Report 22, par 4.11. See chapter 4 page 59 above.

714 King Report 4, par 2.6.1.

715 Cadbury Report 22, par 4.11. See chapter 4 page 59 above.

716 See also par 2.3 below.

717 King Report 4, par 2.6.2.

718 King Report 5, par 3.5.

719 This is also the case with the Code of Best Practice established by the Cadbury Report in England, where the obligation on listed companies to state the extent of their compliance represents only a limited sanction: Putt "Directors" 254. See also chapter 4 par 2.2.1 above.
the Code and identify and give reasons for any areas of non-compliance.\(^{720}\) It is suggested by the Committee that the Code should ultimately apply to all companies listed on the Johannesburg Stock Exchange, large public entities as defined in the Reporting by Public Entities Act 93 of 1992, banks, financial and insurance entities as defined in the various Financial Services Acts, and large unlisted public companies.\(^{721}\) All companies should, however, be encouraged to adopt the Code.\(^{722}\)

An assumption underlying the King Committee's recommendations is that self-regulation, rather than statutory regulation and enforcement, is the optimum way to improve corporate governance.\(^{723}\) It is believed that companies which fail to reach acceptable standards of corporate governance are likely to be more effectively policed by the financial markets than by any form of legal regulation.

Codes of Conduct are designed to achieve the necessary high standards of corporate behaviour.\(^{724}\) The crucial question is: how likely is it that a Code will achieve this objective? It is submitted that the effectiveness of a Code must necessarily depend on the mechanisms available for enforcing it. This is especially so given that a company whose current practices are most at variance with a Code would want to disregard it.\(^{725}\) Clear guidelines should therefore be available in this respect. The King Committee suggests that the adoption of the Code be achieved mainly via the support of prominent associations, which should bind their members to comply with the Code, by incorporating the principles in the listing requirements for main board companies on the Johannesburg Stock Exchange and by peer pressure.\(^{726}\) It has been suggested that the Johannesburg Stock Exchange is likely to change its listing requirements to insist that companies state whether or not they comply with the Code.\(^{727}\) In England, where a similar system has been operative since 1992, delisting

\(^{720}\) King Report 35, par 21.1. In par 22.9 the following wording is suggested as appropriate: "The directors endorse, and during the period under review, have applied the Code of Corporate Practices and Conduct as set out in the King Report. By supporting the Code the directors have recognised the need to conduct the enterprise with integrity and in accordance with generally accepted corporate practices."

\(^{721}\) King Report 31, par 20.1.1. In the South African context, large companies are those with a total shareholders' equity greater than fifty million Rand: King Report 32, par 20.1.2.

\(^{722}\) King Report 32, par 20.1.3.

\(^{723}\) King Report 9, par 5.6. This was also assumed by the Cadbury Committee: Leigh-Pemberton "Corporate Governance" 269; Rees & Sheikh "Regulation" 370: Sealy "Corporate Governance" 211.

\(^{724}\) Rees & Sheikh "Regulation" 374.

\(^{725}\) Leigh-Pemberton "Corporate Governance" 269. The King Committee agrees that recommendations for the Code of Corporate Practices and Conduct are valueless unless they are implemented: King Report 35, par 22.1.

\(^{726}\) King Committee 36, par 22.6.

\(^{727}\) Business Mail Vol 1 No 29 December 2-8, 1994.
is apparently seldom used as sanction.\footnote{Rees & Sheikh "Regulation" 374. The London Stock Exchange has, however, incorporated a new listing requirement that all public-issue companies must report annually, after review by their auditors, on whether or not they have complied with the voluntary Cadbury Code. Reasons must be furnished for non-compliance: London Stock Exchange announcement, 23 April 1993. See also Sealy "Corporate Governance" 211.} Even if it were, delisting of companies for non-disclosure may have the detrimental effect that investors will find it more difficult to get rid of their shares in the offending company by selling them.\footnote{Rees & Sheikh "Regulation" 374.} Sanction must therefore come largely from the public sector. In England companies' failure to comply with the Cadbury Code has in fact resulted in their being shunned by institutional investors.\footnote{Financial Mail Dec 2, 1994 at 24.} Whether these sanctions will be sufficient in South Africa remains to be seen. It is, furthermore, submitted that a single Code of Conduct cannot easily provide for the needs of all South African companies in view of the differences in their size, nature and objects.

4.10 Codification of Directors' Duties

A possible solution to clarify the issue of directors' fiduciary duties in general, and therefore also to state the law of corporate opportunities, is that these duties should be set out in a statutory Code.\footnote{In this regard, the Standing Advisory Committee on Company Law that has indicated that "[c]onsideration will have to be given to the possibility of codification of directors' duties in general" (Press Release Future Development of Company Law 1989-06-15 par 9). On the distinction between a codification and an ordinary statute, see Goode "Codification" 139 and Hahlo "Letter to the Editor" 607. The latter author distinguishes statutes, codes and restatements on the following grounds: "Unlike a statute, which is superimposed on the common law, and a restatement, which is merely a glorified textbook setting out the common law, a code means a break in tradition, requiring new techniques of application and interpretation."} This has not been the traditional source of company law in Commonwealth countries. Thus Sealy states:

Every Companies Act since [the Joint Stock Companies Act of 1844 and the Limited Liability Act of 1855] has done no more than engrat modifications on to the legislation which was already there, or amplified or qualified the rules of the common law upon which this legislation was a gloss. It follows that company law in Commonwealth countries has not traditionally been found in a self-standing Code, or even based upon one. It also follows that it has remained untidy in form, and not always easy to locate or state in the form of clear synthesised principles. It is also a consequence that it is in places illogical and contains obsolete and archaic rules which have long since lost their relevance but have escaped the attention of the reformers.\footnote{Sealy "Corporate Reform" 4.}
But pertinent suggestions have been made in this respect in many countries. The 1973 and 1978 Companies Bills in England were referred to above. The proposals of the American Law Institute provide an example of an informal codification, in the sense that it is not binding by itself. However the statutes of many states are based upon these proposals. In France management is effectively controlled by means of the codification of directors' powers and obligations. In Germany, control over management is achieved by a combination of statutory regulation and the application of common law principles, as well as by the creation of supervisory boards. The statutory entrenchment of certain obligations facilitates their enforcement, whilst not limiting directors' liability. Thus a measure of flexibility is retained in order to meet the demands of changing circumstances. As a result of recent review in Canada and New Zealand, the recent Companies Acts of both these countries contain provisions confirming certain aspects of directors' obligations, although neither of the statutes is comprehensive in the sense that recognised common law principles are excluded.

The question to be considered is whether company law, or any portion thereof, should be codified. Some commentators are of the opinion that a codification of directors' duties may make the fiduciary obligation either too restricted, or too wide. The disadvantages and advantages of codification must therefore be considered.

Any code has limitations. In the first place, it is unreasonable to expect a code that is simple and fully comprehensible to the layman. Commercial law is necessarily complex because of the complexity of commercial life. Therefore a code cannot be expected to be simple. However, the policies, purposes and concepts expressed in a code should be clear. Secondly, competing norms often have to be accommodated within the same code. Therefore a code cannot be expected to speak with total unity of purpose or language. Thirdly, every eventuality cannot be foreseen in a code and, should the codification be effected in the usual sense of the statute being exclusive, there will be little flexibility to cope with changing times. The best that can be done is to cover the typical case with reasonable precision and

733 See chapter 4 par 4.9 above.
734 See chapter 5 par 6.4.6 above.
735 See chapter 6 page 215 above.
736 See chapter 7 page 257 above.
737 See chapter 8 page 273 above.
738 Du Plessis Grondslae 97-98. The King Commission (see par 2.1 above) too does not, in view of the awesome array of duties owed by directors, support the suggestion by the Melamet Commission that there should be a statutory manual of directors' duties: King Report 9, par 5.6.
739 Goode "Codification" 157.
740 Ibid.
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to build in a measure of flexibility to allow the court to adjust for the atypical situation and to accommodate changes in practice not envisaged when the code was drafted. In the fourth instance, as a consequence of the nature and limitations of language all inconsistencies and ambiguities can never be eliminated.\(^{741}\) There is, moreover, the matter of enforcement of the obligations imposed by a code. Criminal sanction works well in some systems, but there the codified law pertaining to directors' duties is integrated into extensive codification of the law in general.\(^{742}\) In South Africa the trend is more in favour of the decriminilisation of company law in favour of civil sanctions.\(^{743}\) This is also the recommendation in respect of Australian law reform.\(^{744}\) Any codification of directors' duties should therefore, it is submitted, be accompanied by suitable civil sanctions in the event of non-compliance. It is suggested that a director whose act has breached any duty arising from his fiduciary relationship should be liable to the company for any loss suffered as a result thereof by the company, or for any economic benefit derived by the director by reason thereof.\(^{745}\) An additional disadvantage of codification shown up by the New Zealand experience, is that if the approach of adopting a "core" Companies Act, with topics such as securities regulation and related topics contained in separate Acts is adhered to, a reformed Companies Act may be delayed because other reform measures have not been finalised.\(^{746}\)

On the other hand, codification has several advantages. It simplifies the law, makes it more readily accessible and more readily ascertainable.\(^{747}\) According to

\(^{741}\) Ibid.

\(^{742}\) The French and German systems serve as examples: see chapters 6 and 7 above.

\(^{743}\) Fourie "Reform" suggests that the Close Corporations Act 69 of 1984 is instructive in this regard. The author submits that the principle of disclosure which runs through our Companies Act also applies to the numerous criminal offences created by the Act, most of which involve rather light and seldom enforced penalties.

\(^{744}\) Recommendation 7 by the Cooney Committee provides that criminal liability should not apply in the absence of criminality.

\(^{745}\) This sanction is similar to the one provided for in the event of breach of the fiduciary obligation owed by members of a close corporation to the corporation: Close Corporations Act 69 of 1984, s 42(3).

\(^{746}\) Fourie "Reform" 776-777.

\(^{747}\) Fourie "Reform" 775; Goode "Codification" 137. See, however, Hahlo "Common Law" 241ff and Hahlo "Codifying Common Law" 23 where it is doubted (in respect of codification of the common law generally) that the objective of accessibility to the layman is at all attainable, even by codification. Goode "Codification" 137 mentions the additional benefits that codification helps to identify weaknesses in the existing law, enables the law to be modernised by adapting doctrine to practice and reduces the ambiguities and inconsistencies which arise from a patchwork of statutes compiled by different drafters at different times. For interesting views in favour of and against codification (but here in respect of the common law generally), see Gower "Comment" 259; Hahlo "Common Law" 241; Hahlo "Letter" 607; Hahlo "Codifying Common Law" 23; Topping & Vandenlinden 'Jus Commune' 170.
some commentators codifications may therefore be expected not only to produce substantial improvements in the law itself, but also to effect enormous savings of time, effort and money spent in ascertaining the law, advising on it and complying with it. Moreover, a statutory statement of directors' duties may educate directors, enabling them to discover and understand their duties much more easily than if they were expected to search through a maze of case law. The general view is that if directors have easy access to the law regarding their position, they will be less likely to act in breach of it.

If our company law as a whole is codified, the mass of older case law would cease to be relevant as a primary source of law. This seems a favourable course of action in a developing country where libraries are few and poorly stocked and where there is no market large enough to support the writing of textbooks. This was the situation in Ghana when Gower compiled his cogent codification of the Ghanaian company law. The Ghana Companies Code is a true codification of the law and does not only superimpose a number of statutory rules upon an existing body of common law and equitable principles. At the time of proposal of the Draft Code there were few experts in company law and complete sets of law reports were not readily accessible. In addition, there were virtually no decided cases in the Ghanaian courts on company law. The principles and rules would have had to be extracted from decisions in the English reports. An exclusive code would also facilitate dealings between Ghana and other African countries with French-type Acts. The special circumstances prevailing in Ghana thus necessitated this approach to codification. However, it is submitted that none of these circumstances are relevant to the South African situation.

It is suggested that a comprehensive and exclusive statutory codification of company law is not desirable in South African law, since it will lack the flexibility that is required to cope with changing commercial realities. Moreover, it cannot adequately meet the demands of the existing variety of companies in our law. But South African company law would, it is submitted, benefit from a general statement of directors' duties in the Companies Act. In this area of the law, eliciting clear

748 Goode "Codification" 138.

749 Birds "Making Directors do Duties" 67. In this regard, see also the recommendation by the King Committee that the special circumstances prevailing in South Africa, more particularly the emergence of a new class of entrepreneur being members of the disadvantaged communities, should be considered: King Report 3, par 2.4 (see also par 2.1 above).

750 Fourie "Reform" 775; Sealy "Corporate Reform" 4.

751 Sealy "Corporate Reform" 4.


753 Nevertheless, the provisions of the Ghana Companies Code are of considerable comparative value.
statements of principle is often extremely difficult. Such a statement should, lest it mislead, be at least as comprehensive as the present case law. There is no apparent reason why a statutory statement of directors’ duties should be exclusive. There are several examples of codification from which we can learn. Reforms in many Commonwealth countries, notably the Companies Acts of Canada, New Zealand and Ghana are noteworthy and the reports preceding them contain invaluable information. Corporate law reformers in South Africa should not attempt to re-invent the corporate wheel.

It is therefore suggested that the Companies Act should be amended to include a statement of certain primary obligations of directors. The stated object of this statement should be to inform, but not to replace the existing law. Matters which should be addressed include an exposition of the basic fiduciary duty to act in good faith and in the interests of the company; the consideration of the interests of specific groups; and the position of nominee directors. The obligation to avoid a conflict between personal and company interests should, furthermore, be elucidated. Specific attention should, it is submitted, be given to corporate opportunities; use of confidential information; and competition between directors and their companies. Specific recommendations in this regard are made below.

In conclusion, it should be borne in mind that this is not a field of legislation in which finality is to be expected. Company law is a growing and changing subject matter. As has been pointed out by Sealy, there is a wealth of precedents for any would-be reformer of company law, and the choice has to be dictated not by reference to any single ideal, but by the needs of the particular jurisdiction at that time. A search for perfection would be futile. What is important, however, is that corporate law reform in South Africa should proceed rapidly.

5 CONCLUSIONS

A company, although a separate legal entity, is not a natural person. Therefore the management functions of a company are undertaken by an individual or individ-

754 Fourie "Reform" 775, who suggests that reducing major judge-made rules relevant to the law of directors' fiduciary obligations to statutory form, would undoubtedly make the law much more intelligible and accessible.

755 Birds "Making Directors do Duties" 69.

756 Birds "Making Directors do Duties" 68.

757 Fourie "Reform" 770.

758 See chapter 10 par 4 below.

759 Sealy "Corporate Reform" 22.

760 Fourie "Reform" 785.
uals acting as a board.\textsuperscript{761}

Various statutory and common-law duties are imposed on directors. Moreover, a directorship is regarded as one of the most complex fiduciary offices.

Under South African law anyone who occupies the office of director, whether he be an alternate, nominee or \textit{de facto} director, is regarded as a director and is therefore subject to the obligations of that office.\textsuperscript{762} The English shadow director is not recognised in our company law.\textsuperscript{763} His position resembles the first category of \textit{de facto} directors referred to above, namely persons who act as directors without having been appointed as such in the manner prescribed by the articles.\textsuperscript{764} But in English law shadow directors are not held to be subject to any fiduciary obligation, whereas \textit{de facto} directors are.\textsuperscript{765} It was suggested above that under South African law a \textit{de facto} director has placed himself in a fiduciary position and should, therefore, bear the consequences and responsibilities of that station.\textsuperscript{766}

The designation of a director as "executive" or "non-executive" may be indicative of the director's level of involvement. It does not, however, necessarily indicate a lesser fiduciary duty on the part of a director who is less actively involved in the management of the enterprise.\textsuperscript{767} This classification of directors is thus not particularly helpful in the assessment of their fiduciary obligations,\textsuperscript{768} but may be important in respect of the assessment of the duty of care and skill.

The fiduciary duties arise once the director's appointment takes effect and last for the duration of his tenure of office. As is the position under English law, a prospective director or director-elect does not occupy a fiduciary position. If the director has not formally been appointed, the fiduciary relationship commences when he starts to act as a director.\textsuperscript{769} Some courts have indicated that the fiduciary obligation may continue beyond the director's resignation, holding him liable for

\textsuperscript{761} See par 2 above.

\textsuperscript{762} See pages 303-305 above.

\textsuperscript{763} See chapter 4 par 2.1 above.

\textsuperscript{764} See page 307 above.

\textsuperscript{765} The distinction between the two concepts in English law is that the concept of a shadow director presupposes the valid appointment of a board of directors. A \textit{de facto} director, on the other hand, can be identified irrespective of the valid appointment of any directors.

\textsuperscript{766} See page 308 above. This is in accordance with the position under American law: see chapter 5 page 128 above.

\textsuperscript{767} See par 2.2 above.

\textsuperscript{768} \textit{Howard v Herrigel and Another} 1991 (2) SA 660 (A) at 678. See also page 311 above.

\textsuperscript{769} See chapter 4 note 51 and page 312 above.
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opportunities appropriated after termination of his office. Yet a former director cannot be regarded as a fiduciary, since he no longer holds the position from which he derived his fiduciary obligation. It is submitted that release from the fiduciary obligation upon termination of a director's office follows as a direct consequence of the fact that the obligation arises from the position held by him. But in certain circumstances the director remains accountable to the company in respect of competitive activities which occurred after the termination of office. The decisions in O'Malley, Cranleigh Precision Engineering, Cooley, Umunna and Magnus Diamond Mining Syndicate are, for this reason, correct.

Proper exercise of the fiduciary duty may require that other interest groups than the company as a separate legal entity be considered. For example, recent decisions in Australia, New Zealand and England indicate that, at least in circumstances of insolvency or near insolvency, the interests of company creditors will merit consideration. American law goes further, and recognises the creditors as beneficiaries of the obligation in these circumstances, although the extent of the obligation to creditors is as yet uncertain. There is also increased recognition of a fiduciary duty owed directly to shareholders under American law.

Directors' compliance with their fiduciary obligations cannot be assessed without taking cognisance of all surrounding circumstances. Therefore the interests of various groups should be considered. But it is submitted that the implication is not that these groups become direct beneficiaries of the fiduciary obligation. Recognition of various beneficiaries, who may well have conflicting interests or expectations, could result in the loss of all effective control over company management and in the disposal of well-established principles governing corporate decision-making. Furthermore, no means of effectively dealing with the problems of standing to sue and ratification have thus far been suggested. It is therefore suggested that the beneficiary of directors' fiduciary duties remains the company as a separate entity and that authorities seeking to prove other beneficiaries only serve to confirm the need to protect these groups. There are other means of arranging such protection,

771 See pages 312 and 376 above.
772 See page 313 above.
773 The most important groups are creditors, employees and shareholders. In appropriate circumstances the interests of bondholders may merit consideration: Botha "Bondholders" 287ff. This aspect is discussed in more detail in chapter 3 above.
774 See chapter 3 page 33ff.
775 See chapter 5 page 133 above.
776 See chapter 5 page 132 above.
777 See, generally, chapter 3 above.
for example the specific statutory provisions aimed at the protection of creditors. However, in view of the growing uncertainty on this aspect of the law, it is suggested that the Companies Act be amended to reconfirm the company as beneficiary, at the same time expressly permitting the consideration of other interest groups.\(^{778}\)

As is the position in the other jurisdictions researched, a director cannot be relieved of his fiduciary duty in the company's articles, contractually, or in any other way.\(^{779}\) The fiduciary obligation only concerns the exercise of a director's powers in his capacity as director. When exercising his powers as a member of the company, the director is free from any fiduciary obligation.

The comparative legal survey undertaken above confirmed the sui generis basis of a director's fiduciary duties. It has thus far been accepted that the basis of his liability for breaches of fiduciary duties is similarly unique. But recently it was suggested that in order to promote legal certainty the liability should, in South African law, be based on delict. Proponents of the proposition contend that, to date, unnecessary reliance has been placed on principles derived from English law. It was indicated above that the South African common law provides a sui generis action for breach of fiduciary duties.\(^{780}\) It is therefore not an automatic consequence of non-reliance upon English trust principles that the claim for breaches of fiduciary duty should be delictual in nature.\(^{781}\) Application of the elements of delict may impose a limit on liability,\(^{782}\) and thereby to some extent create legal certainty. But an undesirable consequence could be that liability might prove to be so restricted that the strict rule regarding the duties of directors becomes ineffective. Another argument advanced in support of legal certainty is that delictual principles also form the basis of liability for breaches of the duty of care and skill. It is suggested that it is important to retain the distinction between the types of duty. Fiduciary duties have, for sound commercial reasons, always been regarded as more onerous than the duties of care and skill. To require that the delictual elements be satisfied in respect of breaches of fiduciary duty would, furthermore, be an unnecessary deviation from the present law.\(^{783}\) It is therefore submitted that the proper basis for liability in respect of breaches of directors' fiduciary duties remains sui generis. The plaintiff retains the option to institute a delictual action in appropriate circumstances. There seems no need to restrict him to the exercise of this option.

\(^{778}\) See chapter 10 par 2 below.

\(^{779}\) See par 3.3 above. In respect of the corresponding position under English law, see chapter 4 par 3.4.1 above.

\(^{780}\) See page 314 above.

\(^{781}\) See par 3.1 above.

\(^{782}\) The extent to which liability will be limited is, in view of the flexible boni-mores criterion applied in respect of the element of wrongfulness, debatable. See par 3.1.3.2 above.

\(^{783}\) See par 3.1.3 above.
As is the case in many other jurisdictions, the director's fiduciary relationship arises from the purpose for which his office and powers are entrusted to him, namely the benefit of the company. The fiduciary principles evolved in English law have considerable influence on our law. They should, nevertheless, be carefully considered in the South African context. These principles were developed by courts of Equity to fulfill a need of the time and to cater for specific circumstances. In as far as they conflict with our own law they should not be adhered to.

The fiduciary duties of a director entail that he must act *bona fide* in the best interests of his company and that he must not place himself in a position in which his personal interests conflict, or may possibly conflict, with his duties to the company. Often these duties are treated as two distinct obligations. It is suggested that they may equally well be seen as part of one global duty to act in the best interests of the company. Attempts to categorise different fiduciary duties are not objectionable, provided that the underlying principle is not forgotten. Such categorisations are not exclusive and are bound to overlap. Specific duties include the duties to act with an unfettered discretion, in good faith, in the interests of the company as a separate legal entity and within the limits of the powers conferred upon the particular director. The director must also avoid any conflict of interest and duty. He may not make so-called "secret profits" and should acquire economic opportunities for the company instead of for his own benefit. If he acquires these opportunities for his personal gain the law refuses to give effect to his intention. The acquisition is treated as having been made on behalf of the company.

The appropriation of corporate opportunities is regulated differently in the various jurisdictions investigated. The relevant rules in English law are based almost exclusively on Equity principles. American courts have developed a doctrine of corporate opportunities, based on the fiduciary position occupied by corporate directors. According to this doctrine, if a business opportunity is deemed to be a corporate opportunity of a given corporation, the fiduciaries of that corporation may not take or usurp the opportunity for themselves. The investigation revealed that the biggest drawback of the application of the doctrine is that lack of uniformity in determining the existence of a corporate opportunity in the various American states may lead to varying results. It is therefore submitted that the doctrine of corporate opportunities does not always succeed in promoting legal certainty. French company law does not recognise any general fiduciary doctrine in respect of its management. It relies instead on statutory provision for extensive civil and criminal liability in respect of management or lack of concern for company affairs. The gen-

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784 See pages 1 and 13 above.
785 See par 3.2.3.1 and par 4 above.
786 See chapter 4 above.
787 See chapter 5 par 6 above.
788 See chapter 6 above.
eral approach in Germany is to categorise particular fiduciary obligations as they become apparent in case law. The concept of directors' fiduciary duties is recognised, but is not as developed as it is in Anglo-American law.789 Statutory measures, such as the one prohibiting business ventures within the field of the company's activities, as well as the general obligation to exercise the diligence of an ordinary and conscientious manager, applied in conjunction with general fiduciary principles, sufficiently provide for this situation.

A principle which limits recovery to benefits received from office may not always be adequate. For example, the director may benefit from the exploitation of an economic opportunity which falls within the general line of business of the company but knowledge of which he acquired in a capacity other than that of his position in the company. In South African law, it seems that this problem is sufficiently resolved by application of the general fiduciary principles used in conjunction with the recognised remedies in delict for unlawful competition and misuse of confidential information.790

Anglo-American jurisdictions are uncertain about the effect of a company's inability to pursue a particular opportunity and its rejection by the company. Some American decisions allow financial inability as a sound defense, without precisely defining the term. Other jurisdictions maintain the strict rule generally applied by courts of equity in decisions on the duty of undivided loyalty, maintaining that if financial disability absolves a director, the inevitable result is to permit the diversion.791 The approach of disclosing the opportunity to the company and waiting for its rejection after proper disclosure as suggested by the American Law Institute therefore seems the safest. However, it still does not clarify precisely what will establish financial inability, neither does it indicate the effect of factors such as the passage of time between the rejection and the appropriation by the director, or changed circumstances occurring after the rejection.

Most Commonwealth decisions rely on the profit and conflict rules and require directors to account for profits in all instances where corporate opportunities have been appropriated personally. Rejection by the company or inability to pursue it, has consequently not been considered relevant in several Commonwealth decisions.792 But the decision in Peso followed a different approach, holding that the rejection of the opportunity by the company had the effect of removing the conflict of interest problem. This approach has been followed in New Zealand and Australian company law.

These matters have not been pertinently discussed in South African case law. It is submitted that the principles at the root of director's fiduciary obligations indi-

789 See chapter 7 above.
790 See pars 4.6 and 4.7 above. Few South African decisions on corporate opportunities have, in fact, referred to that term: see par 4.3 above.
791 See chapter 5 page 186ff and par 4.5 above.
792 See chapter 8 page 289 and authorities cited in note 198.
cate the answer.793 Directors are placed under a strict fiduciary obligation in order to prevent them from abusing their privileged position. They are, moreover, normally generously compensated. These factors, considered with the fact that allowing financial disability and rejection of the opportunity by the company as absolving factors still leaves certain questions unanswered,794 lead to the conclusion that a director may only avail himself of these defenses in circumstances where there is no conflict of interest. If, for example, it would be illegal for the company to pursue the opportunity, the director may take it up without disclosure to and rejection by the company. In all other instances, the director should obtain the approval of the company, acting through the majority of shareholders, before taking up the opportunity.

The comparative legal survey revealed various approaches to the issue of competition between a director and his company.795 If the director personally appropriates a corporate opportunity he is in breach of his fiduciary duty and may, at the same time, be competing unlawfully. Where a rival company appropriates an opportunity that a company is interested in, it amounts to unfair competition, also where the same person is on both directorates.796 But it is also generally acknowledged that a director's obligation to act in the best interest of the company rather than his own interests is in jeopardy where he is on the board of competing companies. In addition he may commit the delict of unlawful competition, or misuse confidential information. A director should therefore be precluded from holding multiple directorships if competing companies are concerned, irrespective of his position in the company. It was argued above that such provision should preferably be contained in the Companies Act, failing which it should be included in the articles or any existing service contract.797

It was seen that, although their approaches differ, all the legal systems investigated forbid directors to use confidential information in order to compete with their company.798 The appropriation of corporate opportunities frequently overlaps with misuse of confidential information, although it may also involve information which is not confidential in nature. Another difference lies in the source of protection, which in the case of a corporate opportunity is always the fiduciary obligation between a director and his company. Protection of confidential information has various other sources.799 The appropriate remedies include an accounting of profits in

793 See par 4.5 above.
794 See page 387 above.
795 See par 4.6 above.
796 See page 383ff above.
797 See page 387 above.
798 See par 4.7 above.
799 See page 390 above.
the case of appropriation of a corporate opportunity, but not where confidential information has been misused.

It was concluded above that when a previous employee uses knowledge and skills either in his own enterprise or in someone else’s employment which the previous employer alleges is confidential in nature, the *boni-mores* criterion will be vital both in the determination of the fiduciary obligation to act in good faith in the interests of the company, and in the assessment of unlawfulness in a delictual action for misuse of confidential information.\(^{800}\) It was further concluded that the existing measures adequately protect a director’s misuse of confidential information belonging to the company.\(^{801}\)

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 are indeed ratifiable.\(^{802}\) Unratifiable wrongs include acts in breach of the rights of the company as set out in the corporate constitution, unlawful conduct and conduct in breach of the common law, and those acts which are said to constitute a “fraud on the minority”.\(^{803}\) 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 is prejudiced so as to place assets in the hands of the wrongdoer. The ratifying majority will, almost without exception, therefore not be acting in the best interests of the company. The making of a secret profit, by contrast, is ratifiable.

Despite the disadvantages of codifications referred to above, codification, in the sense of the enactment of a number of rules based upon existing common and statutory law, has several advantages which apply to the South African situation.\(^{805}\) It simplifies the law, makes it more readily accessible and more readily ascertainable. It should therefore produce substantial improvements in the law itself, as well as effect enormous savings of time, effort and money spent in ascertaining the law, advising on it and complying with it. An additional advantage of a statutory statement of directors’ duties is that it educates directors, enabling them to more readily understand their duties. Consequently, they should be less likely to breach them.

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\(^{800}\) See page 394 above.

\(^{801}\) Ibid.

\(^{802}\) See par 4.8 above.

\(^{803}\) See page 397 above.

\(^{804}\) See page 407 above.

\(^{805}\) See page 408 above.
It is therefore submitted that a comprehensive and exclusive codification of directors' fiduciary duties is not desirable, since it will lack the flexibility that is required to cope with changing commercial realities. It is, however, suggested that the South African Companies Act should include a statement of certain primary obligations. Guidance can be found not only in the Companies Acts of Canada, Ghana and New Zealand, but also in our Close Corporations Act 69 of 1984.806 Matters that should, it is suggested, be addressed include the basic fiduciary duty to act in good faith and in the interests of his company; the consideration of the interests of specific groups; and the position of nominee directors. The obligation to avoid a conflict between personal interests and those of the company should be confirmed, as should the duty not to personally appropriate economic opportunities in which the company is or might be interested. The holding of multiple directorships in companies which are trade competitors should, finally, be prohibited for the duration of the director's term of office.807 Civil, rather than criminal, sanctions should be imposed for non-compliance with the provisions of the Act.808 It is submitted that this approach is preferable to that of a Code of Conduct such as the one proposed by the King Committee.809 Because it does not attempt to codify to the exclusion of common law principles, flexibility is retained in the application of the appropriate principles. This is important in view of the vast differences in the types and sizes of affected companies. Enforcement will, furthermore, be more certain when particular civil sanctions apply rather than relying on peer pressure and sanction by institutions such as the Johannesburg Stock Exchange. Specific recommendations are made and motivated below.810

806 See especially s 42 in respect of the fiduciary position of members of a close corporation.

807 See chapter 10 below for more specific recommendations in this regard.

808 See page 408 above.

809 See par 4.9 above.

810 See chapter 10 par 4 below.
CHAPTER 10
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

1 INTRODUCTION

In this final chapter the principles pertaining to directors’ fiduciary obligations as apparent from the previous chapters are summarised and certain conclusions are drawn. First, directors and their fiduciary obligation are examined. In the second place the appropriation of corporate opportunities and certain related matters thereto are reviewed. As a result of these conclusions specific recommendations are suggested.

2 DIRECTORS AND THEIR FIDUCIARY OBLIGATION

All companies must of necessity act through individuals. Therefore each company has, under South African law and depending upon the type of company concerned, a director or directors assuming responsibility for its management. The fiduciary duties attaching to this office apply equally to *de iure* and *de facto* directors.¹

The law of fiduciaries applies to a number of commercial relationships in South African law, including that between a company and its director or directors.² The fiduciary duties exist in addition to the various statutory duties contained in the Companies Act and the duties of care and skill and irrespective of whether the director serves in an executive or non-executive capacity.³ In the recommendations below,⁴ which concern only directors’ fiduciary obligations, no mention is therefore made of executive or non-executive directorships.⁵ No director may be relieved of his fiduciary obligation, whether contractually or in the company’s articles.

A director’s position is often compared to that of other fiduciaries. The most frequent comparisons are between a director and a trustee, and between a director and an agent.⁶ These analogies do little more than prove the existence of a fiduciary duty. They do not determine the content of a director’s fiduciary obligation, neither

¹ See chapter 9 par 2.1 above.

² See chapter 2 par 2 and chapter 9 par 3 above. 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 authorised to act on its behalf and, in particular, to those acting in a managerial capacity: chapter 9 page 310 above.

³ See chapter 9 par 3.2 above.

⁴ See par 5 below.

⁵ It is submitted that this distinction would be relevant to any codification of the duties of care and skill.

⁶ See chapter 2 pars 3.1 and 3.2 above.
do they prove the basis of his liability for breaches of it. A director is not a trustee, neither is he an agent. His relationship with the company is unique, or *sui generis.* Therefore specific legal principles and guidelines have and should be developed by the courts to regulate his situation. Principles pertaining to other fiduciaries will obviously be of substantial comparative value. In this respect especially English law, where the law of fiduciaries was refined by courts of equity, has considerable comparative influence.

The fiduciary duties arise by virtue of the position which a director holds. Therefore he cannot owe a fiduciary obligation to his company before his appointment, and, it is submitted that his resignation from office similarly releases him from that obligation. Nevertheless, although a former director is no longer a fiduciary, he may, in certain instances, be accountable on the basis of his prior fiduciary obligation for certain activities which occurred after his resignation. In *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others,* the court found that the mere incorporation of a competing company on the initiative of a company's managing director whilst serving his month's notice did not constitute a breach of the director's fiduciary obligation to the company. This decision can, it is submitted, be distinguished from the one in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others,* on the basis that the director's resignation in *Sibex* was clearly with the object of setting up the competing business. Where a director's resignation is influenced by a wish to acquire for himself an opportunity, or where his position with the company, rather than a fresh initiative, led him to the opportunity, he should remain precluded from taking it.

Thus former directors should be accountable for profits made when either a conflict between self-interest and fiduciary duty led to the situation in which the profit was made, or if the opportunity to make the profit can be attributed to the fiduciary position formerly occupied. But there should be some limit to accountability to prevent the setting of too harsh a standard. Various factors should be considered. They 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 resignation by the director. It would, for example, be unrealistic to expect former directors to indefinitely refrain from using information which is general in nature.

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7 See chapter 2 par 3.3 above.
8 See chapter 2 par 1 and chapter 9 par 4 above.
9 See chapter 9 pars 3 and 4.4 above.
10 1981 (2) SA 173 (T), discussed in chapter 9 page 365 above.
11 1988 (2) SA 54 (T), discussed in chapter 9 page 369 above.
12 See chapter 9 par 4.4 above.
13 See chapter 9 page 376 above.
reasonably be expected of him to abstain from using business contacts or information acquired by him during his term of office in order to establish alternative employment for himself. In terms of the present Constitution, a director may in appropriate circumstances rely on his right freely to engage in economic activity and to pursue a livelihood anywhere in the national territory of South Africa.\textsuperscript{14} His former company must then prove that any limitation of that right is reasonable, justifiable, and that it does not negate the essential content of the right in question.

A director only owes fiduciary duties to his company when he acts in his capacity as director and not when exercising his powers as a member. But, in order to curb the power of directors who are also shareholders, it is recognised that courts will protect minorities if what is resolved at a general meeting of shareholders amounts to a "fraud on the minority".\textsuperscript{15}

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 authorised to act on its behalf and, in particular, to those acting in a managerial capacity.\textsuperscript{16}

The entity to which directors owe fiduciary duties is commonly described as "the company as a whole". This phrase has been interpreted in various ways,\textsuperscript{17} since various interest groups exist, notably individual shareholders,\textsuperscript{18} creditors of the company,\textsuperscript{19} the public,\textsuperscript{20} and employees.\textsuperscript{21} The possible existence of a duty owed directly to any one of these interest groups is a topic for independent research and could not be fully discussed in this thesis. Certainly the directors' fiduciary obligation to the company may at times include consideration of the particular needs of these parties. This does not imply that directors' fiduciary duties are owed to them directly. Substantial authority exists for acceptance of the proposition that the directors have only one master, namely the company as a separate entity.\textsuperscript{22} Recognition of various beneficiaries of the fiduciary obligation would, it is submitted, inevitably result in the loss of effective control, since the different interest groups are bound sometimes to have conflicting interests or expectations. And ratification of breaches of duty will

\textsuperscript{14} Section 26. See also chapter 9 par 3.2.2.2 and page 394 above.

\textsuperscript{15} See chapter 9 page 398 above.

\textsuperscript{16} Canadian Aero Service Ltd \textit{v} O'Malley [1974] SCR 592, (1973) 40 DLR (3d) 371 at 381. See also chapter 9 page 314 above.

\textsuperscript{17} See chapter 3 par 1 above.

\textsuperscript{18} See chapter 3 par 2 above.

\textsuperscript{19} See chapter 3 par 3 above.

\textsuperscript{20} See chapter 3 par 3.2 above.

\textsuperscript{21} See chapter 3 page 46 above.

\textsuperscript{22} See chapter 3 above.
become an even thornier issue if the ratifier varies in accordance with the circumstances of each case.\(^23\) It is submitted that protection of other interest groups will be better achieved by means of legislation. An example is found in section 424 of the Companies Act, which protects a company's creditors.\(^24\)

In view of existing case law recognising other interest groups as beneficiaries, at least in certain circumstances, it is submitted that the Companies Act be amended to expressly state that the directors' fiduciary obligation is owed to the company. This is in accordance with modern company law statutes.\(^25\) The Act should furthermore, without distracting from the fundamental obligation, permit consideration of interests of other groups such as creditors and employees of the company. The interests of individual shareholders should be protected, but at the same time it must be clear that the fiduciary obligation to the company is paramount.

Directors' fiduciary duties are usually broadly stated to entail that directors should act in good faith in the interests of the company, and that they should avoid a conflict of interests. Specific fiduciary duties include the duties to act with an unfettered discretion, in good faith, in the interests of the company as a separate legal entity and within the limits of the powers conferred upon the particular director. The duties are not exhaustive. The particular circumstances of a case may be indicative of the existence of a fiduciary obligation. Compliance with the obligation to act in good faith in the interests of the company cannot be evaluated without due regard to all surrounding circumstances.\(^26\) Moreover, compliance with the open-ended standard of good faith will in any future dispensation have to be measured in the light of the \textit{boni mores} or legal convictions of the South African community as reflected in the bill of rights contained in the Constitution as the supreme law.\(^27\) In addition, and often overlapping with the requirement of good faith, a director must not place himself in a position where his personal interests conflict, or may possibly conflict, with his duties to the company.\(^28\) A director should not make any profit from his position, other than that specified in the articles or in any separate contract he has concluded with the company. Certain instances of profit-making are regulated by the Companies Act,\(^29\) others by application of common law principles.\(^30\) In

\(^{23}\) Because the company can surely not ratify breaches of fiduciary duty in general meeting if it is not the beneficiary of that duty.

\(^{24}\) See chapter 3 note 44 above.

\(^{25}\) For example, the English Companies Act 1985, s 309(2); and the New Zealand Companies Act 1993, s 101.

\(^{26}\) See also chapter 3 and chapter 9 par 2.4 above.

\(^{27}\) See chapter 9 par 3.2.2.2 above.

\(^{28}\) See chapter 9 par 3.2.3 above.

\(^{29}\) See chapter 9 page 345 above.

\(^{30}\) See chapter 9 par 3.2.4.1 above.
certain other instances a director is not permitted to retain profits which have not necessarily been made by virtue of his office, because the acquisition of these profits is in conflict with his basic obligation to act in the best interests of the company. It is submitted that the two fiduciary rules mentioned above may equally be regarded as part of one global duty to act in the best interests of the company.

Acceptance of the position of a director as unique or *sui generis* usually results in the acceptance that the basis of his liability for breaches of fiduciary duties is similarly unique. However, it has been suggested that in the interests of legal certainty liability should, in South African law, be based on the *actio legis Aquiliae*. It is submitted that this is unnecessary. The *sui generis* origin of the fiduciary principle recognised in South African law can be traced to Roman law. Moreover, the investigation into the application of delictual principles to breaches of directors' fiduciary duties revealed some uncertainties. For example, neither wrongfulness nor damages, both essential elements of delict, is required to establish liability based on breach of a fiduciary obligation. To require that they be established will probably result in entrenched principles, such as the "secret profit rule", being ignored. This may, in turn, lead to uncertainty in respect of the enforcement of directors' fiduciary duties.

In the field of company law potential abuse by management of their privileged, often highly compensated, position is great. Moreover, shareholders often find it difficult and costly to enforce their rights. Therefore it remains necessary to observe a strict rule as a deterrent for abuse of the fiduciary position occupied by directors. This aim, it is submitted, is better served by the development of flexible rules in respect of the unique position of a company director than by enforcing delictual principles in order to establish liability for breaches of his fiduciary obligation. It is, on the other hand, accepted that the basis of liability for directors' breaches of their duties of care and skill is delictual. But these duties are traditionally regarded as less onerous than directors' fiduciary obligations. The need for observance of a strict

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31 See chapter 9 par 3.1 above. See also Du Plessis *Grondstae* 101-103; Du Plessis "Grondslag van Aanspreklikheid" 100-103; Fourie "Perspektiewe" 350.

32 See chapter 9 par 3.1 above.

33 See chapter 2 page 20 above.

34 See chapter 9 par 3.1.3 above.

35 See chapter 9 par 3.1 above. See also Heydon, Gummow & Austin *Trusts* 216 where it is confirmed that it is not necessary in all cases that the abuse of a fiduciary obligation should have occasioned either loss to the principal or profit to the fiduciary.

36 In America and France shareholders are more able to effectively control directorial conduct: see chapter 5 page 158 and chapter 6 page 216ff.

37 See chapter 9 page 320 above.
fiduciary rule has been recognised for many years, and is in accordance with other Anglo-American legal systems.38

Nothing prevents a plaintiff to sue in delict where appropriate in company law matters. In Cohen NO v Segal,39 for example, the company elected to base their claim in respect of an ultra vires application of the company's money on the actio legis Aquiliae. And in McLelland v Hulett40 the company's shareholders sued the directors of a company in delict after the dissolution of the company for an omission which caused pure economic loss. However, there seems no need to restrict a plaintiff to this basis for liability in respect of breaches of fiduciary duty if other remedies also exist. The imposition of such a restriction may have implications for other areas of company law. It is, it is submitted, not desirable seen against the background that South African company law is currently undergoing comprehensive review with the object of its principled reappraisal and reform.41

3 THE APPROPRIATION OF CORPORATE OPPORTUNITIES

A director is sometimes forbidden to retain profits which have not necessarily been made by virtue of his office, because the acquisition of these profits is in conflict with his basic obligation to act in the best interests of the company.42 For example, he has a duty to acquire certain economic opportunities for his company, if at all. If he acquires these opportunities, the so-called "corporate opportunities" for himself, the law refuses to give effect to his intention and treats the acquisition as having been made on behalf of the company.43

Generally, the term "corporate opportunity" denotes any property or economic opportunity to which the company has a claim.44 Various tests have been suggested to determine whether a particular opportunity is corporate in nature.45 They

38 See chapter 4 par 3 (England); chapter 5 par 3 (America); chapter 8 par 3.3 (Australia, Canada and New Zealand) above.

39 1970 (3) SA 702 (W).

40 (1992) 1 SA 456 (D).

41 To this end, the Co-Ordinating Research Institute for Corporate Law (CRIC) held a conference during July 1993 with the theme "Future Development of SA Corporate Law". At this conference it was accepted that recent national and international developments necessitate a comprehensive review of South African corporate law. It was accepted that the present system of ad hoc amendments and modifications does not lend itself to a principled reappraisal and reform of South African company law: (1994) 1 Corporate Development Series i.

42 See chapter 9 page 353 above.

43 Ibid.

44 See chapter 9 par 4.2 above.

45 See chapter 9 page 355ff.
range from the very wide approach of demanding that directors should pass on to the company any and all opportunities of which they become aware, irrespective of the nature of the opportunity and its affinity to company interests, and irrespective of the manner in which knowledge of such an opportunity was acquired. The narrowest approach is to provide that only those opportunities in which a company has an existing legal right is a corporate opportunity. The directors would then be free to appropriate almost every opportunity for their personal use. In between these two extremes, a number of tests have been applied. In our law, the company has a claim to the opportunity if it is in the line of business of the company and if the company has justifiably been relying upon the director to acquire it or to assist in its acquisition for the company. The opportunity should therefore not only be in the line of business of the company, but in all circumstances the company should be seen to have been justifiably relying upon the director(s) to acquire it or to assist in its acquisition for the company.

In South African law the application of the recognised fiduciary principles suffice to resolve corporate opportunity matters. Essentially the application of these rules amount to a determination whether the director has complied with his fundamental fiduciary duty to act in the best interests of the company. The fact that information belonging to the company has been used, or that the director has unfairly competed with his company may be indicative of a breach of his fiduciary obligation. There seems 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. It is submitted that any reference to a "doctrine of corporate opportunities" in our law is only a convenient collective name for the applicable fiduciary and other rules governing the acquisition of an economic opportunity by a director for his own benefit, rather than for the advantage of his company, and does not prove the existence of a separately developed doctrine.

However, it is suggested that for the sake of clarity any statement of directors' general fiduciary obligations should include not only the general obligation to avoid a conflict of interests, but also the obligation not to personally appropriate "corporate opportunities". One advantage of such a statement is that it will stress

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46 The "position test", "conflict test", "expectancy test", "present interest test", "line of business test" and "fairness test" are discussed above: see chapter 9 page 355ff above. The various tests applied in American decisions are discussed in chapter 5 par 6.4 above.

47 See chapter 9 page 359 above.

48 This is in accordance with the "line of business test", discussed in chapter 9 page 357 above.

49 See chapter 9 par 3.2 above.

50 See chapter 5 par 6 and chapter 8 par 3.4 above.

51 See the recommendation in this regard in par 5 below.

52 On the general advantages of codification, see chapter 9 par 4.10 above.
the difference between making a secret profit and appropriating a corporate opportunity. This, it is suggested, is important with regard to the effect of ratification of the conduct in question. It is further proposed that the proposals formulated by the American Law Institute may provide a viable model for the formulation of the duty not to appropriate a corporate opportunity.

The effect of a company's rejection of an opportunity, whether for financial or other reasons is as yet uncertain. Some jurisdictions allow these defenses in order to promote flexibility in the application of directors' fiduciary duties. Thus the director in *Peso-Silver Mines Ltd v Cropper* was allowed to retain a profit acquired after the board of directors had decided in good faith that the company did not have the financial resources to take the opportunity itself. The company's rejection of an opportunity was found to have removed any conflict of interest. Unfortunately, this inevitably involves the courts in the company's business decisions. Moreover, it is uncertain what test is applied to establish financial inability. In other jurisdictions, the defense of financial inability is not allowed. In America the uncertainty caused the American Law Institute to recommend that a director or senior executive should only appropriate an opportunity for his personal use if that opportunity has been rejected by the corporation after proper disclosure. Rejection may be based on the financial inability of the corporation to pursue the particular opportunity. The rejection by the corporation must be by a disinterested vote of the board of directors after full disclosure to it.

There is no South African decision directly on this point. Some authorities suggest that where the board of directors has *bona fide* 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. However, it was suggested above that directors' fiduciary obligations should be strictly applied in order to prevent temptations to abuse their office. Strict control over corporate governance has the benefit of enhancing investor confidence and protecting third parties. This, it is suggested, will be beneficial to a growing economy. The suggested approach also does away with the problems of proof in respect of financial inability, the effect of pas-

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53 In this regard, see also chapter 9 par 3.2.4.1 and page 355 above.
54 In this regard see chapter 9 par 4.8 above.
55 See chapter 5 page 177 above.
56 See chapter 4 par 4.5 (England); chapter 5 par 7.3.2 (America); chapter 8 par 3.4.6 (Australia, Canada and New Zealand) and chapter 9 par 4.5 (South Africa) above.
57 (1966) 58 DLR (2d) 1 (see chapter 8 page 290 above).
58 See page 379 above.
59 See chapter 5 page 187 above.
60 LAWSA Companies par 228.
sage 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.

Directors should therefore only be absolved on the basis of financial inability or rejection by the company where there was no real conflict of interest. In instances where there is, or may be, a conflict of interest directors should disclose the opportunity to the company before appropriating it for their personal use.

Decisions by the general meeting of shareholders and the board of directors, who are company organs, are regarded as decisions by the company. Internally, company management must be fulfilled by human functionaries. In practice the initial constitution of the company will provide for the appointment of a board of directors and expressly delegate all powers of management to it. But, although it is fast becoming accepted that the general meeting of shareholders can no longer necessarily be regarded as the company's supreme organ, it is suggested that it remains the appropriate organ to ratify breaches of directors' duties, provided that these breaches are indeed ratifiable. Since directors owe their fiduciary obligations to the company, it is the company that is wronged if those obligations are breached. As the investors in the company, the members should be able to condone actions which would otherwise, in their interests, be avoided. Unratifiable wrongs include acts in breach of the rights of the company as set out in the corporate constitution, unlawful conduct and conduct in breach of the common law, and those acts which are said to constitute a "fraud on the minority". The objective test to be applied to determine whether the majority could validly ratify a particular wrong is whether the resolution to ratify was taken in the best interests of the company. The circumstances of each case, including factors such as the participation of interested directors in the ratifying resolution, must be considered. If interested directors were unchecked in the ratifying process, the door would be open to possible abuse, thereby harming investor protection and confidence in the company as a form of

61 For example, if it is illegal for the company to pursue the particular opportunity. In Gross v Neuman 337 NYS2d 623 (AD 1972) (see chapter 5 note 449), for example, the corporation could not acquire a lease agreement due to Public Health Laws.

62 See chapter 9 par 4.5 above.

63 Van Rooyen Thesis 1.

64 Gower Company Law 140.

65 Du Plessis Grondslae 24; Gower Company Law 147.

66 See chapter 9 par 4.8 above.

67 See chapter 3 above.

68 See chapter 9 page 398 above.

69 See page 400 above.
It is submitted that even the involvement of only "disinterested" directors in the ratifying process may cause problems. For when can it be said that a director is truly disinterested? Where a director has no direct financial interest in a particular transaction, he may regard it in the company's, and accordingly in his own, interest to ratify (or not to ratify, depending upon the circumstances) a particular transaction in order to avoid negative publicity which may arise.

The acquisition of secret profits is ratifiable, provided that it does not constitute a fraud on the minority. The acceptance of a bribe, for example, is a fraud on the minority and would therefore not be ratifiable. The appropriation of corporate opportunities, it is submitted, can never be ratified.\textsuperscript{70} It is almost impossible for full and frank disclosure to be made in such circumstances. Moreover, the appropriation of a corporate opportunity constitutes a fraud on the minority, in some cases because the director's action was \textit{mala fide}, otherwise because it amounts to the receipt by the wrongdoer of 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.\textsuperscript{71} Because of this lastmentioned fact, the decision to ratify can, furthermore, not be regarded as being in the interests of the company.

4 \textbf{COMPETITION AND CONFIDENTIAL INFORMATION}

A director who concludes contracts with his company remains obligated to comply with the basic fiduciary obligation not to place himself in a position where his interests and duties conflict. If he does not comply with this duty the contract is not void, but voidable at the instance of the company. The rule is the same when the company contracts with a company in which the director has an interest. The contract will not be voidable if the directors are permitted in the articles to contract with the company by an "exclusion clause". Should the articles not contain such a provision, or if the provision has not been observed, the contract is voidable until the general meeting has ratified it pursuant to sections 234-240.\textsuperscript{72}

The traditional view is that, subject to certain qualifications and unless the articles or any separate contract provides otherwise, a director is not precluded from becoming a director, officer or employee of a rival company.\textsuperscript{73} But is is difficult to envisage one person being a director of competing companies without subordinating the interests of one of the companies to his own interests, thereby breaching his

\textsuperscript{70} See chapter 9 page 378ff above.

\textsuperscript{71} See chapter 9 page 399 above.

\textsuperscript{72} See chapter 9 page 383 above.

\textsuperscript{73} See chapter 9 page 384 above. See also \textit{Bellairs v Hodnett} 1978 (1) SA 1109 (A), discussed in chapter 9 page 362 above; \textit{Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others} 1981 (2) SA 173 (T), discussed in chapter 9 page 365 above.
fiduciary obligation. In addition his actions may amount to unlawful competition, misuse of confidential information, or oppressive conduct in terms of section 252 of the Companies Act. These matters will inevitably overlap to some extent, but should be distinguished, since the bases of the actions and, accordingly, their appropriate remedies, are not necessarily the same. There are other important differences. For example, if confidential information is misused, it is irrelevant whether or not the purpose of the use of the information is to compete.

It is submitted that, for purposes of establishing competition between a director and his company, the position occupied by the director and, accordingly, his specific powers in relation to acts on behalf of the company, are not relevant. Any division between directors who are able to perform legal acts on behalf of the company individually, and all other directors, seems to be based upon the agency principle, which is not at the root of directors' fiduciary obligations. It was suggested above that the proper basis for directors' fiduciary duties is sui generis.

Because of the inherent difficulties when the same person is a director in competing companies, it is suggested that the Companies Act should prohibit the holding of multiple directorships in companies who are trade competitors for the duration of the director's term of office. Until the Companies Act is amended in this way it is suggested that the articles or separate service contracts include a clause precluding directors from occupying directorships in competing companies.

A director may not use confidential information in order to compete with his company. This aspect frequently overlaps with the appropriation of corporate opportunities, but there are clear differences between the two issues. In the first instance, the appropriation of a corporate opportunity may also involve information which is not confidential in nature. Secondly, the bases of liability may differ. But 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, and possibly Anton Piller orders, but not an accounting of profits, which is claimable when a director has appropriated a corporate opportunity.

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74 *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others* 1988 (2) SA 54 (T) at 67D-E, discussed in chapter 9 page 369 above.

75 See chapter 9 page 381 above.

76 See chapter 9 par 4.7 above.

77 See chapter 9 page 382ff above.

78 See chapter 2 par 3 above.

79 See chapter 9 page 384ff above.

80 See chapter 9 par 4.7 above.

81 See chapter 9 page 353 above.
It was suggested above that existing measures adequately protect a company’s confidential information in South African law. It is therefore submitted that any statement of a director’s duty to avoid a conflict of interests should confirm the obligation not to make use of company information, which includes information that is not necessarily confidential in nature, but that confidential information as such need not be specifically referred to.

5 RECOMMENDATIONS

A Code of Conduct as a means of effecting control over corporate governance was discussed above. The Cadbury Committee in England and the King Committee in South Africa have recently proposed Codes with this object in mind. The suggested enforcement of these Codes relies heavily on policing by the financial markets rather than on any form of legal regulation. In England companies’ failure to comply with the Cadbury Code has resulted in their being shunned by institutional investors. And as a result of the Cadbury Report the listing requirements of the London Stock Exchange have been amended to incorporate the requirement that all public-issue companies must report annually, after review by their auditors, on whether they have complied with the Cadbury Code. The Johannesburg Stock Exchange is likely to adopt a similar approach in respect of the King Committee’s proposed Code of Corporate Practices and Conduct. Whether already listed companies who do not comply will be delisted, is uncertain. In England, delisting is apparently seldom used as sanction. Even if companies were sanctioned by delisting, this may have the detrimental effect that investors will find it difficult to sell their shares in the offending company. It is submitted that one of the disadvantages of a Code of Conduct is that it cannot easily provide for the needs of all South African companies in view of the differences in their sizes, natures and objects.

Another alternative to bring about more legal certainty in respect of directors’ fiduciary duties in general, and therefore also in respect of corporate opportunities, is to list these obligations in a statutory Code. Although codification is not the traditional source of company law in Commonwealth countries, the Standing Advisory Committee on Company Law has indicated that this approach is to be considered. But the possibility exists that a codification of directors’ duties may make their fiduciary obligation either too restricted, or too wide. And it is accepted that because of

82 See chapter 9 pars 4.9 and 4.10 above.
83 See chapter 4 par 2.2.1 above.
84 See chapter 9 par 4.9 above.
85 See chapter 9 note 728 above.
86 See chapter 9 page 405 above.
the inherent complexities of commercial life any code has limitations. But codification also has advantages. It simplifies the law, makes it more readily accessible and more readily ascertainable. Therefore it may be expected not only to produce substantial improvements in the law itself, but also to effect enormous savings of time, effort and money spent in ascertaining the law, advising on it and complying with it. Moreover, a statutory statement of directors' duties may educate directors, enabling them to discover and understand their duties much more easily than if they were expected to search through a maze of case law. The general view is that if directors have easy access to the law regarding their position, they will be less likely to act in breach of it.

As is the case with Codes of Conduct, the success of codification lies in its effective enforcement. In accordance with the South African trend to decriminalise company law, it is therefore submitted that any codification of directors' duties should be accompanied by suitable civil sanctions in the event of non-compliance.

It is suggested that a comprehensive and exclusive statutory codification of company law is not desirable in South African law, since it will lack the flexibility that is required to cope with changing commercial realities. Moreover, it cannot adequately meet the demands of the existing variety of companies in our law. But South African company law would, it is submitted, benefit from a general statement of directors' duties in the Companies Act. In this area of the law, eliciting clear statements of principle is often extremely difficult. Such a statement should, lest it mislead, be at least as comprehensive as the present case law. There are several examples of codification from which we can learn. Reforms in many Commonwealth countries, notably the Companies Acts of Canada, New Zealand and Ghana are noteworthy and the reports preceding them contain invaluable information.

It is therefore suggested that the Companies Act should be amended to include a statement of certain primary obligations of directors, particularly where problems have been identified. The stated object of this statement should be to inform, but not to replace the existing law. Some of these duties were discussed above and are addressed in the recommendations below. Other matters, such as the duties of care and skill do not fall within the ambit of this thesis.

In respect of directors' fiduciary duties, it is submitted that the South African Companies Act should, in the first instance, reiterate the paramount duty of every company director to act in good faith and in the best interests of the company. The consideration of specific interest groups should be provided for when merited. The position of nominee directors deserves specific mention. It was pointed out above that the South African Companies Act should, in the first instance, reiterate the paramount duty of every company director to act in good faith and in the best interests of the company. The consideration of specific interest groups should be provided for when merited. The position of nominee directors deserves specific mention. It was pointed out above

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88 See chapter 9 page 407 above.

89 See chapter 9 page 408 above.

90 There are, obviously, other aspects of the fiduciary duty which could also be included in the suggested statement. However, only aspects which were discussed in connection with the investigation conducted in this thesis are considered here.

91 See par 1(1) and 1(2) of the recommendations below.
that if directors have been appointed by a particular class, the obvious intention is that they should pay special attention to that class. If they are at the same time required to act in the best interests of the company as an entity, they may be placed in an untenable situation.\(^92\) It should therefore be provided that nominee directors may give special consideration to the interests of the class of members, employees or creditors they represent.\(^93\) The obligation to avoid a conflict between personal interests and those of the company should be confirmed. The problems surrounding the appropriation of corporate opportunities, and whether it may be ratified, were pointed out above as should the duty not to personally appropriate economic opportunities in which the company is or might be interested.\(^94\) The traditional view in respect of competing directorships is that, unless the articles provide otherwise, and subject to any contract between a director and his company, the director is not precluded from becoming a director, officer or employee of a rival company.\(^95\) But, where companies are trade competitors it is difficult to envisage one person being a director of more than one of the companies without subordinating the interests of one of the companies to his own interests, thereby breaching his fiduciary obligation.\(^96\) Therefore it is submitted that the holding of multiple directorships in companies who are trade competitors should be prohibited for the duration of the director's term of office.\(^97\)

It was suggested above that misuse of confidential information is adequately protected by the existing remedies in South African law.\(^98\) But it was also pointed out that the appropriation of corporate opportunities may concern use of information which is not necessarily confidential, but to which the company has some right. It is therefore submitted that the Act should prohibit the use of company information without the consent of the company.

Finally, in view of the above, it is recommended that the Companies Act be amended to contain the following provisions:

92 See also chapter 3 page 26; chapter 4 par 2.1 and chapter 9 par 2.2 above.

93 See par 1(3) of the recommendations below.

94 See par 2 of the recommendations below.

95 See chapter 9 page 383 above.

96 See chapter 9 page 383 above. Goldstone J warned against this problem in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC and Others* 1988 (2) SA 54 (T) at 67D-E (see chapter 9 page 383 note 558 above).

97 See par 2(1) of the recommendations below.

98 See chapter 9 par 4.6 above.
1 Fundamental Duty of Directors

(1) The fundamental duty of every director of a company, in the performance of his functions as a director, is to act in good faith in the best interests of the company as a whole.

(2) Without limiting the duties or obligations of directors as set out in this Act, a director may, in the performance of his functions as a director, have regard to the interests of creditors, employees and members of the company.

(3) When appointed by, or as representative of, a special class of members, employees or creditors, a director may give special, but not exclusive, consideration to the interests of that class.

2 Conflicts of Duty and Interest

(1) A director shall not be interested directly or indirectly, otherwise than merely as a shareholder or debentureholder in a company, in any business which competes with that of the company.

(2) Notwithstanding anything contained in the memorandum or articles, a director shall not, without the consent of the company place himself in a position in which his duty to the company conflicts or may conflict with his personal interests or his duties to other persons. In particular, without such consent a director shall not:

(a) use for his own advantage any money or property of the company or any confidential information or special knowledge obtained by him in his capacity as director;

(b) be personally interested, directly or indirectly, in any contract or other transaction entered into by the company except as provided by sections 234-240 of this Act;

(c) take advantage of any opportunity to engage in a business activity (including the acquisition of any contract right or other tangible or intangible property) of which the director becomes aware either:

(i) in connection with the performance of his functions as a director, or under circumstances that should reasonably lead him to believe that the offeror expects him to offer the opportunity to the corporation; or

(ii) through the use of corporate information or property, if the resulting opportunity is one that the director should reasonably be expected to believe would be of interest to the corporation; or

(iii) if he knows or reasonably should know that the activity is closely related to the business in which the corporation is engaged or may reasonably be expected to engage.

3 Civil Liabilities for Breach of Duty

(1) A director who breaches any of the duties referred to above shall be liable to the company for:

(a) any loss suffered by the company as a result thereof; or

(b) any economic benefit derived by the member by reason thereof.

(2) Any contract or other transaction entered into between a director and the company in breach of the duties referred to above, may be rescinded by the company.

Comments on Recommendations

Section 1 deals with directors' fundamental fiduciary obligation. Subsection (1) lays down the long established general principle, namely that directors should act
Directors' Fiduciary Duties and Corporate Opportunities

bona fide in the interests of the company. It was suggested above that this duty includes a director's obligation not to place himself in a position in which his personal interests conflict, or may possibly conflict, with his duties to the company.99 The later sections and subsections are particular examples of the general duty. In view of recent speculation about the beneficiary of the fiduciary obligation, it is recommended that it should be clearly stated that it remains the company as a separate entity.100

No evaluation of the way in which the interests of the company was served can take place in isolation. Various factors must be considered. Amongst these may well be the interests of other interest groups. For example, if a company is insolvent, or nearly insolvent, the interests of its creditors may require specific attention.101 Similar considerations may apply in respect of other interest groups.102 Subsection (2) provides for the consideration of these interests, but stresses that the fundamental duty remains to act in the interests of the company.

In view of the specific problems facing nominee directors,103 subsection (3) clearly provides that such directors may pay specific attention to the interests of the class they represent. However, this remains subject to the provision of subsection (1). The interests of the company therefore prevail.104

Conflicts of duty and interest are addressed in section 2. Subsection (1) prohibits the holding of multiple directorships in companies who are trade competitors for the duration of the director's term of office. It was submitted above that it is difficult to envisage how a person who holds such directorships could refrain from subordinating the interests of one of the companies to his own interests. Admittedly no actual breach of fiduciary duty occurs by virtue of the holding of multiple directorships in competing enterprises. But it is suggested that the complexities surrounding this area of the law necessitate a strict formulation of the duty, especially against the background of the educative object of codification of directors' duties.105 Subsection (2) reiterates the basic principle that a conflict of directors' personal interests and those of the company cannot be allowed. There is no breach of duty if the company consents to the particular action. It is suggested that inter-

99 This is sometimes regarded as a second facet of the fiduciary obligation: see chapter 9 page 413 above.

100 See chapter 3 par 4 above.

101 See also chapter 3 par 3.1 above.

102 Although this is a topic which merits independent research, it was briefly touched upon in chapter 3 par 3.2 above.

103 See chapter 3 page 26; chapter 4 par 2.1; chapter 9 par 2.1 and page 408 above.

104 A similar provision is contained in the Ghana Companies Code, s 203(3).

105 See page 408 above.
estimated directors should be prohibited from voting in their capacities as members.\textsuperscript{106} In subsection (2)(a) the prohibition on the use of company assets and confidential information is confirmed. It was submitted above that South African law adequately protects misuse of confidential information, but this aspect, based upon a similar provision in the Ghana Companies Code,\textsuperscript{107} is retained in the recommendation for the sake of completeness. Subsection (2)(c) deals with the appropriation of corporate opportunities.\textsuperscript{108} It was submitted above that in South African law the application of general fiduciary principles, used in conjunction with the recognised remedies for unlawful competition and misuse of confidential information adequately provide for corporate opportunity matters.\textsuperscript{109} The general principle is therefore merely restated.\textsuperscript{110} Subsection (2)(iii) applies the "line of business test".\textsuperscript{111} This is in accordance with the approach followed by our courts and the King Committee.\textsuperscript{112} Read in conjunction with the preamble, this subsection only allows the appropriation of a corporate opportunity if the company has given its prior authorisation to the transaction.

As was indicated above,\textsuperscript{113} any codification of directors’ duties should be accompanied by suitable civil sanctions in the event of non-compliance. Subsection (3) which codifies the existing law, therefore indicates the nature of the liabilities which may be incurred by directors. The Ghana Company Code permits a company to recover any profit made by a director as a result of the breach.\textsuperscript{114} Because of the uncertainties surrounding the term "profit",\textsuperscript{115} the formulation adopted in the Close

\textsuperscript{106} This suggestion was also made by Gower in his comments on the Ghana Companies Bill: "Company Law of Ghana" 147, par 2.

\textsuperscript{107} Ghana Companies Code s 205(a). For an alternative wording, see s 112 of the New Zealand Companies Act 1993.

\textsuperscript{108} Subsection (2)(b) does not, strictly speaking, fall within the scope of this thesis and is not discussed further.

\textsuperscript{109} See chapter 9 page 414-416 above.

\textsuperscript{110} In this regard, the definition of a corporate opportunity as recommended by the American Law Institute (see chapter 5 page 178 above) was followed.

\textsuperscript{111} This test is discussed in chapter 9 page 357 above.

\textsuperscript{112} See chapter 9 page 373 above. In its proposed Code of Ethics the Committee recommends that managers shall not acquire for the benefit of the enterprise any economic opportunity which is in the same line of business as the enterprise he represents (par 7.3.4).

\textsuperscript{113} See chapter 9 page 408 above.

\textsuperscript{114} Section 209(b).

\textsuperscript{115} See chapter 4 par 3.2.1 and chapter 9 par 3.2.4.1 above.
Corporations Act,\textsuperscript{116} was preferred. The proposed section 3(1)(b) therefore refers to any economic benefit derived by the member by reason of the breach.

\textsuperscript{116} Section 42(3)(a)(ii).
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