

# Directors Duties

As can be seen from the **Automatic Self Cleansing** and the **Shaw** cases the Directors are quite powerful. To balance this power are some important duties and responsibilities.

**There are 5 main Directors Duties.** They are the duty to;

- act in the **best interests** of the Company
  - use their powers for a **proper purpose**
  - avoid **conflicts of interest**
  - act with **care skill and diligence**
  - not to prejudice creditors interests – prevent **insolvent trading**
1. **3 of these duties namely, best interests, proper purpose and conflicts of interest are fiduciary duties.**

A fiduciary duty is a duty of trust. The director is in an important position as they are managing the wealth and assets of the company on behalf of the real owners. **(Fiduciary is common law.)**

## A. *The duty to act in good faith and the best interests of the company*

This means that the Directors whenever they sit in a board meeting or make a decision as a director must look after the Company's interest. Not their own interests or related company's interests.

It seems quite simple but the cases show that this can be a complex issue – especially as the Company's interests may not be the shareholders interests.

This duty is set out in the Common law and **s181(1)a**

To show that the Company's interests may not be the shareholders interests we need to look at the **development** of the **common law** in this area. See

The starting point is this 1902 case of **Percival v Wright**. The Court held that the Directors owe a duty to the Company as a whole and not to individual shareholders.

This case has been criticised because of the directors inside knowledge. Later Courts followed the basic principle but were able to "distinguish" their cases on the facts.

Two later cases followed the principle but gave more protection to the shareholders

- A Director may owe a duty to shareholders where they possess confidential information, are involved in a transaction with the shareholder and are actively promoting it **Coleman v Myers**
- Where there are negotiations for a takeover or an acquisition of the Co's undertaking – it is the directors duty to loyally promote the joint interests of all shareholders **Brunninghausen v Glavanics**
- Nominee Directors must act in the best interests of the subsidiary Company **Scottish Co-op Wholesale Soc Ltd v Meyer** L&H 307
- Except where it is a wholly owned subsidiary and the constitution authorises the Directors to act in the interests of the Holding Co **s 187**

An interesting example of this principle is **Parke v Daily News** L&H 309. Where the directors tried to give some surplus funds to dismissed employees. This was extra compensation which they were not legally required to pay. It was found to breach this duty. The **Parke v Daily News** decision has become topical with the **James Hardie** case where the Company is making extra compensation which they are paying to calm public disquiet. Some commentators argue that as they aren't strictly legally liable to pay - it breaches the duty. There has been a call for the government to amend the Act to allow directors to act in a way to benefit stakeholders and the environment.

## B. *Duty to Exercise Powers for a Proper Purpose*

A number of powers are conferred on the Board of Directors by the Replaceable Rules or by the Constitution, these include s.198A which includes the broad powers of management.

The **most common area of breaches of this duty is in issuing shares**. The power to issue shares is given to the directors pursuant to s.198A to raise capital for the company.

It is not to be used to:

- **Maintain the control of the company by the directors,**
- **Defeat a takeover**
- **Create or destroy voting power**

" The power must be used bona fide for the purpose which it was conferred, that is to say, to raise sufficient capital for the benefit of the company as a whole.

It must not be used under the cloak of such a purpose for the real purpose of benefitting some shareholders or their friends"

**Ngurli v McCann L&H para 13.0.50**

## P461 Q4 Conflicts of interest and disclosure **IMPORTANT**

At a recent board meeting of Welstar Ltd, Victor, one of the company's directors, became aware that Welstar was about to buy a large parcel of shares in Flexizin Ltd, a listed company. After buying the Flexizin shares Welstar intended to make a takeover bid for the rest of Flexizin's shares. Victor thought that when Welstar Ltd's initial purchase became public knowledge it would signal Welstar's takeover intentions and that Flexizin's share price would increase significantly. He therefore arranged for his wife's company, Spousal Investments Pty Ltd, to buy shares in Flexizin Ltd ahead of Welstar's purchase. Spousal Investments Pty Ltd later sold the Flexizin Ltd shares after Welstar's takeover bid was publicly announced and made a large profit. You as a professional accountant are asked to write a formal letter to generally advise ASIC whether there has been a breach of the Corporations Act 2001 (Cth) in the above circumstances. (20 marks)

You should consider to use both primary and secondary sources, e.g. legislation, case law, text books, journal articles and websites, to demonstrate your research skills in support of your advice in the letter. Wherever necessary, you should reference the sources in the letter.

### Issue:

Whether Victor and SI have breached any statutory duties in the purchase of shares in FL?

### Rules:

S183 prevents directors improperly using information to gain advantage for themselves or someone else. **S1043A** states that an insider must not procure another person to apply for, acquire or dispose of, a security or other Division 3 financial products.

### Application:

In the case, Victor is an insider as according to s1043A, he is the person possesses "insider information" and he knows or ought reasonably to know that it is insider information. Under s1042A, Victor possesses insider information of Welstar's takeover intention. This information is not generally available to the public, and it is price sensitive to FI's share price because he reasonably expected that FI's share price would increase significantly: R v Firms. Therefore, he breached prohibitions under s1043A, as he procures his wife's company, SI, to trade on the information.

At the same time, SI may also breach s1043A as it became an insider after being told by Victor, it possesses inside information and it bought the shares of FI and made a large profit.