

NOTES ON DIRECTORS' DUTIES

DUTIES OF CARE AND DILIGENCE

TOPICS

1. Background
2. What are the differences between a director's fiduciary duties and the duty of care?
3. What are relevant issues when ascertaining the duty of care?
4. What are the remedies available for a breach of the duty of care?
5. The business judgment rule
6. Analysis of cases already decided
7. Introduction to insolvent trading
8. Employee entitlements
9. Theoretical analysis of the application of the duty of care.

1. BACKGROUND

- Powers of the board of directors: s.198A.
- No formal qualifications required for directors: s.201B.
- Role of directors in making decisions which expose the company to risk in the expectation of commensurate rewards: *Daniels v Anderson*, ,
- Directors are not "agents" of shareholders

2. DIFFERENCES BETWEEN FIDUCIARY DUTIES, SIMILARITIES OF EQUITABLE AND COMMON LAW DUTY OF CARE

- *Fiduciary duties are duties of loyalty – proscriptive duties*
 - Role of fiduciary duties, CB 364-365, See also *Canadian Aero Service Ltd v O'Malley*, per Laskin J
- Duty to act in good faith in the best interests of the company as a whole,.
- Duty to avoid conflicts of interest,
 - Special obligations to avoid conflicts of interest in dealings with related parties, Part 2E,
- *Duty of care – prescriptive duty*
 - The shirking problem, .
 - Common law duty of care, equitable duty of care, and statutory duty of care: s.180(1).
 - *Daniels* .
- **What is the duty of care?**
 - May be equitable or
 - Common Law or
 - Statutory or
 - Contractual for executive officers

3. RELEVANT ISSUES IN ASCERTAINING THE DUTY OF CARE

- **Daniels** – great risks may be undertaken in the hope of commensurate rewards. If venture fails, how is undertaking to be judged against an allegation of negligence by entrepreneur?
- **Wheeler** – the question whether a director has exercised a reasonable degree of care and diligence can only be answered by balancing the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the co from the conduct in question.
- **Components of the duty of care:**
 - What does director need to know?
 - What standard does a director need to reach
- **Knowledge**
 - Become familiar with the business of the company, *Daniels*.
 - Guide and monitor the management of the company, *Daniels*
 - What does Director need to do to guide and monitor co?
 - Look at frequency of board meetings *Daniels*
 - Conform to professional standards *Daniels*
 - Conform to an objective standard of care which is not affected by considerations such as lack of knowledge or lack of experience *Daniels*
 - Supervise managers and practices. *Daniels*– Cannot shut eyes to corporate misconduct
 - Maintain familiarity with financial status of co *Daniels*
 - Review management where there is mismanagement and where investment imposes a risk *Daniels*
 - Supervise managers and practices to determine whether business methods are safe and proper *Daniels*
 - This is an affirmative duty to seek out knowledge, and will be the backdrop against which the issue of breach of duty will be determined, see, *Permanent Building Society v Wheeler*
 - **A sub-issue** here is whether, and when, directors may rely upon information provided by corporate officers, *Daniels C*.
 - See also CA s.189.
 - On the basis of the above knowledge make business judgments and decisions, *Daniels CB 385-388, 390-391*
- **Standard**
 - Familiarity with the business of the company.
 - What level of understanding must a director have of the business of the company? - *Daniels* .
 - Is this level of understanding similar for all directors or does it depend upon whether directors were appointed to the board for a specific purpose or for special skills? *Daniels*.
 - Note: *CLERP Act* introduced “business judgement rule”: s.180(2).
 - Duty to guide and monitor management;
 - What is the role of the directors in guiding and monitoring the management of the company? See *Daniels*, and ss.189-190.
 - When will directors have to consider reviewing the effectiveness of management? See *Daniels*, see also ss.189-190.
 - Duty of care in relation to the business judgments of directors:
 - How is the duty of care applied to business judgments of directors? See *Daniels*, see also ss.189-190.

- What is the standard of care which directors are expected to comply with in making business judgments?
 - What are the reasonable expectations of shareholders in relation to the standard of care expected of directors? *Daniels*.
- **Factors relevant in determining the application of the duty of care**
 - The purpose of corporate law.
 - The role of fiduciary duties.
 - Ambiguity and fiduciary duties.

4. REMEDIES FOR BREACH OF DUTY

- **Damages**
 - **Wheeler** Equity restitution, Common law damages – test and measure of damages the same *Permanent Building Society v Wheeler* (1994) 14 ACSR 109 at 161-168.
 - **Civil Penalty** – section 1317E CB 375-77
 - **Claim for Damages by co** – Section 1317H
 - **Disqualification** – section 206C
- **NOTE NOT A CRIMINAL OFFENCE**

5. THE BUSINESS JUDGMENT RULE

- **Section 180(2)**
 - **The Rule** - Director or other officer who makes a business judgement is taken to meet the requirement of the statutory duty of care and diligence and equivalent duty at common law
 - **What is a business judgement?**
 - 180(3) – decision to take or not to take an action
 - derivative suits – does business judgement include a determination by the directors whether or not the derivative suit is in the best interests of co?
 - Compliance procedures – where do they fit in?
 - **Safe Harbour** – the rule has been described as a safe harbour. The EM says it was intended to create a rebuttable presumption in favour of a director. Does it? Maybe not because the wording says the rule applies if a director meets 4 criteria.
 - If presumption is rebutted, the plaintiff still needs to establish a breach of the duty of care.
- **Limits to the Rule**
 - Directors breach duty if they totally disregard compliance with the law demonstrating a sustained or systematic failure to exercise reasonable oversight
 - Question – are issues with regard to compliance with the law included or excluded from business judgements? Is there a duty to monitor compliance in Australia?
 - Limited application of the rule, eg, does not apply to actions brought under s.588G.
 -
- **Pros and cons of the rule**
- **Pros:**
 - Where directors act honestly, there is uncertainty with regard to the issue of liability. May lead to failure by co of responsible risk-taking
 - Reduction of agency costs
 - encourage appropriate risk-taking

- **Cons:**
 - Existence of a like presumption under the general law: see eg AWA CB 380.

6. ANALYSIS OF CASES ALREADY DECIDED

- **Would the existence of the rule have affected the outcomes in:**
 - *Daniels v Anderson*,
 - *Permanent Building Society v Wheeler*.

7. INSOLVENT TRADING

- **Insolvent Trading Generally**
 - Note the application of s.588V to corporate groups.
 - A person who is a director of a company that;
 - Incurs a “debt”: s.588G(1)(a),.
 - When the company is “insolvent”, or is rendered insolvent by entering into the debt: s.588G(1)(b)
- **Other issues:**
 - **Debt** – what is a debt 588G(1)(a). co must have incurred a debit ie a liability to pay. Assumption of a contingent liability like a guarantee is within 588G
 - **Insolvent** – see section 95A – need to take into account existing debts, present and expected resources and dates for payment
 - **Suspecting** – that a co is insolvent. It is one thing for a co to be insolvent and another for that fact to be apparent. Reason to suspect is more than a reason to consider or look into the possibility of its existence.
 - **Reasonable grounds** – person aware of reasonable grounds for suspecting insolvency – this does not concern knowledge of the reasonable person, but rather reasonable inferences to be drawn from a concrete situation as disclosed in the evidence as it affects the particular person whose knowledge is in issue. **CBA v Freiderich** (1991) 5ACSR 115 – that model reasonable person would be one who would be able to understand in general terms at least, what the co’s accounts and auditors’ reports show.
- **Defences:**
 - **Reasonable grounds to expect co solvent** – 588H(2) – director can point to facts that were taken into account but reasonable grounds also looks at what a director should have known. Reasonable grounds” – see **DANIELS** this means that there needs to be some knowledge and understanding of the company’s affairs. See also the Full Court’s analysis of the insolvent trading provisions and how they glean a duty of care from that analysis
 - **Reasonable reliance on 3rd person** - 588H(3) – need to prove reasonable grounds and did believe competent person was responsible for providing adequate information. Further that there are reasonable grounds for believing person was fulfilling that responsibility so on the basis of that information it was expected that the co was solvent.
 - **Non-participation in management** – 588H(4) – must be for justifiable reason
 - **Reasonable steps to prevent incurring of debt-** 588H(5) & (6) – note the examples especially the appointment of administrator.
- **Remedies and Consequences:**
 - Court orders for compensation: s.588J, 588K.
 - Recovery by liquidator: s.588M.
 - Recovery of debts by the creditor: s.588R - s.588U.
 - Civil penalty provision: s 1317E.

8. EMPLOYEE ENTITLEMENTS

- Amendments aim to increase protection to employees
- Target agreements and transactions entered into with the intention of preventing the recovery of employee entitlements (596AA)
- What is an employee entitlement? 596AA(2)
- Employee entitlements are protected as far as priority is concerned under s556 (note excluded employee 556(2))
- 596AB – offence applies to “person” – not just directors although it is anticipated that directors will primarily be caught
- 596AC person who contravenes 596AB is liable to pay compensation
- Who can sue?
 - 596AC(2) the liquidator
 - employee 596A(3)
 - liquidator’s consent 596AF
 - notice to liquidator and consent from court 596AH
 - 596AI – employee cannot sue if liquidator has begun proceedings under insolvent trading provisions and employee entitlements tied in with these proceedings

9. THEORETICAL ANALYSIS OF APPLICATION OF THE DUTY OF CARE

- **What is the purpose of the corp law?**
 - Facilitation of co-operative activity that provides wealth.
- **What is the significance of a director’s fiduciary duty?**
 - Capital protecting devices but they are costly
- **Ambiguity in fiduciary duties**
 - Corporate management might deploy technically correct rules but these do not necessarily advance the interests of the long-term investor. Can cause a net loss or a net benefit depending on how the fiduciary duty is enforced
- **Modes of decision-making**
 - **Moralistic** – Allen not agree with this because it does not take into account the real world
 - **Pragmatic** – Allen prefers this as an approach that accommodates contrary principles and arguments.
- **duty of care and corporate governance**
- Maximise long-term value of capital. Compare Blair and Stout, “shareholders benefit from granting directors discretion to favour other constituencies ...because shareholders long-term interest should be interpreted to be the long run interest of all the shareholders who hold, have held, or will hold stock in the firm”
- Provides way of compensating co
- Regulates directors– command and control procedure – question its effectiveness
- Institutional investors – is this another effective monitoring system?. Does duty of care motivate top-quality performance or only impose a minimum standard?
- What will be regulatory impact of business judgment rule?

DUTY TO ACT IN GOOD FAITH FOR BENEFIT OF THE CO AS A WHOLE

TOPICS FOR DISCUSSION:

1. Fiduciary duties of directors
2. Examining the fiduciary duty more closely
3. Examples of how directors can breach their fiduciary duties
4. What remedies are available against directors?
5. Models of the company and regulation of corporate governance

1. FIDUCIARY DUTIES OF DIRECTORS

- Basic fiduciary duty is one of loyalty
- It is activated when the fiduciary seeks to advance their own or other collateral interests at the expense of the co
- A director may not profit from a breach of fiduciary duty even if the beneficiary is not thereby deprived **Chan v Zacharia**
- Fiduciary duties of directors can be broken into the following:
 - **Duty to act in good faith** – director must do what they honestly believe will be in the best interest of the co
 - **Duty to exercise powers for a proper purpose** – directors are given extensive powers of management so some measure of control is necessary – many issues in this regard relate to the exercise by the directors of their power to issue shares
 - **Duty with regard to discretions** – director cannot enter into a contract which will bind them to vote in a particular way at board meetings
 - **Duty to act in the best interests of co** – avoid conflicts of interests
- Also note statutory duties:
 - 181 – duty to act in good faith in the best interests of the corporation and for a proper purpose
 - 182 – no improper use of position
 - 183 – no improper use of information
- **In what context could the duty be breached?**
 - Business judgments, eg, *Harlowes Nominees*
 - Compare with “business judgement rule”: s.180(2),
 - Takeovers, eg, *Howard Smith*, *Teck* CB 443.
 - Chapter 6 of the Corporations Law, in particular s.657A, s.657C, s.659B prevent litigation before a Court concerning the validity of any element of a takeover bid during the period of any takeover, CB 467-468.
 - Issue of shares to gain control or affect the outcome of a takeover, eg, *Howard Smith*; *Whitehouse v Carlton* CB 452, Section 124(1), 198A, 254A.
 - Refusal to register shares upon transfer, eg, *Re Smith and Fawcett* (relevant for many proprietary companies: s.1091E – replaceable rule).
 - Intra-group transactions

EXAMINING THE FIDUCIARY DUTY MORE CLOSELY

- **Good faith**
- **Proper purpose**
- **Best interests of co as a whole**

- **Good Faith**
- How do you determine whether a director has acted in good faith?
- **Smith v Fawcett** – in a small co directors may take into account a wide range of considerations not open to directors of a listed co eg the directors can consider whether the proposed transferee is a competitor of the co
- **Howard Smith** – Ampol and Howard Smith were rivals in take over of Miller. Miller issued 4.5m shares to H/S diluting Ampol's holding in Miller. Ampol applied for order to set aside the issue of sh. Privy Council held that the power to issue shares was improperly exercised. Judge found the purpose was to dilute majority holding of Ampol and Bulkship to enable minority to sell their shares more advantageously. An issue of shares purely for the purpose of creating voting power has been repeatedly condemned by the courts see Court here looked at primary purpose but see later in Whitehouse v Carlton
- Is the process of decision making undertaken by the directors a guide to determining whether or not the directors have acted in good faith?
- **Teck** – Teck held majority shares in Afton mines, which held valuable mineral rights. Teck was going to replace Afton's board and then make agreement with Afton for Teck to exploit mineral rights. Before this could happen, Afton made an agreement with Canex for Canex to exploit the mineral rights and as was common in these types of agreements for Canex to get shares in Afton. Teck now no longer had majority. Court said – purpose was to obtain best agreement for co's assets. This was legitimate even though integral part of the scheme meant that Teck's majority was displaced. see
- **Whitehouse v Carlton** – Carlton Hotel had 3 classes of shares. Mr Whitehouse had one class of shares =governing director for his life. Mrs W had 2nd class of shares – these carried voting rights only after hubby died and 3rd class belonged to kids – these carried no voting rights at all. Mr & Mrs W divorced. Mr W was worried that daughters influence mum after Mr W died and so that wife would not control co he issued more class 2 shares to sons. Had argument with sons and now going to court arguing the share issue was made for improper purpose and is therefore invalid. Court held that the issue of shares was made for improper purpose. Was an argument before the court that Mr W was not motivated by selfish reasons – he believed that changing the voting power was in the best interests of co. Court said that the exercise of a power for an improper purpose is still bad even if the motives are genuine and sincere. “But for” test- DON'T look at dominant purpose but ask would share issue have been made but for improper purpose? see
- **Proper Purpose**
- Directors are required to act in good faith in the best interests of the co as a whole. What are the factors which will determine whether or not the directors have acted for an improper purpose?
- What is an improper purpose?
- **Howard Smith** – issue of shares to create voting power
- **Whitehouse** – manipulation of voting power
- **Teck**
- For mixed purposes see **Whitehouse CB**
- How can directors act in good faith but for an improper purpose?
- **Best Interests of Co as a Whole**
- What is the point of reference for determining the best interests of the co as a whole?
- **Howard Smith** – effect of self-interest
- **Teck**– not follow Hogg
- **Whitehouse**
- **Wheeler** –
- When will the best interests of the co be defined in terms of the best interests of outsiders?
- **Kinsella** – family in financial difficulties. Resolution passed by shareholders giving 2 directors a lease of property at advantageous terms. Board of Directors also passed similar resolution. Co wound up – liquidator trying to set lease aside. Court held that lease was voidable. Directors failed to realise where co is near insolvency duties to co as a whole also extend to

creditors. If interests of creditors and not the shareholders are at risk, the shareholders do not have the power to authorise breach of fiduciary duties by directors. Does duty extend to secured or unsecured creditors? CB 244

- How are best interests of co defined where co is part of corp group?

2. EXAMPLES OF HOW DIRECTORS CAN BREACH THEIR FIDUCIARY DUTIES

- When making business judgements
- Harlowes Nominees - **issue of shares to raise money**
- Compare this with the business judgement rule in section 180(2)
- Takeovers
- **Howard Smith**— dilute majority voting power
- **Teck**— object was to obtain best agreement while directors in control
- Issue of shares to gain control or affect outcome of takeover
- **Howard Smith** — dilute majority voting power
- **Whitehouse**
- Refusal to register shares upon transfer in Pty co. Note replaceable rule 1091E – Pty co may refuse to register share transfer for any reason
- **Smith v Fawcett**
- Intra-group transactions
- **Equiticorp**
- **Walker v Wimborne**

4. WHAT REMEDIES ARE AVAILABLE AGAINST A DIRECTOR?

- If agreement or act of the co entered into is in breach of directors' fiduciary duties – agreement or contract is voidable
- **Howard Smith.**
- Also note possibility of injunction under s1324
- Accounting of profits or constructive trust imposed on those in breach of duty eg conflict of interest or secret profits.
- Equitable compensation for losses sustained by the co – like damages at common law that are compensatory in nature. For an example of a successful action to recover equitable compensation for breach of the duty to act in good faith in the best interests of the company as a whole see *Permanent Building Society v Wheeler*
 - If breach of 181, 182:
 - **Civil Penalty** – section 1317E
 - **Pecuniary penalty orders** - section 1317G – after declaration of contravention under 1317E(2)
 - **Claim for Damages by co** – Section 1317H
 - **Disqualification** – section 206C
 - **Contravention extends to those involved** - section 181(2)
 - **NOTE also a CRIMINAL OFFENCE** (section 184)

3. MODELS OF CO AND THE REGULATION OF CORPORATE GOVERNANCE

- Property model – Purpose of corp law – increase wealth – investors allowing themselves to be safely passive. The agency sufficiently constrained to assure that investors' interests will be advanced over the term
- Fiduciary concept adds ambiguity – causing net cost or gain depending on how it is enforced

DIRECTORS' INTERESTS WITH THEIR COMPANY

TOPICS

1. What is meant by conflict of interests? – Source of directors' duties
2. Equitable duties and the right to equitable remedies
3. Alteration of equitable obligations by corporations law and the constitution
4. Remedies
5. Objectives

1. SOURCE OF DIRECTORS' DUTIES

- Directors' duties in this area are a combination of :
 - Equitable principles relating to fiduciaries
 - Modification of those principles by the constitution and the replaceable rules
 - Impact onto equitable principles, though not replacement of equitable principles, by the corporations law in particular ss 191, 192, 193, 194, 195 ,196 and Part 2E

2. EQUITABLE DUTIES AND THE RIGHT TO EQUITABLE REMEDIES

- Equitable remedies arise where there is a “**significant possibility of conflict**” between the fiduciary duty to act in the best interests of the company and the personal interests of the director, *Chan CBDeane J* (Brennan and Dawson JJ agreed with Deane J).
 - Compare: *Aberdeen v Blaikie Bros* CB 496 where the “possibility” of a conflict of interest was sufficient: see also *Transvaal Lands Co*.
- Multiple directorships - mere existence of a conflict of interest because of directorship in two companies does not give right to obtain a remedy. Right arises out of actual pursuit of the interest where there is a “significant possibility of conflict”:
- Duty of confidentiality to one company will not have the effect of “rolling back” the duty to act honestly (s.181(1)) by disclosure to the second company where the transaction involves pursuit of a conflict of interest:.
- The fairness of the contract entered into by the company, or the gain or benefit obtained by the director, is not relevant in determining whether the company has a right to a remedy.
 - But see s.210 (arms length exception to prohibition in s.208(1) & (2).
- No remedy if the conflict of interest, or the benefit or gain is authorised by the company in general meeting, eg, *Imperial Mercantile Credit Association Chan* CB 26.
 - As to level of disclosure see *Imperial Mercantile Credit v Coleman*
 - Where competing duties arising out of multiple directorships the director *may* also have to resign if involved in actual pursuit of conflict: This is particularly relevant where the director has an obligation of confidentiality to one

company concerning information that the director would otherwise have to disclose to the second company.

3. IMPACT OF CORPORATIONS LAW AND THE CONSTITUTION ON EQUITABLE OBLIGATIONS

- **In the case of proprietary companies: s.191, 192, 193, 194.**
 - Duty to disclose, “as soon as practicable” (s.191(3)), to the board of directors a “material personal in a matter that relates to the affairs of the company” s 191(1).
 - Duty to disclose to the board where the holding of an office or the possession of property creates a conflict of interest with his or her duties as a director, s.191(1).
 - 191(2) –When notice need not be given
 - Contravention of 191 – Schedule 3 – 10 penalty units/3months jail
 - Where conflict is disclosed to the board the director may vote on matters involving the contract and may retain any benefits obtained under the contract: s.194 (replaceable rule for proprietary companies).
 - Section 191 operates in addition to any other *restrictions* imposed on directors by the Constitution, s.193.
- **Public Co - 191, 192, 193, 195, 196**
 - Duty to disclose a material personal interest 191(1)
 - Duty is to disclose to other directors 191 (1)
 - Director may give standing notice 192
 - 191(2) when notice need not be given
 - Contravention of 191 – Sch III 10 penalty units/3 months jail
 - 193– 191, & 192 operate in addition to any other *restrictions* imposed on directors by the Constitution,
 - 195 – Where a director as a “material personal interest” in a matter being considered by the board of directors that directory must not
 - (a) vote on the matter or
 - (b) be present for deliberations where the matter is being considered
 - What is a **material personal interest**? –Materiality - a substantial likelihood that under all the circumstances the interest would have assumed actual significance in the deliberations
 - Director may not be counted for the purpose of establishing a quorum (see 248F – quorum is 2)
 - 195(2) and 180(1) – the board of directors by resolution may state that they are satisfied that the interest should not disqualify the director
 - Note Schedule 3 – breach of 195 will lead to a fine of 5 penalty units
 - 196 – ASIC has power to make declarations exempting specified meetings of the board from the operation of 196(1)
 - The constitution of the company may impose restrictions *in addition* to those included in s.195(1).
- **Section 181(1)** - Duty to act in good faith in the best interests of the co
 - Failure to disclose information where conflict of interest may amount to a breach of s181(1)
 - a) The mental element required or a criminal conviction under s184(1)

4. REMEDIES

- Contract or agreement voidable if rescission is possible.
- Account of profits supported by a constructive trust, where necessary.
- Equitable compensation for loss, eg, *Permanent Building Society v Wheeler*
- Note that there are no statutory remedies for breach of s.195(1). Contravention of s.195(1) is punishable by a fine of \$500 only. For civil remedies it is necessary to find a breach of an equitable obligation entitling the plaintiff to an equitable remedy (s.193 preserves the availability of equitable remedies).
- If breach of s.209(2), (related parties) - Civil Penalties Pt 9.4B. Note that s.191(1) is a criminal offence punishable by imprisonment but is not a civil penalty provision.

5. OBJECTIVES TO CONSIDER

- What are the objectives of the duty to avoid conflicts of interest in the overall scheme of regulation of corporate governance?
 - Reduction of agency costs. See also *Canadian Aero Service Ltd v O'Malley* (1973), judgment of Laskin J.
- How effective are the remedies – damages and accounting of profits – in ensuring compliance with the duty to avoid conflicts of interest?
- **Other considerations relating to the grant of equitable remedies:**
- Right to rescind a voidable contract lost where restitutio ad integrum not possible,
- Right to obtain an account of profits remedy.
 - See eg, *Imperial Mercantile v Coleman* CB 499-500.
 - Actual pursuit of conflict required in order to obtain remedy - not merely existence of the conflict; but
- The company does retain a claim for equitable compensation for losses sustained as a result of the breach of duty,.
- All equitable remedies may be granted or withheld subject to ordinary principles of estoppel, laches, acquiescence and delay,.
- Profits assessed by reference to “the scope and ambit of the [director's] duty”,

SECRET PROFITS AND CORPORATE OPPORTUNITIES

TOPICS

1. How does a director breach this duty?
2. Disclosure of the conflict
3. What remedies are available to the co?
4. What is rationale behind the imposition of this fiduciary duty?

1. HOW DOES A DIRECTOR BREACH THIS DUTY?

- **Generally:**
 - By reason of or by use of” his/her position; arising out of fiduciary duty to the company, see .

- Duty is breached where director makes a gain or benefit
- Where there is a conflict of interest or a significant possibility of conflict of interest.
 - **Chan Red**
 - A director diverts or destroys without authority a particular opportunity that is being pursued or which is under consideration by the co. This restriction may apply to an opportunity which the co was never able to take up or consider.
- See also, statutory duties including:
 - Misuse of office, s.182, or misuse of corporate information, s.183.
 - Criminal offences, see, s.184(2), (3).
 - Prohibition on giving of financial benefits to related parties, Part 2E.
 - Duty to disclose interests to the board, s.191(1) and s.191(3), and s.194, 195 and s.181(the obligation to act in good faith in the best interests of the company for a proper purpose.
 - **Part 2E.1** – ss207-227 member approval for related party transactions
 - **Part 2E.2** – ss 228 & 229 related parties and financial benefits
 - **230** – general duties still apply
- What are the kinds of corporate opportunities which a director is prohibited from diverting or destroying:
 - *Furs Ltd v Tomkies* CB- a transaction in which a managing director has an interest, where the managing director is the person responsible for negotiating the terms of the sale of the company's main business undertaking.
 - *Note*, this an obvious example of agency costs generated by a divergence in interests between managers and shareholders. In this instance the agency costs arise out of the managing directors' role in the sale and the lack of any effective remuneration package.
 - *Cook v Deeks* - Directors unable to "divert in their own favour business which should properly belong to the company",.
 - The conflict of interest experience by Deeks and Hinds was that it was they who were excluding the company from gaining a benefit when it was their duty to ensure that the company received.
 - *Regal Hastings v Gulliver* - profits earned "by reason and in the course of" the director's fiduciary role.
 - *Phipps v Boardman* – Boardman received profits from the takeover of Lester & Harris in circumstances where there was a conflict between his duty to the company and his personal interest.
 - There are three steps in the argument that Boardman breached his fiduciary obligations to the Trust.
 - Historically Boardman had provided the trust with legal advice. Boardman was under no obligation to provide legal advice to the trust in any future matter and the trust had not put Boardman on any kind of retainer.
 - Boardman obtained the "commercial information" about Lester & Harris while acting for the trust, in particular, he gained relevant information when seeking a division of the company's assets between the Phipps family and the other shareholders
 - There was a "remote possibility" that Boardman would be asked to advise the trust on the desirability of applying to the court in order that the trustees might use the information that Boardman had obtained. .
 - Lord Upjohn rejected the argument of the majority. His Lordship argued that there was no "real sensible possibility of conflict" because Boardman was no longer acting as a fiduciary when he decided to make the offer of 4 pounds 10 shillings per share,.
 - Boardman and Phipps obtained the relevant information by reason of, and by use of, their fiduciary position : *Regal (Hastings) Ltd v Gulliver*.

- A second string to this part of the argument is that the “confidential information” obtained by Boardman by use of his fiduciary position “can properly be regarded as property of the trust”
 - In what sense could it be argued that the “confidential information” belonged to the trust? Lord Upjohn rejected the view that the information obtained by Boardman was “confidential information”.
- *Peso Silver Mines v Cropper*. Where the board of Peso Silver Mines used its ordinary process of decision-making in rejecting an investment opportunity which was later taken up by Cropper (a director) who had access to the same information as the company.
- *Canaero* - “ripeness” of the business opportunity set up by the company, Resignation of two directors just before Canaero was to bid for a mapping contract. The two directors set up Terra Surveys Ltd, which submitted a tender for, and obtained, the mapping contract.
 - Terra Surveys may not have been incorporated for the purpose of intercepting the mapping contract in Guyana but this is not central to the issue of breach of fiduciary duty,
 - Rather O’Malley and Zarzicki “continued after their resignations, to be under a fiduciary duty to respect Canaero’s priority, as against them and their instrument Terra, in seeking to capture” the mapping contract, .
- *Chan v Zachariah* , see reference to *Phipps v Boardman* - no duty to account where the inflexible rule may produce an inequitable result.

2. DISCLOSURE OF THE CONFLICT

- What information concerning any conflict of interest in relation to a diversion of a corporate opportunity is a director required to disclose to the board?
 - Constitutional provisions, if any.
 - Section 191(1) – obligation on all directors of all companies to disclose to the board “any material, personal interest in a matter that relates to the affairs of the company”.
 - Note different rules applying to proprietary companies (s.194) and public companies (s.195).
 - Obligation under the law of equity to fully inform the board of directors so that the board may give “fully informed consent,.
- When will disclosure of a conflict of interest to the board allow the director to retain the benefit?
 - Proprietary companies: s.194.
 - No, *Cook v Deeks* , (limits on the power of majority of shareholders).
 - Yes, *Regal Hastings v Gulliver*.
 - Yes, *Peso Silver Mines v Cropper* .
 - Yes, *Queensland Mines Ltd v Hudson*. Full disclosure by Hudson and a fully informed decision by Queensland Mines’ Board to renounce all interest in the exploitation of the licence.
 - See also *Whitehouse v Carlton*.
- When will disclosure of the conflict of interest to the general meeting be sufficient to allow the director to retain the benefit?
 - *Regal Hastings v Gulliver*
 - Note here requirements upon directors to make full and true disclosure that is not misleading and deceptive,.
- When will disclosure of the conflict of interest to the general meeting be insufficient to allow the director to retain the benefit?
 - *Cook v Deeks*
- See limits on the capacity of the general meeting to ratify breaches of duty:

3. WHAT REMEDIES ARE AVAILABLE TO THE CO?

- Remedies
 - A right to an account of profits.
 - Note that this remedy may be available where the opportunity was one which the company was never able to take up or consider, see eg, *Cook v Deeks* , *Phipps v Boardman* , *Canadian Aero Service Ltd v O'Mally* CB 552. But see *Chan* per Deane J at CB 26-27..
 - Equitable compensation;
- Account of profits remedy - assessment of the profits to which the company is entitled:
 - The director will be required to render an account of profits made within the “scope and ambit of the duty”,
 - Where the fiduciary acquires a specific asset which falls within the scope of the duty allowance may be made for the skills and expertise of the fiduciary, eg, *Phipps v Boardman*(payment to appellants for bringing the scheme to fruition).
 - Where the fiduciary obtains and operates a business, which falls within the scope of the duty, the company may only be able to recover a proportion of the profits. It is necessary to account for the skill, efforts etc of the fiduciary: .

4. RATIONALE

- What is the rationale for imposing fiduciary duties on directors? What is the role of fiduciary duties in the system of regulation of corporate governance?
- One of the devices balancing problems generated by managerial control
- Role as monitoring device to reduce agency costs
- Blair and Stout (that duties of loyalty place strict limits on self dealing but otherwise impose only limited restrictions on directors is consistent with mediating hierarchy model).
- Corbett, (fiduciary obligations have only a limited role as a regulatory mechanism to encourage the adoption of better corporate governance practices).