

TOPIC 8: DIRECTORS' DUTIES

Duty to Act in Good Faith (For the Best Interests of the Company)

WRITE: Directors' duties are designed to encourage care and a high standard of loyalty on the part of the directors. Per **s 181(1)(a)**, [X] has a duty to act in good faith in the best interests of [the Company]. There is no distinction between the statute and general law test, as the statute stands alongside the latter (**s 185**)

Statute

- Consequences and remedies are different to that of the general law (**s 181(2)**)
- This provision is a civil penalty provision
- If the director or officer is **reckless or intentionally dishonest** in exercising the duty, it is a criminal offence (**s 184(1)**)

TEST

WRITE: [X] will have been acting in good faith if [X] believes that they are acting in the best interests of the company (subjective) and the belief was reasonable (objective overlay, Santow J in *Adler*) in those circumstances (*Bell Group (No 9)*)

Step 1: Apply the two-factor test per Per Owen J, *Bell Group Ltd (No 9)*

Subjective Inquiry (*Bell Group (No 9)*)

Write: It is not the role of the court to adjudicate on the commercial value of a decision. But it is upon the court's inquiry to subjectively determine whether [X] exercised his/her powers honestly in what he/she believed to be in the company's best interests and not for some ulterior purpose. Taking into account that Malcom CJ in *Chew v R* held that "honesty" involved [select element] ... [X] is found/not found to be in breach.

Malcom CJ in *Chew v R* held that "honesty" involved the following elements:

- Directors must not misuse or abuse their powers
- Directors must avoid conflict between personal interests and those of the company
- Directors should not take advantage of their position to make secret profits
- Directors should not misappropriate the company's assets for themselves

Objective Overlay

Write: Subjective good faith alone is insufficient, so the court applies an objective overlay to its assessment. Considering the surrounding circumstances of the [transaction], such as [detail circumstances], no reasonable board of directors would have considered the actions to be in the best interests of the company (*Bell Group*, Owen J). This objective inquiry does/does not discount the assertions that the directors made about [insert what they said to be their intention] (*Bell Group*, Owen J).

Step 2: Do the facts suggest particular interests are involved

1. The interests of existing members as a whole

- The oppression remedy provides remedies for conduct of the affairs of the company in a manner that is "contrary to the interest of the members as a whole"
- **s 461(1)(e)** which provides grounds for winding up there the directors "have acted in the affairs of the company in their own interests rather than in the interests of the company as a whole"

2. Corporate groups' interests

Write: As each company in a corporate group is treated as having its own SLE (*Walker*), directors of each company only owed duties to the company in which [X] is a director of (*Walker*). However, there are circumstances where the benefit to the holding company can be for the benefit of the subsidiary and the group as a whole.

- **TEST:** whether an **intelligent and honest man in the position of the director**, could, in the whole of the circumstances, have reasonably believed that the transactions were for the benefit of the company (Pennycuik J, *Charterbridge*)
 - Would the holding Company going into bankruptcy affect the subsidiary?
 - A decision made in the group's interest rather than the individual company's interest alone may not be a breach of duty if it is necessary for corporate group's welfare that the subsidiary is provided with a benefit and the transaction provides that benefit (*Equiticorp*)
- By way of dicta in *Equiticorp* it was held that as a matter of commercial reality, the best interests of one company in a corporate group can be **inextricably linked** to the interests of the other companies in the group
- **s 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

3. Creditors' interests

Write: Where a company is **insolvent** or **nearing insolvency** (*Kinsela v Russell Kinsela*), fiduciary duties are owed so as to not prejudice creditor's interests (*Walker; Kinsela*). However, creditors have no standing to enforce this duty (*Spies v R*) and only the liquidator may sue for breach. As a result, members cannot ratify/authorise a breach of this duty.

5. Employees Interests

Write: directors are not required to consider and put the company's employees ahead of member interests (*Parke*). However, if the interests of employees can be regarded as affecting the interests of the company, they may be considered

6. Individual Shareholders

Write: directors duties are owed to shareholders as a whole, but they are not required to have regard to the interests of individual shareholders. However, a 'special fact' fiduciary relationship may arise where a particular transaction does not concern the company but only another shareholder. In which case the director will owe a duty to the individual shareholder (*Coleman v Myers*).

Consider: if there is some special dependency or special relationships with that shareholder (*Brunninghausen v Glavanics*)

Exception: Nominee Directors

Write: Nominee directors must act in the best interests of the company in which they are directors, but the constitution may permit them to act in the best interests of a particular third party (i.e. shareholder/creditor) (*Levin v Clark*)

- If they honestly believe there is no conflict between their appointer and the company, then they can act for the appointer.
- This does not mean that nominee directors cannot act solely in the interest of their appointer (*Levin v Clark*)

Duty to Act for a Proper Purpose

WRITE: Directors are given a wide range of power (s 198A) and the powers must be exercised for the proper purpose for which they are conferred (s 181(1)(b)). Onus is on the [alleging party] to prove that [insert power] was not exercised for any collateral or improper purpose (Ipp J in *Permanent Building Society v Wheeler*). There is **no distinction** between the statute and the general law test, as the statute stands alongside the latter (s 185)

Statutorily

- **However**, consequences and remedies are different (s 182(2))
 - This provision is a civil penalty provision
 - *Note:* if the director or officer is **recklessly or intentionally dishonest** in exercising duty, it is a criminal offence (s 184(1)) (see remedies)
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General Law - TWO STEP TEST (summarised by Ipp J in *Wheeler*)

(1) As a matter of fact, what are the purposes for which the power was conferred?

Examples of **proper purpose**:

- Share issue as consideration for purchase of asset
- To foster business connections
- Share issue to raise capital to benefit the company
- Share issue as part of employee remuneration (*Whitehouse* – obiter)

Examples of **improper purpose**:

- Defeat a takeover bid (*Howard Smith*)
- Facilitating a friendly takeover by destroying existing/creating new majority (*Howard Smith*)
- Entrenching control of the company by allotting shares in one group of shareholders at the expense of others (*Whitehouse*)

(2) As a matter of law, what are the purposes for which the power can validly be conferred?

- If there is a **sole improper purpose**, then there will be a breach (*Whitehouse*)
- If there are **mixed purposes** (both improper and proper) two tests apply:
 - Substantial purpose test (*Howard Smith*): if the substantial purpose for which the power is exercised is improper, then there will be a breach
 - But for test (*Whitehouse v Carlton Hotel*): If, but for the improper purpose the power would not have been exercised, then there will be a breach
- This will always be determined based on evidence
- Directors' honest belief that it would benefit the company does not make the conduct a proper purpose

