

Chapter 6

Conflicts Between Personal Interests and Duty to the Company

Introduction

Directors have great power in companies. This makes companies very vulnerable to boardroom mischief. Accordingly, the law demands high standards of fidelity and honesty from directors. They must not let their personal interests interfere or compete with their duties to their company. Because they are fiduciary agents of their companies, they may not (either themselves or on behalf of the companies), without appropriate disclosure, enter into contracts in which they have a personal interest that conflicts with, or may possibly conflict with, the interests of their companies. They also may not make what are termed 'secret profits' — that is, profits gained directly or indirectly through the office of director without the knowledge and sanction of the members. Covert deals are unacceptable. Directors breach this duty when, for example, they accept bribes, use the company's assets or secrets to compete with the company, or usurp or appropriate to their own use business opportunities which properly belong to the company. Let us consider aspects of this broad duty.

Contracts between directors and the company

As fiduciaries, directors must not use their power to deal with themselves for their own advantage. Self-dealing can occur where a director enters a contract with his own company (for example, to sell something to the company). The potential for abuse of power is clear and the law is firmly against such practices. In *North-West Transportation Co Ltd v Beatty*, Sir Richard Baggallay set down the basic principle:

... a director of a company is precluded from dealing, on behalf of the company, with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound by fiduciary duty to protect. . . .¹

1. (1887) 12 App Cas 589 at 593. See also *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461; 23 LTR 315 at 316. Mason J summarised the fiduciary's duty in *Hospital Products Ltd v US Surgical Corp* (1984) 55 ALR 417 at 459 as being 'under an obligation not to promote his personal interest by making or pursuing a gain in circumstances in which there is a conflict or a real or substantial possibility of a conflict between his personal interests and those of the persons whom he is bound to protect'.

The director has a duty to use his knowledge and skill for the benefit of his company when he is involved in company affairs. He must seek the best bargain when negotiating contracts for the company. The company cannot be guaranteed his best efforts when he has a conflicting interest.

In *Beatty*,² a steamer was being built for Beatty, who was both a major shareholder and a director of the North-West Transportation Company. The board resolved to buy the steamer from Beatty. The contract to buy, being in breach of fiduciary duty, would have been voidable. However, the resolution to buy had been adopted by a majority of votes at a general meeting, which validated the breach.³

A company can normally avoid such contracts, and recover any profits made by offending directors, where contracts are made by the company with any of its directors, or with some other person or entity in whom the director is 'interested'. What amounts to an 'interest' in a contract in this context? The English Court of Appeal, in *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co*, suggested that holding 'a very small interest as shareholder of a company, that is contracting with the director's company, is enough'.⁴ *Todd v Robinson*⁵ was cited as authority. A merely nominal benefit accruing to him as a shareholder was enough to make an official on a board 'interested' in a contract which the company (in which he held those shares) entered with the board.

In *Aberdeen Railway*,⁶ the chairman of the board entered into a contract on behalf of the company to buy a large number of chairs from a firm in which he was 'interested' as a partner. The Lord Chancellor was succinct:

His duty to the company imposed on him the obligation of obtaining these iron chairs at the lowest possible price. His personal interest would lead him in an entirely opposite direction — would induce him to fix the price as high as possible. This is the very evil against which the rule in question is directed. . . .⁷

The duty to disclose at common law

Under common law, a director has a duty to disclose *to the shareholders in general meeting* the nature of any direct or indirect personal interest he has in contracts to which the company is or will be a party. Disclosure to the directors only is not enough. *Gower's* assessment is compelling:

2. *Ibid.*

3. It was noted that the acquisition was required by the company, no other suitable steamer was available and the price paid was reasonable. The Privy Council also said that Beatty could exercise his votes as shareholder at the general meeting to remedy the defect, despite his being a director and personally interested in the contract, and despite the fact that, at the general meeting affirming the contract, Beatty's 291 shares (out of 306 in favour) were needed to defeat the 289 votes against confirmation.

4. [1914] 2 Ch 488 at 503.

5. (1884–1885) 14 QBD 739.

6. Above n 1.

7. *Ibid* at 316.

It hardly seems overcynical to suggest that disclosure to one's cronies is a less effective restraint on self-seeking than disclosure to those for whom one is a fiduciary.⁸

The board's sanction is insufficient, even if the 'interested' director does not attend or vote at the board meeting purporting to sanction the breach of duty. The law acknowledges the obvious danger that reciprocal self-interest or misplaced loyalty will affect fellow directors' business judgment and blunt their zeal to get the best deal for the company.

The prohibition against being or placing oneself in a situation where one's interest may conflict with duty is strictly applied. But the company to whom the duty is owed may choose to adopt the contract and remedy or forgive the breach.⁹ To circumvent the common law disclosure requirement, articles of association may be drafted to permit directors to be interested in contracts with the company, to allow them to be present at board meetings, and even to vote when contracts in which they are interested are at issue. One such article was upheld in *Peninsular and Oriental Steam Navigation Co v Johnson*.¹⁰ It said:

. . . no director shall be disqualified by his office from entering into any contract or arrangement with the company either as vendor, purchaser, broker, banker, solicitor, commission agent or otherwise, but no such director shall vote in respect of any such contract or arrangement in which he is so interested as aforesaid, or if he does his vote shall not be counted.¹¹

Such articles are now in common use. The courts take the view that they should stand because the company can benefit from the advice of someone who, 'although he may be interested on the other side of the fence',¹² does bring to bear the benefit of his experience in other businesses.

The duty to disclose under legislation

The common law is supplemented by s 228 of the Code. It requires a director who is either directly or indirectly interested in a contract or proposed contract with the company to declare the nature of his interest *at a meeting of the directors*. He must declare not only that he has an

8. (4th ed) at 587.

9. As it did in *North-West Transportation Co Ltd v Beatty*, above n 1 at 596.

10. (1938) 60 CLR 189 at 228, 234–236, per Dixon J (HC). See also *Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company*, above n 4 at 497–499, per Astbury J.

11. Would this article apply to release the director who indirectly 'contracts' with his company in the sense that he has a substantial shareholding in another company with which the first company contracts? See *Peninsular and Oriental*, above n 10 at 228 and *Transvaal Lands*, above n 4 at 498–499. See *Paul A Davies (Australia) Pty Ltd v Davies* (1982) 1 ACLC 66 at 72–73; (1983) 1 ACLC 1091 (on appeal) for another example of an article modifying the common law duty.

12. See *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 1 All ER 716 at 729–730, per Upjohn L J.

interest, but also what that interest is. He must do so 'as soon as practicable after the relevant facts have come to his knowledge'. If the New Zealand lead is taken, the formal disclosure of interests at a directors' meeting may not be required where, as in many 'family' companies, the interests of directors are already well known to the other directors.¹³

If the director's interest lies in being a member or creditor of another corporation which is interested in a contract or proposed contract with his company, he need not disclose his interest unless it is a 'material interest' (s 228(2)). A 'material interest' is not defined.

Under s 228(4), the director may give a 'general notice' to the other directors to the effect that he is an officer or member of a specified corporation or specified firm and is to be regarded as interested in any contract or proposed contract made with that corporation or firm thereafter. This is sufficient, providing that the disclosure is adequate, that the interest has not increased when a relevant contract is considered by the board, and that the notice of interest is given at a meeting of the directors or is read out at the next meeting of directors after it is given. Anyone who is director of two or more companies which have common interests and dealings will find this provision convenient.

Section 228(5) requires a director also to disclose to his fellow directors any offices or property he holds 'whereby, whether directly or indirectly, duties or interests might be created in conflict with his duties or interests as director'. Section 228(8) says that, subject to subs (3), s 228 does not prejudice or derogate from

. . . any rule of law or any provision in the articles restricting a director from having any interests in contracts with the company or from holding offices or possessing properties involving duties or interests in conflict with his duties or interests as a director.

Records must be kept. Section 228(7) requires the secretary to record every declaration of interest in the minutes of the appropriate meeting.

Failure to comply with s 228, unlike the position at common law, does not make the contract voidable. The section imposes a penalty — \$1000 fine or three months' imprisonment or both. *Castlereagh Motels Ltd v Davies-Roe*¹⁴ affirmed that s 228 (then s 123 of the *UCA*) does not give a civil right of action for damages if there is failure to disclose as required by the section. The Court of Appeal ruled that the intent of the section is to prevent directors making secret profits rather than to stop losses being suffered by the company from unfavourable contracts.

The duty to disclose in the articles

Regulation 65(g) of Table A requires directors, on pain of losing office, to declare direct or indirect interests in contracts 'as required by the Act'

13. See *Saunders v The Liquidator of Woodward Products Ltd (in liq)* (1982) 1 NZCLC para 95-039; *Re Universal Management Ltd (in liq)* (1981) 1 NZCLC para 95-026; both cases noted in (1982) 1 C & SLJ 133.

14. [1966] 2 NSW 79 at 84.

— that is, under s 228. Regulation 71 rules that a director may not vote (at board meetings only, one presumes, although this is not specified) in respect of such contracts or any matter arising out of these contracts, and should he vote, it 'shall not be counted'. Although no mention is made of the general law duty to disclose to the general meeting, it would still apply unless removed by the articles.

It is sometimes to the advantage of a company to deal with insiders: there may be savings in time, risks and costs, and the insider may be the best source of a product or service and so on.¹⁵ As we have seen, the articles often relieve directors of their common law obligation and simply require disclosure to the board as required by the statute. Such articles were at issue in *Paul A Davies (Australia) Pty Ltd v Davies*¹⁶ and *Hely-Hutchison v Brayhead Ltd*.¹⁷ In the latter case, a director failed to disclose either to the board or to the members at general meeting that he had interests in contracts entered into by the company. Article 99 of the company's articles said that a director could be interested in contracts with the company, providing he made the disclosure required by the statute (under the equivalent of s 228). If the director had disclosed merely to the board, as required by the section, then, in accordance with the article, the normal consequences at common law would not have followed. Brayhead did not do this. As we have seen, such contracts become voidable (not void or unenforceable) at the option of the company and the director is accountable to the company for secret profits (if any). But in this case, because of delays, it was impossible to restore the parties to their former positions. The delay meant that the contracts were valid and enforceable.¹⁸

Section 228 cannot be altered or varied by the articles. Thus, directors must always disclose their interests to the board. Special articles may relieve them only of the common law obligation of disclosure to the general meeting.

Unless the articles excuse him from it, a director who complies with s 228 is still governed by the common law requirement of disclosure to, and ratification by, the general meeting. Therefore, even if a director observes s 228 satisfactorily, a contract in which he has an interest may still be voidable at the option of the company. Also, as already noted, the director will be accountable for any secret profits he may have made.

In summary, there are four requirements for disclosure of interests in contracts:

1. disclosure under common law to the general meeting (which may be waived by the articles);

15. See advantages listed by Brudney, (1982) 95 Harv L Rev 597 at 623–625.

16. Above n 11. See also *David Neil and Co Ltd (in rec) v Neil* (1986) 3 NZCLC 99,658.

17. [1968] 1 QB 549. Note the effect of s 237 of the Code which renders void provisions exempting officers from or indemnifying them for breaches. See Farrar, *Company Law* (1985) at 325, 357–358.

18. See Lord Denning M R, *ibid* at 585–586.

2. disclosure to the board of directors under s 228 (and under an article like reg 65(g) of Table A);
3. disclosure in the boardroom minutes as required by s 228(7). Although, under s 254, the minutes must be kept at the registered office or principal place of business, they will only be open to members if the directors so decide (reg 85 of Table A gives directors control over inspection of the records); and
4. disclosure in public company directors' reports to annual general meetings (under s 270(3A)(c)).

Overseas legislation

Section 199 of the 1948 UK Act, which was the model for s 123 of the *UCA*, had drafting flaws. Sections 60 and 88 of the 1980 UK Act and now the consolidated s 317 of the 1985 UK Act extend the disclosure requirements. As under s 228(4) of the Australian Code, general notice may be given. Disclosure is also required of all types of transactions with the company, including those with persons connected with directors, even if the transactions do not constitute contracts. Section 317(8) of the 1985 UK Act uses the term 'shadow directors' (those persons in accordance with whose directions or instructions the directors are accustomed to act) and makes them liable under these disclosure provisions.

Civil consequences arise from non-observance of ss 144 and 145 of the 1979 British Columbia *Company Act*. In *Redekop v Robco Construction Ltd*,¹⁹ a conflict of duty and interest arose over a contract entered by the company. Robillard, a director of Robco, was also its majority shareholder and a full-time employee. Robco prospered in the building and leasing industry. Another company, CFR Properties, carried out construction contracts for Robco. Robillard held 49% of the shares and was an employee of CFR. Robco entered into a construction arrangement with CFR. The British Columbia Supreme Court held Robillard liable to account to the company for his 'secret' profits:

It is apparent that, as a shareholder in C.F.R., Robillard had a substantial personal interest in the contract. . . . Robillard stood to make profits at Robco's expense. Robillard, although paid by Robco, was in the employ of both Robco and C.F.R. In these circumstances the *Companies Act* requires that there be disclosure to and approval by the directors of the company [or] approval by a special resolution of the shareholders. . . . Robillard's potential profits in C.F.R. are represented by his shares in that company. He must then account to Robco for those shares.²⁰

Under s 145 of the 1979 British Columbia *Company Act*, a director who does not, in addition to disclosing to either the board or the general meeting, get the approval of that board or general meeting, must account

19. (1979) 89 DLR (3d) 507.

20. *Ibid* at 510–511, per Meredith J.

to his company for any profits made by him as a result of the company entering into such contracts or transactions. The requirement of approval as well as of disclosure seems sensible. Is the mere disclosure required in Australia by s 228 enough?

A director's duty not to make 'secret profits'

The duty not to make 'secret profits' from one's position as a fiduciary is another aspect of the broad duty to avoid clashes of interest and duty. *Regal (Hastings) Ltd v Gulliver*²¹ is the most celebrated authority on this duty. The plaintiff company, Regal, already owned one cinema and it planned to acquire leases over another two through a subsidiary company formed for that purpose. Regal then wanted to sell the three-cinema business as a 'going concern'. However, the lessor of the two other cinemas required the subsidiary to have a paid-up capital of £5000 (in lieu of a guarantee of the rent under the proposed lease), but the parent company, Regal, could only afford to buy 2000 of the 5000 £1 shares. To help find the extra capital, five of the six directors each bought 500 shares. Three weeks later, the sale of the three-cinema concern was carried out by the profitable sale of the shares in the subsidiary, and not by sale of the undertaking itself. During the relevant period, the directors controlled a majority of Regal's shares. They had not, however, used their majority to ratify the transactions at a general meeting.

A new board of directors of Regal proceeded against the former directors, seeking the profits they had made on the sale of their shares in the subsidiary. The five directors were liable to account to the company and had to pay over their profits to the company. Only approval by the general meeting, it was said, would have availed them. The equitable principle was strictly applied. It mattered not that directors may have acted bona fide throughout, or that the company had not been damaged (it could not have taken advantage of the opportunity itself because it lacked sufficient funds).

Lord Russell of Killowen said:

The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of *bona fides*; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.²²

21. [1942] 1 All ER 378; [1967] 2 AC 134 (HL).

22. *Ibid* at 385, 144–145 respectively. See also Lord Russell at 389, 149–150 and Viscount Sankey at 381–382, 137–140.

Regal (Hastings) did not specifically address the problem of whether directors as individuals could take up an opportunity where the company by a bona fide board decision *rejected* it. By implication, it extends to such facts.

The Regal (Hastings)-Boardman 'rule'

Subsequent decisions have reinforced a strict view of the line taken in *Regal (Hastings)*. Lord Upjohn, in *Boardman v Phipps*, affirmed that there is a breach of duty if there is the mere possibility of conflict between the fiduciary's own interests and those he is bound to protect. His Lordship coined a not entirely clear, but often-cited, test:

The phrase 'possibly may conflict' requires consideration. In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a *real sensible possibility of conflict*; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict²³ [emphasis added].

In *Boardman v Phipps*, two trustees (in a fiduciary position equivalent to the position of directors to a company) had acquired shares in a private company in their own names. They sought a controlling interest in an effort to improve the value of the trust's existing holdings in the same company. The House of Lords ruled 3:2 that they had to account to the beneficiaries (their principals) for the profits they had made on the shares. This was so, even though the trustees had acted bona fide throughout, the trust lacked the legal power and the financial ability to buy these shares, and the purchase by the trustees led indirectly to significant profits for the trust (as well as for the defendant trustees).

This strict approach has been criticised.²⁴ The *Regal (Hastings)-Boardman 'rule'* remains and is generally applied. Today, however, s 535 of the Code would have allowed the defendants in both *Regal (Hastings)* and *Boardman* to argue for relief on the grounds that they had acted honestly and ought fairly to be excused for the breach.

*Green & Clara Pty Ltd v Bestobell Industries Pty Ltd*²⁵ followed *Boardman*:

It is enough, I think, to show that the fiduciary gains his knowledge or opportunity within the fiduciary relationship; . . . it is not necessary to go further so as to prove that either the information or the opportunity was in fact used so as to acquire that benefit. The reason for that, I think, rests in policy and it is based, *inter alia*, on the impossibility of proof.²⁶

23. [1966] 3 All ER 721 at 756: Lord Upjohn made this statement in his dissenting judgment. The 'real sensible possibility of conflict' phrase was used by Burt C J in *Green & Clara Pty Ltd v Bestobell Industries Pty Ltd* [1982] WAR 1 at 5-6, but rephrased as 'a real and sensible possibility they may conflict'.

24. See Afterman, *Company Directors and Controllers* (1970) at 69-70; Fridman, (1968) 3 Manitoba LJ 17 at 21ff; Farrar, above n 17 at 338-339.

25. Above n 23.

26. Burt C J, *ibid* at 5-6.

Green was manager of Bestobell Ltd. Just prior to leaving that company, he tendered through his own company (Clara Ltd) against his employer (Bestobell) for a major ceiling construction contract. By so tendering, 'he placed himself in a situation where his duty and his interest in fact conflicted'.²⁷ Green had to account, even though Bestobell's tender ranked only third in priority.

A strict attitude also prevailed in *Paul A Davies (Australia) Pty Ltd v Davies*.²⁸ The two directors, who were also the major shareholders, used company money to fund their 'private' purchase of a restaurant/guest-house without the full knowledge and consent of the company. They had to account. It mattered not that there was no finding of 'fraud, conscious wrongdoing or absence of bona fides in the subjective sense'.²⁹

A softening duty

A 'sophisticated' perception of the fiduciary duty has recently emerged — one that is appropriate, it is said, to modern commercial reality. It leads to a watered-down duty and may invite boardroom mischief. At first instance, Wootten J in *Queensland Mines Ltd v Hudson* adopted the strict view

... that courts will not burden themselves with the difficult and multitudinous enquiries as to whether a person in a fiduciary position has, in all the circumstances, succumbed to temptation. They simply insist that such a person does not act in a way in which he is exposed to temptation.³⁰

This view did not survive on appeal.

Queensland Mines Ltd was interested in an iron ore mining opportunity in Tasmania. The legal title to the two exploration licences at issue had been passed to Hudson, the company's managing director, in his own name (as trustee for the company). Hudson had acquired the licence using Queensland Mines' 'name, prestige and credit'.³¹ Another company jointly involved in the venture had to withdraw from the exploration project, and then Queensland Mines, which also had financial problems, was put into 'mothballs'. Hudson resigned as managing director of Queensland Mines (QM) in 1961. He transferred the licences to a company he controlled. From 1966, largely because of his skill and enterprise, his company received considerable royalties on the ore mined.

Wootten J found that Hudson lacked the informed consent of the board or the shareholders to his taking over of that company's opportunity to mine the iron ore. A 49% interest in QM was owned by AOE, a company of which Hudson was chairman and managing director; 51% was held by Factors Ltd. Factors had two appointees on the QM board and AOE had the other appointee (that is, Hudson). Although he found there to

27. Wickham J, *ibid* at 10.

28. (1982) 1 ACLC 66; (1983) 1 ACLC 1091 (on appeal).

29. *Ibid* at 1094, per Moffitt P.

30. [1976] ACLC 28,658 at 28,685.

31. Wootten J in the NSW Supreme Court, *ibid* at 28,683.

be a breach of fiduciary duty in 1961, Wootten J held that Queensland Mines' claim failed as it was statute-barred through lapse of time.³²

The Privy Council reversed the finding on breach of duty.³³ It advised that, from early 1962 at the latest, the board, 'fully informed as to all relevant facts, had reached a firm decision to renounce all interest in the exploitation of the licence and had assented to Mr Hudson taking over the venture for his own account'.³⁴ Thus, using the language of *Phipps v Boardman*, the Privy Council found there was, after that time, no real sensible possibility of conflict of interest between Hudson and QM. The Privy Council concluded that the legal position could be expressed in the alternative:

It can be said that from that date the venture based on the licence was 'outside the scope of the trust and outside the scope of the agency' created by the relationship of director and company — a relationship which continued to exist between Mr Hudson and Queensland Mines. Or it can be said that at that date Queensland Mines gave their fully informed consent to pursue the matter no further and to leave Mr Hudson to do what he wished or could with the licences. In their Lordships' opinion it does not matter how it is put.³⁵

Limits to the fiduciary relationship: When does it arise and end? The first of the approaches offered in *Queensland Mines* — that some ventures fall outside the director's fiduciary bonds — is supported by *Peso Silver Mines Ltd v Cropper*.³⁶ The defendant director in this controversial case,³⁷ together with two other directors and the company geologist (through the vehicle of a new company), purchased certain mining claims which the company had previously rejected for sound financial reasons (mainly, insufficient capital). The defendant had been one of six on the full board that rejected the licences. The Supreme Court of Canada refused to hold that the defendant held his shares in the new company as constructive trustee for the old company. The Court noted that there had been no suggestion of bad faith by the defendant,³⁸ no use of confidential information, and no loss to the plaintiff company. The vendor of the mining claims had approached the defendant, not because he was a director of the appellant, but as a likely co-adventurer in what was still a very speculative venture. The Court found that the director did not take up the opportunity by reason of his position as director of the plaintiff.

Norris J dissented on the basis that *Regal (Hastings)* applied, despite the lack of loss suffered and the specific rejection of the opportunity by the company. If one accepts that, because of the real difficulties of proof, the

32. Proceedings had not commenced until 1973, some 12 years after the alleged breach. The period of limitation under the *Trustee Act* was six years.

33. (1978) 18 ALR 1; 52 ALJR 399.

34. *Ibid* at 8 and 403.

35. (1978) 18 ALR 1 at 10; 52 ALJR 399 at 403–404.

36. (1966) 58 DLR (2d) 1.

37. See Beck, (1971) 49 Can Bar Rev 80; Prentice, (1967) 30 MLR 450.

38. Cf *Canadian Aero Service Ltd v O'Malley*, below n 65.

rule should be rigidly enforced to prohibit even the *possibility* of conflict of interest, then this dissenting view is to be preferred. The limitation of the *Regal (Hastings)* rule only to where there has been no specific rejection by the company, or where there has been profit made at the company's expense, would accommodate *Peso's* more lenient view of the rule.³⁹

A *Peso*-type view was offered in *Consul Development Pty Ltd v DPC Estates Pty Ltd*.⁴⁰ Gibbs J also suggested that the duty ends in certain circumstances. Grey was employed as working manager to buy properties for the Walton group of companies (of which the plaintiff was one). On several occasions he bought properties for his own profit while in the company's service. He was held to be in a fiduciary position vis-à-vis the company and thus in breach of his fiduciary duty to avoid situations where his duty and self-interest conflict. Gibbs J noted, however, that Grey would not have been in breach if the Walton group 'had (uninfluenced by him) decided not to buy' the properties in question. Nevertheless, his Honour stressed that the Walton decision would have to be 'uninfluenced' or not induced by Grey, and that Grey, in deciding to buy, would have to be 'not acting on information gained from his position with the companies'. Then, 'the property would have been removed from the ambit of his duties'.⁴¹

Grey was not a director of the plaintiff but merely a company employee. He was nevertheless in a fiduciary position because he was, the courts found, acting in a director's role — that is, as a *de facto* director. He was, however, in no position to influence directly the decision of the board rejecting the corporate opportunity.

Could the *Consul* dictum apply where a *de jure* director takes up an opportunity formerly offered to, but rejected by, the company? A director, of course, sits on the board that must reject the opportunity. When, if ever, can one say that a director does not 'influence' a board decision? Is it enough that he not attend or vote at the board meeting rejecting the opportunity? Some commentators have reservations.⁴² Directors, even abstaining or absent ones, can influence board decisions. The scope for subtle, indirect influence on board members by interested directors is too great to justify a relaxation of the traditional rule. There seems no good reason, except the nebulous and often self-serving one of business efficacy, to relax the clear and justifiable standard. After all, directors can 'escape' the consequences of breaches of their duties by forgiveness or ratification or acquiescence by the company in the breach. In the meantime, loyalty must be seen to be honoured: 'to permit utilisation of the opportunity by such board member in the circumstances is to tempt a man to be disloyal'.⁴³

39. Cf the English courts' strict approach: *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162, discussed later.

40. (1975) 132 CLR 373; 5 ALR 231.

41. *Ibid* at 399–400 and 253 respectively.

42. For example, Sullivan, (1979) 42 MLR 711; Butler, (1979) 11 U Qd LJ 99.

43. Butler, *ibid* at 103–104.

Ratification: the company knows and consents or acquiesces

The Privy Council's second explanation of its decision in *Queensland Mines* was that the *company* had given its 'fully informed consent' to what Hudson proposed to do. But was there 'fully informed consent' by the company? Even if the other two members of the board knew of Hudson's activities, the board did not give its formal informed consent. Its decision not to pursue the business opportunity further does not amount to a rejection of the opportunity, even though the company was unable and unwilling to pursue it. At best, the board gave informal consent to Hudson.

In any event, only a majority of fully informed shareholders can forgive a breach of duty owed to the company. Before *Queensland Mines*, no major authority had even suggested that the board could forgive one of its own members for breaches of duty owed to the company. There is quite specific authority to the contrary.⁴⁴ It is dangerous to allow directors to be judges in their own cause. Surely the board, open to influence from even absent directors, should not delineate the scope of boardmembers' fiduciary duties. Absolution should come only from a majority of fully-informed members, and even then, as we shall see later, one can assert on the basis of cases such as *Cook v Deeks*⁴⁵ that, where company assets or property are being expropriated by directors, forgiveness by the general meeting is not enough: 'a majority [in general meeting] cannot gratuitously dispose of an asset which belongs to the company as a whole. *A fortiori* such a disposal should be beyond the competence of the board.'⁴⁶ In *Cook v Deeks*, the property expropriated to their own use by three out of the four directors (confirmed in general meeting by the majority shareholding they controlled) was a valuable railroad construction contract previously offered to the company. The licences at issue in *Queensland Mines* in equity belonged to the company; they also were company property.

It could be argued that, in informing the board, Hudson was in fact informing the shareholders; that the assent of the board was sufficient also to count as the shareholders' assent to a breach of his fiduciary duty (that is, to his usurpation of the company's opportunity).⁴⁷ But compare

44. For example, *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 599; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 150, 154; [1942] 1 All ER 378 at 389, 392.

45. [1916] 1 AC 554 (PC).

46. Sullivan, above n 42 at 713.

47. This argument depends on the fact that the three directors on the board represented the two corporate shareholders which controlled all the shares in the company. Aside from the fact that Hudson on this theory must act as the conduit for information to and from AOE, there was no evidence that the other two directors (representatives of Factors Ltd, the majority shareholder) applied their minds to the issue and made an informed decision in the interests of the company. In fact, Wootten J had held in the lower court that:

Mr Hudson did not disclose to the board of directors the facts which would have given the company a basis for claiming an existing interest or the facts which would have revealed a conflict of interest between him and the company. (Above n 30 at 28,700.)

This was contradicted by the Privy Council: 18 ALR 1 at 8-9; 52 ALJR 399 at 403.

Queensland Mines and Regal (Hastings) (where the directors also controlled the majority of voting shares). *Regal's* directors were liable to account. They failed to disclose fully to, and seek absolution from, a meeting of the shareholders properly called; shareholder majority control, represented on the board, was not of itself enough.

Acquiescence

Another possible explanation⁴⁸ of *Queensland Mines* is that, rather than forgive the breach, the company acquiesced in it. The company (represented by a fully informed board) stood by and, as it were, observed the breach of duty. Having made no objection whilst the breach progressed, the company could not later complain.⁴⁹ It can be argued that because the company's knowledge is that of its officers, and its acts those of its officers, then boardroom knowledge and inactivity should be enough; full and frank disclosure to the shareholders would not be required for acquiescence. Wootten J briefly considered and rejected acquiescence because *Queensland Mines* acted within a reasonable time to do something about the breach of duty;⁵⁰ the company did not stand back and do nothing. However, the Privy Council disagreed with Wootten J on crucial facts. Perhaps in its many references to the company's board, the Privy Council was looking at acquiescence and not just at forgiveness. The Privy Council accepted that the board was fully informed all along and had abandoned its right of action. This explanation, however, was almost certainly not intended by the Privy Council. It would also be objectionable for acquiescence to be so used to the advantage of those who do the acquiescing.⁵¹

The misappropriation of company property: a special category

The main category of 'secret profits' is that found in *Cook v Deeks* (where a contract was usurped) — that is, where company property is expro-

48. Suggested to this writer by Robert Baxter, tutor in corporate law at the Faculty of Law, University of Adelaide.

49. See definition of 'acquiescence' in *Duke of Leeds v Earl of Amherst* (1846) 2 Ph 117 at 124; 41 ER 886 at 888; *Ramsden v Dyson* (1866) LR 1 HL 129; *Cashman v 7 North Golden Gate Gold Mining Co* (1897) 7, QLJ 152 at 153–154; *Glasson v Fuller* [1922] SASR 148; Meagher, Gummow and Lehane, *Equity* (2nd ed, 1984) at 755.

50. Above n 30 at 28,711.

51. On the facts of *Queensland Mines*, justice may have been done. Hudson had, as Wootten J put it, 'made a silk purse out of a sow's ear, and the value has been added [to the project] by an extraordinary combination of astonishing effort, skill, business acumen, financial risk-taking and sheer persistence': above n 30 at 28,712. However, it may be that Wootten J's upholding of the technical limitation of action defence to free Hudson from liability to account was sounder in principle than the Privy Council's advice either that he had received fully informed consent or that on the board's rejection of the opportunity the duty period lapsed. But see Braithwaite, (1980) 44 Conv 200 for his discussion of constructive trusts and limitation periods. See also *Re Sharpe* [1892] 1 Ch 154, where the CA agreed that

... where money has found its way into the hands of a trustee or other person against whom this Court gives the same relief as against a trustee, there the trustee, or the person in a fiduciary position, cannot set up the *Statute of Limitations*, or the analogy of the *Statute of Limitations*, as an answer to the demand for money which was in his hands. (Fry LJ at 172.)

priated or misapplied. Similar cases are *Industrial Development Consultants Ltd v Cooley* and *Canadian Aero Service v O'Malley* (discussed below). If the directors have the legal title to, or are in control of, property beneficially vested in the company, a trusteeship relationship arises. They may not misapply such property or assets. Such mischief cannot be forgiven, even by fully informed, unanimous members.

'Property' can cover anything from railway construction contracts⁵² to manufacturing processes and patent rights.⁵³ It includes any contracts and business opportunities that come to the knowledge of the directors and which they should give the company the chance to acquire or which they should acquire on the company's behalf.⁵⁴ An invention by an employee director whilst in the course of his employment belongs in equity to his company. If the invention concerns the company's business, it does not matter whether or not the director had been asked by his company to work on the design or problem.⁵⁵ In *British Syphon Co Ltd v Homewood*,⁵⁶ a master/servant case, a technician breached his duty to give his employer the best possible advice when he did not tell his employer that he had invented a soda water distribution system. The invention was held to be in equity the property of the employer.

Corporate information But does company property include corporate 'know-how' or confidential information (for example, about a business opportunity)? *Gower* calls this a 'major unsolved problem'.⁵⁷ The cases are not consistent on the matter. Information is frequently treated as property.⁵⁸ In *Boardman v Phipps*, Lord Upjohn said that 'in general, information is not property at all',⁵⁹ but Lord Denning M R in the Court of Appeal⁶⁰ said the information which the agent was employed to gather was the principal's property. Three members of the House of Lords (other than Lord Upjohn) agreed. On their reasoning, when a corporate opportunity is usurped, two 'items' of company property are misused: the knowledge of the opportunity and the opportunity itself. Again, however, the authorities conflict.⁶¹ The interpretation of property to

52. *Cook v Deeks*, above n 45.

53. *Cranleigh Precision Engineering Ltd v Bryant* [1965] 1 WLR 1293.

54. *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295.

55. See Roxburgh J in *British Syphon Co Ltd v Homewood* [1956] 1 WLR 1190 at 1192-1193.

56. *Ibid.*

57. (4th ed) at 608. Finn, *Fiduciary Obligations* (1977) at 131-132 acknowledges that 'certain types of information and particularly trade secrets doubtless can have certain attributes of property' (para 295); see also Stuckey, 'The Equitable Action for Breach of Confidence: Is Information Ever Property?' (1981) 9 Sydney LR 402.

58. For example, *Cranleigh Precision Engineering*, above n 53, re confidential trade secrets. See also *Markwell Bros Pty Ltd v CPN Diesels (Qld) Pty Ltd* (1982) 7 ACLR 425 at 435 (citing *Cranleigh*) and 439; *FCT v United Aircraft Corp* (1943) 68 CLR 525 at 534-535, per Latham CJ.

59. [1967] 2 AC 46 at 127. Cf Lord Hodson at 107, Lord Guest at 117.

60. [1965] Ch 992 at 1018-1019. See also *North & South Trust Co v Berkeley* [1971] 1 WLR 470 at 484.

61. Cf Burt C J in *Green & Clara Pty Ltd v Bestobell* [1982] WAR 1 at 44:

Knowledge, as such, is not property, but the use of it will give rise to a liability to account if such use is in breach of the fiduciary relationship within which it was acquired.

include knowledge gained through acting for the company means that most 'secret profits' cases can be classified as company property cases.

Corporate funds Corporate property includes the company's funds. Thus, where directors use the company's money for their own purposes, recommend the payment of funds out of capital (and not out of profits), apply the funds for ultra vires purposes, or pay retirement compensation to one of their own number without appropriate disclosure, they are in breach of their fiduciary duty.

In *Re Sharpe*,⁶² the directors, acting bona fide throughout, paid 5% interest each year on the paid-up capital for about 10 years when there were no profits earned by the company. Lindley L J noted:

As soon as the conclusion is arrived at that the company's money has been applied by the directors for purposes which the company cannot sanction, it follows that the directors are liable to replace the money, however honestly they have acted. Whether they can in turn get it back from those persons who received it is another matter; but their own liability to restore it is now clearly settled.⁶³

The strict approach towards errant directors

Two important cases, rather similar in their facts, are good examples of the misuse of corporate property: *Industrial Development Consultants Ltd v Cooley*⁶⁴ concerned the misuse of company information and *Canadian Aero Service Ltd v O'Malley*⁶⁵ concerned the misuse of a corporate opportunity.

In *Cooley*, the former managing director did not tell his company that a project was going to be revived after the rejection by a gas board of his former company's offer; nor did he disclose that he had been negotiating future employment with the gas board. Shortly after his resignation, he accepted employment with the gas board, doing the very work he had unsuccessfully tried to get for the plaintiff company. He had also faked illness in order to gain quick release from his employment with the plaintiff. The defendant was liable to account for all the benefit he had received or would receive under his contract with the gas board, even though the construction contracts probably would not have gone to the plaintiff. The defendant breached his fiduciary duty in not disclosing to the plaintiff the information that came to him whilst he was managing director.⁶⁶

Roskill J, in *Cooley*, cited *Keech v Sandford*⁶⁷ for the strict interpretation of the rule. In that case, a trustee held a lease for the benefit of an infant. The lessor, for a variety of reasons, refused to renew the lease for the infant's benefit. Instead, he granted a lease to the trustee. It was held that

62. [1892] 1 Ch 154 at 165–166.

63. *Ibid.*

64. [1972] 2 All ER 162.

65. (1973) 40 DLR (3d) 371.

66. Above n 64 at 173–174.

67. (1726) Sel Cas Ch 61; 25 ER 223; [1558–1774] All ER Rep 230.

the trustee had to assign the lease to the infant and account for profits he had made, even though there was no fraud involved.

It may seem hard that the trustee is the only person of all mankind who might not have the lease, but it is very proper that rules should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease on refusal to renew to *cestui que use*.⁶⁸

*Canadian Aero Service Ltd v O'Malley*⁶⁹ also upheld the traditional view. The plaintiff company pursued an aerial mapping project in Guyana. Two executive directors negotiated for some years, seeking the project for the company, before resigning from the plaintiff and forming their own company, T Ltd. T Ltd tendered for and won the project in competition with the plaintiff. The plaintiff alleged that the executive directors had breached their fiduciary duty by depriving the plaintiff of 'the corporate opportunity which it had been developing'.⁷⁰ The Supreme Court of Canada unanimously agreed:

. . . a director or senior officer . . . is precluded from obtaining for himself, either secretly or without the approval of the company . . . any property or business advantage either belonging to the company or for which it has been negotiating; and especially is this so where the director or officer is a participant in the negotiations on behalf of the company.⁷¹

The resignations of the directors did *not* terminate their fiduciary duties where the resignation was prompted by a desire to take the opportunity for themselves, or where their positions with the company (and not some private approach) presented them with the opportunity.⁷² Laskin J stressed that *Regal (Hastings)* and *Peso Silver Mines* did not restrict the principle to 'the straight jacket of special knowledge acquired while acting as directors or senior officers, let alone limiting it to benefits acquired by reason of and during the holding of those offices'.⁷³ Thus, even if the knowledge of the opportunity did not come to a director whilst he was acting in that role or capacity (that is, if it comes in his individual capacity), he would still be liable.⁷⁴

Can *Canadian Aero Service* be distinguished from *Peso Silver Mines*? In *Peso*, much was made of the fact that the directors apparently acted in good faith in rejecting the corporate opportunity before it was taken up by the controlling shareholders (who were also directors). However, this presents the court with a problem. How can it really judge whether or

68. Per Lord King L C, *ibid* at 62, 223 and 231 respectively.

69. Above n 65.

70. *Ibid* at 373.

71. Laskin J, *ibid* at 382.

72. *Ibid*.

73. *Ibid* at 390.

74. See Beck, 'The Quickening of Fiduciary Obligation: *Canadian Aero Service v O'Malley*' (1975) 53 *Can Bar Rev* 771 at 776-777. See also *Green & Clara Pty Ltd v Bestobell* [1982] WAR 1.

not there was good faith? The board may assert that the company was too poor or financially stretched to take up the opportunity. But if a director stands to gain from a rejection of the opportunity, a shadow lies over the board's decision to reject. It is unhealthy that directors be allowed to get into positions that may compromise their fidelity. Full disclosure to, and approval of, the company must mean full disclosure to, and approval of, the shareholders, if the duty is to have meaning and worth.⁷⁵

At least for directors of larger public companies, there is much to commend a strict view on the duty to avoid clashes of self-interest and duty. Directors must both do, and be seen to be doing, their duty. To echo the *Boardman* view, they should not even be in a position of possible conflict of duty and self-interest. If they wish to be so involved, the proper course is full disclosure to and prospective (or, less satisfactorily, subsequent) forgiveness from the shareholders, not just the board.⁷⁶

The reconciliation of conflicting authorities ✎

Can the conflicting observations and findings of the authorities be reconciled? Is there a 'golden thread' running through the cases? How does one reconcile observations in *Regal (Hastings)* and *Furs Ltd v Tomkies* (that the directors' breach of fiduciary duty could have been put right by shareholder ratification) with the view in *Cook v Deeks* (that the taking of corporate property cannot be ratified, no matter how much support the perpetrators of the taking may have in the general meeting)? *Gower* thinks an answer is difficult, almost impossible:

The solution may be that a distinction is to be drawn between (i) misappropriating the company's property and (ii) merely making an incidental profit for which the directors are liable to account to the company. As we have seen, an incidental profit is not treated as the company's property unless it flows from a use of the company's property. *Cook v. Deeks* clearly came within (i) for it was the duty of the directors to acquire the contracts on behalf of the company. Hence the company in general meeting could not ratify, at any rate if the directors' own votes caused the resolution to be passed. . . .

On the other hand, in *Regal (Hastings) Ltd. v. Gulliver* the directors can be said not to have misappropriated any property of the company. Prima facie, therefore, the company could ratify what they had done and enable them to retain the profits. The difficulty, however, is that they had used information coming to them as directors, and, as we have seen, it may be that this is to be regarded as the company's prop-

75. See Beck, *ibid* at 785.

76. See generally Prentice, 'The Corporate Opportunity Doctrine' (1974) 37 MLR 464; Beck, 'The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered' (1971) 49 Can Bar Rev 80; Jones, (1968) 84 LQR 472. Also, to permit directors to be in situations of conflict without appropriate approval would set the court a task which no court would relish, namely that of examining the minutiae of company transactions to see if the fiduciary has in fact sacrificed his company's interests in favour of his own: see Dawson J in *Hospital Products Ltd v US Surgical Corp* (1984) 55 ALR 417 at 491.

erty. If so, the shares which they acquired belonged in equity to the company. However, the present to them of the shares would not necessarily have been improper. If the company was financially unable to acquire the shares there might have been a bona fide decision of its members that it was in the interests of the company to allow the directors to retain the shares and the profits made from them — especially if the directors refrained from voting. In *Cook v. Deeks* the directors had profited at the company's expense; in *Regal* they had profited without harming it in any way. To forbid ratification in the former and to allow it in the latter makes some sense. Moreover, in *Cook v. Deeks*, unlike *Regal*, the directors had broken their duty to act bona fide in the interests of the company and, as we shall see, a 'fraudulent' breach of this sort cannot be ratified.⁷⁷

The distinction drawn between the two cases is narrow. Can it be said that the directors in *Regal (Hastings)* did not take corporate property? Such complex analysis is unfortunate. Few company directors or legal advisers could hope to understand the law here; regrettably, but understandably, the courts and commentators themselves are puzzled.⁷⁸

Such analysis does not cover the Privy Council's advice in *Queensland Mines* or the High Court of Australia's decision in *Furs Ltd v Tomkies*.⁷⁹ The latter decision can be bracketed with *Regal (Hastings)* as saying that disclosure to, and approval by, shareholders is enough. The managing director of the plaintiff was supposedly negotiating the best possible price for the sale of part of the plaintiff's tanning and dyeing business (including secret processes). During these negotiations, and with the blessing of his fellow directors, he arranged to enter employment with the purchaser. The plaintiff's shareholders did not know of this arrangement.

The company successfully sued Tomkies, alleging that, under his new service agreement, he held on trust for the plaintiff certain shares and promissory notes he received as part of his starting 'remuneration' with the purchaser company. Neither the other directors nor the shareholders of the plaintiff had been told of the shares and promissory notes deal which, in the Court's mind, 'greatly diminished the price [for the business] obtained by the company'.⁸⁰ Rich, Dixon and Evatt J J applied what they termed the

. . . inflexible rule that, except under the authority of a provision in the articles of association, no director shall obtain for himself a profit by means of a transaction in which he is concerned on behalf of the company unless all the material facts are disclosed to the shareholders and by resolution a general meeting approves of his doing so, or all the shareholders acquiesce.⁸¹

77. (4th ed) at 617–618.

78. See generally Baxt, 'Judges in Their Own Cause: The Ratification of Directors' Breaches of Duty' (1978) 5 Monash ULR 16.

79. (1936) 54 CLR 583.

80. *Ibid* at 598.

81. *Ibid* at 592.

Surely it is misappropriation of property to sell the company's business for a low price and, in effect, to pocket the balance of its worth. Accordingly, the finding is at odds with *Cook v Deeks* on ratification. Compare, also, *Furs Ltd v Tomkies* with *Queensland Mines* on board approval. Tomkies had board approval, but it was not enough; in *Queensland Mines*, it apparently was enough.

Regal (Hastings), *Cook v Deeks*, *Cooley* and *Canadian Aero Service* remain the major authorities in this area. *Queensland Mines* is flawed. Because it is of high authority, however, it offers hope to those who seek flexibility in the application of the fiduciary duties. But the very complexity of modern corporate life demands strictness, not flexibility. The four major authorities are easier to reconcile, the main difficulties being over ratification and the definition of the limits and term of the fiduciary relationship. A strict line on both would have the advantage of clarity. But it will not be to the liking of those with multiple directorships and a dulled sense of fiduciary obligation to their companies and their sometimes vast and impersonal memberships.

Ratification: Can directors use their own votes to ratify their breaches?

If full disclosure to, and approval by, the shareholders is sufficient to allow the directors to take up a rejected corporate opportunity, should the directors themselves be able to vote the shares they hold in the company in favour of their own interests? Or, should the approval by the company be by an *independent* majority at a general meeting? Despite the difficulties of enforcement, many prefer the latter approach. Not only should the votes cast be disinterested, but the interested director should also not be able to seek proxy votes. It is little enough to ask that directors submit their goings-on to 'independent' scrutiny.

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.⁸²

Directors can vote as shareholders

With limited exceptions, the law presently says that directors can use their own voting shares in any motion at a general meeting to endorse their own acts. '[A] shareholder is not a trustee of his vote and can use it to advance his own interests at a general meeting.'⁸³ For example, in *North-West Transportation Co Ltd v Beatty*,⁸⁴ the director/defendant was able to use his own votes as a shareholder in general meeting to affirm a

82. Beck, above n 76 at 119.

83. *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 447.

84. (1887) 12 App Cas 589.

contract between the company and himself as vendor of a steamship the company wanted to buy for its business. Megarry V C, in *Estmanco Ltd v Greater London Council*, noted that, providing he is not benefiting himself at the expense of another shareholder, 'When voting, a shareholder may consult his own interests, and may use his voting power to protect himself from being sued by the company'.⁸⁵ Even before *Beatty's* case, the position was clear enough:

Now as to the management of the company by the board, no director is entitled to vote as a director in respect of any contract in which he is interested; but the case is different when he acts as one of the whole body of shareholders. The shareholders of one company may have dealings with interests in other companies, and therefore it would be manifestly unfair to prevent an individual shareholder from voting as a shareholder in the affairs of the company.⁸⁶

In *Northern Counties Securities Ltd v Jackson & Steeple Ltd*,⁸⁷ Walton J also distinguished between the director acting as a director, and thus as a person with fiduciary obligations to the company, and the director acting as a shareholder, when he normally has no fiduciary obligations. As a shareholder, 'in voting, he is voting simply in exercise of his own property rights'.⁸⁸

The limits on a director's right to vote

Vinelott J, at first instance in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*,⁸⁹ challenged the *Beatty* maxim. He noted that all breaches of duty short of fraud or ultra vires acts can be ratified by the shareholders. However, in ascertaining the shareholders' views, 'the court will disregard the votes cast or capable of being cast by shareholders who have an interest which conflicts with the interests of the company'.⁹⁰ His Honour did not mention that the Supreme Court of Canada in *Beatty*⁹¹ had asserted this very point only to be overturned by the Privy Council.

Professor Wedderburn criticised Vinelott J's assertion and pointed out the difficulties of enforcing such a principle:⁹² (for example, What is 'an interest'? How do you find out who has one that conflicts? How do you discover motives? How can you tell whether proxy votes are being cast for someone with such an interest?).⁹³

There are limits to the 'selfish' use of general meeting votes by a shareholder who happens to be a director. Like any other shareholder, he does

85. [1982] 1 All ER 437 at 444.

86. *East Pant Du United Lead Mining Co Ltd v Merryweather* (1864) 2 H & M 254 at 261; 71 ER 460 at 463, per Sir W Page Wood VC.

87. [1974] 1 WLR 1133 at 1144, 1146.

88. *Ibid* at 1144.

89. [1980] 3 WLR 543.

90. *Ibid* at 874.

91. (1887) 12 SCR 598.

92. (1981) 44 MLR 202 at 207-208.

93. Cf analysis of Sullivan, [1985] CLJ 236 at 247ff.

not have a *carte blanche*. Lord Wark, in *Harris v A Harris Ltd*, qualified the general rule:

. . . the majority of shareholders voting in general meeting are supreme, as long as their acts are not inconsistent with the articles or otherwise *ultra vires* of the Company, and are not fraudulent. . . .⁹⁴

In *Clemens v Clemens Bros Ltd*,⁹⁵ Foster J noted that a director/majority shareholder could not use her majority vote in general meeting 'in whatever way she pleases', but added: 'To use the phrase of Lord Wilberforce, that right [to vote] is "subject . . . to equitable considerations . . . which may make it unjust . . . to exercise [it] in a particular way".' Fraud or inequitable conduct will not be permitted, regardless of the letter of the law.⁹⁶ As Latham C J in *Peter's American Delicacy Co Ltd v Heath*, said:

But though a shareholder may vote in his own interests the power of shareholders to alter articles is limited by the rule that the power must not be exercised fraudulently or for the purpose of oppressing a minority. . . .⁹⁷

Although shareholders are not trustees for one another, their voting is subject to these broad equitable considerations and, more specifically, to the rule that the benefit of the company must be paramount. So, if a resolution 'was so extravagant that no reasonable person could believe that it was for the benefit of the company, it should be held to be invalid'.⁹⁸ Decisions made by the shareholders — for example, to make calls on shares, declare dividends, appoint directors, alter the articles, sell property, forgive loans — may be made for selfish motives, but those motives must not be fraudulent or contrary to the company's best interests. Differences of opinion within a company there will be. But the differences and the exercise of majority power must not be based on some advantage to, or enrichment of, the majority at the expense of the corporators as a whole.

There will often be difficulties in reconciling the shareholder's duty to act *bona fide* in the company's best interests with his right to vote his shares in his own interests as he sees fit.

The reconciliation is to be found in the necessity that the shareholder should have a general belief that the proposed action, however much it may benefit him, is in the interests of the company as a whole, including the minority shareholders.⁹⁹

In summary, although he must act in the company's interests, the individual shareholder can have regard to his own interests when voting. He is certainly not required to disregard them.

94. [1936] SC 183 at 191.

95. [1976] 2 All ER 268 at 282.

96. Hermann J in *Schnell v Christ-Craft Industries Inc* 285 A (2d) 437 at 439 (1971) commented: 'inequitable action does not become permissible simply because it is legally possible'.

97. (1939) 61 CLR 457 at 482.

98. *Ibid* at 482.

99. Jacobs J in *Re Broadcasting Station 2GB Pty Ltd* [1965] NSW 1648 at 1662.

No one supposes that in voting each shareholder is to assume an inhuman altruism and consider only the intangible notion of the benefit of the vague abstraction called . . . 'the company as an institution'. An investigation of the thoughts and motives of each shareholder voting with the majority would be an impossible proceeding.¹

The power of unanimous shareholders to ratify

In *Canada Safeway Ltd v Thompson*,² the fraudulent Raley, president and managing director of Canada Safeway, purported to act for the company when he investigated the possibility of buying another company. Instead, using confidential information gained in the negotiations, he and several conspirators (outsiders) bought shares in that other company for themselves. The same shares were later sold to Canada Safeway for a profit to Raley and the others. Manson J, without further explanation, said:

Raley could not buy into Empress [the other company] without full disclosure to his company and to all its shareholders. In my view, nothing less than a unanimous resolution of its shareholders consenting to the buy after such full disclosure would enable Raley to buy Empress shares without rendering himself liable to account for all profits made on their sale.³

This raised the question of whether fraud is capable of forgiveness, provided that it is unanimous. The *Cook v Deeks* line harmonises with the fiduciary nature of the director's role (that is, that there can be no ratification where company property is taken for fear that controlling directors feather their own nests at the company's expense). This approach implies that the company, as a separate entity, is not just the shareholders, and it denies that there is no fraud on the company if all the shareholders know and consent.

Definition of the limits to the power of unanimous shareholders troubled the English courts in *Re Halt Garage Ltd*⁴ and *Re Horsley & Weight Ltd*.⁵ In the former case, remuneration was paid to an inactive director/wife in a husband and wife company:

. . . it cannot be right that shareholder directors acting in unison can draw any sum they like out of company's capital and leave the liquidator and the company's creditors without remedy in the absence of proof of intent to defraud merely because they choose to dignify the drawing with a particular description [that is, remuneration].⁶

1. *Peter's American Delicacy Co Ltd v Heath*, above n 97 at 512, per Dixon J. See also Sullivan, above n 93 at 253–254.

2. [1951] 3 DLR 295.

3. *Ibid* at 321.

4. [1982] 3 All ER 1016.

5. [1982] 3 All ER 1045.

6. Above n 4 at 1043, per Oliver J. The husband and wife were the only directors and the only shareholders of the company.

The articles did not authorise gratuitous, unearned payments to directors. The payments to the wife, to the extent that they were unearned, were held to be ultra vires.⁷ Shareholder sanction (even if unanimous) could not change that. Ultra vires acts are void and so are not ratifiable.⁸ Vinelott J went further in *Rolled Steel Products*:

Shareholders, even acting unanimously, cannot authorise a transaction which is ultra vires in the wider sense of being an application of the company's assets for purposes other than those which the company is authorised to pursue and cannot ratify or excuse such a transaction if entered into by the directors in the purported exercise of their powers as directors.⁹

Wedderburn argues that certain acts are incapable of ratification, no matter what the majority. As noted in Chapter 9, he concludes that where the directors act in bad faith, or where there is misappropriation of legal or equitable property of the company, there can be no ratification.¹⁰ Gower concludes that only if there is expropriation and lack of bona fides, is ratification impossible.¹¹

Is it enough to say that only acts that are ultra vires, or in bad faith, or which involve expropriation of the company's assets cannot be ratified? It seems wrong that directors who, for example, negligently make imprudent investments should be able, as shareholders or by using their influence over shareholders, to ratify their own wrongdoing where the directors' misfeasance is likely to cause loss to creditors.¹² Even unanimous shareholders should not be able to ratify such behaviour. There is, after all, nothing sacred about unanimity, except that if there is unanimity then no shareholder remains to complain of the breach ratified. This is all the more reason why creditors should be able to complain, or at least to have their claims put forward by a liquidator.

If a narrow view is taken of the company, so that the company 'is' only the shareholders, who are unanimous in their forgiveness, then it can be argued that the company is content and that breach of duty cannot be raised. However, it is now established in Australia and New Zealand¹³

7. Ibid at 1044.

8. See *Re Exchange Banking Co, Flitcroft's case* (1882) 21 Ch D 519, where dividends were paid out of contributed capital, not out of profits. It was held that, even if all shareholders had assented, the directors would still be liable to repay the amount distributed because the payments were illegal and ultra vires the company and so incapable of ratification. See discussion by Buckley L J in *Re Horsley & Weight Ltd* [1982] 3 All ER 1045 at 1054–1055. Vinelott J in *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1982] 3 All ER 1057 at 1084 affirmed 'The principle that shareholders, even acting unanimously, cannot ratify or make binding on a company a transaction that is ultra vires whether in the narrow or wider sense'.

9. Ibid 1083–1084.

10. Above n 92 at 205–208.

11. (4th ed) at 650–651.

12. Per Cumming-Bruce L J in *Re Horsley & Weight Ltd*, above n 8 at 1055. See also Templeman L J at 1056.

13. See *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 ACLC 215; *Nicholson v Permakraft (NZ) Ltd (in liq)* (1985) 3 ACLC 453; *Grove v Flavel* (1986) 4 ACLC 654.

that, when a company is financially unsound,¹⁴ creditors' interests must be considered by directors. Accordingly, acts by directors that further threaten the company's solvency may be what Templeman L J called in *Re Horsley & Weight Ltd*¹⁵ 'a fraud on the creditors'. Ratification, even by unanimous vote, will not be able to forgive that wrong and leave the creditors (in particular) lamenting.

Cooke J, in his dictum in *Permakraft*, asserted that there could be a breach of duty to the creditors so that

. . . the unanimous assent of the shareholders is not enough to justify the breach of duty to the creditors. . . . Concurrence by shareholders prevents any complaint by them, but compounds rather than excuses the breach as against the creditors.¹⁶

The suggested answer, then, is that where the company is or is nearly insolvent or the directors' acts threaten the financial base of the company, creditors can themselves enforce a duty owed to them by the directors.¹⁷ The recognition of such a duty means that effective ratification will also have to come from creditors and not just shareholders. Certainly it means that where a company is insolvent or in a shaky financial position, and the directors commit, or propose to commit, a breach of duty 'the shareholders do not have the power or authority to absolve the directors from that breach'.¹⁸

In summary, if the company is solvent, unanimous shareholders cannot ratify an ultra vires act, breaches of duty committed in bad faith, or breaches that involve misappropriation of company property. If the company is in a shaky financial position or is actually insolvent, unanimous shareholders cannot ratify breaches of duty which affect creditors adversely.¹⁹ A concept of 'fraud on the company' is evolving, the 'company' embracing shareholders and, at least in times of doubtful solvency, creditors. The concept will undoubtedly expand to embrace employees. If their interests also must be served, many more breaches of duty will not be open to ratification, no matter what majority of shareholders offers forgiveness.

14. The courts have not yet decided what degree of financial shakiness or instability will be enough to trigger off the requirement that directors, when performing their duties, should have regard to the interests of creditors as well as shareholders. See *Kinsela v Russell Kinsela Pty Ltd (in liq)*, *ibid* at 223, per Street CJ. Section 542, the misfeasance provision of the Code, is one avenue for creditors to consider when the company is solvent and they object to financial policies of management.

15. Above n 8 at 1056.

16. Above n 13 at 460.

17. In Canada, creditors as well as members may be able to bring derivative suits on behalf of the company: see ss 231–232 of the *Canada Business Corporations Act 1974–1976*. See discussion of derivative suits in Ch 9.

18. *Kinsela v Russell Kinsela Pty Ltd (in liq)*, above n 13 at 223, per Street CJ (emphasis added).

19. See Parkinson, 'Non-commercial Transactions and the Interests of Creditors' (1984) 5 *Co Law* 55 at 64. Cf *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services* [1983] 2 All ER 563.

Statutory liability for the improper use of inside information and position

As 'insiders', directors are privy to the company's secrets and other information not available to the general public or even to the company's shareholders. Opportunities arise to use this inside information and fortunes can sometimes be made by its unscrupulous use. Many a director has seen a good buy on the sharemarket just prior to a takeover offer being announced, or has sold his shares just before a company's ills have become public knowledge. One opinion is that such insider 'profits' are the rightful spoils of the corporate battle zone, but such behaviour is usually condemned and law-makers have criminalised it.

Section 229(3) (which, under s 229(10), has effect in addition to, and not in derogation of, any of the general law duties of directors) concerns the misuse by insiders of company information:

An officer or employee of a corporation, or a former officer or employee of a corporation, shall not make improper use of information acquired by virtue of his position as such an officer or employee to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Section 229(4) is closely related to subs (3):

An officer or employee of a corporation shall not make improper use of his position as such an officer or employee, to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Section 229(4) is new. It allows recovery where profit is made by a third party. These provisions would, for example, catch the chairman in *Regal (Hastings)*, who escaped liability because his friends and not he had profited from the breach of duty.²⁰

The term 'officer' includes director (s 229(5)). The section provides both criminal and civil remedies. There are penalties for contravention of the provisions (\$20,000 or five years' imprisonment or both) as well as provision for the corporation to recover profit made from the contravention or failure and to recover for loss or damage suffered by the corporation.

Like s 556(3) (regarding the incurring of debts where the company is unable to pay), s 229(7) says that the corporation can recover, regardless of 'whether or not the person has been convicted of an offence under this section in relation to that contravention or failure to comply'. Before a successful claim for loss or damage and for profits could be made, the corporation would presumably still have to prove that an offence under the relevant provision had taken place. Whether or not the criminal stan-

20. See CCH *Australian Company Law Reporter*, Vol 1, para 25-770. See *Regal (Hastings) Ltd v Gulliver* discussed above. The chairman of the board was exempted because he held shares only on behalf of outsiders. The other five directors bought the shares for themselves and were thus liable to account.

dard — that is, beyond reasonable doubt — is to be applied is in doubt. The 1985 amendments to the *Companies Code* stipulated that the civil standard applied for s. 556(1).²¹

The court itself may order payment of compensation to the corporation on the conviction of an offender, in addition to imposing a penalty (s 229(6)). This obviates the need for separate proceedings. The court also has power under s 574 to issue injunctions restraining or putting right conduct that constitutes an offence under s 229.

The difficulties of proving an offence under s 124(3) of the *UCA*, so evident in *Es-Me Pty Ltd v Parker*²² and *Commissioner of Corporate Affairs v Green*,²³ remain under s 229(3) and (4). In *Green*, for example, a director was charged under s 124(2) of the *UCA* (s 229(3) of the Code) with making improper use of information gained by virtue of his position in Endeavour Oil Co NL. He allegedly used inside knowledge that a call on the shares in the company was imminent when he told another company, Gwello (in which he was a director and major shareholder), to sell 100,000 shares (of 180,000 total it owned) in Endeavour. After the call, the Endeavour shares fell on the market. It was alleged that Gwello directly, and the respondent director indirectly, gained an advantage (that is, avoided a loss on the shares).²⁴ The director claimed that Gwello had a 'liquidity problem' and needed to sell these shares. Further, the shares had not, he said, been producing any dividends. McInerney J held that there was no evidence that the information the director gained was in fact used by him to advise the share sales. 'The mere occurrence of the two events in sequence one to another does not establish causation.'²⁵

Insider trading and the Securities Industry Code

Section 229(3) of the Code runs in tandem with ss 128, 129 and 130 of the *Securities Industry Code*. They are directed specifically at insider trading or dealing. Where an 'insider' (such as a director), by reason of his company connection, gets information that is not generally available and which would affect the market price of the securities, and then deals in the relevant securities so as to gain or to avoid loss, he is guilty of insider

21. See s 556(3A) of the Code, as inserted by s 120 of Act No 192 of 1985.

22. [1972] WAR 52.

23. [1978] ACLC 29,728.

24. Can this be termed an 'advantage' within s 229(3)? The avoidance of loss was held to be a profit in a leading US case, *Diamond v Oreamuno* (1969) 248 NE 2d 910, where two directors sold their shares before the poor monthly financial figures were announced. The release caused the share price to fall significantly. The use of the inside information was held to be a breach of fiduciary duty.

25. Above n 23 at 29,736. All that was required at this preliminary stage of the trial was proof to the balance of probabilities standard (that is, a prima facie case) that there had been an offence. If there had been a case to answer, the test would then become the criminal, 'beyond reasonable doubt' test. [Recently, in *Grove v Flavel* (1986) 4 ACLC 654, the South Australian Full Supreme Court found, on a case stated, that the proven facts there could amount to an 'improper use of information' for the purposes of s 124(2) of the *UCA* (the predecessor of s 229(3) of the Code).]

trading.²⁶ The law acknowledges that insiders (such as directors, employees or professional advisers) will often know in advance of probable price fluctuations in their companies' shares and may be tempted to trade in the shares, thereby disadvantaging other shareholders and unfairly advantaging themselves. The knowledge may be of impending mergers or takeovers, of a mineral strike, or of a downturn in fortune which is not yet public knowledge.

In broad terms, s 128 of the *Securities Industry Code* prohibits a 'connected person' from 'dealing' in securities, or causing others to deal in them or communicating price-sensitive information that is not 'generally available' to someone who will use that information to deal or to cause others to deal. Persons caught by s 128 include any person who within the last six months has been connected with a company and through that liaison has inside information; any connected person who knows inside information about any expected or actual transaction involving his company and another company, or one of them and the securities of the other; and any person (called a 'tippee') who obtains inside information from a person who he knows or ought to know falls under the first two categories.

There are extensions, exemptions and detences in s 128. Penalties for breach are severe: \$20,000 or five years' imprisonment or both; \$50,000 for a body corporate. Civil liability for loss suffered as a result of insider trading is catered for by s 130. Under the same section, the NCSC can bring actions for the recovery of profit and loss on behalf of affected persons. There is a liability to account to the company for any profits and to compensate injured parties. Injunctions to stop threatened breaches of s 128 are available under ss 14 and 149 on the application of the NCSC or any person whose interests have been, are, or would be, affected.

Detailed discussions of insider trading can be found in many specialised studies.²⁷ Although, as yet, there have been no successful pros-

26. See also s 3A(1) of the AASE Listing Requirements. The history and purpose of the insider trading legislation in Australia is considered in *Ryan v Triguboff* [1976] 1 NSWLR 588 by Lee J and in *Hooker Investments Pty Ltd v Baring Bros Halkerton & Partners Securities Ltd* (1986) 10 ACLR 462 by Young J. (*Hooker* went on appeal: see (1986) 4 ACLC 243.)

27. See Mitchell, *Directors' Duties and Insider Dealing* (Butterworths, 1982); Rider and Ffrench, *The Regulation of Insider Trading* (1979); Skoyles, 'The Fiduciary Basis of Insider Trading Liability: Dirks Down Under?' (1984) 2 C & SLJ 13; White, 'Towards a Policy Basis for the Regulation of Insider Trading' (1974) 90 LQR 494; Centre for Commercial Law and Applied Legal Research, Monash University, *Securities Law Seminar — Insider Trading* (July 1985), papers by Ryan, Loss, Mandle and Samuel; Manne, *Insider Trading and the Stock Market* (1966); Branson, 'Insider Trading' [1982] JBL 342 at 413, 536; Baxt, Ford, Samuels and Maxwell, *An Introduction to the Securities Industry Codes* (2nd ed, 1982) Ch 14; Paterson, Ednie and Ford, *Australian Company Law* (3rd ed) Vol 3, paras 229/13ff. The 1986 NCSC issues paper entitled *Insider Trading Legislation for Australia* (prepared by Philip Anisman) discusses the Australian position and offers a model insider trading statute. The *Report* recommends that the term 'insider' should be broadened in meaning; that the standard for determining the significance or price sensitivity of undisclosed information should be a broadened concept of 'materiality'; that civil penalties and sanctions be beefed up; that the limitation period for bringing actions be extended. Corcoran (Adelaide Univ Law School Discussion Paper, Nov 1986) lauds 'the clarity and precision of [Anisman's] drafting technique [which] should be emulated'.

ecutions under the youthful s 128 of the *Securities Industry Code*, there is an understanding in the commercial community that insider dealing is widespread. The lack of success in discouraging the practice will foster a cynical disrespect for senior management, market personnel and the function of the marketplace. The stock markets' reputation will be sullied by rumours of undeserved profits and the cheating of unwitting shareholders. The loss of investor confidence, whether or not insider trading discourages investment in the share markets, would itself be regrettable.

Insider trading and the general law

In *Percival v Wright*, it was held that, in the absence of a special relationship, at general law the director has no fiduciary duties to his shareholders.²⁸ Accordingly, the director who bought the plaintiff's shares did not have to disclose to the shareholders the fact that a takeover offer for the company's shares was under negotiation. The takeover offer would normally, of course, increase the value of the shares.

The New Zealand Court of Appeal regained some of the lost ground in *Coleman v Myers*,²⁹ by establishing that there was no blanket rule that directors do not stand in a fiduciary relationship to their shareholders. In Australia, the courts have yet to recognise a general fiduciary duty.³⁰

The problems of enforcement

Insider trading is not effectively regulated in Australia. Self-regulation by industry, the banks and the stock exchanges has also not yet proved effective overseas. The US Securities and Exchange Commission (SEC) enjoyed a hey-day with *SEC v Texas Gulf Sulphur Co Ltd*,³¹ where company officers had to account for profits made by the use of inside information about the discovery of large mineral deposits on the company's land, but it has been less successful since. In the early 1980s, the SEC renewed its attacks on the practice, which it sees as posing a dire threat to the securities market. Many civil cases are now in progress, but the overall number of cases brought to court are few — far too few, many argue, to control the epidemic of insider trading abuses. The UK Department of Trade has also shown concern.³² Insider trading became a criminal

28. See Ch 4 above and the discussion of *Percival v Wright* [1902] 2 Ch 421; *Allen v Hyatt* (1914) 30 TLR 444; *Coleman v Myers* [1977] 2 NZLR 225; *Strong v Repide* (1909) 213 US 419 for a US view; *Gadsden v Bennetto* (1913) 9 DLR 719 for a Canadian view.

29. *Ibid.*

30. See discussion in Ch 2 above and finding in *Esplanade Developments Ltd v Dinive Holdings Pty Ltd* [1980] ACLC 34,232; 4 ACLR 826 reiterating that directors owed no general fiduciary duty to shareholders. See also *Jones v Dumbrell* [1981] VR 199, where an allegation of breach of fiduciary duty between the plaintiff shareholders and a director was not made out: 'the plaintiffs have not succeeded in satisfying me, as they sought to do, that the adverse decision of *Percival v Wright* [1902] 2 Ch 421 is distinguishable' (at 204, per Smith J).

31. (1968) 401 F 2d 833. See also *Diamond v Oreamuno*, above n 24.

32. See White Paper, *The Conduct of Company Directors* Cmnd 7037 (1977) at paras 22–32.

offence in 1980 and there have been successful prosecutions.³³ However, it is clear enough in the United Kingdom, as in Australia, that the sophisticated insider trader has as yet little to fear.

Forceful arguments are advanced that there is no need for complex legislation to regulate insider trading; that it is too difficult to detect and punish or compensate for — so difficult, that even draconian legislation will not be a deterrent. Others argue that the use of inside information is a justified 'perk' of expertise and involvement in corporate enterprise; that there are no 'victims' when insider trading takes place; and that freeing up the use of inside information would mean more market efficiency with the quicker dissemination of information. The market, however, has much to lose if it is seen as crooked or short on integrity. It is widely accepted that, in fairness and equity, insider trading should be discouraged, even though it may lead to greater market efficiency. Although government regulatory bodies try to crack down on the practice, legislation has not yet shown that it is able to deal with it. The use of sophisticated technology to detect abuses will help enforcement, as can the stock markets and companies themselves, well placed as they are to assess the problems and identify insiders' mischief.

Competition between directors and the company

A director can join the board of and work for a rival company, without breaching his fiduciary duties, if he does not pass on confidential information or use the company's property.³⁴ Indeed, s 228(5) and (6) of the Code anticipate such 'rivalry' when they call for the disclosure of competing offices.³⁵ There may be advantages for the companies in sharing the talents of able directors. Over some issues, however, there will sometimes be tension between the interests of the competitors. In such situations, the director's position may be awkward and will require a clear appreciation of the fiduciary duties owing to each company.³⁶

Where directors on competing companies' boards consider any business matter of substance, there is a 'real sensible possibility of conflict'³⁷ of their duties to their company and to the other, competing company on whose board they sit. They are, admittedly, in a duty-versus-duty conflict and not a duty-versus-personal interest conflict, but the parallel

33. See discussions in (1981) 2 Co Law 278; (1982) 3 Co Law 185; (1983) 4 Co Law 117.

34. See *London and Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165; *Bell v Lever Brothers Ltd* [1932] AC 161 at 194–195; *Re Broadcasting Station 2 GB Pty Ltd* [1964–1965] NSWLR 1648 at 1663; *Markwell Bros Pty Ltd v CPN Diesels (Qld) Pty Ltd* (1982) 7 ACLR 425 at 435. See also Jackson, (1976) 9 U of Qd LJ 260.

35. See also s 231. A register of directors' shareholdings, debentures and other interests in the company or related companies must be kept by the company at its registered office or principal place of business (s 547). It must be open to inspection by members without charge and to others on payment of a charge (s 231(7)). The register must also be available at every annual general meeting (s 231(9)).

36. See discussion of this above in Ch 5 at n 5 and accompanying text.

37. Formulation of Lord Upjohn in *Boardman v Phipps*, above n 59 at 124 (discussed earlier).

is clear and the same rule applies.³⁸ It matters not that the possible cause of any disloyalty by its directors is service to another competing company rather than service to self; the threat is the same. This matter has not yet become a major issue in the courts. In *Abbey Glen Property Corporation v Stumborg*,³⁹ however, McDonald J doubted the authority of the dicta in *London & Mashonaland*, adding:

Even where there is no question of a director using confidential information, there may well be cases in which a director breaches his fiduciary duty to company A merely by acting as a director of company B. This will particularly be possible where the companies are in the same line of business and where acting as a director of company B will harm company A.⁴⁰

In *Berlei Hestia (NZ) Ltd v Fernyhough*, Mahon J did not think that the fiduciary relationship prohibited persons from holding multiple directorships in competing companies, merely on the off chance that the directors might 'at some future time, decide to act in breach of [their] fiduciary duty'.⁴¹ No doubt if, by the consistent application of fiduciary principles, there is seen to be a conflict situation with every multiple directorate involving competing companies, commercial expediency would overrule strict principle.⁴² A company that is concerned about its directors taking on board positions in competing companies would be well-advised to prohibit this in its articles.

Unlike directors, partners cannot compete with the firm, without the consent of the other partners.⁴³ Chitty J did not follow the partnership analogy in *London and Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd*⁴⁴ when he upheld the director's right to hold positions on boards of rival companies, which were incorporated for the same object. The court stressed the director's freedom from contractual obligation to devote time to the business affairs of the company or to devote himself exclusively to one company.

Once directors have used the company's property or information, under usual fiduciary principles they must account for any profits. They are then seen to be 'competing unfairly'.⁴⁵ In *Green v Bestobell Industries*,⁴⁶

38. See Lord Denning M R in *Boulting v Association of Cinematography Television and Allied Technicians* [1963] 2 QB 606 at 626–627. See discussions of this issue and others by McLay, 'Multiple directorates and loss of corporate opportunity! Bases and remedies' (1980) 10 VUWLR 429. Note especially 444–446 and the consideration of the right of action for breach of confidence which may apply to directors in certain circumstances. See also Afterman, *Company Directors and Controllers* (1970) at 82–83, on the anomalous position on competing with one's own company.

39. (1976) 65 DLR (3d) 235.

40. *Ibid* at 278.

41. [1980] 2 NZLR 150 at 161.

42. *Ibid*.

43. See Partnership Acts: s 30 (NSW, SA and UK), s 33 (Qld and NZ), s 34 (Vic), s 41 (WA) and s 35 (Tas).

44. Above n 34.

45. *Markwell Bros Pty Ltd v CPN Diesel (Qld) Pty Ltd*, above n 34 at 435, per Thomas J.

46. [1982] WAR 1.

a fiduciary, through his own company, competed with the company that employed him by tendering successfully for the same contract. He was in breach of his fiduciary duty and liable to account, even though the company would probably not have won the contract in the absence of his competition.⁴⁷

In *Christie & Co Ltd v Greer*,⁴⁸ the direct solicitation of clients of the plaintiff company by a former employee/director through his own company constituted a breach of his fiduciary duty (which duty persisted after the employment relationship ended). The breach was redressable in damages corresponding to the 'total revenues which would have been generated by the seven clients who transferred their business over the course of one year'.⁴⁹ It would not have constituted a breach if he had merely *accepted* business from former clients. The thin line separating permissible from impermissible competition by directors troubled Danckwerts L J in *Aubanel and Alabaster Ltd v Aubanel*:

It seems to me that the dangers of a director using confidential information (acquired as director) to assist him in the competing business and the difficulties of avoiding such use of any confidential information, are considerable, but I must accept the proposition that such competition is permissible. But solicitation of the company's customers is another matter.⁵⁰

As *Christie & Co Ltd v Greer* and *Canadian Aero Service Ltd v O'Malley*⁵¹ show, the director's fiduciary duties can persist after resignation. The position of trust imposes a 'larger, more exacting duty' on directors than that placed on employees,⁵² who can, within limits, compete after resignation.⁵³

Different rules for employees and executive directors

The division of loyalties problem can be a difficult one. Company employees, because of implied terms in their contracts of service, may not work, even part-time or in their spare time, for a competitor because a conflict of loyalties may arise.⁵⁴ As Gower asks, 'How then can it be that

47. *Markwell Bros Pty Ltd v CPN Diesels (Qld) Pty Ltd*, above n 34, reached a similar result.

48. [1981] 4 WWR 34.

49. *Ibid* at 41-42, per Huband J A in the Manitoba Court of Appeal.

50. (1949) 66 RPC 343 at 346.

51. (1974) 40 DLR (3d) 371 at 382 and 390-391 (S Ct of Canada).

52. *Edgar T Alberts Ltd v Mountjoy* (1977) 79 DLR (3d) 108 at 119, per Estey CJHC. Cf *Waite's Auto Transfer Ltd v Waite* [1928] 3 WWR 649.

53. See discussed below.

54. *Hivac Ltd v Park Royal Scientific Instruments Ltd* [1946] Ch 169. See also *Sanders v Parry* [1967] 2 All ER 803; *Wessex Dairies Ltd v Smith* [1935] All ER Rep 75; *Alberts (Edgar T) Ltd v Mountjoy* (1977) 16 OR (2d) 682. In *Hospital Products Ltd v US Surgical Corp* (1984) 55 ALR 417 at 460 Mason J noted that: 'The employee's duty of loyalty may involve him in a breach of duty if he secretly makes arrangements during his employment to compete with his employer after termination of the employment. And the secret development by the employee of a manufacturing capacity by surreptitiously copying the manufacturer's product will certainly constitute a breach of duty.'

a director can compete whereas a subordinate employee cannot?⁵⁵ *Hivac Park Royal Scientific Instruments Ltd*,⁵⁶ however, applies to directors with service contracts. Further, it is common for executive directors' service contracts to include a term expressly prohibiting employment elsewhere and the canvassing of customers for a new employer.

In *Markwell Bros Pty Ltd v CPN Diesels (Qld) Pty Ltd*,⁵⁷ two employee directors set up in competition to a company of which they had been directors. They were held to be simultaneously in breach of their duty under their contracts of employment with, and in breach of their fiduciary duties to, their former companies. They took a business contract, company records and confidential information (customer lists and pricing system).⁵⁸

Unlike directors, employees can canvass the clients of their former employer for a new business, once they have terminated their contracts of service.⁵⁹ But, like directors, they may not use specialised or confidential information about current transactions between the former employer and its clients.⁶⁰ In *Lintas (SSC & B) New Zealand Ltd v Murphy*,⁶¹ the former managing director and creative director were liable for damages, including exemplary damages, for the misuse of confidential information, the conversion of documents and files, and conspiracy. They set up a rival business, taking most of the employees, documents and files with them. Taking full advantage of their knowledge of the company's specialised information, they solicited the plaintiff's clients. Pritchard J also found the former managing director to be in breach of his duty of fidelity to *Lintas*, both as an employee and managing director.

The law on competing directorates is settled enough, but not happily so. It is unsatisfactory that someone with a high-trust, fiduciary position can be active in a similar position with another company to which he owes the very same duty of loyalty. One cannot always be loyal to both; the possibility of conflict is always present. Directors who are also employees, on the other hand, cannot work for competing companies. They are subject to clear-cut contractual rules applying to servants and these rules are being vigorously applied. This uneasy dichotomy — the positions of non-employee as against employee directors — is likely to remain, as long as the pool of suitable boardroom talent is seen to be small and the law tolerates multiple directorates.

55. (4th ed) at 600. See also *Menzies*, (1969) 33 ALJ 156 at 159–160.

56. Above n 54.

57. Above n 34.

58. The plaintiff company received damages for breach of the contract of employment and equitable damages for breach of fiduciary duty. *Ibid* at 438–440.

59. *Lintas (SSC & B) New Zealand Ltd v Murphy* (1986) Aust Torts Reports 67,534 at 67,542–67,545; see also *Christie & Co Ltd v Greer*, above n 48 at 40; *Electric Fittings Ltd v Pankhurst* (1982) 1 NZCLC 98,562 at 98,567; *Roberts v Elwells Engineers Ltd* [1972] 2 All ER 890 at 894. Often this right to compete is removed by contract between employer and employee.

60. Above n 34 at 435.

61. Above n 59.