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DIRECTORS & OFFICERS

S9AC CA

- (1) A **director** of a company or other body is:
- (a) a person who:
 - (i) is **appointed to the position of a director**; or
 - (ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position; and
 - (b) unless the contrary intention appears, a person who is not validly appointed as a director if:
 - (i) **they act in the position of a director**; or
 - (ii) **the directors of the company or body are accustomed to act in accordance with the person's instructions** or wishes (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation).

S9AD CA

- (1) An officer of a corporation (other than a CCIV) is:
- (a) a **director or secretary** of the corporation; or
 - (b) a person:
 - (i) who **makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation**; or
 - (ii) who has the **capacity to affect significantly the corporation's financial standing**; or
 - (iii) **in accordance with whose instructions or wishes the directors of the corporation are accustomed to act** (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation)

WHO ARE DIRECTORS' DUTIES OWED TO?

Percival v Wright	Director's duties are owed to the company which is the primary agent for their enforcement, but this is not an absolute rule
Gaiman v National Association for Mental Health	Director's duties can be owed to present and future members if the facts give rise to it. For example, if you have grounds to suspect your company is being infiltrated by those who want to sabotage it (facts of this case)
Spies v the Queen	Directors don't owe their duties to creditors, even in insolvency. BUT: <ul style="list-style-type: none">• the duty is to the company, which may encompass creditor interests if the company is nearing insolvency• Directors must therefore consider creditor interests when financial difficulty arises, because shareholders' interests no longer dominate
Parke v Daily News Ltd	No duty is owed to employees except as consistent with best interests of the company

Coleman v Myers	Duties may be owed to individual members in family companies where there is a degree of reliance/vulnerability/dependence on a director.
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DIRECTORS DUTIES

S185 CA
Sections 180 to 184: (a) <u>have effect in addition to, and not in derogation of, any rule of law</u> relating to the duty or liability of a person because of their office or employment in relation to a corporation (i.e. General law action survives)

DUTY OF CARE

AT GENERAL LAW:

Daniels v Anderson (1995) [ED and NED negligent in relying on advice of company employees and failing to review financial statements]	A director owes <u>to the company</u> a duty to take reasonable care in the performance of their office . This duty requires directors to take reasonable steps to place themselves in a position to guide and monitor the management of the company. <ul style="list-style-type: none"> • Objective; director's lack of knowledge/inexperience is irrelevant • Follows that it must be exercised with a degree of care and skill that an ordinary prudent person would exercise in a similar position under similar circumstances • Unless, a director holds themselves out as having particular experience or skills (the standard is higher) • Duty applies equally to executive and non-executive directors (cf. <i>Awa Ltd v Daniels</i> (1992)) • Effectively a tort standard (negligence)
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STATUTORY DUTY UNDER THE CORPORATIONS ACT:

S180(1) CA
(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: (a) were a director or officer <u>of a corporation in the corporation's circumstances</u> ; and (b) <u>occupied the office held by, and had the same responsibilities</u> within the corporation as, the director or officer.

ASIC v Maxwell	IN APPLYING s180(1) ...whether the relevant duty had been breached, the foreseeable risk of harm must be balanced against the potential benefits
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	<p>which could reasonably be expected to accrue to the company from that conduct.</p> <p>NOTE: Although liability under s 180(1) does not require actual harm or detriment to the company in contrast to liability in tort, the same balancing of foreseeable risk and benefit applies as under the general law duty.</p>
Cassimatis v ASIC	<p>IN APPLYING THE BALANCE DESCRIBED IN ASIC V MAXWELL:</p> <ul style="list-style-type: none"> • The reference to harm is best understood as a reference to harm to any of the interests of the corporation (may be pecuniary and non-pecuniary) • The competing considerations to be weighed by directors are not always commensurate, it is an imprecise test • Forward looking to what a reasonable person would have done (without the benefit of hindsight) • Analysis under s180(1) must take place from the perspective of the corporation's circumstances and the office and responsibilities of the individual director whose conduct is in question
<p>ASIC v Healey</p> <p>[Directors authorised flawed financial statements]</p>	<ul style="list-style-type: none"> • Directors have a personal responsibility to understand and focus on the financial statements they approve. • They must have a basic knowledge of accounting concepts and conventional accounting practices. • They cannot delegate this duty entirely to others (e.g. management or external auditors). • They must read, understand, and consider whether the financial statements present a true and fair view of the company's financial position.
ASIC v Adler	<ul style="list-style-type: none"> • A failure by a conflicted director to gain an independent valuation and to bring his/her conflicted position to the attention of fellow directors could represent a deficiency in care on the part of the conflicted director

Applying s 180(1) to corporate officers and specific company positions

Shafron v ASIC	Secretary and General Counsel	<ul style="list-style-type: none"> • Shafron's responsibilities as company officer were not determined solely by those referable to his appointment as secretary • i.e. s180(1) is not confined in its operation to persons who hold an office formally recognised in the corporation as contemplated by para (b)
ASIC v Rich	Chair	<ul style="list-style-type: none"> • The chair has special responsibilities but that the scope of such responsibilities is naturally shaped by contextual factors • E.g. if the chair plays a central role in decision-making or communication between management and the board, their standard of care may be higher

		<ul style="list-style-type: none"> • Some factors; Size, business, complexity, delegation and structure of the company
Permanent Building Society v Wheeler	CEO	<ul style="list-style-type: none"> • Special or heavier responsibilities imposed on CEOs compared to other officers or directors, which of become more pronounced when that position is coupled with that of the chair • Still circumstantial, e.g. what type of information does the CEO have available that other directors do not. • Broadly accepted that CEOs are expected to monitor the company's actual financial performance, including its sales and profits • They cannot avoid their duty of care by asserting a conflict of interest, abstaining from board decisions and burying their head in the sand

Examples of a breach of the duty of care:

Case	Summary facts
<i>CBA v Friedrich</i> (1991)	NEDs failed to monitor rogue CEO effectively (insolvent trading)
<i>Vrisakis v ASC</i> (1993)	Alleged (but on appeal not found) that director failed to follow agreed business plan in corporate rescue
<i>Permanent Building Society v Wheeler</i> (1994)	Managing director failed to inform rest of board of risks of new line of business (property development) in which he had a conflicting duty and in which he alone had expertise
<i>Daniels v Anderson</i> (1995)	Managing Director failed to implement controls and tell board of risk management failings on forex trading by young employee
<i>ASIC v Adler</i> (2003)	Directors avoid board governance committee review to pay one of their number \$10 million with no documentation or controls
<i>ASIC v MacDonald</i> (2009)	Directors authorised flawed financial disclosure to market
<i>ASIC v Rich</i> (2003)	Alleged Directors failed to properly inform the board of the financial condition of the Co: ASIC failed to prove this was the case. Bus judgment rule was available but not required.
<i>ASIC v Healey</i> [2011]	Directors authorised flawed financial statements in Annual Report
<i>ASIC v Cassimatis</i> (No 8)	Directors caused company to breach financial advice laws

DUTIES OF GOOD FAITH AND PROPER PURPOSE

AT GENERAL LAW:

Single underlying equitable obligation: a discretionary power must be exercised by directors “bona fide – that is, for the purpose for which it was conferred, not arbitrarily or at the absolute will of the directors, but honestly in the interest of the shareholders as a whole” (*Ngurli v Cann*)

Good Faith

The traditional formulation expressing the duty of good faith requires directors to

act “bona fide for the benefit of the company as a whole”

- In its application to directors, the inquiry is directed to the intention, motive and beliefs of the directors, and whether they have made the “interests of the company” their primary consideration
- Directors will abuse discretionary powers if they use them to achieve an advantage for themselves, confer a benefit upon a third party, a shareholder, a stranger to the company or to damage the company itself

1. Subjective “good faith”

<p>Re Smith and Fawcett Ltd</p> <p>The sole remaining director refused to register the transfer of shares (50%) to block the estate of a deceased co-director from gaining control of the company</p>	<ul style="list-style-type: none"> • Directors must exercise their powers bona fide in what they honestly believe to be in the best interests of the company, not what a court considers it to be. • Discretion is wide, but not unlimited • Company interests aren’t just about what benefits shareholders immediately — directors can make decisions aimed at the long-term health or stability of the company
<p>Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Company NL</p> <p>The directors refused to register share transfers, which could have led to a takeover</p>	<ul style="list-style-type: none"> • Courts will not second-guess directors’ decisions made in good faith and within their powers, even if those decisions appear unwise or controversial — provided there is no evidence of bad faith, improper purpose, or breach of duty. • On the evidence, the directors did not exercise the power for this purpose, they, in good faith issued more shares to ensure the company’s long-term stability, rather than the impermissible purpose of defeating the mystery buyer

2. Objective “benefit to the company”

<p>Hutton v West Cork Railway Co</p>	<ul style="list-style-type: none"> • <i>“Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational”</i>
<p>Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)</p>	<ul style="list-style-type: none"> • The directors must give real and actual consideration to the interests of the company. The degree of consideration that must be given will depend on the individual circumstances. But the consideration must be more than a mere token: it must actually occur. • In ascertaining the state of mind of the directors the court is entitled to look at the surrounding circumstances and other materials that genuinely throw light upon the directors’ state of mind so as to show whether they were honestly acting in discharge of

	their powers in the interests of the company and the real purpose primarily motivating their actions.
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Proper Purpose

Howard Smith Ltd v Ampol Petroleum Ltd	
	<ol style="list-style-type: none"> 1. The court must consider the scope of the relevant power and determine the range of permissible purposes for which the power may be exercised. Informed by context, in light of the company constitution (question of law) 2. The court assesses the evidence before it in determining the actual purpose for which the director exercised the power and whether this falls within the scope of the power (question of fact) <ol style="list-style-type: none"> a. NOTE: Directors are motivated by both impermissible and permissible purposes. If the moving cause for directorial action is improper (i.e. causative), then this will invalidate the exercise of the power (<i>Mills v Mills</i>) b. This is different if the power is exercised ostensibly to benefit the company, but really to benefit themselves (<i>Ngurli Ltd v Cann</i>)

Ngurli Ltd v Cann Directors issued new shares under constitution to the managing director's father (who supported them), which diluted another shareholder's control.	<ul style="list-style-type: none"> • Even if a power (like issuing shares) is within authority, its actual purpose must align with its intended use. • Otherwise, it amounts to an abuse by the directors of the powers conferred on them by the articles
Hogg v Cramphorn Directors issued shares to a trust to block a takeover bid they feared would harm the company and its employees.	<ul style="list-style-type: none"> • Power to issue shares must be exercised to raise capital, not to influence voting power or alter control (that is an improper purpose) • Even if directors honestly believe they're acting in the company's best interests, the means which they adopted to attain their end were improper. • i.e. good faith is not a defence to improper purpose.
Howard Smith Ltd v Ampol Petroleum Directors issued shares to a company making a takeover offer, diluting a rival bidder's stake. The stated reason was to fund a development project (really to prevent takeover)	<ul style="list-style-type: none"> • The issue of shares was within power, but it was exercised for an improper purpose • The vitiating element in this case was the director's self-interest in keeping employment • Where the self-interest of the directors is involved, they themselves are not permitted to assert their action is bona fide in the interest in of the company

STATUTORY DUTY UNDER THE CORPORATIONS ACT:

S181 CA
