

**79014**

**APPLIED COMPANY LAW**

**Note for FINAL exam**

**Good luck studying**

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## Topic 5: Directors' Duties

### To whom are the directors' duties owed? Pg.452

- Directors owed duties to *'the company as a whole'* - meaning not the company as an entity outside and apart from its shareholders, but rather the general body of shareholders. Who can sue?  
**Greenhalgh v Ardenne Cinemas Ltd [1951] pg450.**
- Duties *are not owed to particular individual shareholders* (case **Percival v Wright** (1902): a case where directors who purchase share from an individual shareholder without informing him about the affecting the value of his share as the duty was owed to the company not individual shareholder -> this prevents individuals from taking action against the board of directors for breach the duty, because duty owed to company not individual -> this means only company could take against the board (case **Foss v Harbottle**)
- Officers *don't owe duty to consider the employee's interest.*

### ❖ Duty to consider creditors' interests

(case: **Walker v Wimborne**, pg 454 -> duty to consider interest of shareholders and creditors as creditors often provide financial report vital for the company's success pg.455).

- Duties of company directors and officers are owed to the company.
- Directors don't owe duties to the creditors while the company is solvent pg.557 (Spies case pg. 454; **Spies v R (2000)**, High court decision make it clear that...)

Because in the case: **Walker v Wimborne**, pg 454 -> duty to consider interest of shareholders and creditors as creditors often provide financial report vital for the company's success pg.455. Thus, the duty on director to consider creditors' interests arises when the company is insolvent or approaching insolvent (case **Kinsela v Russell Kinsela Pty Ltd** (1986) -> not harm the interest of creditor on an insolvency context).

- Directors owe duties directly to the creditors is when the company is **insolvent** s588G (**Bell Group Ltd v Westpac Banking Corp** (2008) pg.455) -> Directors personally liable to creditors for insolvent trading.
- Another illustration pg.455: **ASIC v Sydney Investment House Equities Pty** (2008), where a company director breaches s180, s181, allow company to loan another company > both companies is insolvent -> harm creditors' interests.

### ➤ Consequences of breaching this duty

Creditors can't sue the director personally (same with shareholders) because duties are owed to the company pg. 557 (reason discussed in **Spies case** pg.454).

Case: **Barnes v Addy (1874)**, a person who receives property (like money) as a result of breaching of trust or fiduciary duty maybe liable to return money. It relates to the **Bell case** pg.558 that the directors breach the duties by acting to benefit particular companies in a group (and their bankers) without considering the benefit to each individual company at a time when the insolvency of the companies was doubtful.

❖ **duty to prevent insolvent trading ;**

S95A, the company is insolvent where it is unable to pay its debts and when they become due and payable.

- Directors owe duties directly to the creditors is when the company is **insolvent** s588G (**Bell Group Ltd v Westpac Banking Corp** (2008) pg.455)  
-> Directors personally liable to creditors for insolvent trading.

**Reasonable ground to suspect insolvency** : (in **ASIC v Plymin (2003)**, pg.568 list some of relevant factors: continuing losses, overdue taxes, and so on), (**Metropolitan Fire System v Miller** (1997), lack of incoming payments and continuing incur debts -> breach their duty under s588G).

+ Companies, through directors, are prohibited from trading while insolvent as this will place creditors at risk pg.564.

+ The act allows for the **“corporate veil”** to be lifted when insolvent trading occurs.

+ If the company is unable to pay its debt, then the directors should be personally liable for debts incurred after the after the date of insolvency s588M.

+ The insolvent trading provisions allow an creditor to sue the director of an insolvent company to repay for the debt (**Commonwealth bank Ltd v Friedrich** (1991) pg.564.

+ All directors have an obligation to prevent insolvent trading, including non-executive directors (**ASIC v Plymin** (Water wheel case) pg.570).

+ S588G and s588H was based on the assumption that a director would participate in the management of the company -> a total failure to participate shouldn't be regarded as a 'good reason'.

- **Defences to insolvent trading** (s588H) pg.571.

**s588H(2), reasonable expectation of solvency** -> requires directors to have reasonable grounds for being confident that the company is solvent in case **Hall v Poolman** pg.572. (This issue arose in **Metropolitan case** pg.572 -> no ground to prove that), also failed in **Re McLellan; The Stake Man Pty Ltd v Carroll** (2009) pg. 573). Directors who are passive and not asking for information is not success in this defence: **Statewide Tobacco Services Ltd v Morley** (1990) -> Sleeping directors are over -> raising the standards of care, skill and diligence.

**s588H(3), reasonable reliance on others** pg.573. In respect of breaches of s180(1)(care and diligence), who reasonably rely on information of the company is solvent provided by others s189.

In **William v Scholz** (2007) -> fail to establish this defence due to distrust of the person relied on.

In **Re McLellan; The Stake Man Pty Ltd v Carroll** (2009) -> fail to use this defence since the accountant wasn't specifically engaged for the purpose of providing advice as to solvency.

*Elements must prove: Elements must be proved;*

- Director relied on information provided by the other person
- Director had reasonable grounds to believe that the other person had the responsibility of providing the director with information about the company's solvency
- Information provided allowed the director to expect company was solvent and would remain solvent if incurred any debt.

**s588H(4), absence from management**. This defence requires the need for directors to engage with the management, unless they can offer valid reasons for absence based on the statutory criteria of either 'illness' or 'some good reasons'.

In **DCT v Clark** (2003) pg.576 -> couldn't rely avoid liability for insolvent trading on the basis that leaving the business to someone else was 'some good reason'.

S588G and s588H was based on the assumption that a director would participate in the management of the company -> a total failure to participate shouldn't be regarded as a 'good reason'.

In **Morley v Statewide Tobacco Services Ltd** (1993) pg.577 -> couldn't rely on the lack of participation in the management of the family company to excuse from the statutory obligation -> directors (even non-executive directors will not have a valid defence against insolvent trading.

In **William v Scholz** (2007) pg.578 -> fail to use the 'illness' reason since evidences show that he went to the company's premises every day, attend meetings regularly.

**s588H(5), reasonable steps to prevent company incur debts** pg578. Company may avoid the insolvency if the director can take reasonable steps to prevent from incurring debts. In **ASIC v Plymin** (Water wheel case) pg570 -> demonstrates that the director won't be able to escape liability -> are unable to prevent the debt from being incurred.

- **Repay debts incurred during insolvency s588M (consequences)**

+ Breaching of S588G is a civil penalty provision.

+ The amount recoverable is the amount of the creditors' loss or damage. The timeframe for bringing the action is limited to six years from the beginning of the winding up s588M(4).

In **Aris v Express Interiors Pty Ltd** (1996), whether the proceeding brought by the liquidator or the creditor? -> The court states that since the company is the plaintiff and thus it should be the liquidator. For creditors to against the director under

s588M, the liquidator must consent in writing (s588R) or the creditor must obtain leave of the court.

- **Relief from liability s1317S**

Where the directors are found to have contravened the insolvent trading under s588G, they may apply to the court for relief from the liability under s1317S. This applies to civil penalty provisions provided in s1317E.

Where the directors has attempted reasonably to rescue the business from financial ruin -> may possible to obtain relief from the liability pg579. In **Hall v Poolman** (2007) -> be aware of the reasonable grounds to suspect insolvency, then he allowed company to continue trading when it was hopelessly insolvent. He acted reasonably to save company -> was excused from liability. In **Re McLellan; The Stake Man Pty Ltd v Carroll** (2009) pg.581, directors didn't profit himself and regarded the professional advice during insolvency -> relief from liability.

- ❖ **duty of care, skill and diligence; common law duty**

- Non-executive directors cannot avoid liability by claiming the non-executive status pg.523 in case **ASIC v Rich** (2003), **Commonwealth bank of Aus v Friedrich** (1991), **AWA v Daniel** (1992), **Daniels v Anderson** (1995). All directors (no matter about experiences and skills) have a fundamental obligation to monitor the performance of the company.
- Release misleading information -> breach s180 pg528. In **ASIC v Fortescue Metals Group Ltd** (2011), for allowing company to make misleading statement that it has entered into a 'binding contract'. In **ASIC v Citofresh International Ltd**, director drafted a misleading ASX. In **ASIC v Healey** 2011 (Centro case), t involves directors failing to comply with their duty of care under s180 by allowing the company to release inaccurate financial report.
- Acting with negligence.

In **Re City Equitable Fire Insurance Co Ltd** (1925) pg.514, Claims made against the directors of an insolvent company who had signed fraudulent cheques producing from managing director -> issue, whether the director fails to detect the fraud before signing -> act with gross negligence (breach s180).

In **AWA v Daniel** (1992) pg.518, auditors and executive directors liable in negligence -> fail to put in place an effective internal system. The larger the company is, the better level of monitoring will be required.

In **Daniels v Anderson** (1995), principles of the modern directors are in pg519.

In **Commonwealth bank of Aus v Friedrich** (1991), a director is obliged to obtain a general understanding of the business of company and should have independent judgement. It is important to determine the size/nature of the company, 'reasonable director' have done, and director's position to apply this case.