

October 2007

## CORPORATIONS LAW UPDATE: RECENT DECISIONS ABOUT DIRECTORS' DUTIES AND LIABILITIES

Directors exercise extensive powers in the management of their companies, influencing their company's conduct by virtue of their involvement in the decision making process. Resulting from this unique position of power, directors are legally considered to stand in a fiduciary relationship with their company, and are subject to specific duties stemming from that relationship [\[1\]](#). What exactly are those duties and what do recent decisions reveal about the consequences of a director's failure or breach of their duties?

### General Outline of Director's Duties

Over the time, the courts have construed company directors' fiduciary duties as being duties to:

- act in good faith and for proper purpose;
- avoid conflicts of interest;
- retain directors' discretion; and
- act with due care and skill;

Directors also owe a duty of care to their company under the common law of negligence.

In addition to these general law duties, directors owe statutory duties under the *Corporations Act 2001* (Cth), [\[2\]](#) such as duty to act in good faith in the best interest of the company and duty to prevent insolvent trading by company. [\[3\]](#)

### To whom are the duties owed

Directors' fiduciary duties are owed to the company as a whole and not to individual shareholders, creditors, employees or the community. However, in certain circumstances, directors' fiduciary duties may extend to these stakeholders.

For example, where there were negotiations for a sale of company assets or undertaking which would affect shareholders' interest in the company, the nature of the transactions may have given rise to a fiduciary duty owed by directors to company shareholders. Where a company is insolvent, directors owe a duty to the creditors whose interest cannot be overridden by that of the shareholders. [\[4\]](#)

### Duties as a director in company group

Generally, directors of an individual company in a company group must exercise their powers for the best interest of the individual company which they direct, and not for the benefit of other companies in the group. However, this principle is subject to the common law and statutory exceptions. For example, section 187 of the *Corporations*

**Act 2001** allows a director of wholly-owned subsidiary company to take into account the interests of its holding company provided **all** of the following three conditions are met:

- (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.*

The courts have also held that directors will not be in breach of their fiduciary duties to their individual company where a transaction that benefits the group as a whole (or another company in the group) can also be regarded as benefiting the individual company, although such benefits to the individual company may be of a derivative (indirect) nature. [\[5\]](#)

## **Other duties imposed on company directors**

The laws governing trade practices, taxation, occupational health & safety, environmental protection, intellectual property also apply to companies. Therefore, directors' decisions which may cause a company to breach those laws may potentially give rise to breach of directors' duties to act in the best interest of the company.

For example, under the *Income Tax Assessment Act 1936* (Cth), an employer is obliged to make PAYG tax deductions from its employees' salaries at the prescribed rate. Company directors must ensure that this PAYG amount is remitted to the Tax Office. Failure to do so will result in a section 222AOE penalty notice being issued against company directors. Under the penalty notice, the Tax Office will be entitled to recover the penalty equal to the unpaid PAYG amount from company directors, unless within 14 days of the date of notice the directors cause the company to remit the unpaid amount or to go into voluntary administration or liquidation.

## **Recent Decisions on Breach of Director's Duties**

The Courts have decided on breach of directors' duties in several recent decisions. Issues of reliance on professional advice, knowledge and consent of other directors, and disclosure or otherwise of material information were considered in deciding these cases.

### **Re-Engine Pty Ltd and anor v Fergusson and Ors [2007] VSC 57 (9 March 2007)**

Re-Engine Pty Ltd and its liquidators brought an action against the Fergussons and Della Court Pty Ltd, a company in which the Fergussons were directors, alleging that the defendants were liable to account for funds advanced by the ANZ Bank to Re-Engine which funds were subsequently misapplied. The claim was based on a breach of fiduciary and statutory duties by Mr Fergusson, one of Re-Engine's directors. [\[6\]](#)

The Court found Mr Fergusson had breached his director's duties by causing Re-Engine to apply for advances of funds from the ANZ Bank totalling \$1.8 million without the knowledge or consent of any other directors, had caused . The advances were made pursuant to Re-Engine's ANZ International Trade Facility between June 2002 and August 2004, of which some \$388,000 was not paid to Re-Engine nor applied for its legitimate purposes. [\[7\]](#)

The Court further found Mr Fergusson was in breach of his director's duties by causing Re-Engine to continue to apply for the advances without disclosing to the ANZ that Re-Engine had ceased to import used engines in about July 2002, and that the advances were applied for purposes other than international trade.

The Court also found that Della Court was liable to account to Re-Engine the sum of \$70,712.02 which it received but did not pay to Re-Engine. Della Court was therefore liable for the irregular receipt or dealing with property that belonged to Re-Engine.

## **Geoffrey William Vines v ASIC (2007) NSWCA 75 (4 April 2007)**

Mr. Vines was the Chief Financial Officer of the GIO Group but not a director. He was found to have contravened four separate provisions under the *Corporations Law* for failing to disclose relevant information to GIO when it was his duty to do so. Mr. Vines attempted to plead the honesty defence under section 1317S.

Although the Court found Mr Vines had acted honestly, it did not grant him relief after considering the nature and seriousness of the contraventions. It was held that Mr Vines ought to have considered whether to disclose material information of which he was aware. The findings show that in each case, he had acted in a manner which had the effect of excluding the disclosure of material information. [\[8\]](#) Mr Vines' failure to provide the directors with that material information left them to make decisions on the basis of significantly incomplete facts [\[9\]](#).

Mr Vines was also held accountable for relying on another senior executive who reported (inaccurately) to him on a critical financial matter. The said senior executive had operational responsibility for the subject matter of his report. However, it was Mr Vines' responsibility to investigate what was reported to him in order to satisfy himself through his own inquiry that it was essentially valid [\[10\]](#). The Court said that Mr Vines' heavy responsibilities and workload, and the associated pressure, was not a sufficient general excuse for failing to discharge these duties [\[11\]](#).

## **Orrong Strategies Pty Ltd v Village Roadshow Ltd [2007] VSC 1 (25 January 2007)**

Orrong Strategies ("Orrong") and Village Roadshow ("VRL") entered into agreements for Orrong to provide services to VRL for a period between 1996 and 2001. Orrong was a company owned by Ziegler who was an accountant and solicitor, and an expert in company law and taxation law. Since 1993 Ziegler had worked full time for VRL and was appointed director (alternate or actual) of VRL between 1995 and 1999. He was also appointed director of another company which controlled VRL between 1999 and 2001. [\[12\]](#)

The agreements between Orrong and VRL provided for performance bonuses payable to Orrong, including 5% of tax savings and tax refunds obtained for VRL, and 5% of "non/limited recourse" financing raised by VRL as a result of Orrong/Ziegler's efforts. VRL members' approval for the agreements was not obtained, nor were the agreements considered by VRL's lawyers.

Orrong claimed against VRL for payment of termination bonus and unpaid performances totalling nearly \$220 million. In its defence and counterclaim, VRL sought repayment from Ziegler of \$25.68 million which it alleged was paid to Ziegler over six years. VRL argued that a number of events illustrated Ziegler's breach of his duties as an officer of VRL.

The Court found that the bonuses payable under the agreements were excessive and not capped, and the agreements were not reasonable and unenforceable as a result of the contraventions of the "related party financial benefits" statutory provisions under the then Corporations Law.

On the other hand, the Court found Ziegler did not breach his duties as a director or fiduciary of VRL merely because the drafting of and entering into agreements was not approved by VRL members or considered by VRL lawyers. The Court held that Ziegler was acting on behalf of himself and Orrong, and not VRL. The Court reasoned that Ziegler negotiated over a lengthy period with several directors of VRL who should have been well able to look after VRL's interests. [\[13\]](#)

VRL also failed to establish a breach of duty on the part of Ziegler in not disclosing to VRL that Orrong stood to gain US\$10 million in commission if US\$200 million was successfully raised in a project. This was because VRL had become aware of the commission yet still chose to proceed with the project. [\[14\]](#)

## **ASIC v Maxwell and Others [2006] NSWSC 1052 (10 October 2006)**

In this case, ASIC alleged that the defendants, which included two groups of companies (now all in liquidation), officers of those companies, and a consultant and an accountant to them, had contravened the Corporations Act in the promotion and conduct of fund raising schemes by which each group raised funds from the public for the purchase and development of real estate.

Amongst its claims against the defendants, ASIC alleged that Mr Nahed, a director of various companies in the ProCorp Group, breached his duties as a director by permitting, allowing and participating in various contraventions committed by those companies in the fund raising schemes. These included offences under the fundraising, financial services and misleading conduct provisions of the Corporations Act [\[15\]](#).

Having considered Mr Nahed's background and skills, the distribution of responsibility among ProCorp's directors, and the advice from the companies' advisors upon which Mr Nahed was entitled to rely, the Court found Mr Nahed was entitled to suppose that ProCorp's fundraising activities were being performed in accordance with appropriate legal and accounting advice. Accordingly, there was no breach of director's duties by Mr Nahed as he had acted with reasonable care and diligence as a director of the companies in the ProCorp group.

On the other hand, the Court held that Mr Nahed should be disqualified from being a company director because the manner in which he managed the groups of companies had at least partly caused the companies' insolvency.

## **Summary on Liabilities for Breach of Directors' Duties**

Liabilities differ in instances of civil or criminal cases.

For civil liability, the Courts may impose fines up to \$200,000, order disqualification from management, and require payment of compensation. Relief from civil liability occurs if the Court finds that the person has acted honestly, and having regard to all the circumstances, ought to be excused.

In cases of criminal liability, when actions are brought by the ASIC, a director or other officer of a corporation may be found to be either reckless, or intentionally dishonest. If found guilty of failing to exercise their powers and discharge their duties in good faith and in the best interests of the corporation, or for a proper purpose, they may be fined up to \$200,000 and/or imprisoned for up to five years.

The position of company directors carries duties and responsibilities which are enforceable by law, with stringent penalties for breach or failure. It is therefore vital that a director understands the consequences and accountabilities entailed.

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**Stephens Lawyers & Consultants have extensive experience in a broad range of commercial matters. Their strong understanding of the Corporations Act and Trade Practices law, coupled with comprehensive knowledge of the ACCC's views and strategy, adds a pragmatic dimension to their legal advice.**

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[1] *Regal (Hastings) Ltd v Guliver* (1967) 2 AC 134.

[2] Corporations Act 2001, Part 2D.1

[3] Corporations Act 2001, section 181, section 588G

[4] *Kinsela v Russel Kinsela Pty Ltd (in liq)* (1986) 2 ACLC 215.

[5] *Walkerv Wimbourne* (1976) 137 CLR 1; *Equiticorp Finance Ltd v Bank of New Zealand* (1993) 11 ACLC 952

[6] *Re-Engine Pty Ltd and anor v Fergusson and Ors* [2007] VSC 57, 1.

[7] *Re-Engine Pty Ltd and anor v Fergusson and Ors* [2007] VSC 57, 5.

[ 8] *Geoffrey William Vines v ASIC* (2007) NSWCA 75, 546.

[9] *Geoffrey William Vines v ASIC* (2007) NSWCA 75, 547.

[10] *Geoffrey William Vines v ASIC* (2007) NSWCA 75, 546.

[11] *Geoffrey William Vines v ASIC* (2007) NSWCA 75, 549.

[12] *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1

[13] *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1, 804.

[14] *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1, 808.

[15] *Australian securities and investments Commission v Maxwell and Others* [2006] NSWSC 1052, 111.