

# Topic 7 – Directors’ Duties

## Exam Notes

Duty	Source	Owed by	Owed to
Duty to act in good faith and in best interests of the co	s 181(1)(a) and fiduciary law	Directors and officers	The company
Duty to act for a proper purpose	S 181(1)(b) and fiduciary law	Directors and officers	The company
Duty to not fetter discretion	Fiduciary ( <i>Thorby v Goldberg</i> )	Directors	The company
Duty to avoid conflicts of interest	Fiduciary	Directors/senior employees	The company
	s 194 only re disclosure of interest (MPI) rules	Directors	The company (both public and pty cos, except single D pty cos)
Duty to not make a profit	Fiduciary	Directors	The company
Related party transactions	Ch 2E	Directors	Public cos only
Duty not to misuse position	s 182	Directors, secretaries, other officers, employees	The company
Duty not to misuse information	s 183	Directors, secretaries, other officers, employees	The company
Duty of care, skill and diligence	s 180	Directors and officers	The company
	<i>ASIC v Vines</i> (Common law) <b>NB. Not fiduciary</b> Equitable duty of care Tort - negligence	Directors and officers	The company

### Duty to Act in Good Faith in Best Interests of the Company

Duty	Source	Owed by	Owed to
Duty to act in good faith and in best interests of the co	s 181(1)(a) and fiduciary law	Directors and officers	The company

[D/officer] is a D/officer and thus owes both a fiduciary (*Re Smith & Fawcett*) and statutory (s 181(1)(a)) duty to act in good faith (GF) and in the best interests (BIs) of the co. The duties are very similar and so shall be discussed together.

### Whose interests/to whom is duty owed?

- In general, the duty to act in GF means that Ds must act in the BIs of the co: the SHs as a collective group (*Greenhalgh; Percival*)
  - Where different groups/classes of SHs have divergent interests, the duty is to act fairly between all SHs (*Mills v Mills*)
- Generally, the interests of the SHs as a whole is to generate financial benefit for the co (As this is how the SHs receive a benefit)

- Can make a counter argument here that many non-financial activities produce a benefit for the co/SHs (free advertising, improvement to co reputation etc.)
- Such benefits may be intangible and difficult to quantify in specific dollar values, however they may nonetheless justify D's decisions

### Individual Shareholders

#### General Rule

- The general rule is that a duty to act in the BIs of the co doesn't mean that Ds owe duties to particular SHs (*Percival v Wright*)

Case	Facts and Decision
<i>Percival v Wright</i>	D purchased shares from SH but didn't disclose that there was an impending takeover bid at a much higher price; D's failure to disclose info concerning impending takeover even though it did not eventuate did not constitute a breach of duty

#### Exception

- However, [X] will argue that the 'direct and close relationship' or 'trust, confidence and specific dependence' between [D] and [X] gives rise to a special duty owed by [D] to [X] as an individual SH (*Coleman v Myers*)
  - Most likely in small, family-owned cos
- Factors giving rise to a special fiduciary duty to individual SHs:
  - Dependence upon information and advice (per Woodhouse J in *Coleman v Myers*)
  - The existence of a relationship of confidence (per Woodhouse J in *Coleman v Myers*)
  - The significance of some particular transaction for the parties (per Woodhouse J in *Coleman v Myers*) and if transaction is directly between Ds and SHs, rather than co and SH (*Galvanics*)
  - The extent of any positive action taken by or on behalf of the D or Ds to promote it (per Woodhouse J in *Coleman v Myers*)
  - D possessing special knowledge acquired while managing the co (*Galvanics*)

Case	Facts and Decision
<i>Coleman v Myers</i>	<ul style="list-style-type: none"> <li>• MD of <u>family co</u> arranged for co to be taken over at under-value by new co controlled by him; MD failed to disclose material info concerning his potential profits and misled the SHs as to the true value of the co's assets and thus the true value of shares</li> <li>• Breach of duty to individual SHs as SHs heavily depended on him for info and advice (insider knowledge), the transaction as significant and info relevant to the true price of shares had been withheld from SHs</li> </ul>
<i>Brunninghausen v Galvanics</i>	<ul style="list-style-type: none"> <li>• B &amp; G were brothers-in-law and SHs and Ds of a <u>family co</u>; G (minority SH, no mgt role and no access to financial records) sold shares to B (MD), who on-sold them at a much higher price in the context of a takeover</li> <li>• B possessed special knowledge acquired while managing the co re takeover which gave him an opportunity to sell the co's business advantageously; should have been promoted to all SHs</li> </ul>

### Employees (and non-member stakeholders)

- There is no corporate law requirement that Ds consider the interests of co employees, but Ds should not consider the interests of employees at the expense of the interests of the co's SHs (*Parke v Daily News*)
  - → consider whether interests of employees and SHs/co align (if yes, likely permissible to consider employees' interests)

- [X] will argue that the employees' BIs are not in the co's BIs, as [act leading to alleged breach] is not in the BIs of the SHs as a whole (*Parke v Daily News*)
- In most cases, a payment to employees will be in the interests of the co where their employment continues because its industrial relations may be improved → this didn't happen in *Parke*
- NB: labour laws must be complied with as not in the BIs to be in breach of the law

Case	Facts and Decision
<i>Parke v Daily News Ltd</i>	<ul style="list-style-type: none"> <li>• Newspaper co being wound down; Ds intended to distribute surplus proceeds from sale among retrenched employees beyond the usual legal requirements</li> <li>• Proposal was rejected on basis that making these gratuitous payments to former employees was to the detriment of SHs and the co as a whole</li> </ul>

### Corporate Groups

- A HC will usually appoint its nominees as Ds of SCs
- In practice, nominee Ds on the board of a SC are required by the HC to act in the best interests of the group of cos

### General Rule

- The general (legal) rule is that Ds must act in the BIs of the individual co to which the D was appointed (i.e. SC), not in the BIs of the group as a whole (*Walker v Winborne*)
  - This is based on the separate legal entity principle
  - Usually HC and SC interests align - eg/ approving intra-group transactions, loans, guaranteeing other external borrowings of other group members; however, where there is a conflict, the above rule will apply

### Exception

- [D/officer] may argue that [transaction benefiting related co in group] had the collateral benefit of [collateral benefit] to [co eg/ SC], which ultimately rendered it in the interests of [co] (*Equiticorp*).
- Where it can be shown that the first co (eg/ SC) obtained collateral or derivative benefits from the assistance that was given to other cos in the group, there will be no breach (*Equiticorp*)
- Ask: are co + group's interests 'one and the same' (*Equiticorp*)

Case	Facts and Decision
<i>Equiticorp v Bank of New Zealand</i>	<ul style="list-style-type: none"> <li>• Funds were transferred from 2 cos in a group to satisfy the debt of a related co</li> <li>• The welfare of the group was tied up with that of individual cos in the group because they were identified as a group; loss of bank's support would have been potentially disastrous for 2 cos from which funds were used because loss of confidence among bankers and group depositors would impact on their ability to raise money and meet commitments</li> <li>• HC had also guaranteed the loan; if guarantee called on, it would have created liquidity crisis for HC and each individual co</li> </ul>

### Special Case: Directors of wholly-owned SC

- A D of a co that is a wholly-owned SC of a body co is taken to act in GF in BIs of the subsidiary if (s 187):
  - (a) the consti of the SC expressly authorises the D to act in the BIs of the HC; and
  - (b) the D acts in GF and in the BIs of the HC; and

- (c) the SC is not insolvent at the time the D acts and does not become insolvent because of the D's act

### Creditors

- As [co] is [insolvent/nearing insolvency], [X] will argue that [co]'s BIs extend to not prejudicing the creditors' interests (*Westpac; Kinsela*)
  - Duty still owed to co but content of duty has changed to consider creditors' interests in context of insolvency
  - Individual creditors cannot sue if Ds fail to consider creditors' interests but liquidator can
- Members cannot ratify a D's breach that involves prejudicing the interests of creditors (*Kinsela*)

Case	Facts and Decision
<i>Kinsela v Russell Kinsela Pty Ltd (in liq)</i>	<ul style="list-style-type: none"> <li>● SHs unanimously approved the granting of a lease of business premises to two of the Ds at a price substantially lower than market value while co was clearly insolvent</li> <li>● As co was insolvent, Ds had to consider creditors interests not SHs and SHs could not ratify the breach</li> </ul>
<i>Westpac Banking Corp v Bell Group Ltd [No 3]</i>	<ul style="list-style-type: none"> <li>● Bell group couldn't repay loans (i.e. heading towards insolvency) and so entered into refinancing transactions with several banks which allowed them to take security over all the assets of the Bell group and resulted in them getting priority over all other creditors</li> <li>● Bell group found to be in breach of duty as were required to consider interests of all creditors given group was heading towards insolvency</li> </ul>

### Nominee Directors

- Nominee Ds sometimes appointed to represent sectional interests – often to represent interests of individual SHs in joint venture co; but may also be appointed to represent majority SH, class of SHs, creditors, HC, employees or govt body

### General Rule

- Prima facie, nominee Ds have the same duty as regular Ds, meaning they have to act in the interests of the co to which they are appointed, not the entity that nominated them
- May act in interests of their appointor if they honestly and reasonably believe that there is no conflict of interest (*Re Broadcasting Station 2GB Pty Ltd*)

### Exception

- However, a co's consti or SH agreement may specifically permit the appointment of nominee Ds to represent the interests of a particular SH or creditor (*Levin v Clark*)
  - i.e. may act in the BIs of the SH/creditor that nominated them to be D
  - Duty still owed to co, but content of the duty has changed to act in mortgagee/creditor interests (*Levin*)

Case	Facts and Decision
<i>Levin v Clark</i>	<ul style="list-style-type: none"> <li>● Levin purchased majority shareholding in co and simultaneously mortgaged shares to vendor to secure payment of purchase price; sales agreement amended consti to appoint nominee Ds to represent interests of vendor and mortgagee</li> </ul>

	<ul style="list-style-type: none"> <li>When L defaulted and Ds proceeded to exercise their power to enforce the mortgage, they were not acting in breach of duty but the content of their duty changed to allow protection of mortgagee's interests</li> </ul>
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Given [interest(s) of the co], did [D/officer] act in GF in pursuit of these interests?

- Given the interests of the co include [relevant interest], [X] will argue that [D/officer] [did/did not] act in GF in the BI of [relevant interests]. The test is a subjective test with an objective overlay.
- Test: D must have bona fide or subjectively believed they were acting in the BIs of the co (*Fawcett*) AND a reasonable/rational D in those circumstances would reach the same conclusion (*Bell Group*)
  - Court will not second guess the commercial decisions of the co, but will look for objective evidence that D sought to benefit the co (*Bell Group*)
- Ds' actions that confer a benefit on themselves do not prevent those actions also being in interests of the co if the Ds acted in GF in the BIs of the co

Ratification - can ratify breach of fiduciary duty (except breach of duty to act in GF for BIs of co where creditors interests are at risk due to insolvency - *Kinsela*); can't ratify breach of statutory duties under ss 180-184

### Consequences of Breach (Remedies)

Whilst the test to determine the breach of the GF duty is the same under the equitable fiduciary duty and the statutory duty, the remedies for the breach differ.

#### *Remedies for Breach of Fiduciary Duty*

- See equitable remedies below - equitable compensation, account of profits etc.

#### *Remedies for Breach of Statutory Duty*

### Civil Liability

#### Actions pursued by ASIC

- Section 181** is a civil penalty provision. Thus, under s 1317E [D/officer]'s breach entitled ASIC to apply for a declaration of contravention from the Court. If the declaration is granted, then ASIC can seek, against [D/officer]:
  - A pecuniary penalty order (s 1317G); and/or
  - A civil penalty compensation order, on behalf of the co (i.e. money goes to the co) (s 13127H); and/or
  - An order disqualifying [D/officer] from managing a co (s 206C)
- The Court may:
  - decline to impose a penalty (*ASIC v Healey (Centro)*); or
  - decide to relieve [D/officer] from liability, if they have acted honestly and ought fairly to be excused for their breach of a civil penalty provision (s 1317S)

#### Actions pursued by the co

- Regardless of whether ASIC pursues a civil penalty order, [co] may bring incidental proceedings for a compensation order (s 1317H(2)), under s 1317J(2), to recover any loss occasioned due to [breach]
- The co doesn't need a declaration of contravention in order to obtain compensation (in fact, only ASIC can apply for one, although may intervene in an ASIC application (see below))

### Criminal Liability

- [D/officer] will be criminally liable for their failure to exercise their powers and discharge their duties in good faith in the best interests of the co if they were reckless/dishonest in [breaching conduct] (s 184(1)(c))