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<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration of Criminal Justice in The Province of Real Property in Nigeria</td>
<td>1</td>
</tr>
<tr>
<td>G.D. Oke</td>
<td></td>
</tr>
<tr>
<td>The Role of The Judiciary In A Democratic Set up.</td>
<td>21</td>
</tr>
<tr>
<td>Dr. John Ademola Yakubu</td>
<td></td>
</tr>
<tr>
<td>The One Year And One Day Rule In The law of Murder Revisited.</td>
<td>33</td>
</tr>
<tr>
<td>Oluymesi Bamgboso</td>
<td></td>
</tr>
<tr>
<td>Relationship of Master And Servant And the Working Environment</td>
<td>45</td>
</tr>
<tr>
<td>Mrs. S. O. Akintola</td>
<td></td>
</tr>
<tr>
<td>Directors Fiduciary Duty To Avoid Conflict of Duties And Interest - Search for A General Test.</td>
<td>56</td>
</tr>
<tr>
<td>A.A. Aina</td>
<td></td>
</tr>
<tr>
<td>A Critical Examination of The Jurisdiction of The National Industrial Court</td>
<td>68</td>
</tr>
<tr>
<td>J.O.A. Akintayo</td>
<td></td>
</tr>
<tr>
<td>Law Report And Law Reporting</td>
<td>86</td>
</tr>
<tr>
<td>Mrs. O. S. Ekundayo</td>
<td></td>
</tr>
<tr>
<td>Table of Statutes</td>
<td>95</td>
</tr>
<tr>
<td>Table of Cases</td>
<td>99</td>
</tr>
</tbody>
</table>
DIRECTORS FIDUCIARY DUTY TO AVOID CONFLICT OF DUTIES AND INTEREST – SEARCH FOR A GENERAL TEST

BY

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Introduction

The fact that directors are regarded as standing in a fiduciary relationship to the company has never been in doubt. The circumstances and types of their work, however, necessitates a slight relaxation and modification of the rule as it applies to other fiduciary relationship (agents, trustees and partners) as it would be seen later in this paper, the law has been applied with vigour and unrepentant consistency by the courts.

Nature

The director being a business man is functionally different from the trustee or agent. The attitude of the court has been to relax the duty owned by the director to the company in some instances, but by this relaxation, one is not to imagine that the fiduciary duties are relaxed any bit than required from a Trustee or Agent.

The fiduciary duty of directors is owned to the company and to the company alone and not to the Shareholders. This stems from the corporate entity principle though, if the director acts as agent for the Shareholders, he may be liable to them.

1 Percival v. Wright (1902) 2 Ch. 41
2 Salomon v Salomon (1897) A. C. 22.
3 Allen v Hyatt (1914)30 T.L.R. 44: Note, The Australian Case of Coleman v Myers (1977)2 N.Z.L.R. 225 that suggest that Percival v Wright was wrongly decided. See also Jenkins Committee Recommendations (and 1749 paras. 89 and 99).
The following four separate rules have emerged in the course of judicial application of the general equitable principles concerning the fiduciary to company directors:

1. The duty of company directors to act in all honesty and utmost good faith - this is a subjective test to be decided in each particular case.
2. They must exercise the powers conferred upon them for proper purpose.
3. They must not fetter their discretion.
4. They must not place themselves in a position where their personal interest will conflict with their duty to the company.

The last three are objective tests and may be classified together under one theme.

This equitable rule is an inflexible one, and does not depend on whether the principal benefits, or did not suffer any injury by the breach, as in the words of Lord Henshall in Bray v. Ford. The rule is based on the consideration that human nature being what it is, there is danger in such circumstances of a person holding fiduciary position being swayed by interest rather than by duty and thus prejudicing those whom he was bound to protect. It was therefore expedient to lay down this positive rule.

**Conflict Test**

Good faith must not only be done but must be seen manifestly to be done and the law will not allow a fiduciary to place himself in a situation in which his judgment is likely to be biased and then escape liability by denying that in fact it was biased. The situation in which this may occur are numerous and the courts have been called upon on several occasions to formulate the guiding criteria.

The directors are not allowed to enter into transaction with the company, either personally or through another person. The company will normally be able to avoid such transaction.

So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. In...

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2. Wright was wrongly decided. See also Jenius (as 89 and 99).
5. James L. J. in Aberdeen Rly v Blaikie Bro. (1854)
6. (1899) A. C. at 51 - 2.
7. Parker v McKenna (1874) L.R. 10 Ch. 96
Aberdeen Rail-Way Co. v. Blackie Brothers\(^9\), the main issue was whether a company is entitled to avoid a contract between itself and a partner. The fairness of the contract was not in dispute. It was held that the company is entitled to avoid it.

Lord Cranworth stated the rule clearly as follows:

\[\begin{align*}
[A] & \text{ Corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interest of the corporation whose affairs they are conducting, such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which may possibly conflict with the interest of those whom he is bound to protect.}\end{align*}\]

This rule of avoidance of conflict of interest has been extended and applied by the courts in circumstances not earlier envisaged by the courts when it was propounded. For instance, the director must not use his power as director in allotting shares to enable him control the majority, or thwart the will of the majority, or install his own favourite. It must be used bonafide in the interest of the company as a whole. Even, the courts have had occasions to question this criteria. A bonafide exercise of power is of no consequence or that the director himself will not, is immaterial so far as the court is satisfied that there is power that has been exercised one way or the other, the courts have held, that they are entitled to examine the effect and determine if it is a wrong use of discretion.

In the case of Howard Smith v Ampol Petroleum Ltd.,\(^10\) Lord Willberforce said, "It is necessary to start with a consideration of the power whose exercise is in question in this case a power to issue shares. Having ascertained on a fair view, the nature of this power and having defined as can best be done in the light of modern conditions, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged to examine the substantial purpose for which it was exercised and to reach a conclusion whether that purpose was proper or not".

\[^9\] (1854) 1 Marq. 461
The main issue was whether a contract between itself and a partner. The dispute. It was held that the company is likely as follows:

Act by agents, and it is of course the duty of contractors to promote the interest of the company as best as possible by conducting, such agents have a fiduciary nature towards their principal. If application that no one having such fiduciary powers is allowed to enter into engagements in personal interest conflicting or which are not to the advantage of those whom he is bound to control. The conflict of interest has been extended and no earlier envisaged by the courts when a director must not use his power as director but the will of the company. It must be used bonafide in the interest of the company. The courts have had occasions to question this power and found that the director is as the court is satisfied that there is power in the other, the courts have held, that they are bound to determine if it is a wrong use of discretion.

Smith v Ampol Petroleum Ltd., Lord Wilberforce thinks it will, when he said:

"In so doing it will give credit to bona fide opinion of directors, if such is found to exist and will respect their judgment as to matter of management having done this, the ultimate conclusion has to be to the side of a fairly broad line on which the case falls."

In the case of Tika, Tore Press Ltd. v. Ajibade Abina & Ors, Adedipe J. made a point approved in the Supreme Court that:

"...the directors are only competent person to allot shares, such powers, like any other powers of the directors, is a fiduciary power, and must be exercised in good faith to the advantage of the company."

The law as stated by Adedipe J, must necessarily now be qualified, the power or the exercise of it can no longer be judged on the bonafide exercise of it by the director or interest of the company as such, because the question which arises is sometimes not a question of what is fair as between different classes of shareholders where such a case arises, some other tests than that of the interests of the company must be applied. The call by an eminent writer that rules should be devised for testing the impartiality of directors in the circumstances where they are all shareholders will seem to have been answered by the rule laid down in Howard Smiths Case. It is submitted with respect that the substantial purpose rule as laid down in the case will apply. It is my view that whether we classify an exercise of power which need not necessarily be an abuse and other fiduciary obligations owed by directors separately, the final analysis it is submitted will revolve on whether he owes a fiduciary duty, and whether one way or the other the duty has been breached. The issue of making a secret profit out of the office, transacting business with the company or dealing in securities of the company, inside information and knowledge, or interception of corporate opportunity must necessarily be resolved on this basis. It is my submission that the same philosophy runs through all the cases as the basis of liability.

12 (1972)4 SC 63 at page 65
13 Mills v Mills (1938) 60 CLR 150 at page 151
14 1978 N.C.L.J. 1 at page 7
15 Howard Smith v Ampol Petroleum Ltd. supra.
Conflict of Interest

In the cases involving breach through conflict of interest, the courts have been more active, and the impact of the rule is made to bear on the directors with full force. Even then the attitude of the court has been to adopt a broadly generalised formula that can be adopted to take care of any breach of director’s fiduciary duty.

The old case of Keech v Sandford\(^{16}\) in which a trustee purchased a lease meant for the trust, and defended himself by saying that the trust could not in any case have obtained it, Lord Eldon said: “The doctrine as to purchase by trustees, assignees and persons having a confidential character stands much more upon general principle than upon the circumstance of any individual case. It rests upon this that such purchase is not permitted in any case, however honest, justice requiring it to be destroyed in every instance as no court is equal to the examination and ascertainment of the truth in much the greater number of cases.”\(^{17}\) The same result was reached in Aberdeen Railway Co. v Blackie Brothers.\(^{18}\) The above rule applied rigidly to cases where the director intercepts corporate opportunity applies corporate information for personal or wrong use, compete with the company or make secret profits, and in each case he will be rendered liable to disgorge the gain or profit so made.

In the celebrated case of Regal (Hastings) Ltd. v Gulliver\(^{19}\) where a company was unable for lack of funds to subscribe fully for the shares of its subsidiary formed to take over a business belonging to a third party, the company could not be subscribed for the shares itself due to lack of funds, and the directors decided to subscribe for the shares themselves in so doing they made substantial profit therefrom. It was held that they were liable to account for the profit made. Their honest and good intentions were never in doubt\(^{20}\) in the words of Lord Viscount Sankey “...the respondents were in a fiduciary position, and their liability to account does not depend upon proof of malafides. The general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom

\(^{16}\) (1726) Sel Cas. Ch. 61:25
\(^{17}\) Ibid.
\(^{18}\) 25 E. R. 223
\(^{19}\) (1967) 2 A. C. 134
\(^{20}\) It was for this reason, and the fact that the company benefited that the decision was largely criticised. See Gareth Jones, “Unjust Enrichment And Fiduciary Duty” 84 C.I.R. 472.
\(^{21}\) Op. Cit page 137
through conflict of interest, the courts and the rule is made to bear on the attitude of the court has been to adopt a rule adopted to take care of any breach of

s which in which a trustee purchased a share himself by saying that the trust could

said: 'The doctrine as to purchase of a trusteepurchased a share in Keech v Sandford to

in Aberdeen Railway Co. v Blackie rigidly to cases where the director is not permitted in any case, however and in every instance as no court is equal to the truth in much the greater number of cases.

in A Aberdeen Railway Co. v Blackie and in each case is not permitted in any case, however in every instance as no court is equal to the truth in much the greater number of cases.

...the respondents were in a fiduciary duty does not depend upon proof of fact that no one who has duties of a fiduciary character in relation to the negotiations with the directors of Lester & Harris relating to the trust shares, out of such special position and in the course of such negotiation they obtained the opportunity to make a profit out of the shares and knowledge that the profit was there to be made. A profit was made and they were accountable accordingly. "In Lord's Guest view therefore the basis of liability is not, and it is submitted could not be the conflict test as explained by Viscount Sankey (because it could not have applied on the facts of this case), but a position held, opportunity and knowledge acquired through the

he is said to protect"... The defence that the company could not in any case have availed itself of the opportunity could be raised, and in fact it was raised, but this was met by Lord Russel of Killowen,22 that he cannot accept the argument, "It was impossible for the cestui que trust in Keech v Sandford to obtain the lease, nevertheless the trustee was held accountable, in fact this, in the words of Roskill. J.23 has always been treated as irrelevant and as Prontice24 rightly concluded in my view, my other conclusion would have amounted to the director exerting or refrain from exerting himself on behalf of the corporation or offering them an opportunity to profit at the company's expense.

Could Lord Viscount Sankey be said to be laying down a general rule? It is submitted as will soon become clearer that he was not. Even, then what happens to cases where there is no conflict of interest whatsoever? Or where as in Regal (Hastings) Ltd. case the bonafide of the directors was not in doubt.

In Philips v Boardman,25 the use of corporate information gained by virtue of being a director of a company for personal purpose was extensively considered by the House of Lords. In that case, the defendants (a Solicitor, and one of the beneficiaries of a trust which has interest in a company) attended the general meeting of the company as proxies of the trust in an attempt to get the beneficiary elected directors, by virtue of the trust interest. They discovered, the ailing condition of the company and in order to enhance the value of the trust interest, devised a means of taking over the majority interest in the company. The other trustees informed were not interested in the scheme, and only the defendants proceeded to expend money and time into the scheme which eventually yielded profits. It was held, that they were liable to account for the profit so made. The fact that they acted in good faith with best intentions notwithstanding. Lord Guest26 emphatically stated the rule, that Boardman and Philips placed themselves in a special position which was of a fiduciary character, and in the course of such negotiation they obtained the opportunity to make a profit out of the shares and knowledge that the profit was there to be made. A profit was made and they were accountable accordingly. "In Lord's Guest view therefore the basis of liability is not, and it is submitted could not be the conflict test as explained by Viscount Sankey (because it could not have applied on the facts of this case), but a position held, opportunity and knowledge acquired through the

22 Op. Cit page 149
23 Industrial Development Consultant Ltd. v Cooley (1972) 2 All E.R. 162 at page 172
25 (1964)2 All E. R. 187
26 (1964)2 All E. R. 149
company and the profit actually made. The issue of bonafide or the fact that the company could not avail itself of the opportunity is really of no consequence. In this, he is in agreement with Lord Russel of Killowen in Regal (Hastings) case, who himself seems to lay down the criteria for liability. He was 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. The equitable rule laid down in Keech v Standford and Ex P. James and similar authorities applies in full force, or put in another way, by Roskill J., "... information which came to him when he was Managing Director and which was of concern to the plaintiffs and was relevant to the Plaintiffs to know information which it was his duty to pass on to the Plaintiffs because between himself and the Plaintiffs a fiduciary relationship existed."

The issue that now arises is whether Lords Viscount Sankey, and Russel of Killowen be taken to have laid down a criteria to be followed in all cases. It is my submission that they had not done so. But first, we shall pause to consider the position in other jurisdictions.

In United State of America, the courts have formulated what is now known as “expectancy” or “interest” test in Guth v Loft. The rule was said to be that if an opportunity comes to a director in his individual capacity and is one which by its nature falls into the line of the corporation’s business and is of practical advantage to it, or is an opportunity in which the corporation has an actual or expectancy interest the officer is prohibited from permitting his self-interest to be brought into conflict with the corporation’s interest and may not take the opportunity for himself. "This rule was later to be replaced by a broader approach of “fairness” in Rose mblum v Judson Engr. Corps. The interest and expectancy test was rejected as being too lax, bad faith in the sense of using corporate information or resources is immaterial so also is the confidentiality of the information. The rule may therefore be formulated thus “where there is presented to a corporate officer, a business opportunity which the corporation is financially able to undertake and which by its nature falls into the line of the opportunity in which the corporation has an actual or expectancy interest or which in all fairness AND IN THE CIRCUMSTANCES OF THE

\[26^a\quad \text{Emphasis mine}
\[27^b\quad \text{(Ibid.)}
\[28^c\quad (1939) S.A. 2d 503 (Sc. Dd).
\[29^d\quad (1954) 109 A. 2d 558 (SC.NA)\]
The issue of bonafide or the fact that the opportunity is really of no consequence in the enforcement of the fiduciary duty. The issue of property rights in information as alluded to by Lord Denning in Phipps v Boardman as "information or knowledge which the agent has employed ... to collect or discover or which he has otherwise acquired for the use of his principal' as being the property of his principal'. The disagreement in the House of Lords between Lords Viscount Dilhorne, Hodson and Guest on the one hand, that knowledge acquired could be regarded as principal's property, while Lord UpJohn on the other hand holds the view that information could not be property at all, will no longer be of importance. In any case, Loskin J's view, it is submitted, will resolve the argument by attributing the opportunity seized to be the property and not the information used whether confidential or not. Beck suggests that the issue of corporate information be dropped altogether and the main question should resolve itself on the conflict test, even then he like Laskin J felt it not necessary to lay down any hard and fast rule in this area.

In the popular case of Harry Akande v Omosade & Ors., where O and A are co-directors in a company B, B won a contract to arrange for airlifting of Pilgrims from Nigeria, and B was to be paid on commission basis. O later went to Oakland, California, USA and he presented certain facts about B to the foreign partner and that he has formed another company C, which effectively do the contract. The contract was thereby transferred to C on the suit of A for account against O and C, Dosumu J in the trial court, relying on Boardman v Phipps held that O stands in a fiduciary position to the company B and so was not acting bonafide in the interest of the company. However, he refused to hold him liable to account because the rule laid down in Salomon v Salomon is "Sacrosanct". With respect this view, as will presently be explained, is erroneous. At the Court of Appeal Nnaemeka-Agu, J.C.A reading the judgement of the court, relied on Transcaal Lands Company v New Belgium (Transvaal) Land and Development Company, Boardman v Phipps.
I.D.C. v Cooley\textsuperscript{36} and Canadian Aero Service Ltd. v O'Malley et al\textsuperscript{37} held O liable to account because, “the sole purpose of Incorporating the (2\textsuperscript{nd} respondent) C was for the purpose of retrieving his name in the (4\textsuperscript{th} Defendant) company B ... He might have never known about the whole operation if he were not a director of (B)”. He then cited Lord Brougham in Hawten v Wright\textsuperscript{38}. The knowledge which he acquires as trustee is of itself sufficient disqualification and requiring that such knowledge shall not be capable of being used for his own benefit to injure the trust ... “He concludes that the use made by the (1\textsuperscript{st} respondent) O of his position and knowledge as director of the (4\textsuperscript{th} defendant) C was clearly a breach of his fiduciary relationship...” He on his basis lifted the veil of Incorporation. The test applied seems to be the same as propounded by Lord Russel in Regal Hastings Ltd. The defence that he has no control over C was rejected. The learned judge relied heavily on the Canadian Aero Services Ltd. v O'Malley case (which it is submitted is on all fours with the present case, because, in both the directors were, both parties to the negotiations that led to the contracts being negotiated, by the company, in both the directors formed another company to acquire the contract formerly negotiated by their companies, Laskin J, equally held the directors in the Canero case liable). It is, in the words of Nnaemeka-Agu J.C.S. not necessary to prove fraud, or even fault in such cases. The law requires an all pervading probity by a director in a fiduciary relationship to the company. Laskin, J, did not mince words, “a director ... is precluded from obtaining for himself either secretly or without the approval of the company ... any property or business advantage belonging to the company or for which he has been negotiating, and especially is this so where the director or officer is a participant in the negotiations on behalf of the company”. The director will still be precluded from so acting even after he has left the company, where his resignation may have been prompted by the interest in the opportunity which ought to accrue to the company, because “the reaping of a profit by a person at a company’s expense while a director thereof is of course, an adequate ground upon which to hold the director accountable. This it is submitted is enough to hold the defendants in Akande v Omisade & Ors\textsuperscript{39} liable, and the Court of Appeal, fell into the same error by considering at all the defence of separate corporate personality. The issue was never raised in the Canero case, even if it were raised, it would have been dismissed as irrelevant. The fundamental issue is whether a breach of fiduciary obligation has been committed, whether directly

\textsuperscript{35} Op. Cit.

\textsuperscript{36} Op. Cit.

\textsuperscript{37} (1973) 40 DLR (A Canadian Case in which judgment was delivered by Laskin J-later the C.J.)

\textsuperscript{38} (1842) 9 U & F. 111, 124 H. C.

\textsuperscript{39} The appeal to Supreme Court was decided on Technical grounds (1987) 4 SCR 109
or indirectly by a director, the machinery through which this happens will become a subsidiary question.  

Acceptable Test:

Could one then conclude that Viscount Sankey and Lord Russel of Killowen had laid down rules to be followed in all the cases of breach of a fiduciary duty of directors? or is Laskin J’s view that benefits flowing from “a business opportunity which because of their position in the organization they had intercepted against the interest of or without the principal’s concurrence” as a third criteria that could be applied. It is hereby submitted that the statements should not be understood as laying down any formula to be followed. The Judgment of Laskin J. itself is an authority for the view that, the statement of Lords Viscount Sankey and Russel of Killowen should not be seen as doing so, as they should not in his words be as “exclusive touchstones of liability”. Neither could his view be laid down any rule to be followed, in his words, “I am not to be taken as laying down any rule of liability to be read as if it were a statute” because, A in other cases in this developing branch of the law, the particular facts may determine the shape of the principle or decision without setting fixed limits to it”. This is more so where circumstances occur which do not fall within the criteria and is evidently a breach of fiduciary duty. As in case of Abbey Glen Property Corporation v Stumberg et. al where it was “said on behalf of the defendants ... that is cannot be said, that the acquisition by the Stumborgs of shares in Green, Glen and through the shares of a 50% equity in the properties owned by Green, Glen, occurred (in Lord Killowen words) only by reason of the fact that they were directors of Terra, and in the course of the execution of that office, and that the benefits did not flow from a business opportunity which because of their position in the organisation they had intercepted against the interest of Terra, and in the course of the execution of that office, and that the benefits did not flow from a business opportunity which because of their position in the organisation they had intercepted against the interest of without the principal’s concurrence. D.C. McDonals J. held and rightly in my view that no such formula existed, and the Law Lords should not be interpreted as laying down any hard and fast rule.

It should for the avoidance of doubt be stated that, the defence of the director having left office before the breach is of no consequence, or whether the directors acted bonafide or that the company could not have taken the

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40 (1966) 65 DLR 3rd 245
40a (1973) 40 DLR 371 at 380
40b Ibid.
41 (1966) 65 DLR 3rd 245 (another Canadian case)
43 Laskin J in Canadian Aero Service Ltd. et. Supra Roskil J in I.D.C. v Cooley supra.
opportunity, or even that a separate personality was involved are immaterial considerations. “It would be reckless to attempt” any basic criteria to be followed. But, amongst the factors to be taken into consideration are, “position or office held, the nature of the corporate opportunity, as ripeness, its specificness and the directors or managerial officers relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special, or indeed, even private”.

Effect of Codification of the Rules:

It should be borne in mind that the application of the general equitable principle to the acts of director, managing the affairs of the company cannot be as it is in the case of a trustee exercising a special power of appointment”. The recognition of the special position of directors, to companies, the ever-changing condition of our economy, the awareness of ways and schemes of using companies and corporate opportunities in various forms and manner must necessarily make it impossible to formulate in advance any rule either statutory or equitable to take care of every situation that may arise. In the words of Laskin J, “New factual situations may require a reformulation of existing principle to maintain its vigour in the new setting”. This is precisely the reason why one will disagree with the Law Reform Commission for a codification of the directors fiduciary duty. It should be recognised that this area of the Law is still at its formative stage and any codification of the rules cannot adequately take care of any possibility that may arise. I believe that the court have performed creditably in refraining from laying any rules as such.

Therefore, one is of the firm view that the statutory reform or codification of the fiduciary duties of directors is too early, and will not serve any useful purpose. It will only have the effect of stagnating this developing area of the law, by not allowing the courts enough ambit to examine and determine new areas and situations as they may arise. A growing economy needs a vigorous and broad judicial policing and control. The courts have consistently declared that they should not be taken as laying down hard fast rule to be followed”. I therefore submit that the Sections 279-280, of the Companies and Allied Matters Act 1990 be repealed.

44 Roskii J in I.D.C. v Cooley supra
45 Sections 279 – 280 Companies and Allied Matters Act 1990.
46 Laskin J in Canadian Aero Service Ltd. et Supra, Roskii J in I.D.C. v Cooley supra
Directors Judicial Duty To Avoid Conflict of Duties And Interest – search for A General Test

Conclusion

It is obvious, that the rule did not rest upon the narrow ground of injury or damage resulting from betrayal of confidence but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation and possibility of profit flowing from a breach of the confidence imposed by the fiduciary relationship. The attempt by the courts to lay down a rule or guiding principles should not be interpreted as formulating one for a general purpose, but such rules and or guiding principles were formulated to accommodate the particular facts and situation of each case.

The conflict set as used by Viscount Sankey was found to be inadequate, reason and by reason only of being a director the rule proposed by Lord Russel of Killowen could not apply in all situations, while the general utilization of business opportunity which because of their position was intercepted or the American expectancy or interest test or to the latter “fairness test” have all been found inapplicable to some other cases.

It may be, in some years to come, the courts may be compelled to lower the standard but at least up to the end of this 20th century the fiduciary duty of loyalty must be kept as a tradition unbending and invertebrate, uncompromising in rigidity has been the attitude of courts of equity when petitioned under the rules of undivided loyalty and only in this way has the level of conduct of fiduciaries been kept at a higher level than that trodden by the crowd.

47 Judge Cardozo in Meinhard V Salomon 249 NY 56 at 464