INTRODUCTION

- Directors are under a duty to act in good faith in the interests of the company and for proper purposes.
- The two duties are separate and distinct – it is possible to comply with one and not the other
- It seems possible for directors to act in good faith but at the same time exercise their powers for an improper purpose
- The reverse is unlikely – probably unlikely that you have not acted in good faith but have exercised powers for an improper purpose
- These duties are **fiduciary** in nature and are enshrined in the act under s 181(1)(a) and s 181(1)(b)

MEANING OF GOOD FAITH (BONA FIDES)

- Good faith is typically explained as honesty. Therefore, the duty requires directors to have a subjective **honest** belief that they are acting in the best interests of the company
- Courts have held there is an objective bottom line to this test (Santow J in ASIC v Adler)

  **TEST:** *The duty will be breached if a director acts in a way that no reasonable director would have considered to be in the interests of the company (Santow J in ASIC v Adler)*

MEANING OF ‘THE INTERESTS OF THE COMPANY

- The interests of the company are usually equated with the interests of members collectively (i.e. shareholders)
- Directors may have regard to both current and future members which means they may consider the company’s short, medium and long term interests
- Directors do not owe direct duties to individual members, creditors or employees (or other stakeholders)
- Depending on the circumstances of the case, other stakeholder interests might be properly considered
- *Mills v Mills* – where different classes of shareholders, the duty translates and becomes a duty to act fairly between classes of shareholders

MUST DIRECTORS CONSIDER THE INTERESTS OF INDIVIDUAL SHAREHOLDERS?

- Directors’ duties are not owed to individual shareholders.
  - However, it may be possible on the facts of a particular case to establish a fiduciary duty to individual shareholders, applying general fiduciary principles
- A special fact fiduciary relationship may arise where a particular transaction does not concern the company but only another shareholder OR where the transaction involves the sale of shares as between a director or shareholder.
- Note that a special fact fiduciary relationship does not create a comprehensive fiduciary duty.
- The duty is limited to actions by the defendant, necessary to negate the effect, in the particular circumstances of his taking advantage in an unconscionable way, of the superior position occupied by him as against the plaintiff
- Disclosure of negotiations by directors could potentially jeopardise the contemplated transaction. This is reflected in the Listing Rules which permits listed entities to withhold from disclosure information that concerns an incomplete proposal or negotiation
<table>
<thead>
<tr>
<th>CASE</th>
<th>FACTS</th>
<th>DECISION</th>
</tr>
</thead>
</table>
| Percival v Wright    | • Directors of company approached by a couple of shareholders who want to sell some shares  
• Directors decide its easiest if the directors themselves will buy them  
• Directors don’t say that there’s an impending takeover which will increase value of shares  
• Go through with sale  
• Later find out there was info they didn’t have available  
• They try rescind contract of sale  
• Argue D’s breached fiduciary duties in failing to disclose the information   | • Holds that directors owe duties to the company and not the individual shareholders.  
• Court decides there was no obligation on the directors and that premature disclosure of impending takeover may not have been in the best interests of the company                                                                 |
| Coleman v Myers      | • Family dominated company. Douglas, MD wants to own all shares. D sets up interposing entity and gets that entity to make a cash offer to each member of the company  
• With respect to cash offer made to shareholders, who are all family members, a number of important pieces of information were not shared with them such as true value of the shares  
• He makes direct recommendations to shareholders that they ought to accept  
• Shareholders sell, then figure out they were missing key info relevant to price and bring proceedings against D and the Chair for breaching fiduciary duty owed to them  
• D argued Fiduciary duties owed to the company, so members collectively, not individual shareholders   | • Some exceptions may arise to the rule in Percival where the nature of the relationship between the particular director and particular shareholder is fiduciary in nature in which case fid obligations will be owed by that D to that S.  
• Relationship must be one which gives fid a special opportunity to exercise power to the detriment of the other person who is accordingly vulnerable to abuse  
• Court ultimately says that on the circs of this case, each of the Chair and MD owed a fiduciary duty to particular shareholders:  
• Family character of company  
• Position of two D’s in the company and family structure  
• High degree of inside knowledge (no one knew value of assets)  
• The way they went about persuading shareholders to sell – use of inside information, their position within the family and family members would have relied on guidance from them  
• All of these factors gave rise to a special fact fid relationship  
• Here, they wanted compensation for difference in price between what was received and what ought to be received – a personal remedy                                                                 |
| Glavanics v Brunninghausen | • Two brothers in law, together have all shares in company - 5,000 held by MB, remaining 1,000 by G  
• G got his shares because company imported ski accessories and B didn’t speak German but G did.  
• G starts another business that competes, and operates it from the same building as the company  
• G says to B, I’ll leave, resign as D and focus on my company and willing to sell back shares if you buy me out at a fair price – G proposes price and settles  
• G works out at the time he was negotiating, B has been discussing with a TP to sell assets of the company  
• G sold shares at undervalue   | • Launches proceedings against B, seeking individual fid duty that has been breached  
• Court says yes, there was a fid duty  
• Bryson J said directors don’t generally owe to individual shareholders, but to the company  
• In this case, fiduciary duty arose form special facts of the relationship  
• Close family association  
• B was sole effective director, meant he had exclusive advantage or opportunity in receiving offers to sell company assets  
• There was no other way for G to determine the fact an offer had been made other than through B.  
• G gets equitable compensation that makes up difference between price paid and price ought to be paid                                                                 |

**EMPLOYEES AND OTHER STAKEHOLDERS**

- Directors are under no special obligations to consider the interests of employees ahead of the interests of the company (i.e. members) (except to the extent that these interests coincide with the company’s interests) *(Parke v Daily News)*
- “The law does not say there are to be no cakes and ale except such as required for the benefit of the company” – Bowen LJ *Hutton v west Cork Railway*
• Similarly, directors have no direct legal obligation to consider the interests of other stakeholders such as customers or the wider community
• Directors may lawfully engage in philanthropic acts provided they are reasonably incidental to the business of the company, are bona fide transactions and are done for the benefit and to promote the prosperity of the company

<table>
<thead>
<tr>
<th>CASE</th>
<th>FACTS</th>
<th>DECISION</th>
</tr>
</thead>
</table>
| Parke v Daily News    | • The company published two newspapers that had been making substantial losses over a long period.  
• The directors proposed to sell the company’s newspapers and to use the proceeds to make ex gratia payments to employees who were going to lose their jobs due to the sale in addition to satisfying the employees’ entitlements to payment in lieu of notice, accrued annual leave and payment of their pensions  
• A minority shareholding challenged the proposed payments | • Plowman J agreed with the minority shareholder, holding that there was no duty on directors to have regard to employees’ interests.  
• The motives of the directors were described as laudable, and enlightened from the view of industrial relations, but this was not a legal justification for a payment that was not incidental to carrying on the company’s business  
• The fact that the employees were to be made redundant was central to this finding.  
• Providing benefits beyond their legal entitlements to continuing employees might well have been in the interests of the company  
• However, the company as an entity would not benefit from gratuitous payments to former employees |

THE INTERESTS OF THE CORPORATE GROUP
• Each company in a corporate group must be treated as having its own separate legal personality (Mason J in Walker v Wimborne)  
• To fulfil the duty in the group context, there must be evidence that the director considered the interests of the individual company, separate and alone from the interests of the group.  
• A transaction undertaken primarily for the benefit of the group may be upheld if there are collateral or derivative benefits for the individual company (Walker v Wimborne)  
• CHARTERBRIDGE TEST:  
  o Where it is clear that directors have not considered the interests of the relevant company, the proper test is:  
  ▪ Whether an intelligent and honest person in the position of the director could, in the while of the existing circumstances, have reasonably believed the transactions were for the benefit of the company  
  o NB: APPLY MASON J TEST FROM WALKER BUT MENTION CHARTERBRIDGE TEST.

<table>
<thead>
<tr>
<th>CASE</th>
<th>FACTS</th>
<th>DECISION</th>
</tr>
</thead>
</table>
| Walker v Wimborne     | • A had found itself in financial difficulties when one of its major debtors was unable to pay it.  
• The liquidator sought to recover several payments from the directors of A, one of which was a payment of $10,000 by A to another company in the group, Australian Sound and Communications (AS)  
• At the time, AS was in financial difficulty and was not in a position to repay the loan  
• On the same day, A borrowed $10,000 from another group company E.  
• The repayment of this sum was secured by an equitable charge to E. At the time of these transactions A was itself also insolvent | • Mason J, observed that the companies here were not part of a group in the strict sense, in that there were no common or interlocking shareholdings, with the consequence that A did not stand to lose if AS went into liquidation, or conversely derive any benefit if AS succeeded in staving off liquidation  
• Even in a group, each company is a separate and independent legal entity and it was the duty of the directors of A to consult its interests and its interests alone in deciding whether payments should be made to other companies.  
• This was because each company (whether a member of a group or not) had its own creditors who must look to that company for payment, and the creditors’ interests might be prejudiced by the movement of funds between companies if the companies became insolvent |
Equiticorp Finance

- Bank of NZ loaned a lot of money to an entity, U, in the EC group
- The purpose of the loan was to allowed U to make a takeover bid in shares in another company
- U’s direct parent entity secured the loan
- Something went wrong with the bid, stock market crash, and bank got worried about extent of the loan and approached EC and asked for funds that other EC companies had sitting in bank accounts to be applied to draw down U’s debt
- The upshot of the request is that two other entities in EC, FL and SA, transferred money in bank of NZ to draw down U’s debt.
- Sometime after the other entities had arranged for transfer, FL and SA went into liquidation
- Liquidator says the transfer of funds from FL and SA was not in their best interests and therefore directors breached their duty

- NSWCA applies Charter Bridge Test
- The test in this case would be whether an intelligent and honest person in the position of the director of the company could in the whole of the existing circumstances have reasonably believed the transaction were for the benefit of the company
- Walker test forces directors to have regard to the interests of the relevant company and if you fail to do that it is a breach of duty
- Charter Bridge test is different in that if you end up in a group situation where it is evident directors didn’t consider interests of company, it is not automatically a breach.
- NSWCA decided directors duties hadn’t been breached on the basis that intelligent and honest directors could have reasonably believed in the same situation that transferring the funds to the benefit of U would in fact deliver a benefit to FL and SA – the court formed the view that the loss of Bank of NZ’s support to the group overall would have been potentially disastrous to SA and FL – the erosion of confidence among bankers would have immediately impacted FL and SA’s ability to raise money and meet their commitments
- There is a risk that FL and SA if it didn’t keep the bank happy would have been tarred with the same brush as other members of the group
- Directors would have had justification for the belief that the welfare of the group was tied with the welfare of the individual companies
- The majority in obiter said had they been left to their own devices; they would have preferred to use the test by Mason J in Walker v Wimborne

Directors of Wholly Owned Subsidiaries

Section 187 - A director of a corporation that is a wholly-owned subsidiary of a body corporate is taken to act in good faith in the best interests of the subsidiary if:

(a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and
(b) the director acts in good faith in the best interests of the holding company; and
(c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director’s act.

THE INTERESTS OF CREDITORS

- Directors do not have to have regard to the interests of creditors where the company is solvent.
- HOWEVER
- Where the company is insolvent or in financial difficulties the interests of the company are really those of its creditors (Kinsela)
- In a solvent company, the interests of shareholders entitled them as a general body to authorise or ratify actions that would otherwise constitute a breach (Kinsela)
- In an insolvent company, the interests of creditors intrude and shareholders cannot ratify a directors’ breach of duty that involved prejudicing the interests of creditors

Issues that arise

- There is no general test of the degree of financial instability required in order for the duty to be triggered (Kinsela)
- If the duty is triggered, what exactly must directors do in order to avoid breach?
  - Exercise their powers in a way that does not prejudice the company’s ability to pay its creditors