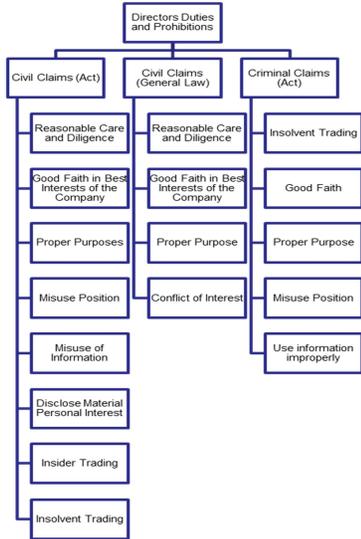


1. CORPORATIONS LAW

Legislation & case law



A. Selected restrictions arising under corporate law (directors/managers)

→ 'Pine Vale': The directors incurred substantial debts from the purchasing of trading outlets of competing companies. Then the directors issued shares to existing S/H to fund the purchase. These actions were challenged by S/H. The court held that the directors exercised their powers primarily or substantially for a proper purpose (a natural expansion of the business of the company). -> in good faith and in the best interests of the company. P. 366

3.3 act for a proper purpose

CORPORATIONS ACT 2001 - SECT 181 - Good faith—civil obligations

Good faith—directors and other officers
(1) A director or other officer of a corporation must exercise their powers and discharge their duties: (a), and (b) for a proper purpose. This subsection is a civil penalty provision

- 1) Must be for the proper purposes of the company as a whole.
- 2) To determine whether a director has exercised a power for an improper purpose the courts determine:
 - a) firstly, the particular power in question and the legal purposes for which the power may be used; and
 - b) secondly, the intentions of the director and the actual purpose for which the director exercised the power.
- 3) Many cases involve the issue of shares for an improper purpose.
3. With reasonable care and diligence (CA s 180) p. 360, 362- same in negligence
 - a. Requirement:

The directors and senior managers of a company must use reasonable care, skill and diligence in the exercise of their powers and in the performance of their duties. (City Equitable; AWA Overend; McGhee; Lagunas; Vrisakis; Dean; Stebbings; Denham; Fermo; Francis)
 - b. Examples of Areas of Application
 - i. Familiarity with the affairs of the company (Re Australasian Venezolana)
 - ii. General oversight and management (Re One.Tel; Rich)
 - iii. Transaction due diligence (Re HIH Insurance; Adler)
 - > Check through company's things, like auditing.
 - > 'Re HIH Insurance': This company has already bankrupted, because it paid too much to buy another company. Its directors did not do due diligence before acquiring FAI company, showing a bad management.
 - iv. Loans (Parker)
 - > Ensure interest rate reflect the risk.
 - > Cannot issue loans to company who can't pay (i.e. don't have income or work).
 - v. Company accounts, financial reports and dividends (Loiterton; Healey; compare Friedrich)
 - > 'Friedrich': Never learned to read financial statements is not an excuse, because as a director, you have to learn.

i. Setting the scene

1. Agency Theory
 - a. The managers of a company may not necessarily also be members of the company
 - b. Rational individuals will act to maximise their utility by acting in a way that is consistent with their perceived self-interest
 - c. Managers of a company therefore may not necessarily act in the best interests of the members of the company
2. S/H and managers are different people. As long as S/H don't own 100% shares, there will be potential Agency Theory problems.

ii. The legal response

1. Power with Responsibility
 - a. Directors generally have the power to manage the company in terms of its operational decisions, strategy and financing. (CA s 198A(1); Cuninghame)
 - b. Accordingly, the law imposes certain restrictions on the actions of a company's directors and senior managers by broadly requiring their conduct to comply with certain requirements. (CA ss 180, 181; Pollitz)

iii. Duty to Act (purpose: to align interests between managers and S/H)

1. In good faith in the best interests of the company (CA s 181(1)(a)) p. 363
 - a. Objective Test:
 - Could an intelligent and honest person in the position of the director or manager (and who is acting reasonably) believe that the action in question is for the benefit of the company? (based on the time when the decision was made, not later on when this decision is challenged by the court) (Linter; Earrow; Charterbridge; Wayde)
 - i. "Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational": (Hutton)
 - b. Does not necessarily mean that a court will scrutinize the merits or otherwise of the decisions of a company's board of directors closely. (Harlowe's) 'The court will not determine you are not guilty owing to the merits of your decisions, because they will probably not scrutinize the merits. They just use an objective test to see if you are acting in the best interest of the company.'
 - c. In general, would prevent directors from benefiting themselves at the expense of the company. (Mills) HOWEVER, the court will not challenge every decision of directors that others personally don't like. -> fairness.
 - Why would directors act at the expense of the company?
 - e.g. Directors who are paid based on NP will ignore long-term interests of the company. Managers are more risk averse than S/H.
 - d. 'The Company'
 - i. The company as a commercial entity (Darvall; cf Ngurli)
 - ii. The company's members (Greenhalgh)
 - iii. Legally, directors must maximize S/H's interests.
 - iv. Not necessarily another company in a corporate group (Walker; Equiticorp)
 - > e.g. X is parent of Y. If the interests of X and Y are conflicted, then directors of X should act in X's best interests. You can act in the interests of outsiders only if these interests are not conflictual with S/H.

c. Standard of care expected may depends on:

- i. Status of the director
 1. Executive (involve in day-to-day running of the company); (Greenlade)
 2. Non-executive (not an employee of the company; only attend the board meetings); (Butte)
 - > The director doesn't like to attend the meetings, but will read all documents after the meetings. The company has fraud and S/H sues the director. The court held that the director is guilty because he must attend the meetings. There is a breach of duty, but no causation (directors who attend every meeting still do not detect the fraud). Thus, the director doesn't have to pay in this case.
 3. Executive directors have higher standard of care.
- ii. Position held
 1. CFO (should know financial status) ((Vines; cf AWA)
 2. Chairperson of the board of directors (should influence what's on or not on the agenda; control) (Rich)
 3. They own higher standard of care than ordinary directors.
 - iii. Special knowledge, skills or abilities (Brazilian Rubber; compare Gamble)
 - 'director had left school at the age of 14 years, had no tertiary qualifications and had spent his life as a fruit and vegetable market gardener.'
 - > To be a director, you must have certain level of knowledge, skills or abilities, otherwise, you are running at your own risk.
 - > IF you have extra knowledge, skills or abilities, your standard of care will be adjusted up.
 - > BUT if you have lower level of knowledge, skills or abilities, your standard of care will not be adjusted down.

3.1 act with care and diligence4

<<<Key provision>>>

CORPORATIONS ACT 2001 - SECT 180

Care and diligence—directors and other officers
(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
(a) were a director or officer of a corporation in the corporation's circumstances; and
(b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

iv. Prohibition in Relation to the improper use of position (CA s 182) p. 367

1. A director, senior manager or employee of a company may not improperly use their position: (alternative)
 - a. to gain an advantage for themselves;
 - b. to gain an advantage for another person; or
 - c. to cause detriment to the company
 - > a member, former member, or person entitled to be registered as a member, of the company or of a related body corporate; or an officer or former officer of the company; and the person is acting with leave granted under section 237.

- v. Not necessarily 'third party outsiders' (e.g. employees, customers, suppliers, the community, the environment ...) (Hutton; cf New South Wales)
 - > 'Hutton': Directors wants to pay compensation to employees who are made redundant, but S/H objects. S/H sue the directors and they win, because these employees are not needed by the company. They should not get paid. IF they can still add values to the company/are productive, they can get paid.

3.2 act in good faith in the best interests of the company

CORPORATIONS ACT 2001 - SECT 181

- Good faith—civil obligations
Good faith—directors and other officers
(1) A director or other officer of a corporation must exercise their powers and discharge their duties:
(a) in good faith in the best interests of the corporation; and
This subsection is a civil penalty provision
2. For proper purposes (CA s 181(1)(b))
 - a. The powers of a company's directors and senior managers must be exercised for proper purposes. (Allen; Ure; Richard Brady; Provident; Rolled Steel; Vatcher; Teck; Topham)
 - b. General Examples of Proper Purposes
 1. To raise funds (cf Pine Vale; Condraulics; McGuire; Ashburton)
 - ii. To promote the company's long-term stability (Harlowe's)
 - c. General Examples of Improper Purposes
 - i. To dilute the shareholding of a member (Kokotovich)
 - ii. To entrench control of the company
 1. member(s): (Whitehouse)
 2. directors: (Hogg)
 - iii. To effect a change in control of a company (Howard Smith)
 - iv. Self-interest is the most common example of improper motive (Wilberforce, Howard Smith)
 - v. Expenditure of Company Funds (not to conduct a campaign to effect a re-election of directors) (Advance Bank)
 - vi. Company Buying or Selling Property
 - In general, not to provide a substantial financial benefit to directors. (Wheeler)
 - d. 'Mixed' purposes (some are proper but others are improper)
 - it has to be shown that improper purposes are: (alternative)
 - i. the 'substantial reason' for the action(s) (Advance Bank; Condraulics; Ngurli; Whitehouse); or
 - ii. a significant reason 'but for' which the relevant action(s) would not have been taken (Haselhurst; Winthrop; Darvall; Wheeler; Pine Vale)
 - It must be shown that the substantial purpose was improper and that, but for the improper purpose, the director would not have exercised the power.
 - Based on which purpose is prevailing, ruling, dominant and influential. IF the improper ones are, then you are in trouble. BUT if the proper ones are, you are fine and the court will not set aside a transaction.

2. IF the director doesn't act in the interests of the company/for proper purposes/with care and diligence, you need to think of whether he uses the position improperly.

3. Examples

- a. Acting to obtain a benefit to the potential detriment of the other creditors of the company (Grave)
 - Based on the situation: IF the director is one of the creditor and pays himself but not pay other creditors.
 - S 588G requires a director to protect the interests of creditors.
- b. Acting without authority (e.g. form a contract) (Byrnes)
- c. Transferring the assets of the company to the detriment of the company (Heilbronn)
- d. Motivation or Intention (irrelevant)
 - It is not necessarily relevant that the person who used his or her position in this way did not intend a detriment to the company (for example, by believing that the relevant action was in fact in the interests of the company): (Chew)
 - Objective test

4. Potential Overlap

Conduct that is in breach of s 182 may also give rise to a contravention of other prohibitions or duties, and vice-versa (Jeffrey; Edwards; Matthews)
-> IF the director uses his position improperly, then you should also consider whether he acts in the best interests of the company, whether he acts for proper purposes and whether he acts with care and diligence, and vice-versa.

CORPORATIONS ACT 2001 - SECT 237(Criteria used by the court when considering whether to grant permission)

- Applying for and granting leave
(2) The Court must grant the application if it is satisfied that:
(a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them; and
(b) the applicant is acting in good faith; and
(c) it is in the best interests of the company that the applicant be granted leave; and
(d) if the applicant is applying for leave to bring proceedings—there is a serious question to be tried; and
(e) either:
(i) at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or
(ii) it is appropriate to grant leave even though subparagraph (i) is not satisfied.