> normally done with the object of preserving the property intact for the ultimate beneficiary. And I find it difficult to accept a construction which would in the present case reduce the value of the corpus of these trusts to less than one-third of their value at the time of the testator's death a little over six months ago or to believe that such was the testator's intention."

This judgment is in accordance with earlier decisions.[34]

Of comparative interest, in attempting to achieve an overview of the rules just discussed, is the provision of section 5 of the American Uniform Principal and Income Act, which is that all dividends payable in the shares of the corporation shall be deemed principal, and other dividends, including ordinary and extraodrinary dividends and dividends payable in shares or other securities or obligations of corporations other than the declaring corporation, shall be deemed income. Where the trustee has the option of receiving a dividend in cash or in stock of the declaring corporation, it is income regardless of the choice made by the trustee. It is submitted that in the final analysis Australian case law is moving pragmatically in this direction, although it has the capacity to deal with other possibilities.

Lastly it is perhaps proper to point out that the principles just discussed, for the purposes of determining whether company dividends are distributions or capitalisations in relation to the rights inter se of successive beneficiaries under a trust, having nothing whatever to do with the definition of capital and income for the purposes of fiscal legislation. The definition of capital and income in fiscal legislation is exclusively a matter of the interpretation of the given legislation.[35]

34. See per Griffith C.J. (quoting Lord Eldon) in *Mitchell* v. *Hart* (1914) 19 C.L.R.33 at p. 40 and *Re Speir* [1924] 1 Ch.359.
35. See *Commissioner of Income Tax (Queensland)* v. *Brisbane Gas Co.* (1907) 5 C.L.R.96 per Griffith C.J. at pp. 104-5.

Exploiting the Rejected Corporate Opportunity

P.A. Butler*

In the case of *Queensland Mines Ltd.* v. *Hudson*[1] the Privy Council was concerned with the resolution of the problem of whether or not a director should be made liable to account for profits accruing from the exploitation of a business opportunity or advantage specifically renounced by his company. The problem, which was left unanswered in *Regal (Hastings) Ltd.* v. *Gulliver*[2] was decided upon in the director's favour by the Supreme Court of Canada in *Peso Silver Mines Ltd* v. *Cropper*.[3] But that decision was much criticised by some

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1. (1978) 52 A.L.J.R. 399.
2. [1967] 2 A.C. 134n.
3. (1966) 58 D.L.R. (2d) 1.

commentators,[4] and although not overruled, has been subsequently distinguished on its own facts by the court in *Canadian Aero Service Limited* v. *O'Malley* (Canaero).[5] The judgment of the Privy Council in *Queensland Mines Ltd* v. *Hudson* which reversed on the facts the decision of Wootten J.[6] in the Supreme Court of New South Wales reflects the more lenient stance of *Peso* and represents a relaxation of the strict approach previously adopted by it in *Cook* v. *Deeks*[7] and by the House of Lords in *Regal* and *Boardman* v. *Phipps*.[8]

The facts in *Queensland Mines Ltd* v. *Hudson* were as follows. In 1959 Queensland Mines Ltd., the appellant-plaintiff, was formed by Hudson, the respondent-defendant, and one Stanley Korman, at that time a major figure in Australian business and financial circles. The company was formed for the purpose of exploiting an option over Anderson's Lode, an area known to contain uranium. The option was held by Australasian Oil Exploration Ltd. (AOE) which was almost wholly owned by Kathleen Investments Ltd. Hudson was chairman and managing director of AOE and managing director of Kathleen Investments. AOE lacked the finance necessary to take up the option. Pursuant to the agreement between Hudson on behalf of AOE and Korman, a forty-nine percent interest in the shares of Queensland Mines was allocated to AOE, and fifty-one percent to Factors Ltd., a company controlled by Stanhill Consolidated Ltd., the holding company of the Korman family. Factors thereby gained two appointees to Queensland Mine's three-man board to AOE's one. Throughout the relevant period the Chairman was a Factors' appointee and both Factors' appointees were also directors of Factors. AOE was represented by Hudson who was also managing director until his resignation in March 1961.

Although Queensland Mines had been ostensibly formed for one purpose, it soon became apparent that Hudson and Korman were prepared to use and did use the company to further the mining of iron ore. By the summer of 1960 the company's uranium activities had been "mothballed" until the uranium market became favourable. After investigations into iron ore mining in New Zealand had met with no success, Hudson commenced negotiations with the Tasmanian Government for the issue of exploration licences in connection with a venture for the exploitation of iron ore deposits in the Savage River district of Tasmania. During these negotiations Hudson used the resources and good name of Queensland Mines and in February 1961 succeeded in securing two mining exploration licences in his own name. In March 1961 Korman, his financial affairs now in a critical state, informed Hudson that there was no possibility of his proceeding with the licences because of lack of capital resources. A week later Hudson resigned from his position as managing director and informed the Tasmanian Government that

4. See Beck, *The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered* (1971) 48 Can. Bar Rev. 80; Prentice, (1967) 30 Mod. L. Rev. 450.
5. (1973) 40 D.L.R. (3d) 371.
6. (1977) C.C.H. A.C.L.C. 28, 658.
7. [1916] 1 A.C. 544.
8. [1967] 2 A.C. 46.

Korman had withdrawn. By the 30th May he was able to inform the Tasmanian Government that he had formed a company (the second defendant) to finance the project. Ultimately in 1966, after much effort, determination and personal expenditure, Hudson gained royalty rights to ore to be mined by subsidiaries of an American company.

The trial judge, Wootten J., in the course of an exhaustive judgment occupying 178 pages of the record, found that:

> "Mr Hudson has not established any informed consent to his appropriation of the opportunities on the part of Queensland Mines whether by directors, general meeting or shareholders, or any rejection of the opportunity which was not tainted by Mr Hudson's non-disclosure to the company of relevant facts".[9]

As far as the shareholders of Queensland Mines were concerned, Wootten J. pointed to the lack of evidence that Hudson ever informed AOE or its holding company, Kathleen Investments, that through his activities as managing director Queensland Mines had an interest in the licences. Even if Factors was aware of the relevant facts through the knowledge of their two representatives on the board, Wootten J. did not think it:

> "sufficient that there should be disclosure to one shareholder even if that shareholder may be a majority shareholder. It is not to be assumed that a majority shareholder would be immune to arguments and considerations advanced by a minority shareholder if an issue came to be considered by the shareholders as a whole, and, in any event, there are limits to the extent to which majority shareholders may impose their will on a minority".[10]

Applying the principles laid down by the House of Lords in *Regal* and in *Boardman* v. *Phipps*, Wootten J. held that there had been a breach of fiduciary duty by Hudson, but that the claim by Queensland Mines for an account of profits was statute barred through lapse of time.

On appeal to the Privy Council by Queensland Mines, Wootten J.'s finding as to lack of informed consent was set aside as untenable on the undisputed facts. Their Lordships concluded:

> "that in the circumstances there was after 13th February 1962 no real sensible possibility of a conflict of interest between Mr Hudson and Queensland Mines . . . "[11]
>
> "that by February 1962, at the latest, and possibly much earlier, the board of Queensland Mines, 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".[12]

Accordingly, there had been no breach of fiduciary duty by Hudson and therefore there was no liability on his part to account. It therefore became unnecessary to consider whether the action had become statute-barred, and the appeal was dismissed with costs.

In their Lordships' view after the rejection of the Tasmanian Iron

9. Op. cit., 28, 699.
10. Op. cit., 28, 699.
11. (1978) 52 A.L.J.R. 399, at p. 401.
12. Ibid., at pp. 403-404.

Ore Project by the board of Queensland Mines on 13th February 1962 due to lack of finance, the legal position could be expressed in either of two ways:

(1) "from that date the venture based on the licences 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

(2) "on that date Queensland Mines gave their fully informed consent . . . to leave Mr Hudson to do what he wished or could with the licences".[13]

The pivotal fact from which each legal position is said to be derived is the rejection of the opportunity by the board of directors. It is proposed to examine the two legal positions separately.

The first position whereby as a result of the board's rejection the corporate opportunity is placed outside the scope of the director's duty to his company would appear to be the approach which was adopted in *Peso*. In that case the defendant was a member of the six-man board of the plaintiff company which rejected on offer to purchase certain mining claims, mainly for financial reasons. Subsequently the defendant and two other directors of the company together with the company geologist formed a new company to purchase and exploit these claims. The plaintiff company, following a takeover and reshuffle of the board, claimed that the defendant held his shares in the new company on constructive trust for the plaintiff. The claim failed. The Supreme Court of Canada distinguished *Regal* on the ground that the defendant had acted in good faith in the initial decision of the board renouncing the claims. He was therefore free to take up a subsequent offer in his private capacity without being liable to account for his profit. Likewise, a similar approach to the effect of a rejection of a business opportunity was taken in *Consul Development Pty. Ltd* v. *D.P.C. Estates Pty. Ltd.*[14] In that case the High Court of Australia was concerned with examining the liability of Grey, an employee of a group of property development companies of which the plaintiff was one, and of the liability of a private company which had become involved through the activities of its managing director Clowes. Grey was under a duty to find suitable properties for purchase and had undertaken not to engage in real estate business other than for the group. Grey divulged information to Clowes about such properties which were then acquired by the defendant company. At the same time he informed Clowes, quite falsely, that the group was not interested in those properties for financial reasons. The plaintiff claimed that the properties were held in constructive trust for it. In the course of his judgment Gibbs J. said:

> "Did the fact that he was employed to find properties for purchase by the Walton companies mean that he would have been acting in breach of his duty if he had participated in the purchase of a property *once those*

13. Ibid.
14. (1975) 132 C.L.R. 373

companies had (uninfluenced by him) decided not to buy it. The answers to questions of this kind may of course vary in the different circumstances of particular cases. In the circumstances of the present case I have concluded that Grey would not have been in breach of his fiduciary duty to any of the Walton companies in buying a property which Walton had decided not to buy, *assuming that the decision made by the Walton companies had not been induced by Grey*, but had been forced upon them by their financial straits, *and also that in making his decision to buy, Grey was not acting on information gained from his position with the companies* . . . once Walton had decided not to buy the property there was no possibility that if Grey considered buying it he would be faced with a conflict between interest and duty — the property would have been removed from the ambit of his duties."[15] (Emphasis added).

Where the rejection of a business opportunity by a board of directors has the dual effect of not only depriving the company of the business opportunity, but also of facilitating its subsequent exploitation by some or all of the directors, it is difficult to see how a conflict of duty and interest for an individual director could be eliminated by such rejection.[16] Yet it will be a very exceptional situation in which a board's rejection of a business opportunity does not have this dual effect. One such exceptional instance, perhaps, might be where there is a considerable time lapse between the rejection by the board and subsequent utilisation by a director, unaccompanied by any change in the circumstances of the company and the market from those which prevailed at the time of the rejection. Thus this dual effect would have operated, it is suggested, in both *Regal* and *Peso*. In *Regal* the board had at first resolved that the company subscribe for all of the shares in the subsidiary before bona fide deciding to take up some of the shares themselves because the company though still interested could not afford it. In *Peso* the board from the outset bona fide rejected the mining claims on the company's behalf. In other words, *Regal* and *Peso* are in truth indistinguishable. On the other hand on the facts postulated in *Consul* the rejection could not have a dual effect as Grey was not a director but a company employee whose duty it was to recommend business opportunities, but who had no say in the ultimate decision. Will there be any cases in the normal company situation where a director on the board of management will not influence a decision to reject? Might it be argued that *Queensland Mines* v. *Hudson* could be equated with *Consul* if it were the other two directors and not Hudson who rejected the project on behalf of the company? The facts in the judgments, just as in *Peso*, do not reveal what attitude Hudson took to the licences at the board meeting.

Clearly where a director actually votes in favour of rejection he is influencing the decision. But even where a board member is not party to the rejection of a business opportunity, either because he votes in favour or because he abstains, he would have an indirect influence on the ultimate decision. Furthermore, it is submitted that to permit utilisation of the opportunity by such board member in the

15. Ibid., pp. 399-400.
16. See Prentice, op. cit., at p. 454.

circumstances is to tempt a man to be disloyal. It is readily foreseeable that a director might abstain from voting so as to be free to take up an opportunity rejected by the majority of the board, either for himself or on behalf of another company. And, with the same purpose in mind, it is also quite possible that a director might recommend the taking up of an opportunity, but on unreasonably inflated terms in anticipation of a rejection by the majority of the board when ordinarily his recommendation could be expected to be reasonable and acceptable.

But, even if the proposition is accepted that rejection of a business opportunity removed a director from the ambit of his fiduciary obligation not to permit his self-interest to conflict with his duty to pursue the opportunity for the company, is the director thereby always free to make use of that opportunity? The main ground of the majority decision in *Boardman* v. *Phipps* would indicate that a director may still be liable if he has misused his fiduciary position to gain the profit even where there is no conflict of duty and interest.[17] Some support for the operation of the "profit from position rule" independently of the "conflict rule" is also to be found in Gibb J.'s judgment in *Consul* previously quoted.[18] Thus in *Boardman* v. *Phipps*, although on a realistic view of the facts the trustees had clearly decided against purchasing additional shares, the defendants were liable because they wrongly held themselves out as representing the trust and thereby gained valuable information concerning the trust property. Likewise in *Queensland Mines* v. *Hudson* it could be argued that the defendant secured the licences by using the resources and good name of Queensland Mines and should be held liable, although rejection of the venture by the board had removed the possibility of a conflict between interest and duty.

The second way according to the Privy Council, in which the legal position in *Queensland Mines* v. *Hudson* could be expressed following the board meeting of the 13th February 1962 was to say that rejection in effect constitutes consent or authorisation of the director's conduct by the company. The question arises whether the board of a company is empowered to give such consent.

Wootten J. in his judgment emphasised as significant the absence of evidence that AOE or Kathleen Investments had been kept informed of the position regarding the licences.[19] The Privy Council rejected the necessity for such concern:

> "This could be relevant only if the matter of the licences could be said in the circumstances to fall outside the scope of the authority of the Board."[20]

It is undoubtedly true that the question whether an exploration licence should be exploited by the company is a managerial decision for the board. But it may be questioned whether the granting of the licences, and for no consideration, to one of its directors to exploit

17. [1967] 2 A.C. 46. per Lord Cohen at p. 103, per Lord Cohen at pp. 106-109, per Lord Hodson at pp. 115-117.
18. (1975) 132 C.L.R. 373 at p. 393; pp. 399-400. See also *Canaero* op. cit., at p. 384.
19. (1977) C.C.H. A.C.L.C.28, 658.
20. (1978) 52 A.L.J.R. 399 at p. 404.

for himself is "a board matter". The licences had already been issued by the Tasmanian Government to Hudson in his own name, but only as the result of the use of the resources and good name of Queensland Mines. It was therefore incontestable that the licences were "company property".

In certain circumstances it has been held that neither a majority of shareholders nor even all of the shareholders can consent to the giving away of company assets. This principle applies not only where it is a case of the majority making a gift of a corporate asset or advantage to themselves — the so-called "fraud on the minority" or "fraud on the company" situation.[21] But it also applies where fraud and the interests of minority shareholders are not in issue, that is, where the assent of all shareholders has been obtained but yet corporate assets are not being applied for the purposes of company business.[22] In perplexing contrast is the less stringent principle stated by the High Court of Australia in *Furs Ltd.* v. *Tomkies*[23] and by Lord Russell in *Regal*[24], that a director would not be liable if he had obtained the informed consent of the shareholders in general meeting. But whichever of these two principles is applicable, it would appear that a majority of a board of directors is not able to authorise a director to take up a corporate advantage for his own purposes.

When the facts of *Queensland Mines Ltd* v. *Hudson* are tested against these principles, it is clearly not a case of the majority making a gift of corporate property to themselves at the expense of a minority. But neither, it is submitted, is it a case of a corporate asset being applied for a corporate purpose. And even if the shareholder's ratification principle is applied, it is doubtful that the board of Queensland Mines could be said in effect to constitute the shareholders. The only facts revealed in the judgments were that AOE was *almost* wholly owned by Kathleen Investments, suggesting that there were still some other shareholders.[25] Furthermore, the fact that the Factors' directors on the board had control of the company, just as in *Regal*, would not remove the need for disclosure to a meeting of shareholders.[26]

Ultimately resolution of the problem of the exploitation of the rejected corporate opportunity must turn on the basic policy question as to how stringent should be the fiduciary obligations which regulate the activities of directors. The policy of protecting an established corporate enterprise needs to be balanced against that of the need not to discourage and shackle individual entrepreneurial talent. Wootten J.'s reading of the most recent English cases led him, cor-

21. *Cook* v. *Deeks* [1916] 1 A.C. 554; *Ngurli* v. *McCann* (1953) 90 C.L.R. 425.
22. *Hutton* v. *West Cork Railway Co.* (1883) 23 Ch.D. 654; *Parke* v. *Daily News Ltd.* [1962] Ch. 927. See McPherson, *Duties of Directors and the Power of Shareholders* (1977) 51 A.L.J. 460., at pp. 462-463.
23. (1936) 54 C.L.R. 583
24. [1967] 2 A.C. 1 34n at p. 150, see also per Lord Wright at p. 157 c.f. *Canaero* op. cit. at p. 382.
25. Such as those, perhaps, who found it necessary to protect their interests in *Australasian Oil Exploration Ltd* v. *Lachberg* (1958) 101 C.L.R. 119.
26. (1977) C.C.H. A.C.L.C. 28, 658, 28, 693

rectly it is respectfully submitted, to recognise that a strict prophylactic rule was necessary:

> "There constantly runs through the later cases the theme 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".[27]

The Privy Council, although it stressed in its judgment that it was reversing Wootten J.'s decision only on the facts, has in effect refused to endorse this strict approach, and at the same time has cut across well established authority dealing with misappropriation of corporate assets. It is submitted that before a director is free to exploit a rejected corporate opportunity, it is necessary that he be required to obtain after full disclosure the consent of disinterested shareholders. Hudson was described by Wootten J. as having made "a silk purse out of a sow's ear" by a combination of "astonishing effort, skill, business acumen, financial risk-taking and sheer persistence". The Privy Council's verdict in his favour may therefore, as Wootten J. himself suggested, have produced "substantial justice". But though the judgment for this reason may be regarded as exhibiting robust common sense, it has made little contribution to the jurisprudence of this area.

27. Op. cit., 29, 685.