

6. Directors' Duties

Nature of directors' duties

1. Who owes directors duties?

- a. Depends on the duty (see table)
- b. Officers
 - i. An officer of a corporation includes (s 9):
 1. Director
 2. Secretary
 3. A person:
 - a. Who participates in making decisions that affect the whole or a substantial part of its business
 - b. Who has the capacity to affect significantly the corporation's financial standing, or
 - c. In accordance with whose instructions or wishes the directors are accustomed to act
- c. Directors
 - i. The statutory definition of a director includes (s 9)
 1. Person validly appointed as a director [appointed director]
 2. Alternative director [appointed director]
 3. Directors appointed under another name [appointed director]
 4. Person who acts in the position of a director [de facto director], or
 5. Person where the directors of the company or body are accustomed to act in accordance with their instructions or wishes [shadow director]
 - ii. De facto directors
 1. A de-facto director is someone who works in the position of a director without being appointed (s 9)
 2. They must exercise top management functions and have practical direction and effective control of the company (*DCT v Austin; Grimaldi v Chameleon Mining*)
 - a. Examples of functions include:
 - i. Attending and voting in board meetings
 - ii. Participating in management/decision-making of the company
 - iii. Negotiating with creditors, regulators, banks and other major transactions
 - iv. Drafting ASX releases and disclosure documents
 - b. Relevant factors include:
 - i. Size of company
 - ii. Internal practices/structure of the company
 - iii. How they were reasonably perceived by outsiders who deal with the company
 - iii. Shadow director
 1. A shadow director is a person who exercises a controlling influence over the board, such that the directors are accustomed to act in accordance with their instructions or wishes (s 9)
 2. Generally:
 - a. Necessary to establish that (*Buzzle Operations v Apple*):
 - i. Defendant directed those directors how to act in relation to the company
 - ii. Directors acted in accordance with such directions
 - iii. Directors were accustomed to so act
 - b. Must be both a willingness and ability to exercise control and an actuality of control over the management and financial affairs (*Standard Chartered v Antico*)
 3. Extent of influence:
 - a. Influence must extend to the governing majority of the directors (*Buzzle Operations v Apple*)
 - b. Influence does not need to extend over the whole field of corporate activities, but it cannot just be in the field of a manager (*Buzzle Operations v Apple*)

2. To whom are the directors' duties owed?

- a. Directors owe their fiduciary duties to the company as a whole, not to the shareholders (*Percival v Wright; Bell v Westpac*)
 - i. Consequences:
 1. Right of action to enforce duties lies with the company (**proper plaintiff rule**) (*Foss v Harbottle*)
 2. Damages are assessed according to what was suffered by the company, not the shareholders
 - a. Any profits recovered via a shareholder derivative lawsuit will be recovered for the company
- b. In limited circumstances, an officer may owe fiduciary duties to individual shareholders instead of the company as a whole (*Bell Group v Westpac*)
 - i. Those duties arise because of the particular relationship between the officer and shareholder, not from the officer's position in itself (*Bunninghausen v Glavanics*)
 1. Typically, closely held companies (e.g. small family companies, companies with only one director) where there is a relationship of reliance, dependence and confidence between the officer and shareholder is one of dependence and reliance
 - ii. Consider (*Coleman v Myers*):
 1. Dependence upon information and advice

2. Existence of a relationship of confidence
 3. Significance of some particular transaction for the parties
 4. The extent of any positive action taken by or on behalf of the directors to promote a particular transaction
 5. The extent of inside knowledge of directors
- c. Directors of a company in discharging their duty to the company must take account of the interest of its shareholders and its creditors (*Mason J in Walker v Wimborne*)
- i. Generally, no fiduciary duties are owed to creditors, duties are owed to the company which has contractual relationships with creditors (*Spies v R*)
 1. Any fraud committed by a director would be to the company, not the creditors

Duty	Source	Persons liable	Result
Duties of loyalty and faith			
Duty to act in good faith for the benefit of the company	<i>Smith & Fawcett</i>	Directors	Voidable
Duty to act for a proper purpose	<i>Howard Smith</i>	Directors	Voidable
Duty to avoid conflict - Direct conflict - Secret profits	<i>Boardman v Phipps</i> <i>Regal Hastings</i>	Directors	Voidable Constructive trust or account of profits
Duty not to fetter discretion	<i>Thorby v Goldberg</i>	Directors	Voidable
Duty to exercise powers in good faith and for a proper purpose	<i>S 181</i>	Directors and officers	Contravention (<i>s 181</i>) – civil penalty provision Criminal liability (<i>s 184</i>)
Duty to disclose material personal interests	<i>S 191</i>	Directors	Contravention (<i>s 191</i>) If satisfied director of proprietary company allowed to vote and retain benefits (<i>s 194</i>)
Duty not to improperly use position	<i>S 182</i>	Current and former directors, secretaries, officers, employees	Contravention (<i>s 182</i>) – civil penalty provision Criminal liability (<i>s 184</i>)
Duty not to improperly use information	<i>S 183</i>	Current and former directors, secretaries, officers, employees	Contravention (<i>s 183</i>) – civil penalty provision Criminal liability (<i>s 184</i>)
Related party transactions	<i>S 208</i>	Person involved in contravention	Contravention (<i>s 209(2)</i>) – civil penalty provision Criminal liability (<i>s 209(3)</i>)
Duties of care			
Duty of care at general law	<i>Daniels v Anderson</i>	Directors and officers	Equitable compensation Potentially, common law damages or contractual remedies
Duty of care at statute	<i>S 180</i>	Directors and officers	Contravention (<i>s 180</i>) – civil penalty provision
Duty to avoid insolvent trading	<i>S 588G</i>	Directors	Contravention (<i>s 588G(2)</i>) – civil penalty provision Criminal liability (<i>s 588G(3)</i>)

Duties of loyalty and good faith (page 96 – notes)

1. **Generally**

- a. Source:
 - i. In general law as fiduciary duties
 - ii. In statute
- b. Duties arise in the exercise of power or discretion, both by directors individually and collectively as a board
- c. Common law duties apply only to directors, as fiduciaries (*Bray v Ford*)

2. **Common Law Duty to act in good faith for the benefit of the company and for a proper purpose (page 96 – notes)**

- a. Duty to act in good faith for the benefit of the company
 - i. Directors have a duty to act in good faith for the benefit of the company as a whole (*Smith & Fawcett*)
 - ii. **[1] Good faith**
 1. A director acts bona fide or in good faith if they exercise their discretion bona fide in what they (not the courts) honestly consider to be in the best interests of the company and not for any collateral purpose (*Smith & Fawcett*; confirmed in *Bell v Westpac*)
 - a. Subjective good faith is a necessary, but not sufficient, condition for validity (*Hutton v West*)
 - b. Bona fide – exercising power honestly in the interests of shareholders as a whole, not arbitrarily or at the absolute will of the directors (*Issac J in AMLA v Ure*)
 2. Onus lies on person making the allegations, on the balance of probabilities (*AMLA v Ure*)
 3. If a director breaches its duty of care:
 - a. A board does not act in bad faith merely because they make a decision in ignorance of relevant facts, or induced by a misrepresentation (*Mahoney J in Darvall*)
 - b. They are necessarily in breach of the duty to act bona fide because there has been a failure to satisfy themselves of all the necessary information (*Kirby J in Howard Smith*)

4. If company's constitution provides power to refuse to register, the only condition on the exercise of that power is that it must be exercised in good faith (*AMLA v Ure*)
- iii. **[2] Company as a whole**
 1. For a solvent company, this means the shareholders as a whole (*Ngurli*)
 - a. Necessary to consider the effect of the decision on the hypothetical member (*Ngurli*)
 - b. Where there are different classes of shareholders, it is a question as to what is fair as between different classes of shareholders (*Mills v Mills*)
 - c. Appropriate to consider both present and future shareholders where (*Gaiman*):
 - i. The director's act could cause continuing problems to the company going forward
 - ii. It is necessary to preserve the nature and objects of a company
 1. E.g. scientologists in a mental health organization who posed a threat to the basis of the organization (*Gaiman*)
 - d. Appropriate to consider the interests of an individual shareholder where a fiduciary duty is owed to them (*Bunninghausen*)
 2. For an insolvent company, this means shareholders and creditors as a whole (*Kinsela v Russell*)
 - a. Insolvency changes the interest of the company from the shareholders to the creditors
 - b. Directors cannot, as shareholders, approve their own conduct to the detriment of creditors
 3. Other interests
 - a. The company is not permitted to act solely for the benefit of other parties (e.g. employees, general public) unless it is also in the interests of the shareholders (*Parke v Daily News*)
 - b. Rule is not applied strictly:
 - i. Directors are not in breach of their fiduciary duties merely because they consider other interests (*Teck v Millar*)
 - ii. Breach will happen when there is no legal way to justify the exercise of power for the benefit of the shareholders despite the actions being laudable (*Parke v Daily News*)
 1. E.g. paying the proceeds from sale of a business to employees who are made redundant after the sale (*Parke v Daily News*)
 4. Interests of the company in a group of companies
 - a. Where there is a wholly owned subsidiary
 - i. A director of a wholly-owned subsidiary is deemed to have acted in good faith and in the best interests of the subsidiary if (s 187):
 1. The subsidiary's constitution expressly authorises the director to act in the best interests of the holding company (s 187(a))
 2. The director acts in good faith in the best interests of the holding company, and (s 187(b))
 3. The subsidiary is not insolvent and does not become insolvent as a result of the act (s 187(c))
 - b. Generally
 - i. It is unsettled to whether a director is in breach if they consider the interests of the entire group rather than the company to which he is appointed
 - ii. Strict approach:
 1. Directors must consider the interests of the company to which they are appointed only, not the broader corporate group, as each is treated as a separate legal entity (*Walker v Wimborne*)
 - iii. Some movement to relax this strict test
 1. Liberal approach – in the absence of actual consideration of the individual company's interests, test is whether an intelligent and honest man in his position could have reasonably believed that the transactions were for the benefit of the company (*Charterbridge v Lloyd's Bank*)
 - a. E.g. Where the welfare of the group intimately tied up with welfare of each company
 2. Intermediate approach – Director breaches his duty if he fails to consider the interests of the company, but no consequences will flow from that breach if his actions were objectively in the company's interests (*Equiticorp*)
- b. Duty to act for a proper purpose
 - i. Directors must exercise corporate powers only for the purposes for which they were granted (*Howard Smith*)
 - ii. Generally
 1. Two-limb test (*Howard Smith*)
 - a. [1] Ascertain, on a fair view, the nature of this power, and define as can best be done the limits within which it may be exercised
 - b. [2] Examine the substantial purpose for which the power was exercised, and reach a conclusion whether that purpose was proper or not
 2. Onus lies on person making the allegations, on the balance of probabilities (*AMLA v Ure*)
 3. Dual purposes – mere presence of improper purpose does not necessarily taint the directors' actions – only if the improper purpose is the dominant purpose, applying the "but for" test (*Whitehouse v*)

Carlton; Hogg v Cramphorn

4. Duty may be breached even though (**Hogg v Cramphorn**):
 - a. Directors acted honourably and gained no personal advantages
 - b. Directors honestly believed that they were acting in the company's best interests
 - iii. What is the proper purpose?
 1. Courts will scrutinise the directors' claims and seek the real purpose for the transaction (**Howard Smith**)
 2. Court will not interfere with the exercise of managerial discretion made within the proper sphere of management (**Teck v Miller**)
 - a. Applies to acts which commonly and routinely occur during ordinary management of the company
 3. Not proper merely because there was no self-interest (**Howard Smith**)
 4. Transactions contrary to laws or ASX listing rules are more likely to be improper (**Howard Smith**)
 - iv. **Share transfer**
 1. Subjective belief by directors that they are acting in the best interests of the company is sufficient, i.e. will not look to objective purpose (**Smith & Fawcett; AMLA v Ure**)
 - v. **Share allotments**
 1. Subjective belief by directors that they are acting in the best interests of the company is not sufficient (**Whitehouse v Carlton; Hogg v Cramphorn**)
 2. Most common proper purpose is to raise capital which is immediately required, though this is not exhaustive (**Howard Smith**)
 3. Prima facie improper purposes:
 - a. Self-interest (**Ngurli**) (e.g. financial gains)
 - b. Issuing shares as a form of takeover defence (**Howard Smith**)
 - c. Maintaining directors' control (**Hogg v Cramphorn**)
 - d. Diluting control of other shareholders (**Whitehouse v Carlton**)
 - e. Interfering with exercise of the majority of their constitutional rights (**Hogg v Cramphorn**)
 4. Dilution of control may be justified where:
 - a. There is apprehended damage to the company (**Teck v Miller**)
 - b. It is for the purpose of providing shareholders with an alternative bid (**Darvall**)
 - c. It is commercially essential (**Whitehouse v Carlton**)
 - d. Statutory provisions make a particular spread of voting power necessary (**Whitehouse v Carlton**)
 - c. **Attenuation of duty**
 - i. Constitution may attenuate the duty to act for a proper purpose by making otherwise improper purpose proper (**Whitehouse v Carlton**)
 - ii. Difficult to attenuate duty to act in the best interests of the company (**ASIC v Maxwell**)
 - d. **Remedies**
 - i. Transaction is voidable
 - ii. Shareholder remedies
 1. Fraud on the minority – personal right to be protected against dilution of voting rights by improper allotment of shares (**Howard Smith**)
 2. Oppression, etc.
- 3. Statutory Duty to exercise powers in good faith and for a proper purpose (s 181) (page 108 – notes)**
- a. **Civil liability (s 181)**
 - i. A director or officer must exercise their powers and discharge their duties
 1. In good faith in the best interests of the corporation; and (s 181(1)(a))
 2. For a proper purpose (s 181(1)(b))
 - ii. s 181 is breached if a director acts in a way that no reasonable director would have considered to be in the best interests of the company (**ASIC v Adler**)
 - iii. Honest intentions and subjective beliefs – unclear whether a requirement for subjective dishonesty is enough
 1. Standard of behaviour required by s 181(1) is not complied with by subjective good faith or by a mere subjective belief by a director that his purpose was proper (**ASIC v Adler**)
 2. s 181 is contravened only where a director engages deliberately in conduct, knowing that it is not in the interests of the company (**ASIC v Maxwell**)
 - iv. Attenuation
 1. Difficult to attenuate duty to act in the best interests of the company in s 181(1)(a) (**ASIC v Maxwell**)
 2. Attenuation of duty through constitution/resolution may make otherwise improper purposes not so in s 181(1)(b) (**ASIC v Maxwell**)
 - b. **Criminal liability (s 184)**
 - i. A director or other officer of a corporation commits an offence if they contravene s 181 and:
 1. Are reckless, or (s 184(1)(a))
 2. Are intentionally dishonest (s 184(1)(b))

And fail to exercise their powers and discharge their duties (i.e. s 181):
 3. In good faith in the best interest of the corporation, or (s 184(1)(c))
 4. For a proper purpose (s 184(1)(d))
 - ii. Director is intentionally dishonest if they deliberately fail to disclose relevant information despite a duty of disclosure and full knowledge of the relevant facts (**Duncan v ICAC**)