

7. DIRECTOR'S DUTIES: GOOD FAITH & AVOIDANCE OF CONFLICT OF INTEREST

1. duty to act in good faith in the best interests of the company

- director must act in good faith in the best interests of the company
 - general law duty
 - statutory duty
 - s 181 - *a director or other officer of a corporation must exercise his or her powers and discharge his or her duties in good faith and for a proper purpose*
 - restates equitable principles of duties owed btwn fiduciaries & those they protect

the duty requires that:

- director must act in GOOD FAITH = honestly
- director must do what they believe is BEST for the COMPANY
 - not themselves or a particular stakeholder group (eg. majority)
- director must understand what is meant by the *'interests of the company'*
- director must genuinely believe that they are acting in the best interests of the company
 - **subjective test**: honest belief, AND
 - **objective test**: breach if they act in a way no reasonable director would say is in the best interests of the company
 - onus on person alleging breach of duty

interests of the company

- generally, the interests of a solvent company are those of its MEMBERS
- *Bell Group [2008]*
 - directors must look to the company *'as a whole'*, and balance competing interests
- must act fairly as between members of different classes
- separate commercial entity
 - *are directors entitled (or required) to look to the long term viability of the company as a commercial entity, not just at the short term benefit to current shareholders?*
 - issue not resolved - although sometimes creeps into takeovers cases

interests of creditors

- the creditors' interests become those of the company when a company is insolvent/ 'nearing insolvency' - *Kinsella (1986)*; *Walker (1976)*
- it is a duty to the company, not a duty to creditors - *Bell Group (2012)*; *Kalls Enterprises (2007)*

interests of corporate groups

- *do directors have to consider the interests of each subsidiary separately, or can they do what is best for the group overall?*
 - for some wholly-owned subsidiaries, directors allowed to act in interests of holding company if the requirements of s 187 are met
- directors are taken to meet the requirements of s 187 if:
 - constitution expressly authorises
 - acts in good faith in best interests of holding company
 - company not insolvent or made insolvent

interests of other group companies

- where s 187 does not apply, each company's separate interests prevail
- TEST
 - whether a person in the position of the director could have reasonably believed the decision would benefit the company
- *Charterbridge Corp Ltd v Lloyds Bank Ltd [1970]*
 - must balance group benefit from the benefit that may flow to the individual company

interests of other stakeholders

- *can directors take into account the interests of employees, customers, suppliers and the community?*
 - technically, cannot receive priority over interests of members
- *Parke v Daily News [1962]*
 - coy owned 2 major daily newspapers - sold 1
 - intended to distribute surplus proceeds of sale to employees who lost their jobs as a result of the sale
 - shareholder tried to stop those payments to employees
 - HELD
 - the payments were not beneficial to the company as a whole because it gave the employees a greater benefit than the company as a whole
 - 'best interests of the company' = payment to employees whose employment continues

2. duty to exercise powers for proper purposes

even if directors actions are in the company's best interests, may still be a breach of duty if a power is NOT exercised for a proper purpose

- statutory duty (s 181) & general law duty

two step test - *Howard Smith case*

Howard Smith v Ampol Petroleum [1974]

- takeover battle for RW Miller (Holdings) Ltd
 - A/Bulkships owned 55% of Miller - made takeover bid for M for the balance
 - HS 'white knight' – offer higher price
 - M's directors issued extra shares = reducing A/B's position to under 50%
- HELD: breach of their duty
 - not accept directors' explanation to raise working capital
 - no defence that in interests of shareholders to promote auction for shares

1. question of law – for what purpose was the power conferred?
2. question of fact – for what purpose was the power exercised?

'but for' test - *Whitehouse case*

Whitehouse v Carlton Hotel (1986)

- ▶ MIXED PURPOSE - if there is a mix of proper and improper purposes
 - test is the 'but for' test, not the 'dominant' purpose
- *eg. allocation of shares is the impermissible purpose causative in the sense that, but for its presence, no allotment would have been made*

examples

• SHARE ISSUE POWER

- normally a power of the BoD – s124, s198
- proper purposes include:
 - to raise capital
 - for an employee share scheme as consideration for purchase of an asset
- improper purposes include:
 - to entrench the existing board of directors
 - to fight off a hostile takeover bidder
 - to make a majority member a minority member

• USE OF COMPANY FUNDS TO PROMOTE RE-ELECTION OF DIRECTORS

- expenditure of company funds in a contested election of directors?
- *Advance Bank Australia Ltd v FAI Insurance (1987)*
 - no absolute prohibition - kept to a minimum
 - confined to supplying information which promotes an informed decision by shareholders

• DIRECTOR'S REFUSAL TO REGISTER TRANSFER

- RR - Pty Ccy s 1072G CC
- power cannot be used for improper purpose
- see also s 1071F

consequences of breach

- ▶ s 181 - civil penalty provision
 - declaration of contravention and orders - s 1317E
 - pecuniary penalty of up to \$200,000 - s 1317G
 - disqualification from management - s 206
 - compensation for damage suffered - s 1317H
- ▶ s 184 - criminal (offence) provision
 - reckless or intentionally dishonest
- ▶ general law duties
 - company's right to equitable compensation for breach of duty

3. conflicts of interest and disclosure

- ▶ director must not place him/herself in a position where there is an actual or substantial possibility of conflict between a personal interest and the director's duty to act in the interests of the company
- ▶ UNLESS the permission of the company is obtained or the constitution allows it

general law conflict rule

- ▶ very strict duty - designed to protect shareholders
- can arise eg. where director:
 - contracts with the company
 - makes personal profit as a result of her or his position as a director
 - misuses confidential company information
 - works for a competitor

transactions with the company

- very common situation triggering the general law conflict rule
- director's interest in the transaction may be:
 - direct
 - indirect - eg. through another company/partnership (*Aberdeen Railway (1854)*)

taking corporate property, information or opportunity

- *Furs Ltd (1936)*
- when can a director resign to take up an opportunity?

- *Industrial Development Consultants Ltd v Cooley [1972]*
- director will be in breach even if the company cannot itself take up the opportunity, unless the company formally agrees
 - ***Regal Hastings Ltd v Gulliver [1942]***
 - RH owned a cinema - wanted to lease 2 other cinemas & sell the business as a going concern - subsidiary set up for this purpose
 - RH took up 2000 shares and 4 directors, company solicitor and another allocated the balance
 - sale all shares in RH & subsidiary to purchaser
 - profit of 3 pounds p/share in subsidiary
 - new directors of RH brought action against directors to recover profit they had made due to non-disclosure
 - HELD - even though transactions were honestly made, old directors liable to account for that profit
 - not relevant that the company could not proceed
 - not relevant that the company had not suffered

conflict of duties

- director may not place her/himself in a position where there is an actual or substantial possibility of a conflict between the director's duty to the company and the director's duty to someone else (eg. another company)
- *South Australia v Marcus Clark (1996)*
 - MD of the State Bank of SA arranged for the bank to enter into a contract with another company in which Clark was a director and shareholder
 - HELD to be a conflict of interest and in breach of his duty of care

other conflicting interests

- competing companies
 - non-executive director can be on boards of competing companies if no breach of duty (ie. no actual conflict of duties) and no disclosure of confidential information
- nominee directors
 - duty to the company prevails over duty to nominator

BUT will not be a contravention if...

- company consents
 - full disclosure made to members in general meeting and members 'ratify' by passing an ordinary resolution approving OR
 - CC permits it with full disclosure to board, and full disclosure is made
 - eg. RR s 194; *Queensland Mines (1978)*
- CC modifies the duty

- CC may include provisions allowing conflict with full disclosure to, and consent of, the board
 - proprietary companies, see RR s 194
 - public companies must expressly include - s 195

statutory duty to avoid conflict of interest - s 182-183

- disclosure of interests by directors - s 191-194
- restrictions on voting by directors of public companies - s 195
- prohibition on improper use of position or information - s 182-183
- financial benefits given by public companies to related parties, including directors - s 208

disclosure of interest - s 191-194

- director must disclose material personal interest to the board (unless exempt)
- *Grand Enterprises (2009)*
 - matter must relate to affairs of the company, and
 - potential for conflict must be real and substantial
- s 194 Pty companies: RR – may vote (provided disclosed)
 - does not apply to single director proprietary company

voting restrictions (public company directors) - s 195

- director with a material personal interest in a matter being considered by the board must not be present or vote at the meeting unless the other directors (or ASIC in limited circumstances) allows it

improper use of position or information

- directors are not allowed to use:
 - their position (s 182), or
 - information obtained in that position (s 183)
- to gain advantage for themselves or someone else, or to cause detriment to company

s 182

- a codification of the principle that officers or employees cannot improperly use their position to gain an advantage for themselves or to cause detriment to the company
- statutory version of *Regal Hastings [1942]*
- *ASIC v Adler [2002]*
 - A used position in HIH to improperly gain an advantage for Adler Corp (s 182)
- *ASIC v Vizard [2005]*
 - improper Use of Information (s 183)

breach of fiduciary duty (and statutory equivalents)

- personal profits from acting as director (*Regal Hastings*)
- receiving bribes or other undisclosed benefit
- misusing company funds
- diverting contracts away from the company
- causing the company to not make use of beneficial opportunities
- misusing confidential information
- competing with the company

ASIC v Adler (2002)

- **HIH collapse 2001 with \$5.3b debts**
 - A (director of HIH & its subsidiary)
 - HIH provided undocumented, unsecured \$10m loan to Adler Corp (*Pacific Eagle Equity*)
 - \$4m buy HIH shares (later sold at \$2m loss)
 - \$4m to buy shares in unlisted technology companies from Adler Corp (at cost even though market value significantly less)
 - \$2m unsecured & undocumented loan to A & associates
- **action by ASIC (cf the common law duty)**
 - breach **s 181** duty to act in good faith
 - breach **s 182** duty not to improperly use position
 - breach **s 183** duty not to improperly use information
 - contravention of related party provisions - **s 208**
 - provision of financial assistance in purchasing shares in HIH – **s 260A**
- **civil penalty - s 1317E**
 - pecuniary penalty of up to \$200,000 - **s 1317G**
 - disqualification from management - **s 206**
 - compensation for damage suffered - **s 1317H**
- **criminal liability under s 184(1) where reckless or intentionally breach of duty**
 - A banned for 20 yrs
 - A & Adler Corp each fined \$450,000
 - A & Williams ordered to pay \$7.05m as compensation

related party transactions

- **Ch 2E - restricts ability of public company/entity controlled by public company, to confer a financial benefit upon (among others) the public company's directors, their family or entities controlled by them**
 - unless exempt or approved by ordinary resolution of GM
- **s 208 - if a director of a public company derives a financial benefit, shareholder approval is required for benefit to 'related party'**

- 'financial benefit' defined in **s 229**
- related party defined in **s 228**
- procedure set out in **s 217-227**
- approval not required for matters set out in **s 210-6**
 - eg. 'terms that would be reasonable in the circumstances if the public company were dealing at arm's length'

▸ **related party disclosures in financial statements**

- **Accounting Standard AASB 124** - must disclose the value of all benefits to related parties
- eg. director or related party is a customer or supplier

consequences of breach

- **general law duty**
 - eg. claim for damages, account of profits, rescission of contracts
- **statutory provisions**
 - **s 191** - fine \$1,100 and/or 3 months prison
 - **s 195** - fine \$550
 - **s 181, 182, 183** - civil penalty provisions
 - **s 184** - criminal offence provision
 - **Ch 2E s 208**: civil penalty provision