



# Corporations Law

Exam notes

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# Directors' duties

## Summary

Duty	Source	Owed by	Sanctions
<b>Duty of care and diligence</b>	s 180(1)	Directors and officers	Civil penalty (s 1317E)
<b>Good faith</b>	s 181(1)(a)	Directors and officers	Civil penalty (s 1317E) Criminal penalty (s 184(1)(c))
<b>Proper purpose</b>	s 181(1)(b)	Directors and officers	Civil penalty (s 1317E) Criminal penalty (s 184(1)(d))
<b>Disclosure and voting restrictions</b>	ss 191–195	Directors only	Criminal offence
<b>Misuse of position and information</b>	ss 182–183	Directors, officers, secretaries and employees	Civil penalty (s 1317E) and for persons 'involved' (ss 182(2), 183(2)) Criminal penalty (ss 184(2), 184(3))
<b>Related party transactions</b>	ch 2E	Directors only	Civil penalty for persons 'involved' (s 209)
<b>Financial assistance</b>	s 260A	Directors only	Civil penalty for persons 'involved' (s 260D)
<b>Insolvent trading</b>	s 588G	Directors only	Civil penalty (s 1317E) Compensation of company (s 588J)

## Sanctions

- Where a director or officer breaches their duties, they are liable under the Act's statutory penalties regime.
  - Where a court is satisfied that a contravention has occurred, it will be declared under s 1317E.
  - After it has been declared, a pecuniary fine may be imposed on the defendant (s 1317G).
  - Criminal penalties are also available. For a 'reckless' or 'intentionally dishonest' breach of good faith duties, criminal penalties are available (s 184). Similarly, where a director or officer 'dishonestly' gain a financial benefit without shareholder approval, they commit an offence (s 209(3)).
  - Disqualification from managing a company may also be imposed (pt 2D.6).
  - Compensation orders may also be made under ss 1317H and 1317J.

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# Identifying directors and officers

## Definition of director

- The *Corporations Act* defines ‘director’ as extending to three categories: (1) **duly appointed directors**; (2) **de facto directors**; and (3) **‘shadow directors’** as legal persons who are not appointed, but the directors of the company are accustomed to act in accordance with the person’s instructions or wishes (*Buzzle*).
- Directors are in fiduciary relationships with their company (*Hospital Products*).

**Hospital Products** — Mason J stated that a fiduciary ‘undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of the other personally in a legal or practical sense’

On the facts, [X] is a duly appointed director of [the Company] (s 9). [X] is therefore subject to the suite of directors’ duties set out in the Corporations Act.

## De facto directors

- De facto directors are persons either appointed as director but given a different title, or persons whose appointment is *invalid* but they act in the role of director regardless (s 9).
- Examples include: where there is no valid appointment (*Richborough*); where a person purports to resign but carries on to continue to act as director (*Williams v Bearing Traders*); where a person is removed, but continues to act as director (*Resource Equities*); where a person undertakes duties of a director (*Mistmorn*); or where a person represents to be director to third parties (*Forkserve*).

**Deputy Commission of Taxation v Austin** — in considering the characteristics of de facto directors, Madgwick J noted the following considerations: whether the person exercises ‘top management functions’; how that person is perceived by outsiders of the company; authorised by the board to negotiate on important matters; determine content of prospectus; making decision affecting the financial standing of the company.

‘Top management functions’ may include being authorised by the board to negotiate on the company’s behalf on important matters; deciding on the content of a prospectus; deciding who should be issued shares; and making other high-level management decisions that could affect the company’s financial standing (*Chameleon Mining v Murchison Metals*).

Noting that [X]’s appointment as director was invalid because [...], and having regard to the fact that [X] has nevertheless continued to act as a director, a court is likely to consider [X] to be a ‘de facto’ director, and therefore subject to directors’ duties.

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## Shadow directors

- Shadow directors are persons who are not appointed as director but the (actual) directors of the company are accustomed to act in accordance with the persons instructions or wishes (s 9).
- A person is not a shadow director merely because directors act on the advice of that person (s 9)
- To demonstrate that a person is a shadow director, it must be shown that the **governing majority of the board of directors habitually comply, or are accustomed to act in accordance, with the wishes or instructions of the alleged shadow director, over a period of time** (*Buzzle*, White J).
- It is not necessary that the wishes or instructions concern the whole areas of corporate activity for which the directors are responsible
- Being 'accustomed to act' requires 'habitual compliance over a period of time'. A mere *tendency* to following the third party's advice, or feeling *compelled* to follow the third party's advice is not sufficient.
- There needs to be some causal connection between the instructions given, and the directors' subsequent actions.

***Buzzle v Apple Computer*** — The liquidator of Buzzle alleged that Apple and its Australian managing director were 'shadow directors', such that recovery was possible under s 588M.

Court held that what needs to be shown is that the governing majority of the board of directors must act in accordance with the third party's wishes or instructions. The mere fact that the board will tend to follow the advice of a third party will not make that third party a shadow director. **Directors must have surrendered their individual discretion** and will such that they are in a habit of following the instructions of the third party for that third party to be considered a shadow director. Certainly Apple had considerable bargaining power over and above Buzzle — and Buzzle may well have felt that it had no choice but to follow the instructions of Apple — but this is not sufficient for a finding of 'shadow director' under s 9.

- Body corporates cannot be appointed, but nevertheless can constitute shadow directors (*Antico*).

***Antico*** — Pioneer indirectly owned 42% of the shares in Giant, and three of Pioneer's officers were nominee directors on Giant's board. Alone, these factors were not enough to indicate Pioneer was a (corporate) shadow director of Giant, but the following factors indicated it was: **(1)** Pioneer had **effective control** of Giant by virtue of the distribution of shareholdings (other shareholdings were 10%, 6%, 6% and 3%); **(2)** Pioneer **imposed financial reporting standards** on Giant used by the rest of the Pioneer group; **(3)** major decisions made by Giant were effectively decisions made by Pioneer and **decisions were accepted** by Giant; **(4)** Pioneer's decision to fund Giant showed 'a willingness and ability to excretes control, and an actuality of control, over the management and financial affairs of Giant' (Hodgson J).

Court held that accordingly, Pioneer could be held liable for certain debts of Giant under s 588G (insolvent trading).

Due to the fact that [...], it appears that the governing majority of the board of [the Company] habitually comply with the wishes of instructions of [X], such that [X] may be a shadow director of [the Company]. In agreeing to do [...], the directors of [the Company] have surrendered their individual discretion.

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## Definition of officer

- The *Corporations Act* defines ‘officer’ as a director or secretary of the company or a person: **(1)** who makes or **participates in the making of decisions that affect ‘the whole, or substantially the whole’ of the company**; **(2)** who can **affect the company’s financial standing**; or **(3)** a person on whose instructions the directors of the company are accustomed to act (s 9).
- Persons including directors of holding companies (*ASIC v Adler*), management consultants (*Dwyer v Lippiant*) and CFOs or joint secretary-GCs (*Shafron*) may be caught by the definition of ‘officer’ and made liable for any applicable directors’ duty breaches.

**ASIC v Adler** — Santow J considered whether Adler fell within the meaning of ‘officer’ at s 9 of the Act. Due to Adler’s active role on the investment committee of HIHC and the fact that the company’s investments underpinned its entire business, Adler was in a capacity to affect the financial standing of the company, and therefore, was considered an ‘officer’ under s 9.

- In determining whether a person ‘makes or participates in the making of decisions’, regard must be had to the **general role played by the person in a corporation**, not necessarily their role in relation to a specific issue introspect of which there has been an alleged breach (*Shafron*).

**Shafron** — Shafron was the company secretary and general council of James Hardie; ASIC alleged he contravened s 180(1) of the Act by failing to discharge his duties with reasonable care and diligence. Shafron argued that as general council, he only provides advice which is used by other who make decisions which may attract liability under s 180(1). Shafron sought to argue he s only an ‘officer’ in respect of his responsibilities as company secretary.

Court rejected Shafron’s argument: once a person is an officer of a company in respect of *some* aspects of their role, they are an officer in relation to *all* aspects of their role. Regardless, the court found an independent grounds for finding Shafron to be an officer: Mr Shafron was a senior executive in the company’ responsible for formulating proposals for the restricting of the James Hardie group; his role was not confined to providing advice and information to the board; he played a ‘large and active part in formulating proposals’.

Court held that participation in the making of a decision is about making a ‘significant contribution’ to a decision being made. A person will be an ‘officer’ within s 9 if they make: (1) a ‘real contribution’ to (2) a ‘decision that affects the whole or substantially the whole of the business of the corporation’ (it must affect financial standing), and (3) their contribution has some causal connection to the decision made.

- In determining whether a person can ‘affect the financial standing of the company’, regard must be had to whether the person is involved in the **management of the company** (cf *ASIC v Citigroup*: trader was only responsible for his own share trading, so no real ability to affect the company’s financial standing).

**Buzzle** — White J held that the definition of ‘officer’ under subs-s (b)(ii) (‘affect financial standing’) should not be read literally. Apple certainly had the ability through its bargaining strength to ‘affect the financial standing for the company’, but its ability to do so did not relate to playing a role in the management of Buzzle.

[X] is likely to be regarded as an ‘officer’ within the meaning of s 9 of the Act by a court. On the facts, [X] was actively involved in [the Company]’s decision to [...] (similar to *ASIC v Adler*), which plainly affected the ‘financial standing’ of [the Company] by making it become insolvent (s 9).