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Directors' Duties

Note: Members cannot ratify statutory duties (*Miller v Miller*)

Note: Can be both a director *and* an officer at the same time

Note: if *general law* duties are breached, regular remedies lie in the hands of the company for breach of fiduciary duty

ALWAYS: consider involvement in a breach (s 1317E(4) and s 79)

Consequences: Breach of a civil penalty provision makes possible, inter alia, a declaration of contravention, pecuniary penalty order, or compensation order against the infringing director(s) (s1317J(1)).

Directors and officers

[!] **Threshold: Is the person and director or officer of the corporation?**

- **[1] Duly appointed director (regardless of position name):**
 - a person who is appointed to the position of director (**CA s 9(a)(i)**); or
 - a person who is appointed to the position of alternate director and is acting in that capacity (**CA s 9(a)(ii)**)
 - **Note:** to be duly appointed, director must be appointed by a resolution passed in general meeting (s 201G)
 - The **directors** of a company may appoint a person as a director. A person can be appointed as a director in order to make up a quorum for a directors' meeting even if the total number of directors of the company is not enough to make up that quorum (**s201H**)
- **[2] De facto director**
 - **Unless contrary intention appears**, a person who is not validly appointed as a director but acts in the position of a director (**CA s 9(b)(i)**)
 - **Objective test (Smithton)**
 - A person's honest belief that they're not acting as a director will not prevent a court deciding that the person is a de facto director contrary to the objective evidence
 - Must exercise **top-level management functions** (*DCT v Austin*)
 - **Relevant factors:**
 - Do they exercise the duties expected to be performed by a director in the relevant company? (*DCT v Austin*)
 - Size of the company and allocation of resources of company relevant to this (*DCT v Austin*)
 - **See s 198A** (replaceable rule); company constitution
 - Were the duties actually performed by that person (*Grimaldi; Austin; Smithton*)
 - Did others in the company *perceive* them to be a director? (*Smithton*)

- Did the company *hold out the person* as a director? (*Grimaldi*)
 - Did the person *hold themselves out* as a director (*Forkserve*)
 - Did those outside the company consider the person to be a director? (*Grimaldi*)
- **Facts in *Grimaldi*:** person was authorised by the board to negotiate on its behalf, decided the content of the mining prospectus, decided who would be issued shares, and was perceived by outsiders as a director
- **[3] Shadow director**
 - **Note:** a company can be a shadow director
 - **Unless contrary intention appears**, a person in accordance with whose instructions or wishes the directors of the company or body are accustomed to act (**CA s 9(b)(ii)**)
 - **Note:** a person is not a shadow director merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors of the company (**CA s 9**)
 - **Basic requirement (*Buzzle*):** the directors must be **accustomed to act** as directors of the company (and not in some other capacity) **in accordance with the shadow director's instructions** or wishes regarding how the directors should so act
 - ***Buzzle*:** must be a **causal connection** between the **instruction** or the wish of the shadow director **and the directors acting** on it.
 - Not sufficient if the act that was specified in the instruction is something that the directors **would do irrespective of the instruction (it's a 'but for' test)**
 - For the directors to be "**accustomed to act**" in accordance with the instructions or wishes requires "**habitual compliance over a period of time**" (***Buzzle***)
 - The directors **collectively** must be accustomed to act on the shadow director's instructions or wishes and it is sufficient if a "**governing majority**" of the board is so accustomed to act (***Buzzle***)
 - ***Buzzle*:** Not sufficient if —
 - executives who are **not directors** are **accustomed** to act on a person's instructions or wishes (although such a person might be a de facto director); or
 - if the instructions or wishes are **given to a director in their capacity as an executive** and not in their capacity as a director: at
 - **Relevant facts in *Buzzle*:**

- **Apple ≠ shadow director.** Apple had considerable control over important decisions made by Buzzle which the directors of Buzzle felt constrained to make to meet targets needed to obtain rebates, which in turn were necessary to achieve realistic margins. A lender is free to **act in its self-interest and impose such conditions on the company as the lender sees fit, using the lender's bargaining power.**

- [4] Officer

- **CA s 9(a): a director or secretary of the company**
- **CA s 9(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
 - **Argument that you need to be involved in plural decisions?**
 - (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 business relationship with the directors or the corporation)
- **For para (b)(i), guidance in *Shafron*:**
 - Participation includes any material or significant contribution to a significant decision (*Shafron*)
 - Not limited to sole/joint decision makers; extends to include any person who makes a **significant contribution** to decisions (*Shafron*)
 - **Broad definition** — even *giving information* that leads to a decision is likely to be enough (*Shafron*)
 - **Not satisfied in *Buzzle*:** Apple's requests to Buzzle were made only to protect Apple's own interests and not for the purposes of benefitting Buzzle
 - **Essential part of analysis:** does it affect 'the whole or a substantial part' of the business
- **For para (b)(ii), guidance in *ASIC v Adler*:**
 - This capacity arguably arises from one's involvement in the affairs of the company (*Adler*) (see relevant facts below)
 - Apple's position as **creditor** of Buzzle didn't satisfy this (although Apple had strong bargaining power) — what is required is that such a capacity be exercised as *part of the company's governance structure* (*Buzzle*)

- For para b(iii) of 'officer', if someone is a **shadow director** under para b(ii) of 'director', they **will also be a shadow officer** under para b(iii) of 'officer'
 - **As for shadow directors, a company is capable of being a shadow officer**
- **Some factual scenarios:**
 - **Shafron:** Shafron was both general counsel and company secretary. Shafron signed off on misleading statement about compensation fund before it was voted in. This was deemed to be **significant participation**.
 - **ASIC v Adler:** Adler was the most powerful person on the informal Investment Committee and fully participated in investment decision-making that substantially affected HIH's business
 - **Therefore, Mr Adler = officer under para (b)(ii) ('has the capacity to affect significantly the corporation's financial standing') and also officer under para b(i) as someone who participates in making decisions**
 - As a director of HIHC's parent, HIH, Mr Adler had at the relevant times 'the capacity to affect significantly HIHC's financial standing'
 - **ASIC v Morley:** Morley was the CFO
 - **ASIC v Citigroup:** a trader had a trading limit of \$10M but this significant financial exposure was not enough to make them an officer; they didn't have any involvement in **management decisions**. Also, \$10M was, **relatively speaking**, not a large sum for Citigroup.

Persons involved (s 79)

Section 1317E(4): A person who — (a) attempts to contravene a civil penalty provision; or (b) is involved in a contravention of a civil penalty provision is taken to have contravened the provision.

Section 79 defines 'involved'

A person is involved in a contravention if, and only if, the person:

- (a) has aided, abetted, counselled or procured the contravention; or
- (b) has induced, whether by threats or promises or otherwise, the contravention; or
- (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or

- **Note:** 'knowingly concerned' = **actual knowledge (not just imputed/constructive knowledge)** of essential facts and elements

constituting the contravention but not that those facts actually amounted to a contravention per se (*Duke; Active Super*)

- A person is not involved in a contravention unless they have **knowledge of the facts constituting the contravention** although they **do not have to know that those facts amount to a contravention** (*Yorke v Lucas*)

(d) has conspired with others to effect the contravention.

Duty to act in good faith (s 181(1)(a))

- **Section 181(1)(a):** a director or other officer of a corporation must exercise their powers and discharge their duties in good faith in the best interests of the corporation.
- **This is a civil penalty provision (s 1317E(3))**
 - A person **involved** (s 79) in a contravention also contravenes the section (ss 181(2), 1317E(4))
- **Criminal offence** if reckless or dishonest breach (s 184(1))
- **Same duty under the general law**
- **[1] Has the director acted in good faith in the best interests of the company?**
 - This entails a **two-stage inquiry (subjective and objective elements — CONSIDER BOTH)**
 - **[a] Subjective — Did the director honestly believe they were acting in the best interests of the company?**
 - It is the directors who determine what are the best interests of the company and courts should not substitute their own views about the commercial merits of a decision (*Bell Group*)
 - Did they actually consider the best interests of the company?
 - **[b] Objective — Would no reasonable person in the director's position consider the director's conduct to be in the best interests of the company? (*Bell Group*)**
 - Courts shouldn't substitute their own judgment for judgment of the directors (*Bell Group*)
- **[2] What are the 'best interests of the company'?**
 - **[a] Generally, best interests of the company = 'best interests of the company as a whole' (*Bell Group*)**
 - In general, this means the financial interests of the shareholders of the company (CAMAC; PJC Reports)
 - **[b] Can you consider non-shareholder interests?**
 - ***Parke v Daily News*:** directors can consider non-shareholder interests to the extent that those interests might benefit the shareholders (CAMAC; PJC Reports)
 - This requires a **commercially sensible** argument to be made about a benefit flowing back to the shareholders
 - **Might be able to use this to support the consideration of corporate social responsibility-related matters**
 - **[i] Employees**

- Yes, but only if by advancing employee interests, the interests of the shareholders are advanced (*Parke*)
 - **In *Parke***, bonus payments to employees were not in the best interests of the company because those employees were going to be made redundant and therefore would no longer be **employed by** the company
 - **Exception:** statutory obligations to pay redundancies; paying money to remove an ineffective employee
- **[ii] Creditors**
- If a company is in financial distress, it is more relevant to consider creditors' interests (*Bell Group*)
 - 'in an insolvency context', the duty to act in the best interests of the company entails an **obligation on the directors** to take into account the interests of creditors (*Bell Group*)
 - It is this is **not** an independent duty owed to creditors
 - 'insolvency context' may exist in a circumstance 'short of actual insolvency' (*Bell Group*)
 - Relevant timeframe is immediately before the company or crashes or once the company becomes insolvent
 - **NB:** Creditors' interests are **not** prioritised, only *taken into account*
 - **Test:** whether an **intelligent and honest** person in the position of the directors could not have reasonably believed that the transaction was for the benefit of the company, **bearing in mind the interests of creditors** (*Linton*)
 - ***Bell Group***: this has subjective and objective elements
 - **It's about not causing prejudice to creditor interests** (*Bell Group*)
 - As the company approaches liquidation, from a practical view, the company's assets are the creditors' assets (***Kinsela — funeral home case***)
 - The plainer it is that it is the *creditors'* money that is at risk, the lower is the risk to which the directors can justify exposing the company (***Kinsela***)
 - **In *Kinsela***, directors are not permitted to agree to rent their business premises for a price considerably lower than market value in an insolvency context (as this prejudices creditors' interests)
- **[iii] Holding company/corporate group**
- Each company in the group must be treated as having its own interest when it is a wholly owned subsidiary (*Walker v Wimborne*)

- Each duty is owed separately to each company (*Walker v Wimborne*)
 - **Mason J in *Walker v Wimborne***: it is a fundamental principle that “each of the companies was a separate and independent legal entity, and that it was the duty of the directors of Asiatic to consult its interests and its interest alone in deciding whether payment should be made to other companies
- Note, in later cases, courts have said that if directors of a subsidiary made a decision with a view to benefitting the corporate group, then that does **not automatically result** in breach of duty (*Maronis; Equiticorp*)
 - **NOT followed by HCA in *Walker***: ‘Whether an **intelligent and honest person** in the position of a director of the company could, in the whole of the circumstances, have **reasonably believed** that the transaction was for the benefit of the company (*Charterbridge (UK)*)
- Note the special case of **wholly owned subsidiaries (s 187)**. A director of a corporation that is a wholly-owned subsidiary of a body corporate is **taken to act in good faith in the best interests of the subsidiary if (s 187)**:
 - (a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and
 - (b) the director acts in good faith in the best interests of the holding company; and
 - (c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.
- **[iv] Potential investors**
 - No direct duty owed to potential directors
- **[v] Nominee directors**
 - Nominee director = director appointed by a particular shareholder(s) to represent their interests on the board
 - A nominee director can act in the interests of their appointing shareholder(s) **as long as that does not conflict with the interests of the company (*Re Broadcasting Station 2GB*)**
 - **The interests of the company remain paramount**
- **[vi] Takeover bid?**
 - It may be necessary for the directors to **consult all the members** to see what they would wish to be done in a

particular situation where there is a **takeover bid which promises favourable terms for shareholders** who wish to sell and the directors have in mind transactions which could in the long-term bring greater benefits to shareholders than they would receive by acceptance of the offers (*Darvall*)

Duty to act for a proper purpose (s 181(1)(b))

- **Section 181(1)(b):** a director or other officer of a corporation must exercise their powers and discharge their duties for a proper purpose.
- **This is a civil penalty provision (s 1317E(3))**
 - A person **involved** (s 79) in a contravention also contravenes the section (ss 181(2), 1317E(4))
- **Criminal offence** if reckless or dishonest breach (s 184(1))
- **Three steps:** (1) **identify** the power; (2) **determine for what purpose it was conferred**; (3) **determine for what purpose it was exercised**
- **Seems generally to be related to where conduct is not for constitutional purpose, or where conduct involves issue of shares or borrowing of money**
- [1] What was the power which was exercised?
- [2] What was the legal purpose for which the relevant power was conferred?
 - **Onus of showing that a power was misused rests on the person asserting misuse (*Australian Metropolitan Life Assurance v Ure*)**
 - **[a] Analyse the particular power-conferring provision (*Permanent Building Society*)**
 - Usually this is a constitutional provision
 - Consider the function of the power for the particular company, having regard to the constitution as a whole and the 'constitutional' relationship between directors and shareholders
 - Consider the size and nature of the company
 - Directors of a small company who are also its shareholders may be given **more extensive powers as directors** than directors of a large publicly listed company
 - Note that a company's constitution may simply restate the powers in **s 124**
 - Might also consider **agreements external to the company's constitution** to determine how the power is intended to be exercised!
 - **[b] Power to issue shares**
 - Has the purpose of raising money for the company (*Howard Smith v Ampol*)
 - Might have secondary purpose of **paying for things** (*Howard Smith*)
 - Company can create shares and exchange them for something other than cash (eg assets) (*Salomon*)
 - **Court should give credit to the bona fide opinion of the directors and respect their judgment as to matters of management (*Howard Smith v Ampol*)**

- **Limitations set by *Howard Smith*:**
 - Cannot use this power to create such a large number of shares in hands of someone else to *install that person* as majority owner
 - The directors of Miller issued shares to Howard Smith in such a large number that Ampol and Bulkships no longer owned 50% (*Howard Smith*)
 - The purpose of **perpetuating** one's own control in the company would be an improper use of the power (*Howard Smith*)
- **Dilution of ownership through issue of 7 million shares was improper (*Western Ventures*)**
- **Issue of shares not improper in *Bell IXL*:** the share placement was directed to raising immediate funds **and** also locating an investor who may be able to provide funds in future
- **[c] Power to borrow money**
 - Might *analogue* to what we know about the power to issue shares (above)
 - The purpose is to *raise money for the company*
- **[d] Powers which influence control**
 - **Examples:** issue of shares (see above); rights issues; entrance into new contracts with employees/contractors/suppliers where doing so will discourage bidders from trying to gain control; giving shareholders the power to buy shares **rateable**; using assets to conduct a campaign for election of directors; a director deciding whether or not to register a transfer of shares
 - The purpose of **perpetuating** one's own control in the company would be an **improper** use of the power (***Howard Smith***)
 - If the dominant purpose is to preserve the existing majority or to displace them, the purpose will be improper (*Howard Smith*)
 - Proposition that it is **improper** to take action to defeat a takeover option is **too widely stated (*Darvall*)**
 - In particular circumstances action for the dual purposes of advancing the interests of the company and of defeating a takeover **may be within power (*Darvall*)**
 - ***Darvall* — exception:** It is within the powers of directors to ensure that, where an unsatisfactory takeover offer is made, there is an alternative offer at a better price

- **Position may differ for non-large public companies**
 - Directors of a proprietary company (and, possibly, a public company with few members and in which the public has not invested) are usually directed by the constitution **to be concerned about the identity of members and are given appropriate powers to refuse registration of transfers of shares.**
 - **Note from Kirwan:**
 - if a company **has need of capital** and there is **only one avenue of obtaining that capital**, then even though the person who is subscribing the extra capital has a dominant purpose in obtaining control and even though that person is a director of the company, **there would be no improper purpose in making the allotment**
 - **Improper to sell company assets below market value (Cassegrain)**
- **[3] Has the power been exercised for that legal purpose?**
 - The court must determine whether, but for the improper or collateral purpose, the directors would have performed the act in dispute (*Permanent Building Society v Wheeler*)
 - **This involves considering both objective and subjective elements**
 - **For what purpose would an objective person conclude the power has been exercised?**
 - Honest or altruistic behaviour does not prevent a finding of improper conduct if that conduct was carried out for an improper purpose (*Permanent Building Society*)
 - But evidence as to the subjective intentions or beliefs of directors is **nonetheless relevant** (*Permanent Building Society v Wheeler*)
 - **Court should give credit to the bona fide opinion of the directors and respect their judgment as to matters of management (*Howard Smith v Ampol*)**
 - This involves considering both objective and subjective purpose
 - **Where there are dissenting directors** and the majority directors do not all share the same purpose(s), the court's task is to **ascertain the substantial purpose of the majority directors**, even though the majority of the majority may be a **minority of the total board** (*Harlowe's Nominees*)
 - In ascertaining the state of mind of the directors the court may have regard to the circumstances surrounding the decision: **Hindle**
 - **[!] Mixed purposes**

- **[Two approaches]**
- If evidence bespeaks the existence of **multiple purposes**, must:
 - **[a]** According to Dixon J in *Mills*, look to the ‘**substantial object the accomplishment of which formed the *real ground* of the board’s action**’
 - **[b] [but for test]** According to Mason, Deane and Dawson JJ (obiter) in **Whitehouse**, ask whether the ‘**impermissible purpose was causative in the sense that, but for its presence, “the power would not have been exercised”**’
 - **Whitehouse but-for test** is more recent, and comes from more judges, so is probably more authoritative