The Strict Ethic of the Equitable Principle: A Comment on Canadian Aero Service v. O'Malley

Introduction

It is perhaps common knowledge that the power to manage the affairs of the modern corporation vests in the board of directors.[1] It is also common knowledge (at least in business circles) that directors rarely do in fact manage the company[2] — except perhaps in closely held corporations — and that this task is generally entrusted to the management, and more specifically, to the president and other executive officers.[3]

While the fiduciary duties of directors have been the subject of much study, only fleeting references are to be found on the question of the officer's fiduciary duties towards the company.[4] The reason may very well be that most cases involving breaches of fiduciary duties in the corporate context have dealt with individuals who were directors as well as officers.[5] In such cases, consequently, the court would assume *a priori* that the individual was a fiduciary by virtue of his position as director and consideration of the question of his liability *qua* officer would therefore be mere surplusage.

In *Canadian Aero Service Ltd.* v. *O'Malley et al.*[6] the Supreme Court explored the scope of the officer's fiduciary duty *qua* officer

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[1] In letters patent jurisdictions, the power to manage the company is vested in the board of directors as an incident of incorporation by statutory provisions such as s.97(1) of the new *Canada Business Corporations Act*, S.C. 1974-75, c.33.

[2] Taylor, *The Role of Today's Director* (1974) Bus.Q. 47. See also Koontz and O'Donnell, *Principles of Management: An Analysis of Managerial Functions* 5th ed. (1972), 384; and Palmer, "Directors' Powers and Duties" in Ziegel (ed.), *Studies in Canadian Company Law* (1972), 365-366.

[3] This is done via delegation. See, for example, s.116 of the new *Canada Business Corporations Act, supra,* f.n.1.

[4] See Gower, *The Principles of Modern Company Law* 3d ed. (1969), 518; and Palmer, *supra,* f.n.2, 369.

[5] See Note, *Corporate Opportunity* (1961) 74 Harv.L.Rev. 765, 769. In Canadian corporate opportunity cases, the defendants have usually been directors *and* officers. See, for example, *Cook* v. *Deeks* (1916) 1 A.C. 554, 559 (P.C.); *Peso Silver Mines* v. *Cropper* (1966) 54 W.W.R. 329 (B.C. C.A.); 58 D.L.R. (2d) 1 (S.C.C.).

[6] (1974) 40 D.L.R. (3d) 371, hereinafter referred to as *Canaero.*

and irrespective of whether or not he is a director as well.[7] Consequently, the *Canaero* decision represents a definitive extension of fiduciary duties to officers via the rules of agency, based upon a functional approach.

The *Canaero* decision is of particular interest for another reason. Traditionally, there have been two legal principles applicable to corporate opportunity cases: namely, the profit and conflict rules.[8] In the *Canaero* decision, however, the Supreme Court of Canada adopted a recent trend[9] which refuses to consider these two rules as "exclusive touchstones of liability", and proceeded to impose liability for breach of fiduciary duty on an entirely new basis, *i.e.*, on the basis of the corporation's "continuing interest" in the opportunity. However, it is unclear whether this is a new ground of liability or whether it is really the conflict and profit rules in disguise, extended to a situation where the agent has left the corporation before taking personal advantage of the "corporate opportunity". In any case, it is clear that, as a result of the *Canaero* decision, corporate opportunity cases will henceforth be dealt with as *causes d'espèces* requiring a rigid application of a "strict ethic" to compel promoters, directors and managers to obey "norms of exemplary behaviour".[10]

The Facts and the Judgments

The facts of the *Canaero* decision were the following: Canadian Aero Service Ltd. ("Canaero") was a wholly owned subsidiary of an American corporation which in turn was controlled by Litton Industries. Canaero's main business was topographical mapping and geophysical exploration, a highly specialized business which required

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[7] S.117(1)(a) of the new *Canada Business Corporations Act, supra,* f.n.1, expressly imposes fiduciary duties on officers as well as directors and it may therefore be seen as a codification of the common law on this point.

[8] Both these rules apparently owe their origin to a statement by Lord Herschell in *Bray* v. *Ford* [1896] A.C. 44 (H.L.):

> "It is an inflexible rule of a Court of Equity that a person in a fiduciary position ... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict" (at 51).

See generally McLean, *The Theoretical Basis of the Trustee's Duty of Loyalty* (1969) 7 Alta.L.Rev. 218.

[9] See *New Zealand Netherlands Society "Oranje" Inc.* v. *Kuys and the Windmill Post Ltd.* [1973] 1 W.L.R. 1126, [1973] 2 All E.R. 1222, [1973] 2 N.Z.L.R. 163. See generally Sugarman, *Seeing Through the Double-Dutch of Corporate Opportunity?* (1974) 52 Can.Bar Rev. 280.

[10] *Supra,* f.n.6, 384.

competent staff. Among the members of the staff were the defendants O'Malley and Zarzycki, who were respectively president and executive vice-president of Canaero. Neither man had actually served on the board of directors of the company.[10a]

Since Canaero's business success hinged on its obtainment of contracts with foreign countries through the intermediary of the External Aid Department, the defendants[11] were required to perform promotional work on behalf of Canaero with a view to obtaining contracts for topographical mapping. Canaero had sent the defendants to Guyana on several occasions for the purpose of developing and procuring a contract for the topographical mapping of Guyana ("the Guyana project"). The defendants' efforts were temporarily unproductive due to the political climate in Guyana at the time. Subsequently, however, negotiations were resumed and the defendants were once again charged with this responsibility. Just as the Guyana contract was about to materialize, however, the defendants resigned their positions in Canaero on the apparently justified pretext that their freedom of action was curtailed by the domineering Litton Industries.

Shortly prior to Canaero's acceptance of the resignations, the defendants incorporated a company named Terra Surveys Inc. whose line of business was identical to that of Canaero. The Canadian External Aid Office was informed of the existence of this new company. Terra Surveys, in competition with several other companies including Canaero, was invited to submit a proposal for the mapping of Guyana. Terra's proposal was subsequently accepted and it was awarded the Guyana contract. An agreement was signed with the Government of Guyana to carry out the project for the sum of $2,300,000, the same amount that Canaero had requested if it obtained the contract. Canaero felt aggrieved by the situation and instituted an action against the defendants and Terra Surveys[12] for an accounting and payment of profits.

[10a] Although all three defendants had been appointed to the board of directors, the Trial Judge found as a fact that "no meetings of the board of directors or annual meetings of the company were ever in fact held" after the control of Canaero was acquired by Litton in 1964. See *infra,* f.n.13, 11-12 *per* Grant J.

[11] The "defendants" will henceforth be used to designate O'Malley and Zarzycki. The liability of Wells, an inactive director of Canaero who was never an officer thereof, will be considered separately.

[12] The defendants, if liable, could not escape the effects of a fiduciary duty by attempting to act through a corporation: *Patton* v. *Yukon Consolidated Gold Corp.* [1934] 3 D.L.R. 400 (Ont. C.A.).

The company sued the defendants in the High Court of Ontario for alleged breach of their fiduciary duties as directors thereof. It alleged that the defendants had breached their duty of loyalty and good faith in appropriating to themselves, shortly after their resignations, a corporate opportunity (the Guyana project) belonging to the company. The defendants O'Malley and Zarzycki having raised the irregularity of their appointment as directors as a defence, the principal issue that arose was the precise nature of the relationship between the defendants and the plaintiff company and whether or not the alleged irregularity in their appointment had any bearing on that relationship. In other words, the problem was primarily one of characterization: were the defendants employees or fiduciaries? Should the Court apply the principles of competition or those of corporate opportunity?

The Trial Judge held that he did not consider it necessary to determine whether or not the defendants were in fact directors[13] and stated that "[i]f there is liability on their part in this case, it must flow more from their activities as senior officers than as directors".[14] Grant J., basing himself on Lord Russell of Killowen's formulation of the profit rule in *Regal (Hastings) Ltd.* v. *Gulliver*,[15] stated the test of liability as follows:

> It is not the coming upon or learning of the proposed contract while directors [or senior executive officers] that establishes liability, *but rather obtaining the same because of such fiduciary position and in the course of their duties as such.*[16]

The Trial Judge held that although the defendants owed a fiduciary duty to Canaero by reason of their positions as senior managerial

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[13] (1970) 61 C.P.R. 1, 16 *per* Grant J.

[14] *Ibid.*, 15.

[15] [1942] 1 All E.R. 378, 389 (H.L.):

"In the result, I am of the opinion that the directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares *by reason and only by reason of the fact that they were directors of Regal and in the course of the execution of that office,* are accountable for the profits which they have made out of them" (italics added).

Lord Wright stated the profit rule as follows:

"... an agent must account for net profits secretly (that is, without the knowledge of his principal) acquired by him *in the course of his agency*" (at 392; italics added).

[16] *Supra,* f.n.13, 39 (italics added). This test is based on a narrow interpretation of *Regal, supra,* f.n.15, and *Peso Silver Mines Ltd., supra,* f.n.5. This narrow interpretation has been criticized by Beck, *The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered* (1971) 49 Can.Bar Rev. 80, 105-106, but approved by Ballem, Comment, (1952) 30 Can.Bar Rev. 179, 194-185.

officers thereof,[17] no breach of duty had been established for two reasons. Firstly, the defendants had not used any confidential information belonging to Canaero in their preparation of the Terra proposal.[18] Consequently, they did not obtain the Guyana contract *because of their fiduciary position.* Secondly, since the defendants had resigned before they obtained the said contract, they did not derive the impugned profit *while in the course of their duties as such.* For these reasons, Grant J. dismissed Canaero's action. Canaero appealed the decision.

In the Ontario Court of Appeal,[18a] MacKay J.A. examined the power structure within the Litton Group and concluded that the defendants' appointment to their respective positions as president and vice-president was irregular[19] and that their authority was curtailed to such an extent[20] that they were mere employees "with imposing titles but without the authority ordinarily attaching to such titles".[21] As employees, therefore, the defendants were not "within the classification of persons to whom the [equitable] principle ... applied";[22] and, even assuming that they were, they did not fall

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[17] Grant J. adopted Professor Gower's thesis, *supra,* f.n.4, that:

> "... these [fiduciary] duties, except insofar as they depend on statutory provisions expressly limited to directors, are not so restricted but apply equally to any officials of the company who are authorized to act on its behalf and in particular to those acting in a managerial capacity. This is a matter of considerable importance now that it is common for the management of public companies to be delegated by the board [of directors] to a smaller body."

See also *Bell* v. *Lever Bros.* [1932] A.C. 161; *Reading* v. *Att.Gen.* [1951] A.C. 507; and *Re Faure Electric Accumulator Co.* (1889) 40 Ch.D. 141, 151.

[18] *Supra,* f.n.13, 18.

[18a] (1971) 23 D.L.R. (3d) 632.

[19] *Ibid.,* 634 *per* MacKay J.A.: the defendants "were entered on the books as holders of these positions on the instructions of a senior official of Litton".

[20] The curtailment of the defendants' administrative authority consisted in the fact that they "were required to obtain approval from Litton for any expenditures including travelling expenses more than $100", and that they "had no authority to employ or discharge senior personnel": *ibid.* One should not, however, confuse administrative functions with agential functions such as negotiating a contract on behalf of the company. It must be pointed out that the Court of Appeal implicitly endorsed Grant J.'s view that promotional work does not constitute negotiation and that the negotiation stage had not yet been reached at the time of the defendants' resignations. See *infra,* "Prior Negotiations: an Agential Function".

[21] *Ibid.*

[22] *Ibid.,* 642. Mackay J.A. appears to be of the opinion that only directors fall within this classification. A more correct view, it is submitted, is that taken by Arnup J. in *Laskin* v. *Bache & Co.* [1972] 1 O.R. 465, 472, 23 D.L.R. (3d) 385, 392 (C.A.):

> "In my opinion the category of cases in which fiduciary duties and

within the *Regal* principle[23] for the reasons stated by the Trial Judge.

The Supreme Court of Canada, in a unanimous decision delivered by Laskin J. (as he then was), held that the amount of control exercised by Litton Industries over the officers of Canaero was mere "supervision" which did not reduce Zarzycki and O'Malley to mere marionettes.[23a] Rather, the defendants were "top management" whose duty to the company was "similar to that owed to a corporate employer by its directors".[24] The basis for thus assimilating the defendant officers to directors was that they had acted as agents of the company in respect to the Guyana project: they had conducted negotiations on behalf of Canaero in their attempt to procure the Guyana contract and could not subsequently negotiate on their own behalf.[25] Secondly, the Court held that the Trial Judge's narrow conception of the equitable rule as requiring the profit to be obtained while in the course of duty was mistaken in view of Canaero's prior and continuing interest in the opportunity.[26] It is submitted that the *Canaero* decision rests upon these two "touchstones of liability"; namely, the prior negotiations and the company's continuing interest.

I. Prior Negotiation: An Agential Function

It is submitted that upon a functional analysis[27] of the defendants' responsibilities, the Supreme Court judgment regarding them as agents of Canaero is uncontroverted by the facts. The functional approach, as the name suggests, is concerned with functions, not

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obligations arise from the circumstances of the case and the relationship of the parties is no more 'closed' than the categories of negligence at common law."

[23] *Supra*, f.ns.15 and 16.

[23a] The defendant Wells however, was at no time an officer of Canaero and Litton's control effectively prevented him from performing agential functions with respect to the Guyana project. In effect, he did not participate in any manner whatsoever in the promotional work done by O'Malley and Zarzycki. Consequently, the scope of Wells' agency was restricted, and the fact that he was nominally a director could not result in condemnation if the facts showed, as they did, that he had not participated in the promotional work on behalf of Canaero.

[24] *Supra*, f.n.6, 380. Laskin J. adopted Gower, quoted *supra*, f.n.17.

[25] *Ibid.*, 382.

[26] *Ibid.*, 390-391.

[27] It is to be noted that the nomenclature used herein to describe the various approaches is novel in the company law context. The idea, however, is not novel. See generally Sugarman, *supra*, f.n.9, 281, where he states that:

"[e]mphasis on the scope of duty prevents the determination of the ambit of the beneficiary's interest [and the fiduciary's duty] from being telescoped into a question-begging exercise".

titles. It consists in an examination of the scope of duties to determine the fiduciary's liability and, indeed, to determine whether or not he is a fiduciary. An illustration of this approach is *Cook* v. *Deeks*[27a] where Lord Buckmaster stated that the question whether the plaintiff company was entitled to claim from the defendants the benefit of a certain contract

> ... cannot be properly answered by considering the abstract relationship of directors and companies; the real matter for determination is what, in the special circumstances of this case, was the relationship that existed between Messrs. Deeks and Hinds and the company that they controlled. Now it appears plain that the entire management of the company, so far as obtaining and executing contracts in the east was concerned, was in their hands, and, indeed, it was in part this fact which was one of the causes of their disagreement with the plaintiff.[27b]

Where the individual acts in a representative capacity, fiduciary duties flow from the fact of agency, not from the fact that he is called a "director" or "officer". As Professor Palmer has pointed out,

> ... fiduciary obligations are imposed on directors *because of the work they perform.* It is for this reason that the same duties may extend to the members of the management whether or not they are also directors.[28]

The functional approach, with its emphasis on function and scope of duty, is to be contrasted with what may be called the "nominalist" fallacy exposed by defence counsel in *Phipps* v. *Boardman.* There it was argued that it is a fallacy to

> ... first impose [on the defendants] all the duties and obligations of a general agent and then ask whether, on that assumption, the [defendants] have divested themselves of their fiduciary duty. The first question is whether the [defendants] were agents at all, and if so, what were the terms on which they were expressly or impliedly appointed.[28a]

The question, therefore, is whether the functions actually performed by defendants O'Malley and Zarzycki indicate that they acted as agents of Canaero with respect to the Guyana contract. A brief review of the work performed by the defendants indicates that in 1961 O'Malley had engaged in "[p]romotional work to persuade the local authorities [of Guyana] that Canaero was best equipped to carry out the topographical mapping".[29] In May 1962, Zarzycki had spent several days in Guyana meeting with government officials.[30] In 1965, Zarzycki prepared a "sales-slanted" proposal which was

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[27a] *Supra,* f.n.5.
[27b] *Ibid.,* 561.
[28] *Supra,* f.n.2, 369 (italics added).
[28a] [1967] 2 A.C. 46, 63.
[29] *Supra,* f.n.6, 375 *per* Laskin J.; see also Grant J., *supra,* f.n.13, 16.
[30] *Supra,* f.n.6, 375.

submitted to a Guyana cabinet minister for consideration,[31] and just prior to their resignations, both O'Malley and Zarzycki had met with the Prime Minister of Guyana during his visit to Ottawa.[32] Under these circumstances, Laskin J. concluded that the defendants were agents of the company with respect to the Guyana contract. As agents, therefore,

> O'Malley and Zarzycki stood in a fiduciary relationship to Canaero, which in its generality betokens loyalty, good faith and avoidance of a conflict of duty and self-interest. Descending from the generality, the fiduciary relationship goes at least this far: a director or a senior officer like O'Malley or Zarzycki is precluded from obtaining for himself, either secretly or without the approval of the company (which would have to be properly manifested upon full disclosure of the facts), any property or business advantage either belonging to the company or for which it has been negotiating; *and especially is this so where the director or officer is a participant in the negotiations on behalf of the company.*[33]

Reference has been made several times to the fact that the defendants performed promotional work on behalf of Canaero. Laskin J. refers to this work as "negotiations".[34] But while there is no doubt that actual negotiation of a contract on behalf of a company constitutes an agential function[35] which, in the absence of full dis-

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[31] *Ibid.*, 378; Grant J., *supra*, f.n.13, 17-18, describes the precise nature of this proposal:

> "The proposal is obviously an attempt to persuade [the Guyana] government to undertake the work therein with the hope that by giving them the guidance that the proposal provides and other help in connection with the application for the loan necessary to provide funds therefor, that the contract for the work might be directed to the plaintiff company. Dr. Zarzycki describes the same as half technical and half sales promotion but actually *more sales slanted*" (italics added).

[32] *Supra*, f.n.6, 377; *supra*, f.n.13, 19.

[33] *Supra*, f.n.6, 381-2 (italics added).

[34] *Ibid.*

[35] See *Cook* v. *Deeks*, *supra*, f.n.5. In this case, the Toronto Construction Company was controlled by four directors, the three defendants and the plaintiff. The defendants and the plaintiff Cook had a dispute over the management of the company, whereupon the three defendants secretly agreed amongst themselves that they would negotiate on their own behalf for a contract in which the company was interested. The defendants continued as directors of the company, and it was only after the negotiations were completed that the defendants formed a new company to execute the contract they had appropriated to themselves. The Court held that the defendants

> "were not at liberty to sacrifice the interests which they [were] bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent" (*per* Lord Buckmaster, at 563).

closure by the fiduciary[36] or cessation of interest on the part of the corporation,[37] prohibits the agent from subsequently negotiating for the contract on his own behalf, it is submitted that there was ample evidence to suggest that the defendants had not in fact negotiated but had merely done "promotional work"[38] on behalf of Canaero. The Supreme Court decision seems to be predicated on the assumption that the defendants had negotiated or that promotional work constitutes negotiation. The work performed by the defendants consisted in "manoeuvering" "to get the selection of the contractor made in Guyana",[39] and attempting to persuade the authorities that Canaero was the best contractor for the job. It did not involve the actual negotiation of the terms of the eventual contract. This is clear from the finding of fact made by the Trial Judge in the High Court of Ontario:

> It is to be noted that the proposals are not based on price but the purpose of the [External Aid Department's] report is the selection of the contractor. *Following that,* the one chosen to do the work negotiates with the [Canadian] Government as to price and other terms of the contract.[40]

The implication here is that there is a distinction between promotional work and negotiation, and that the negotiation stage had not been reached when the defendants resigned from Canaero. This is the reason why the Trial Judge did not think that the

> ... mere fact of learning of the contract *or even doing extensive work and preparation in attempts to secure the same for the plaintiff* while they

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[36] *Furs Ltd.* v. *Tomkies* (1936) 54 C.L.R. 583. It is not entirely clear what facts the defendants in the *Canaero* case should have disclosed to their principal. The Trial Judge held that there was "no obligation to tell the employer about the application or the actual incorporation of Terra". Moreover, it was held that Canaero knew of the defendants' association with Terra on the day of Zarzycki's resignation (O'Malley had resigned several days before). See *supra,* f.n.13, 33. Since the obtainment of the Guyana contract by the defendants was not a certainty at the time of their resignations, it is submitted that the only duty to disclose, if any existed, related to the defendants' intention to compete with Canaero. Laskin J., however, merely refers to the duty to disclose in an *obiter* remark and does not suggest that such a duty actually existed in the Canaero case: *supra,* f.n.6, 382, 384.

[37] *Peso Silver Mines Ltd.* v. *Cropper, supra,* f.n.5. Some Canadian writers have suggested that cessation of interest should be rejected as a defence. See Beck, *supra,* f.n.16; and Prentice, *Director's Fiduciary Duties — The Corporate Opportunity Doctrine* [1972] 50 Can.Bar Rev. 623, 632.

[38] The promotional work consisted in "persuading the local authorities that Canaero was best equipped to carry out the topographical mapping"; *supra,* f.n.6, 375 *per* Laskin J.

[39] These are O'Malley's own words in a letter to a senior officer of Litton Industries: *supra,* f.n.13, 20.

[40] *Per* Grant J., *supra,* f.n.13, 24 (italics added).

> were still in their offices for it, of itself prevents them, after severing relations with their employer, from seeking to acquire it for themselves.[41]

The Supreme Court judgment, however, can be interpreted as meaning that promotional work constitutes part of the negotiation process and is therefore an agential function which prohibits the agent from subsequently negotiating on his own behalf. If interpreted too widely, this might mean that the slightest contact with a corporate opportunity will render the corporate officer (or ex-officer) liable to account if he subsequently obtains it for himself. If interpreted this way, the *Canaero* decision may indeed unduly restrict the officer's post-employment right to compete with his corporate employer,[41a] especially since the "strict ethic" of the equitable principle regards the absence of restrictive covenants and the lack of confidential information[42] as irrelevant considerations. Nevertheless, this does appear to be consistent with the deterrent approach[42a] in corporate opportunity cases, which requires directors and officers to comply with "norms of exemplary behaviour".[43] These norms may vary according to whether the defendant is merely a nominal director or an executive officer. Thus a nominal director such as the defendant Wells is free to engage in post-employment competition with his corporate employer, whereas executive officers such as O'Malley and Zarzycki are not.

II. The Continuing Interest Doctrine: Beyond the Profit and Conflict Rules?

Having ascertained that the defendants were agents of Canaero with respect to the Guyana project, the problem then became whether there had been a breach of the fiduciary duty flowing from that relationship. As most of the decisions relating to breach of fiduciary duty have been concerned with breaches while in the course of duty,[43a] the difficulty that arose in *Canaero* was that the contract for

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[41] *Ibid.*, 39 (italics added).

[41a] Palmer, *supra*, f.n.2, 382.

[42] Laskin J., *supra*, f.n.6, 388, stated that the confidentiality of the information has no relevance in determining whether there has been a breach of fiduciary duty. See also Beck, *supra*, f.n.16, 111-112. For a discussion of the cases relating to confidential information, see Wright, *Confidentially Speaking Equity in Industrial Property Matters* (1970) 61 C.P.R. 53.

[42a] See generally Waters, *Law of Trusts in Canada* (1974), 619-620, 642, 651; see also Beck, *supra*, f.n.16, 87.

[43] *Per* Laskin J., *supra*, f.n.6, 384.

[43a] *Regal (Hastings) Ltd.* v. *Gulliver*, *supra*, f.n.15; *Cook* v. *Deeks*, *supra*, f.n.5; *Peso Silver Mines Ltd.* v. *Cropper*, *supra*, f.n.5. A notable exception is *Industrial Development Consultants* v. *Cooley* [1972] 2 All E.R. 162. This

the Guyana project was not concluded by the defendants until after they had resigned their positions as senior officers of Canaero. The Trial Judge concluded that the defendants were not in breach of their fiduciary duty because

> [i]t is not the coming upon or learning of the proposed contract while directors that establishes liability, but rather obtaining the same *because of such fiduciary position and in the course of their duties as such.*[44]

The Trial Judge, therefore, saw the judicial formulations of the equitable principle in *Peso*[45] and *Regal*[46] as formulas within which the facts of each case must fall in order for liability to ensue.[47]

Laskin J., however, considered this view as "too narrowly conceived"[48] and thought that it was a mistake

> ... to seek to encase the [equitable] principle ... in the straitjacket 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 such offices.[49]

After stating that the conflict and profit rules should not be considered as "exclusive touchstones of liability",[50] Laskin J. proceeded to impose liability on the defendants on the basis of what may be called the "continuing interest" test. Although this test seems to be referred to merely *en passant*,[51] it is submitted that it

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latter decision was not cited in the High Court and Court of Appeal of Ontario because it had not yet been rendered. It was, however, cited in the Supreme Court and it is submitted that this is one of the reasons for the diverging views of the Supreme Court on this matter.

[44] *Supra*, f.n.13, 39 (italics added).

[45] *Supra*, f.n.5, 8 *per* Cartwright J.

[46] *Supra*, f.n.15.

[47] The Court of Appeal implicitly endorsed this view: *supra*, f.n.18a, 642.

[48] *Supra*, f.n.6, 387.

[49] *Ibid.*, 390.

[50] *Ibid.*, 383.

[51] Laskin J. refers to Canaero's "priority" (at 390), Canaero's "continuing interest" (at 389), and to its "prior and continuing interest" (at 372). The nature of this interest was clearly pecuniary. On the one hand, Canaero had incurred expenses in preparing the Guyana project. It made preliminary surveys and proposals, it sent its officers to Guyana to persuade the local authorities that Canaero was best equipped to carry out the project, and it even invested $75,000 for an aerodist (an airborne electronic distance-measuring device) especially for that project. On the other hand, the pecuniary interest was also the eventual profit that Canaero would derive if it succeeded in obtaining the Guyana contract. Laskin J. appeared to be sympathetic towards Canaero because it "risked initiative and expenditure in preparatory work for projects without assurance of return in the form of contracts" (at 375). It is to be noted, however, that the Trial Judge regarded these expenditures as deductible business expenses, similar to advertising, which did not give Canaero more of a right to the corporate opportunity

constitutes — along with the prior negotiations — one of the "touchstones of liability" in the *Canaero* decision. In effect, it seems logical to say that if Canaero had a prior and continuing interest in the Guyana project, the defendants should have a corresponding duty to pursue the opportunity on behalf of Canaero, or, having resigned, to respect Canaero's priority in the opportunity. Laskin J. appears to base his judgment on that logic. It is because Canaero had a prior and continuing interest that

> O'Malley and Zarzycki continued, after their resignations, to be under a *fiduciary duty to respect Canaero's priority,* as against them and their instrument Terra, in seeking to capture the contract for the Guyana project.[52]

The defendants' resignations prior to the maturation of the project, therefore, did not operate to extinguish their liability for breach of fiduciary duty. Put in another way, the defendants' resignations could not operate to sever their accountability to Canaero because their fiduciary duty survived the tenure of their offices. The rationale for this proposition was admirably stated by Botein J. in the American case *Albert A. Volk Inc.* v. *Fleschner Bros. Inc. et al.:*

> Were the rule otherwise, the fiduciary obligation would disintegrate by resignation of the fiduciary whenever the attraction of personal gain at the expense of the *cestui que trust* proved stronger than what would then be an unenforceable moral obligation.[53]

That the defendants' decision to resign may have been motivated by a desire to enrich themselves can be inferred from the fact that they "entered the lists in the heat of the maturation of the project".[54] In fact, the defendants' resignations were prompted by several factors, including their increasing disenchantment with the domineering Litton Industries.[55] However, the most important factor was that the defendants learned that the Canadian Government had adopted a policy of preferring Canadian controlled firms in the awarding of external aid contracts. Since Canaero did not qualify as a Canadian controlled firm, in all probability the defendants

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than it otherwise would have had: *supra,* f.n.13, 48. The true pecuniary interest involved, therefore, was the eventual profit to be derived from the Guyana contract. The Supreme Court awarded Canaero $125,000 for the loss of such contract.

[52] *Supra,* f.n.6, 390-391 (italics added).

[53] 60 N.Y.S. (2d) 244, 245 (1945). See also *Ex Parte James* (1803) 8 Ves. 337, 32 E.R. 385, 390; *Pre-Cam Exploration & Development Ltd.* v. *McTavish* [1966] S.C.R. 551; *Mile-O-Mo Fishing Club Inc.* v. *Noble* 210 N.E.(2d) 12 (1965); *Industrial Development Consultants Inc.* v. *Cooley, supra,* f.n.43a.

[54] *Supra,* f.n.6, 391.

[55] *Supra,* f.n.13, 26.

honestly[56] thought that Canaero's chances of success had diminished considerably. Consequently, they decided to go into business for themselves in an attempt to encourage "local initiative". The Canadian Government, however, had made the decision to invite Canaero to submit a proposal several days before the defendants' resignations.[57] It is for that reason that Laskin J., while considering the issue of good faith to be irrelevant, found it difficult to believe that it was mere coincidence that the defendants resigned when the project was about to materialize, and suspected that their resignations "were prompted by a wish to acquire for [themselves] the opportunity sought by the company".[58]

The case, it is submitted, could therefore have been decided solely on the basis of *Industrial Development Consultants Inc.* v. *Cooley*[58a] where Roskill J. held that the defendant, a former managing director of the plaintiffs who resigned on the false pretext of ill-health, had "embarked on a deliberate policy and course of conduct which put his personal interest as a potential contracting party with the Eastern Gas Board in direct conflict with his *pre-existing and continuing duty as managing director* of the plaintiffs".[59] In *Cooley* the third party was unwilling to contract with the plaintiff company; the Court held that the defendant's duty as managing director of the plaintiff company was precisely to "try and persuade [the third party] to change their minds".[60]

It can therefore be said that in *Canaero* (where the Government's policy was to prefer Canadian controlled firms in awarding contracts), the defendants' resignations at a moment when the Guyana contract was about to materialize put them in a situation where their personal interests came into conflict with their pre-existing and continuing duty to pursue the contract on behalf of Canaero. Since

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[56] *Ibid.*, 30. Grant J. held that "no scheme was devised [by the defendants] that [Terra Surveys] should be used as an instrument to destroy Canaero's opportunity of getting the Guyana contract" (at 31). However, it should be pointed out that good faith is irrelevant in determining whether there has been a breach of fiduciary duty, as a fiduciary's "liability to account does not depend upon proof of *mala fides*": *Regal (Hastings) Ltd.* v. *Gulliver, supra,* f.n.15, 381 *per* Viscount Sankey; see also Laskin J., *supra,* f.n.6, 389.

[57] The decision was taken on August 18, 1966. Canaero did not receive the Government's invitation to submit a proposal until August 23rd: *supra,* f.n.13, 23. Canaero accepted O'Malley's resignation on the 26th and Zarzycki's on the 29th of August. Wells' resignation had been tendered in February, 1965.

[58] *Supra,* f.n.6, 382.

[58a] *Supra,* f.n.43a.

[59] *Ibid.*, 174 (italics added). See generally Prentice, *supra,* f.n.37.

[60] *Ibid.*, 176.

the defendants' resignations were not accompanied by disclosure of their intention to compete, their positive duty to pursue the contract on behalf of Canaero became transmogrified into a continuing negative "hands-off" duty to "respect Canaero's priority" in the opportunity. A continuing *affirmative* obligation would have implied that the defendants were not entitled to resign until they had accomplished the mission with which they had been charged; namely, the obtainment of the contract on behalf of Canaero.[61] It is submitted that Laskin J. did not go that far. He did, however, go farther than Grant J.[62] and MacKay J.,[63] both of whom appeared to content themselves with the finding that prior to their resignations the defendants had done everything in their power to obtain the Guyana contract on behalf of Canaero. Laskin J., however, did not think that sufficient to exonerate the defendants and imposed upon them a negative duty to avoid competing for an opportunity in which Canaero had a prior and continuing interest.

Traditionally, the only defence open to a fiduciary in an action for an accounting and payment of profits has been full disclosure to[64] and approval by the principal or *cestui que trust*.[65] Recently, however, a second defence seems to have developed: absence of conflict between duty and interest as a result of the corporation's cessation of interest in the opportunity.[66] Laskin J. seems to have facitly reaffirmed this new defence. He distinguished the *Peso* case,[66a] where it was held that the defendants were not required to account for the profits they had made as a result of a speculative transaction con-

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[61] Fridman, *The Law of Agency* 3d ed. (1971), 303, says:

"Aside from any agreement between principal and agent, or any unilateral act by either of them, the relationship between principal and agent will terminate when the transaction which has been undertaken has been performed."

It is to be noted, however, that in the *Canaero* case there was a *bilateral act* purporting to end the relationship: (1) the defendants' resignations; and (2) the plaintiff's acceptance of these resignations. Consequently, no continuing affirmative duty to obtain the contract on behalf of Canaero could be presumed. Laskin J. ingeniously circumvented that difficulty by superimposing a negative duty. This analytically tortuous reasoning can only be justified on policy grounds: see *supra*, f.n.6, 384.

[62] *Supra*, f.n.13, 21-22, 29.

[63] *Supra*, f.n.18a, 636.

[64] *Furs Ltd.* v. *Tomkies*, *supra*, f.n.36.

[65] *Ex Parte James*, *supra*, f.n.53.

[66] *Peso Silver Mines Ltd.* v. *Cropper*, *supra*, f.n.5. Repeated pleas have been made to reject such a defence: see Beck, *supra*, f.n.16; and Prentice, *supra*, f.n.37, 632.

[66a] *Supra*, f.n.5.

cerning mining claims because the company's interest in the claims had ceased when the board of directors, acting in good faith, decided not to acquire the claims. The implication was that because of the company's *bona fide* rejection of interest in the claims, there was no possibility of conflict between duty and self-interest on the part of Cropper, a director of the company.[67] In the *Canaero* case, on the other hand, the possibility of a conflict between duty and self-interest was very real because the defendants had not disclosed their intention to the shareholders or directors and there had not been any rejection of the opportunity by the corporation.

Conclusion

It is submitted that if the foregoing analysis is correct, the *Canaero* decision constitutes a reaffirmation of the conflict rule.[68] Nevertheless, it is to be noted that the conflict and profit rules will no longer be considered as "exclusive touchstones of liability", *i.e.*, these judicial formulations of the equitable rule should not be applied as rigid formulas within which the facts of each case must fall in order for liability to ensue. The rationale for this flexible approach is that "new fact situations may require a reformulation of existing principle to maintain its vigour in the new setting".[69] It was for this reason that Laskin J. adopted a case by case approach to the problem of corporate opportunity:

> The general standards of loyalty good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior

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[67] *Ibid.* It is to be noted that Laskin J. also distinguished the *Peso* case on the ground that "there was evidence that Peso had received many offers of mining properties and ... the acquisition of the particular claims out of which the litigation arose could not be said to be essential to the success of the company": *supra*, f.n.6, 390. Laskin J. is implicitly using the *Lagarde* formula ("seizure by the executive of an opportunity of major importance to the corporation"): *Lagarde* v. *Anniston Lime & Stone Co.* 126 Ala. 496, 28 So. 199 (1900). See generally Note, *Corporate Opportunity* (1961) 74 Harv.L.Rev. 765. It is submitted that Laskin J. rightly employed this test, as there was evidence that Canaero had not obtained any contracts since 1964. See *supra*, f.n.13, 21, where Grant J. cites a letter by the Canadian Secretary of State for External Affairs to the president of the Air Transport Association of Canada to the effect that "the last contract actually awarded to a wholly foreign controlled firm was in 1964".

[68] See *Aberdeen Railway Co.* v. *Blaikie Bros.* (1854) 1 Macq. 461; *Phipps* v. *Boardman, supra*, f.n.28a; *Industrial Development Consultants Inc.* v. *Cooley, supra*, f.n.43a.

[69] *Supra*, f.n.6, 383.

> officer must conform, *must be tested in each case* by many factors which it would be reckless to attempt to enumerate exhaustively.[70]

It appears that Laskin J.'s approach in *Canaero* is quite similar to that taken by Lord Green M.R. in *Hivac Ltd.* v. *Park Royal Scientific Instruments Ltd.* where the learned Judge pointed out "the danger of laying down any general proposition and the necessity of considering each case on its facts".[71]

It is submitted that the *Canaero* decision is itself a *cause d'espèce* and cannot be interpreted to have the effect of abolishing the conflict and profit rules. Rather, it makes them two among many possible guidelines to be used in determining whether there has been a breach of a fiduciary duty. The introduction of this more flexible — though perhaps less predictable — approach in Canadian company law will likely make this area of the law even more uncertain. Nevertheless, it is submitted that the conflict and profit rules will continue to be useful "touchstones" in determining whether there has been a breach of fiduciary duty under section 117(1)(a)[72] of the new *Canada Business Corporations Act.*

Michelangelo Iacono*

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[70] *Ibid.*, 391 (italics added).

[71] [1946] 2 All E.R. 350, [1946] Ch. 169, 175. See also *Phipps* v. *Boardman, supra,* f.n.28a, 123 *per* Lord Upjohn.

[72] *Supra,* f.n.1. This section reads as follows:

> "117.(1). Every director and officer of a corporation in exercising his powers and discharging his duties shall
>
> a) act honestly and in good faith with a view to the best interests of the corporation; ...".

This section is a skillful attempt to codify the common law fiduciary duty; see the *Dickerson Report* (1972), 81, para.237. It is "largely declaratory of the common law": *Detailed Background Paper for the New Canada Business Corporations Bill,* 14.

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