

Whatever Happened To . . . Can. Aero v. O'Malley

Posted By [Peter Bowal](#) On November 5, 2014 @ 9:40 am In [Famous Cases](#) | [Comments Disabled](#)

Ethics 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 . . . - [Can. Aero v. O'Malley](#), [1974] SCR 592 [1]



Introduction

Beginning in 1948, Canadian Aero Service Ltd (Canaero) was in the business of aerial topographical mapping and geophysical exploration.

Most of the work in the geophysical survey industry at the time related to mapping developing countries, and most of these projects were funded by government grants and loans from wealthy nations such as Canada and the United States. In July 1966 Guyana convinced the Canadian government to fund a survey project in Guyana.

Thomas M. O'Malley was the President and CEO; J. M. (George) Zarzycki was the widely respected chief engineer, Vice-President and director; and James E. Wells was a lawyer, former employee and long term director at Canaero. The three friends cooked up a plan to quit Canaero and start a new competing business. In August 1966 they formed a new company, Terra Surveys Ltd. A fiduciary duty is one of the most onerous legal obligations devised by judges in the category of equity. It is imposed on people who are in substantial control of the property or lives of others (beneficiaries). O'Malley became the President of Terra; Zarzycki was named Executive Vice-President. Wells became a major shareholder. Terra would pursue profitable business opportunities for these three men.

Canaero and Terra were two of the five companies later invited to submit a bid for the Guyana project. Eventually, the Terra proposal was selected because it "covered the operation in much greater detail than might be normally expected."

When Canaero discovered what O'Malley and Zarzycki had done, it sued both of them, along with Wells, for damages related to the value of the contracts lost to Terra and the Guyana project in particular. Was there any legal duty owed by O'Malley, Zarzycki, or Wells to Canaero, especially after they had resigned?

The legislation under which Canaero incorporated in 1948 had no provision that mandated directors' legal duty of care to their company. A director was anyone in the company performing a management role, regardless of the title used. O'Malley and Zarzycki had not been elected to their positions of President and Vice-President by a board of directors or shareholders. They had to obtain approval from Canaero's parent company for travel expenditures over \$100 and had no power to dismiss senior personnel.

The trial judge dismissed the claim on the basis that the three men were employees and, accordingly, not liable to Canaero. The Ontario Court of Appeal dismissed the appeal.

Fiduciary Duty

A fiduciary duty is one of the most onerous legal obligations devised by judges in the category of equity. It is imposed on people who are in substantial control of the property or lives of others (beneficiaries). Fiduciary duty, which relates to loyalty and faithfulness in the context of a serious imbalance of power, requires those who control beneficiaries to put the interests of those beneficiaries ahead of the fiduciary's own interests. Fiduciary duty in the corporate world encompasses prohibitions against managers taking corporate opportunities for themselves. In this way the law protects the interests of vulnerable beneficiaries. Failure to comply with that duty may lead to an order to fully return all gains attained in the breach.

Corporate officers and directors have complete control over the property and business activity of the companies they are appointed to manage because the corporation itself is a mere legal fiction that can do nothing on its own. Companies cannot stand up for themselves but act only through human beings.

Modern corporate legislation acknowledges the special role of managers. For example, the *Canada Business Corporations Act* [2] states:

122(1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

(a) act honestly and in good faith with a view to the best interests of the corporation; and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Fiduciary duty in the corporate world encompasses prohibitions against managers taking corporate opportunities for themselves, insider trading, making contracts with the beneficiary company, conflicts of interest, competing with the beneficiary company, abuse of confidential information, taking secret profits and other forms of self-dealing.

In the Supreme Court of Canada

Lawyers for O'Malley and Zarzycki relied upon the eight-year-old Supreme Court precedent, *Peso Silver Mines Ltd. v. Cropper* [1966] SCR 673 [3]. In that case, a prospector selling speculative claims approached Peso, a mining exploration company. Peso routinely received two to three pitches per week to buy mining claims. Peso's Board of Directors analyzed this offer and rejected it.

The prospector then approached Cropper, one of Peso's directors and two other people from the company to buy the claim, which they did. Peso sued the director Cropper for breach of fiduciary duty, but the Supreme Court of Canada said the director had no liability in that case. Cropper had rejected the opportunity in good faith as a director of Peso. When he was approached later in his individual capacity he was not working for Peso. That was the opportunity accepted.

The Supreme Court distinguished the Canaero case thus:

What is before this Court is not a situation where various opportunities were offered to a company which was open to all of them, but rather a case where it had devoted itself to originating and bringing to fruition a particular business deal which was ultimately captured by former senior officers who had been in charge of the matter for the company.

The Supreme Court viewed these senior management positions as *de facto* directorships and found O'Malley and Zarzycki in breach of their fiduciary duty to Canaero. The Court said, "there is no doubt that Terra Surveys Limited was conceived as a company through which

O'Malley and Zarzycki could pursue the same objects that animated Canaero.”

Moreover, these managers had taken advantage of Canaero. The Court said the Terra proposal would not have been as detailed if Zarzycki had not been at Canaero. The details of the Guyana operation he learned at Canaero through his numerous visits to the country contributed to the success of Terra's proposal. Since no one from Terra had visited Guyana between the opening date of bids and the date of Terra's proposal, all details about the project had been gained by Zarzycki from his time with Canaero. Canaero had paid for his salary and trips to Guyana to gather information to advance the Canaero bid. At the time of their resignations, these Canaero managers knew of Canaero's continuing interest in, and bid for, the Guyana project. They incorporated pieces of it in their Terra bid. The Court concluded that for them to use such information in a competing bid was a breach of fiduciary obligation.

Conclusion

Terra's Guyana project was worth \$2.3 million. Its profit was \$125,000, which were the monetary damages O'Malley and Zarzycki were ordered to pay Canaero, plus court costs. Wells had no fiduciary duty to Canaero because he had left the company a year earlier, well before Canaero started work on the Guyana project.

This *Canaero* case did not provide an exhaustive checklist of fiduciary rules, although factors will include the managerial position held, nature of the business opportunity, and the knowledge possessed. Resignation of the managers will not end their fiduciary obligations.

Fiduciary issues continue to arise in various forms in the business world. They all started with the 1974 *Canaero* case.

After this case, Zarzycki left the photogrammetry industry and worked as a director of topographic survey for the Canadian government. He passed away on June 15th, 2012.

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- [1] *Can. Aero v. O'Malley*, [1974] SCR 592: <http://canlii.ca/t/1twwf>
- [2] Canada Business Corporations Act: <http://laws-lois.justice.gc.ca/eng/acts/C-44/INDEX.HTML>
- [3] *Peso Silver Mines Ltd. v. Cropper* [1966] SCR 673: <http://canlii.ca/t/227p2>

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