THE CORPORATE OPPORTUNITY DOCTRINE IN NEW ZEALAND

SSC & B Lintas New Zealand Ltd v *Murphy*[1] is the first decision in a Commonwealth jurisdiction other than Canada to have expressly applied the "corporate opportunity" doctrine. Developed by American courts, the doctrine[2] "makes it a breach of fiduciary duty by a director to appropriate for his own benefit an economic opportunity which is considered to belong rightly to the company which he serves". Anglo Commonwealth courts prefer to base accountability of directors (and other fiduciaries) for undisclosed profits derived from their position, on wrongful use of confidential information, where the circumstances give rise to conflict of duty and interest. The latter principle is far reaching — unless the transaction is at least approved by the shareholders, following proper disclosure, its fruits are held in trust for the company. Accountability for undisclosed profits is imposed irrespective of whether the company had suffered damage, had discarded the information or could not have made the profit itself.[3]

A principle which limits recovery to benefits *derived from office* may not, however, be always adequate. For example, the director may make personal use of information that could be utilised by the company, but which he, the director, had acquired in a personal capacity rather than through his position in the company.[4] As one commentator puts it,[5] "A

1 Unreported, High Court, Auckland, No A 966/81, Holland J, 12 October 1981.

2 Prentice, (1974) 37 MLR 464. For a summary of the leading American cases, see ibid.

3 The leading English cases are *Regal (Hastings) Ltd* v *Gulliver* [1967] 2 AC 134n; [1942] 1 All ER 378; *Phipps* v *Boardman* 1967 2 AC 46. See also *Industrial Development Consultants Ltd* v *Cooley* [1972] 1 WLR 443; [1972] 2 All ER 162.

4 See, for example, *IDC Ltd* v *Cooley* supra n 3. Cooley had been managing director of the plaintiff company. While in this position he had conducted negotiations on behalf of the plaintiff towards obtaining certain construction work from the Eastern Gas Board (EGB). The negotiation came to nothing. Subsequently Cooley was approached in his private capacity, by a representative of EGB, with an offer to take up the work himself. He resigned his position under pretext of ill health and entered into a contract with EGB.

Upholding the plaintiff company's claim to recover from Cooley, as their constructive trustee, all the profits derived from the EGB contract, Roskill J said (ibid at 173-174),

> Counsel for the defendant argued that the [defendant was not in a fiduciary relationship with his principal] because he received the information which was communicated to him privately. With respect, I think that argument is wrong. The defendant had one capacity and one capacity only in which he was carrying out business at that time. The capacity was as managing director of the Plaintiff. Information which came to him when he was managing director and which was of concern to the Plaintiff to know, was information which it was his duty to pass on to the Plaintiff . . . .

As the Judge held that Cooley had been approached in his private capacity, did not utilize any corporate facilities in obtaining the EGB contract for himself, and that the company itself had virtually no chance of landing the contract, the reasoning in the above quotation seems unrealistic (though the result in the case is undoubtedly correct). It lends force to the criticism that indiscriminatory application of the principle may lead to inequitable results. (See Jones, "Unjust Enrichment and the Fiduciary Duty of Loyalty" (1968) 84 LQR 472). For a more satisfactory analysis of Cooley's breach of duty, based on the corporate opportunity doctrine, see Prentice (1972) 50 CBR 623.

5 Prentice, supra n 2 at 465.

corporate opportunity doctrine . . . is needed where a director benefits from the exploitation of an economic opportunity which falls within the general line of business of the company but knowledge of which he acquires in a capacity other than that of director.'' Another situation which calls for corporate opportunity analysis is when the circumstances make it hard to classify the relevant information as ''confidential'' or as ''belonging'' to the company. The case under discussion is a good example.

The plaintiff company (''Lintas'') was the New Zealand subsidiary of an American company operating a group of advertising agencies worldwide. It started business in New Zealand in 1931. The first defendant (''Murphy'') had been employed by Lintas since 1971. In July 1978 he was appointed managing director. The second defendant (''Truman'') was appointed in November 1980 as the company's creative director, a senior appointment which entitled him to a seat on the board (though he never took up the appointment). Both defendants were in charge of the company's Auckland operations. This was Lintas' main New Zealand branch, accounting for 51 per cent of its national revenue. It was a substantial operation (1981 estimated turnover $3,289,000), employing 23 staff. Much of its income was created by Lintas' on-going relationship with 15 large industrial concerns whose head offices were in Auckland.

The remarkable turn of events that led to the litigation was described by Holland J as follows[6]:

> On 21 September, 1981, the First Defendant circulated a notice to the Auckland staff requesting them to attend a meeting which was described as urgent, to be held at 4 pm on 23 September. On 22 September that notice was amended to call the meeting for 4 pm that day. All the staff except for one attended and the First Defendant informed the staff that he was resigning from his position, to be effective from 5 pm that day. He had, immediately prior to the meeting, tendered his resignation to the Secretary of the Plaintiff . . . . He told the staff that it was his intention to operate an advertising agency on his own. The Second Defendant then told the assembled staff that he also was resigning and was joining the First Defendant. Following this announcement, 17 members of staff thereupon handed in their notices of resignation.

Within two days Murphy and Truman started working as advertising agents from offices in central Auckland. A company called Murphy-Truman Group Ltd was incorporated, of which they were the only shareholders. The next day almost all Lintas' former employees who had resigned on 22 September commenced employment with the defendants' company.

In less than a week nine of Lintas' major customers either transferred their business to the defendants or indicated that they proposed to do so. They included well known names such as Leopard Breweries Ltd, Dominion TV Rentals Ltd, Feltex Furnishing NZ Ltd, James Hardy & Co Pty Ltd and Club Mediterranee.

Prior to his resignation Murphy had communicated with the customers of Lintas and informed them of his forthcoming resignation. According

6 Supra n 1 at 5-6.

to him, he did it because "it would have been quite improper for them to be left to find for themselves that the very people who they relied upon for advice and for the continuity of their advertising programmes were no longer available". As the Judge wryly remarked,[7] this loyalty to the customers contrasted with Murphy's attitude to his company — the major customers of Lintas were made aware of his departure before he saw fit to inform his own employer.

On 1 October 1981 Lintas issued a writ against both defendants, seeking an injunction and damages. At the same time it obtained an ex parte interim injuction restraining both defendants from "soliciting, approaching or otherwise performing" any advertising services for a number of named Lintas former customers. In the decision under review Holland J considered whether the order should be extended beyond its initial 12 day period.

Despite the "extraordinary coincidence" of all the members of the staff tendering their resignation on the same day as Murphy and Truman, the Judge was not prepared, on the available evidence, to find inducement of the staff to breach their contracts of service. Likewise, there was no sufficient evidence to support Lintas' allegations that the defendants had induced their customers to breach their advertising agencies, simply because most of the customers were under no contractual obligation to place their advertising work with Lintas.

The issue, therefore, was whether Lintas had shown a reasonably arguable case of breach of the defendants' contracts of service, or of their failing their duty to serve their employer with good faith and fidelity as its directors and employees, that would entitle it to an interim injunction.

For the defendants it was argued that any duty owed by them to Lintas had ceased upon their resignation as employees and directors on 22 September. If any breaches of duty had occurred before that date, those breaches would give rise to an action for damages, but not to an injunction. It might be added that the question of an interim injunction was of crucial importance to both parties. Even a temporary injunction would have destroyed the business basis of Murphy and Truman's new company. Refusing it would have severely impaired Lintas' operation.

Was there, therefore, a duty imposed on the two defendants which had survived their resignation, the continuing breach of which could be restrained by an injunction? Following *Thomas Marshall Ltd* v *Guinle,*[8] Holland J held that an employment contract was not, in principle, automatically terminated by a unilateral repudiation by either the master or the servant. The general rule applied, allowing the innocent party to elect either to accept the repudiation and terminate the contract or to continue to treat it as valid. In the present case, however, the contracts of service between Lintas and each defendant contained no provision fixing its duration. The defendants were, therefore, free to terminate their re-

7 Ibid at 8.
8 [1979] 1 Ch 227, per Sir Robert Megarry VC.

spective employment at any time — subject, of course, to reasonable notice.

The defendants did not deny that 24 hours did not constitute sufficient notice. However, they continued to argue that failure to give adequate notice would only sound in damages. This seemed a strong argument in view of the principle, acknowledged by His Honour,[9] that "there must be a continuing right of the Plaintiff being infringed before grounds exist to order an injunction." Yet, having held that adequate notice meant six months in Murphy's case and three months in Truman's, he went on to hold, somewhat surprisingly, that the failure to give adequate notice could be restrained by an injunction. The implied term of notice, His Honour reasoned, gave the employer the choice to make arrangements for replacement of staff to ensure that existing customers were properly served. There was, therefore,[10] "an arguable case that the right may continue for a reasonable period after the unlawful termination of the contracts and that actions by an employee prejudicing that right may likewise be restrained for a reasonable period."

It should be appreciated that Murphy's and Truman's breach of duty as *employees* was not easy to pin down. Each had had an informal contract of service which did not contain restraint of competition or non-disclosure of confidential information provisions. An employees' implied duty of fidelity and good faith operates even in the absence of such provisions, but always[11] "depends upon whether the service agreement is . . . still in being and binding on the defendants." It could continue to be so binding if the employer rejects the employee's repudiation and continues to treat the contract as valid.[12] But in our case the defendants were under no obligation to serve for a fixed period. Their resignation was, therefore, effective. Moreover, the company treated the contract as terminated, having issued a writ in which it claimed, inter alia, damages for breach of contract.[13] Failure to give reasonable notice thus remained the only ground upon which relief could be granted. Though sounding in damages, its finality made it an unlikely ground for an injunction.

Holland J ingeniously overcame this difficulty by looking at the *effects* of failure to give notice; namely, the company being given no time to recruit alternative staff to maintain its business. The defendants could be restrained from taking advantage of this situation while it lasted.

Turning to the question of Murphy's liability as a director, His Honour relied on the Supreme Court of Canada decision in *Canadian Aero Services Ltd* v *O'Malley*.[14] The defendants in that case were the president and executive vice president of the plaintiff company. It was alleged that while at the service of the plaintiff company they had devoted effort and planning in respect of a particular corporate oppor-

9 Supra n 1 at 12.
10 Ibid at 15.
11 *Thomas Marshall (Exports) Ltd* v *Guinle*, supra n 8 at 243H.
12 Ibid.
13 Supra n 1 at 13.
14 (1973) 40 DLR (3D) 371, quoted in *Lintas* at 17.

tunity as representatives of the plaintiff but had subsequently resigned, tendered for the project, and obtained the contract for themselves. Having established that the defendants as senior officers stood in a fiduciary relationship to their company, Laskin J, speaking for the Court, said[15]:

> Descending from the generality, the fiduciary relationship goes at least this far: a director or a senior officer like O'Malley or Zarzychi 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.
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> An examination of the case law in this Court and in the Courts of other like jurisdictions on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.

Applying the above analysis, Holland J found that Murphy and Truman had appropriated a proprietary right of the plaintiff,[16]

> [The plaintiff] had a proprietary interest in the preliminary work done by it through the agency of the Defendants in relation to preparatory work for advertising contracts and the very close continuing personal relationship between a client and his advertising agent to which the First Defendant deposes.
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> The Plaintiff had no proprietary right to the continuing patronage of its customers in the absence of any specific contract to that effect. It did, however, have the benefit of a continuing relationship which placed it in a position of advantage over its competitors so long as that relationship continued. The Defendants have obtained the benefit of that continuing relationship and its importance and value must be judged by the speed and ease with which the customers of the Plaintiff immediately transferred their allegiance from the Plaintiff to the Defendants when the Defendants left the Plaintiff.

Holland J also found an arguable case of wrongful use of confidential information. The information, namely knowledge of the customers' advertising requirements, though freely available to advertisers, gave the defendants a head start over other firms competing for the business. It was confidential because it was obtained by the defendants while they were employed by Lintas, and was not meant to be used to Lintas' disadvantage.

The classification of the personal experience gained by the defendants while serving Lintas customers as "confidential information", belonging to Lintas, appears somewhat artificial. It is more apposite, it is suggested, to examine the defendants' behaviour in respect of a "corporate opportunity" belonging to Lintas. In the *Canadian Air Services* case the

15 Ibid at 381-382.
16 Supra n 1 at 18-19.

opportunity was work done in preparation of a *specific* project by the officers on behalf of the company. In the *Lintas* case the concept has been extended to general ground work to secure continuous patronage of established customers. Seen in this light, the defendants' contention that their professional relationship with the customers was based on *personal* confidence and therefore "belonged" rightly to them, had acted as a boomerang. The Judge emphasised that such personal relationship[17] "is and was a matter in respect of which they were accountable to the Plaintiff to whom they owed fiduciary duty. They are not permitted to apply it for their own purposes."

In granting an injunction restraining the defendants from giving advertising services to Lintas former customers, over a period of three months, His Honour took into consideration the balance of convenience. He agreed that there was no guarantee that the injunction would cause the customers to return to Lintas, but held that the company was entitled to try to retain its business. Damages for loss of non-contract customers, His Honour noted, would be difficult to prove.

On the other hand, an injunction for a longer period would greatly inconvenience the customers, denying them a free choice of their advertising agent.

The decision is welcome. Lintas was clearly entitled to protection, but the legal grounds for an interim injunction were shrouded in difficulty. The complicating factors were the lack of a definite period of employment, lack of contractual restraint of post employment competition, and absence of binding contracts with the customers.[18] Nevertheless, their fiduciary obligation to Lintas imposed on the defendants a duty of loyalty. Lintas' expectations to a continuing relationship with its established customers had been developed by the defendants themselves as officers of the company. It was, however, an economic opportunity rightly belonging to Lintas. An attempt by the defendants to appropriate it for themselves was properly restrained by an injunction.

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17 Ibid at 19.

18 The importance of these factors is highlighted by a comparison with the *Thomas Marshall* case, supra n 11. Holland J saw that case as "considerably similar" to the situation in *Lintas*. With respect, however, the two cases are distinguishable on a number of grounds. In *Thomas Marshall* the director had resigned half way through his 10 years employment contract. The company rejected his repudiation and could, therefore, rely on provisions in the contract prohibiting competition and disclosure of confidential information. And finally, the director, before and after resignation on his own account and without telling the company, bought from the company's suppliers and sold to its customers in a nearly monopolistic market. The injunction granted by Megarry VC was based largely on these facts.
Compare also *Westminster Chemical Ltd* v *McKinley* [1973] 1 NZLR 659 (not cited in *Lintas*) where the circumstances were substantively similar to those in *Lintas*. Speight J granted an injunction prohibiting the defendant, an executive director, from canvassing customers who had had contracts with his former company. But he refused to restrain the defendants from soliciting business from non-contract customers. His reason was that the information learnt about these customers was public knowledge, and not private information gained by the defendant in his position of confidence. It is suggested that the better question to ask would be whether, in the circumstances, the company's relationship with its non-contract customers amounted to an economic opportunity belonging rightly to the company.