General Stuff Re Directors’ Duties

Who owes Corporations Act duties?

Directors’ Duties: S181(a) Good Faith + Best Interest

Directors’ Duties: S181(b) Proper Purpose

Directors’ Duties: S182(1) Improper Use of Position

Directors’ Duties: S183(1) Improper Use of Information

Directors Duties: Equitable Duty Not to Fetter Discretion

Directors’ Duties: The Conflict Rule

Directors’ Duties: Remedies for breach of conflict duty

Disclosure as remedy to breach of fiduciary duty

Directors’ Duties: s191 Give notice of Material Personal Interests

Remedies & Penalties (context of conflicts duty)

Directors’ Duties: Voting & Conflict of Interests + Related Party Transactions

Directors' Duties: The Misappropriation Rule

Directors’ Duties: The Profit Rule

Directors’ Duties: Duty of Care (general law)

Directors’ Duties: Duty of Care (statutory: s180(1))

Directors’ Duties: Insolvent Trading & Misc

Member’s Rights

Becoming a Member & the Members’ Register

Enforcing Corporate Rights

Statutory Derivative Action
General Stuff Re Directors’ Duties

Overview of Lecture
• Introduction to Concepts of Good Corporate Governance
• Duty to Act Bona Fide in the Best Interests of the Company as a Whole
• Duty to Exercise Powers for a Proper Purpose
• Statutory Duties of Propriety
• Remedies & Penalties
• Duty Not to Fetter Discretion
• Concepts of Good Corporate Governance

What is Corporate Governance?
ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations defines corporate governance as:
• “…the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. It encompasses the mechanisms by which companies, and those in control, are held to account. Corporate governance influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised.”

Simply put, corporate governance concerns the control of corporations and the accountability mechanisms put in place.

Corporate governance is regulated by a mix of legal regulation and self-regulation.

Regulating Corporate Governance
• Legal obligations:
  • Corporations Act 2001 (Cth)
  • Common Law - Fiduciary Duties
• Requirements with force of law:
  • ASX Listing rules
  • Accounting & Auditing Standards
• Voluntary Codes of corporate governance:
  • ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations with 2010 Amendments

In relation to the legal obligations, these include:
• directors’ duties;
• shareholders’ meetings, rights and remedies;
• the continuous and periodic disclosure obligations;
• the requirement for, and regulation of, auditors; and
• the regulation of takeovers.

ASX corporate governance listing rule
ASX Listing Rule 4.10.3 requires the annual reports of listed companies to disclose the extent to which they have followed the recommendations in the ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations. Compliance is not compulsory, however, the ASX employs an “if not, why not?” approach. It is recognised that listed companies are different from one another and have varying needs depending on their size, complexity and other considerations, yet there is
Directors’ Duties: S181(a) Good Faith + Best Interest

Duty to Act Bona Fide in the Best Interests of the Company as a Whole
Section 181(1):
- A director or other officer of a corporation must exercise their powers and discharge their duties:
  - a) in good faith and in the best interests of the corporation; and
  - b) for a proper purpose.

This is a civil penalty provision, however will amount to a criminal offence under section 184 if they are reckless or intentionally dishonest in the breach.

STATUTORY and COMMON LAW elements are the same, as follows.

As per ASIC v Adler there are two components:
1. Director must have an honest belief that their actions are in the best interests of the company (subjective); and
2. The action must not be such that no reasonable director would have considered it to be in the best interests of the company (objective).

The duty is breached if a director acts in a way that no rational director would have considered to be in the best interests of the company: ASIC v Adler.

- Directors must act
  - “bona fide in what they consider – not what the court may consider – is in the interests of the company…”
  - Re Smith & Fawcett Ltd [1942] Ch 304 at 306 per Greene MR

Both subjective and objective elements:
- The Bell Group Ltd v Westpac Banking Corporation (no 9) [2008] WASC 239 per Owen J.
  - Directors will breach their duty “if, on consideration of the surrounding circumstances (objectively viewed), the assertion of directors that their conduct was bona fide in the best interests of the company and for proper purposes should be doubted, discounted or not accepted;

- Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL (1968) 121 CLR 483
  - “The principle is that although primarily the power is given to enable capital to be raised when required for the purposes of the company, there may be occasions when the directors may fairly and properly issue shares for other reasons, so long as those reasons relate to a purpose of benefiting the company as a whole, as distinguished from a purpose, for example, of maintaining control of the company in the hands of the directors themselves or their friends … [the] ultimate questions must always be whether in truth the issue was made honestly in the interests of the company.”

Consider:
Re Smith and Fawcett Ltd [1942] Ch 304:
- Smith, director, refused transfer of shares. Instead, he offered to buy half of the shares and registered the remaining which would give him 75% control of the company. Court
found there was no evidence that showed Smith was exercising power not in best interests of company and in the absence of that evidence there was no breach. It was held that directors were acting in best interests of company as solicitor was a dodgy guy.

*Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199

- Fight between two groups of shareholders. One group led by Mrs Ure who had acquired shares which allowed her to vote in her husband, a solicitor who had been struck off roll due to misconduct, as a solicitor. Other group of shareholders & directors said they would issue shares to current staff and members to dilute Ure’s group of shares’ proportion so she wouldn’t be able to appoint her husband.

**What are the company’s interests?**

- “The phrase “the company as a whole”, does not … mean the company as a commercial entity distinct from the corporators it means the corporators as a general body”
- In other words, the directors must act in the best interests of the shareholders as a collective group.
  - Per Evershed MR in *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286

  - “In my view it is proper to have regard to the interest of the members of the company, as well as having regard to the interests of the company as a commercial entity. Indeed it is proper also to have regard to the interests of the creditors of the company. I think it is proper to have regard to the interests of present and future members of the company, on the footing that it would be continued as a going concern.”

  - In other words, and this is a somewhat alternative view, directors must have regard to both the interests of present and future shareholders as well as the interests of the company as a commercial entity. Directors may act in what they consider to be the best interests of the company as a commercial entity even though this may not be in the short-term interest of shareholders.
  - Per Hodgson J in *Darvall v North Sydney Brick and Tile Co Ltd* (1988) 6 ACLC 154 (text p294)

- Note that the duty to act in the best interests of the company does not mean that directors owe duties to particular shareholders, rather only to the collective group: *Percival v Wright* [1902] 2 Ch 421.

- In special circumstances, a director may owe fiduciary duties to an individual shareholder. The director must have been in direct and close contact with the individual member so that the director caused the member to act in a certain way which turned out to be detrimental to them: *Peskin v Anderson* (2001) 19 ACLC 3001.

- What about nominee directors? (ie those nominated to represent certain sectional interests) They are permitted to act in the interests of their appointor if they honestly and reasonably believe that there is no conflict of interests: *Re Broadcasting Station 2GB Pty Ltd*. In other words, whether interests conflict, they are bound to act in the company’s interests: *Scottish Co-operative Wholesale Soc Ltd v Meyer*.

- Company groups pose another complexity. In most cases, the interests of the holding company and the interests of a wholly-owned subsidiary will correspond. However, if there is a conflict, nominee directors on the board of the subsidiary must act in the subsidiary’s best interests and not in the interests of the group as a whole: *Walker v Wimborne*.
Section 187 provides some relief. It states that a director of a wholly-owned subsidiary (ie rule doesn’t apply in case of non-wholly-owned subsidiary) will be taken to act in good faith in the best interests of the subsidiary where:

- the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and
- the director in fact acted in good faith in the best interests of the holding company.

Directors should not consider the interests of employees at the expense of the interests of the company’s shareholders: Parke v Daily News Ltd.

The ‘best interests’ of the company differ when the company is insolvent:

- The interests of the company correspond to the interests of its creditors; directors have a duty to exercise their powers in a way that does not prejudice the company’s ability to pay its creditors: Walker v Wimborne (1976) 137 CLR 1.
- Directors will breach this rule if they cause their company to enter into arrangements that reduce the pool of company assets that would otherwise be available to be shared among creditors when the company is wound up.
- This might occur in the context of corporate groups, eg one company in a group may lend money to another in the same group. If the lending company is in financial difficulties, its directors prejudice the interests of the lending company’s creditors if the interest rate on the loan is not on commercial terms or if the borrowing company is, or becomes, insolvent and cannot repay the loan.

“Directors’ Duties in the Zone of Insolvency” by John Sheahan SC

- This academic articles argues that the duties of corporate officers ought to be conceptualised as directed to the corporate enterprise as a separate entity, rather than to the body of shareholders or creditors or both (but note that this is not the law at the moment).

The Bell Group Ltd v Westpac Banking Corporation (No 9)

- Reference to the “concomitant” interests of creditors and shareholders (at 6042)
- “Brought down to its most basic terms, the directors failed to ensure that there was a corporate benefit to the individual companies in entering into the respective transactions”

Modern Concept of Directors' Duties

- “the best interest of the corporation” to mean “the best interest of the company”
  - “the corporate enterprise conceived of as a legal entity separate from both members and creditors” (p23)
Directors’ Duties: S181(b) Proper Purpose

Duty to Exercise a Power for Proper Purposes

Section 181(1):

• A director or other officer of a corporation must exercise their powers and discharge their duties:
  • a) in good faith and in the best interests of the corporation; and
  • b) for a proper purpose.

Australian Metropolitan Life Assurance Co Ltd v Ure (1923) 33 Isaacs J at 217:

• “A regulation such as [the article giving power to refuse to register the transfer of shares] entrusts to the directors a corporate power, which is exercisable by them as agents of the Company. But, although it is a power which necessarily involves some discretion, it must be exercised, as all such powers must be, 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 … The general character of such a regulation is clear, but the ambit of the purpose of the power of course varies with the circumstances of each particular case. The nature of the company, its constitution and the scheme of its regulations as a whole must all be taken into account in determining whether a...

if a director issues shares for an improper purpose, the main remedy is to rescind the share issue.

When does this issue arise?

Cases regarding exercise of power for improper purpose most commonly concern where a director has issued shares. The power to issue shares is ordinarily conferred for the purpose of raising capital for the company. Other proper purposes for issuing shares include raising capital providing consideration for the purchase of property and providing a means of remunerating employees of a company.

Directors breach their fiduciary and statutory duties to exercise their powers for a proper purpose if they issue shares to:

1. maintain control of the company’s management or majority shareholding: Ngurli v McCann (1953) 90 CLR 425
2. create or destroy the voting power of majority shareholders: Howard Smith Ltd v Ampol Petroleum Ltd,

If directors suspect that a share issue may result in them breaching their fiduciary duty they should obtain shareholder approval at a general meeting. Shareholders may ratify an improper share issue.

Determining Whether A Power is Exercised for a Proper

As per Howard Smith Ltd v Ampol Petroleum Ltd, there are two questions:

1. Question of law – what are the objective purposes for which the power may, and may not be, exercised?

2. Question of fact – what were the intentions of the director, and what was the actual purpose (or motivation) for which the director exercised the power?
The onus of establishing that the directors acted improperly rests with those alleging the breach of duty: *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199.

### May Consider Surrounding Circumstances

*Hindle v John Cotton Ltd* (1919) 56 Sc LR 625:
- “Where the question is one of absence of powers, the state of mind of those who acted and the motive on which they acted, are all important, and you may go into the question of what their intention was, collecting from the surrounding circumstances all the materials which genuinely throw light upon that question of the state of mind of the directors so as to show whether they were honestly acting in the discharge of their powers in the interests of the company or were acting from some bye-motive, possibly of personal advantage or for any other reason.”

### Mixed Purposes

- **Substantial purpose test:**
  - *Mills v Mills* (1938) 60 CLR 150 at 186 per Dixon J, it was stated that you look for
    - “the substantial object the accomplishment of which formed the real ground of the board’s action.”

- **“But for” test:**
  - *Whitehouse v Carlton Hotel Pty Ltd*, at 294,
  - *Mason, Deane & Dawson JJ in dicta stated:*
    - “As a matter of logic and principles, the preferable view would seem to be that, regardless of whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose was causative in the sense that but for its presence, ‘the power would not have been exercised.’”

The **“but for” test is to be preferred** over the substantial purpose test.

### Ngurli v McCann (1953) 90 CLR 425

Clifford set up four companies which had no assets apart from shares in main company. Clifford had sold the shares to the companies but they had not paid them so the companies owed him a debt. All the other shares of the companies were held by McCann, although one share was given to his granddaughters (...I think). The others all had a ‘life governing share’ such that if Clifford or one of his personal representatives had the shares, he would have control over the company. In his will he left the four shares and the debts owed to him by the companies to his brother Horace. Horace caused the four companies to issue shares to him in payment of the debts + he inherited the life shares so he ended up with 98% of the shares. McCann therefore ended up with almost no shares.

1. What did the court hold was the purpose of the share issue in this case?

Court held he didn’t issue the shares to, for example, shore up the company’s balance sheet. Instead, he did it to gain control of the company.

2. The court said that the power had to be used bona fide for the purpose for which it was conferred. What was the proper purpose of the power to issue shares?

The power must be used bona fide for the purpose it was conferred (ie to raise share capital), it must not be used just so you can wrest control of the company.
3. How does the concept of proper purpose overlap with the concept of acting in the best interests of the company as a whole?

Horace was accused of thinking only what would benefit himself, not the company as a whole.

*Mills v Mills (1938) 60 CLR 150*

UR Dry Limited carried on the profitable business of sheep breeding. It was managed by Neilson Mills who was managing director and shareholder and his nephew Ainsley Mills who was also a director and a shareholder. Burchill was another director but not a shareholder. Neilson and Alnsley had a long running dispute. Neilson agreed to resign as trustee of two trusts which held shares in the company. The combination of his control over the trust shares + his shares + the shares of his sister Winifred = he had control over the company.

Prior to Neilson registration, Neilson and Burchill issues a resolution as directors that bonus shares be issued to shareholders. This means Neilson would maintain his voting strength. Burchill said, “it has always been his intention that ordinary shareholders receive the profits by bonus share issue”.

1. What did the court hold was the “main reason” for passing the resolution issuing bonus shares from undistributed profits?

Finding was that Neilson and Burchill had acted in the best interests of shareholders to secure the best outcome if the company was ever wound up.

2. What did Ainslie Mills argue was the extraneous or improper purpose for issuing the bonus shares?

Ainslie said that the shares were issued to maintain Neilson and Birchley’s voting share. Judge held that this was an *incidental* effect that N and B were aware of, but it was not the main one.

3. If a proper and a collateral purpose can be identified, what test did Dixon J outline for establishing whether or not the exercise of the power is valid?

“If except for some ulterior and illegitimate object the power would not have been exercised that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable.”

Basically this is a version of the but for test; but the ‘but for’ formulation in other cases is to be preferred.

*Howard Smith Ltd v Ampol [1974] AC 821*

Ampol had a number of holding companies, including Ampol, Bulkships, and Howard Smith. Ampol had 30% of the shares in Miller and made a takeover bid. Miller’s board recommended to shareholders that they reject the takeover offer and instead invited Howard Smith to make its own takeover offer. Apol then said that would operate jointly with Bulkships who had 25% holding in Miller Holding (giving them a combined 55%) which
should have been enough to undergo the takeover process. Miller Holdings issued a large number of shares to Howard Smith which reduced Bulkships and Ampols shareholding to 36%. Miller Holding’s directors asserted the primary reason for the issuing of the shares was to raise capital (which is a valid object).

1. What did the Privy Council hold was the directors’ primary object for allotting the shares to Howard Smith?

To dilute the voting power was held to be the primary purpose, although Miller Holding actually did need capital.

Court said there may be reasons for issuing shares apart from raising capital, eg to secure the financial stability of the company. But issuing shares just to dilute voting power is an improper purpose.

2. After considering the judgment in Harl owe v Woodside, in what circumstances did the Privy Council consider that a purpose other than that of raising capital in a share issue could be valid?

Teck Corp Ltd v Millar (1973) DLR (3d) 288
Afton discovered Teck Corp was purchasing shares in it and had acquired a majority. Afton was interested in mining agreement with different company (Cannex) and issues shares to that company (Cannex). This prevented Teck Corp exploiting mineral rights owned by Afton. Teck Corp challenged the share issue on the basis that it was for the purpose of frustrating Teck Corp (an improper purpose). Court held that the share issue was to obtain the best agreement they could while still inc control. In this sense it was to defeat Teck Corp but not to foreclose the takeover bid. Rather it was to foreclose to foreclose Teck Corp’s opportunity to obtain the ultimate deal to exploit the mineral rights. Because the agreement w/ Cannex to exploit the mineral rights was better for the company than to have Teck Corp overtake the company and exploit the mineral rights, this was the best deal for the company and the share issue was therefore ok.

deal for the directors while they were still in control BUT

Was the share issue upheld, and on what basis did the Supreme Court of British Columbia arrive at its decision?

Whitehouse v Carlton Hotel Pty Ltd (1987) 162 CLR 285
Charles Whitehouse is governing director of Carlton Hotel. Charles owned A-class shares which have full voting rights. His wife Mrs Whitehouse had been issued B-class shares which had partial voting rights. The daughters and the sons both who had C-class shares and no voting rights. The couple divorced and the daughters aligned themselves with the mother, the sons with the father. The dad was concerned that on his death the mother and daughters would get control of the company so he issued B-class shares to his sons. He then had a falling out with his shares and then resolved that no B-class shares had ever been given to his shares and directed that the share register be amended. The sons sued.

1. What was held to be the substantial purpose of Mr W’s share issue and allotment to his sons?
Share issue was made for impermissible purpose of diluting voting power. It might have been permissible if constitution had expressly authorised allotment of shares for that purpose. But that wasn’t the case here.

Power to allot initial A-class and B-class shares, after this structure was established you’re not allowed to issue more shares just for the purpose of changing voting power.

2. On what basis did the court hold that such a purpose might not invalidate a share allotment?

3. Was this a case of competing permissible and impermissible purposes?

**Darvall v North Sydney Brick and Tile Co Ltd (1989) 16 NSWLR 260**

Darvall is shareholder of NSBT and made a takeover offer. Directors of NSBT thought the takeover offer was inadequate. NSBT entered into a JV with Chase to make another takeover. As a result of the agreement, Chase would provide money to Lancley (director of NSBT) in order that he could make another takeover bid for NSBT.

1. What did the plaintiff, Darvall, allege was the breach of fiduciary duty by the directors of North Sydney Brick and Tile?

Darvall said that the JV was entered into not for the benefit of the company but purely to prevent the takeover by Tarvall.

2. Did the court consider that the joint venture / alternative takeover transaction would have proceeded if not for the plaintiff’s takeover bid?

Court held that yes, it was for the purpose of defeating the takeover. But that was not the sole purpose (although it was a dominant purpose) and provided there is a secondary proper purpose, it is OK.

“action taken taken for the dual purpose of advancing the interests of the company and for defeating a takeover, will be permissible”.

3. According to Justice Mahoney, was this an exercise of power for a proper purpose?

He was satisfied that the directors directed themselves to the right question and prompted by the existence of the plaintiff’s offer, they did what they did for the right reason.

The dirs would not have entered into the arrangement but for the takeover BUT although prompted by the takeover bid, the action was in the best interests of the company as a whole.

So there is a distinction between actions prompted by a takeover bid, and actions taken to defend against a takeover bid.

**Permanent Building Society (in liq) v Wheeler (1994) 14 ACSR 109**

Directors of PBS caused it to buy land from Tower Co at twice the market value. This allowed Tower to proceed with the purchase of a business owned by the dirs of PBS which they otherwise would not have been able to do.