CHAPTER 4

DIRECTORS' FIDUCIARY DUTIES

4.1 A company director has a fiduciary relationship with the company. This relationship gives rise to certain legal obligations that are part of the director's so-called traditional duties. The term 'fiduciary' is derived from Roman law and is used to describe a person who has the character of, or similar to, a trustee. The fiduciary's legal obligations stem from his or her position of trust.[1]

4.2 Professor Finn described what fiduciary law entails. It

> starts off with the notion that one person [the fiduciary] is in a position that gives them a power or capacity to affect the interests of another [the beneficiary] ... but in circumstances where the other is entitled to expect that that power or capacity will be used in that person's interest. ... The general object of fiduciary law ... is to ensure that the power or capacity that that person possesses is not used to further any interest other than the beneficiary's interests - the company's interest.[2]

4.3 The rules which impose fiduciary obligations are rules of equity, developed over time by the Court of Chancery in England and by Australian courts exercising equitable jurisdiction. To some extent the rules of equity have been reproduced as statutory provisions,[3] but they remain judge-made rules capable of judicial development to meet new situations and

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1. *See Black's Law Dictionary (5th ed), West Publishing, St Paul, 1979, p 563; Jowitt's Dictionary of English Law (2nd ed), Sweet & Maxwell, London, 1977, vol 1, p 788.*
2. *Evidence, pp 160-1.*
3. *Companies Code, s229(1),(3),(4) (Corporations Act, s232(2), (5), (6)).*

changing mores. They are far wider than the provisions in the Companies Code or the new Corporations Act.[4]

4.4 The relationship of director and company is just one of a number of relationships based on trust in which fiduciary obligations apply. Others include the relationships of solicitor and client, trustee and beneficiary, and executor and beneficiary under a will.[5]

4.5 The fiduciary relationship is reflected in two distinct (but sometimes overlapping) bodies of rules. The first set of rules

> concerns itself with the manner in which powers and discretions are to be exercised by a fiduciary. ... [It] is concerned with the manner of decision making, the propriety of decisions. ... So it is decision orientated.[6]

It is designed to ensure that when the fiduciary exercises a discretion within his or her 'fiduciary powers', he or she does so bona fide and in the beneficiary's interests.

4.6 The second set of rules

> is concerned with the standards of conduct to be expected of a fiduciary and with the types of behaviour that will constitute disloyalty. ... The focus ... is not on the propriety of a decision as such but on the propriety of the conduct of the individual.[7]

It is designed to ensure the fiduciary's loyalty to the beneficiary. The fiduciary must not allow his or her own

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4. *Evidence, p 169 (Professor Finn).*
5. *Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, p 3; Evidence, p 160 (Professor Finn).*
6. *Evidence, p 161 (Professor Finn). See also Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, p 3.*
7. *Evidence, p 161 (Professor Finn).*

interests (or another duty) to conflict with the fiduciary duty, or to use his or her position to gain a personal advantage, without the informed consent of the beneficiary.[8]

4.7 While fiduciary law has two distinct parts directed to two different kinds of phenomena, in practice the parts may often overlap. For example:

> An improper decision may be infected by improper conduct.[9]

4.8 The essence of fiduciary law is the notion of faithful and loyal service. Directors are also required to exercise a reasonable degree of care and diligence and not to be negligent, but those requirements go to competence. Competence is not part of fiduciary law.[10]

4.9 As Professor Finn emphasised,

> fiduciary law is only one of a number of bodies of law that can apply to directors and it is by no means the universal solvent to all the problems that can flow from the actions and activities of company directors.[11]

The fiduciary's powers and discretions

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> The general idea of fiduciary law ... is to contrive how and to what end powers and discretions are to be exercised.[12]

4.11 When applied to a company director, it is

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8. *Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, pp 3-4.*
9. *Evidence, pp 161-2 (Professor Finn).*
10. *See, eg, Evidence, p 162 (Professor Finn).*
11. *Evidence, p 162 (Professor Finn).*
12. *Evidence, p 162 (Professor Finn).*

> commonly put in terms or in a formula such as a director must act bona fide in the interests of the company.[13]

4.12 It is settled law that a director must 'act bona fide for the benefit of the company'.[14] Expressed like this, the duty seems clear enough where the company's interests are considered against those of some outsiders (in the extreme case, a competing company), but when the interests of different classes of shareholders, or of shareholders and the company as an artificial legal person, are concerned, the expression is not helpful.

4.13 Professor Finn pointed out to the Committee that the application of the duty was far from simple because

> we have no settled understanding as to what is meant by the company's interests.[15]

He suggested that

> the statement that the directors owe their fiduciary duty to the company is really no more than a statement about who can complain about a breach.[16]

He put the view that 'the Companies Code maintains an understandable and a commendable silence'[17] on whose interests directors are obliged to serve in the exercise of their powers.

4.14 The courts have interpreted the duty to act in the company's interests in various ways.[18] As a general statement, the board is expected to act in the interests of the company as a

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13. *Evidence, p 162 (Professor Finn).*
14. *Eg Mills v Mills (1938) 60 CLR 150 at 158 per Latham CJ.*
15. *Evidence, p 163.*
16. *Evidence, p 163.*
17. *Evidence, p 163.*
18. *Refer generally to Heydon, JD, 'Directors' Duties and the Company's Interests' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1986, pp 120-36.*

whole in relation to issues external to the company, and fairly between members in relation to issues internal to the company.

4.15 The general rule is that directors owe their duties to the company and not to the shareholders.[19] In Coleman v Myers[20] directors were held to owe fiduciary duties directly to a group of individual shareholders. This was because of the particular personal relationship between those shareholders and the directors, including their dependence on him for investment advice.[21] The law expounded in that case could have application in the many small to medium-sized companies where directors and shareholders are friends or relatives of each other.

4.16 A court will usually leave decisions about what is in a company's interests to the directors. It will inquire only as to whether a power was exercised for proper purposes,[22] that is, whether the directors exercised their decision making powers in what they believed to be the company's interests. Professor Ford has said 'courts do not hear appeals from the decision of a board but they will control misuse of a discretion'.[23]

4.17 In fiduciary law, there have long been exceptions to this rule where the fiduciary's actions have been 'demonstrably' not in the beneficiary's interests.[24] In company law, there are some activities which will always be deemed to be improper, even where they enhance the prosperity of the company. In several cases directors have been held to be in breach of their fiduciary duties when acting in a way which influenced the balance of power within the company, even though the directors honestly believed

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19. *Percival v Wright [1902] 2 Ch 421.*
20. *[1977] 2 NZLR 225.*
21. *Ibid at 323-4 per Woodhouse J; at 330-1 per Cooke J; at 370-1 per Casey J.*
22. *Eg Mills v Mills (1938) 60 CLR 150 at 185-6 per Dixon J.*
23. *Ford, HAJ, Principles of Company Law (4th ed), Butterworths, Sydney, 1986, p 384.*
24. *Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, p 41.*

that their efforts to secure control of the company for one faction rather than another were in the company's best interests.

4.18 A director's decision is not unlawful merely because it imposes unequal burdens or confers unequal benefits on different classes of shareholders. However, the directors must not deliberately interfere with shareholders' rights, so as to advantage or disadvantage one group of shareholders, even as a tactic for furthering (as they see it) the company's interests. Put another way, the directors cannot justify a decision by saying that they believed that it was in the company's interests to advantage or disadvantage a particular group.

4.19 Recent examples of this principle at work are:

- use of the power to issue shares for the purpose of destroying an existing majority or preventing a particular group attaining majority status in the future, when the directors believed that the shareholders thereby foiled would have destroyed the company if they had gained control;[25] and

- use of company funds to boost the chances of existing directors in a contested election for positions on the board, where the board believed that it would be detrimental to the company if those who opposed the existing directors were elected.[26]

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25. *Whitehouse v Carlton Hotel Pty Ltd (1987) 162 CLR 285. See also Howard Smith v Ampol Petroleum [1974] AC 821 at 835, discussed in Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, p 71.*

26. *Advance Bank Australia Ltd v FAI Insurances Ltd (1987) 9 NSWLR 464. It was held by the majority in that case that directors had the power (and possibly the duty) to provide shareholders with any information necessary to make informed voting decisions (even if that information was highly prejudicial to the chances of a candidate) and to solicit proxy votes. However, it was held that the directors' power did not extend to using company funds to run an expensive and emotive election campaign on behalf of their colleagues and ostensibly in the name of the company.*

4.20 What the courts are requiring of directors in these situations is that they act fairly as between shareholders as well as acting in the interests of them all.

Ratification

4.21 As a general rule of fiduciary law, a beneficiary may forgive acts of a fiduciary which are in breach of the fiduciary's duty. Thus the company can ratify an action by a director which was undertaken for an 'improper' purpose.[27]

4.22 Ratification will usually be up to the shareholders in general meeting. Whether the majority of shareholders should be prevented from ratifying decisions which infringe the rights of minority shareholders is discussed in chapter 11.

The interests of the company

4.23 The notion of the interests of the company is not a simple one. Whether particular interests need protection will depend on the situation and the matter to be decided. In some situations the interests of the company will be straightforwardly opposed to those of some other body or group. In others, the directors will need to balance the interests of different classes of shareholders against each other, or the immediate interests of the shareholders against the interests of future shareholders.

4.24 It may be argued that the law is unclear, but the Committee accepts the view of Professor Finn:

> The fluidity [in this aspect of fiduciary law as it applies to company directors] in part is a response to the very diverse range of business arrangements that can occur involving companies and the very diverse circumstances in which companies can find themselves: they are big, they are small, they are solvent,

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27. *Eg Hogg v Cramphorn Ltd [1967] Ch 254 at 271.*

> they are insolvent, they are related, they are unrelated, they discharge different functions. It seems to me to be a hazardous enterprise, to put it moderately, to try simply to reduce this part of the law into a straitjacket - particularly into a legislative straitjacket - unless the terms in which legislation is framed are so broad as to allow the very flexibility that currently exists within the common law ...[28]

Standards of conduct

4.25 The second part of fiduciary law (see paragraphs 4.5-4.7 above) is designed to secure the fiduciary's loyalty to the beneficiary.

> [B]ecause a director's function is to act in the company's interests, to serve the company's interests, the fiduciary law insists on loyalty in that service. The fiduciary is not to use his or her position or the power or opportunity that it gives to advance any interests other than the company's.[29]

4.26 This means, first, the fiduciary must not allow a situation to develop in which the duty owed to the beneficiary conflicts with his or her own interests or with a duty owed to a third person. Secondly, the fiduciary must not make use of his or her position to gain a personal advantage or an advantage for a third person.[30]

4.27 These two broad rules are sometimes confused in the case law.[31] Often both apply to the same set of facts. For example, if a director is buying property from the company, there is clearly a conflict of interests, but if he or she misuses privileged access to information about the true value of the property, the

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28. *Evidence, p 168 (Professor Finn). See also pp 170-1.*
29. *Evidence, p 171 (Professor Finn). See also p 172.*
30. *Chan v Zacharia (1984) 154 CLR 178 at 198-9 per Deane J.*
31. *Evidence, pp 171-2 (Professor Finn). See, eg, New Zealand Netherlands Society v Kuys [1973] 1 WLR 1126 at 1129 per Lord Wilberforce.*

director is also abusing his or her position.

4.28 The law in this area covers a wide range of activities including misuse of corporate assets, misuse of confidential information, dealing with the company, and taking for personal gain business opportunities which ought to be taken up on behalf of the company.

4.29 The purpose of the law is to protect people (such as shareholders) who entrust their interests to the care of others (such as directors). It does this not by compensating individual beneficiaries for losses suffered but by imposing standards of conduct the breach of which will always give rise to liability:

> The fiduciary's conduct may be condemned, notwithstanding that it has no adverse effect whatever on the beneficiary's interest.[32]

4.30 Powerful remedies may therefore be available to a beneficiary who has suffered no loss. In this way, the available remedies can bring gain to the beneficiary which could be seen as a 'windfall'.[33] This situation is a result of the general principle that the aim of fiduciary law is to <u>prevent</u> improper conduct rather than <u>remedy</u> its consequences.

4.31 This principle can be justified on two grounds. First, where one person trusts another to see to his or her interests, very strict standards are necessary.[34] Secondly, in many situations, proof of harm would depend on facts best known to, or

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32. *Evidence, p 171 (Professor Finn).*
33. *A prime example is <u>Phipps v Boardman</u> [1967] 2 AC 46. In that case the beneficiaries had got all they were entitled to expect, but the fiduciary had made further profits for himself. The House of Lords found that there had been a breach of fiduciary duty; the beneficiaries were therefore entitled to the extra profits, less an allowance for the fiduciary's 'services'. See also Evidence, p 171 (Professor Finn).*
34. *See, eg, <u>Meinhard v Salmon</u> (1928) 164 NE 545 at 546; 249 NY 458 at 464.*

controlled by, the fiduciary.[35] For example, if a director takes a chance to make a personal profit in breach of duty, a shareholder would have difficulty disproving a claim by the director that the company could not have exploited the opportunity and therefore has not suffered any loss as a result of his or her actions.

Disclosure

4.32 The object of fiduciary law where there is potential conflict is not to prohibit the action but

> to compel disclosure of certain types of actions so that consent can be given ... notwithstanding there is a conflict of interest or a conflict of duty ...[36]

As with the duty to act in the beneficiary's interests, the beneficiary may consent to, or approve in retrospect, actions by the fiduciary which otherwise would be in breach of duty. There are limits, however, to the breaches of duty which can be ratified in this way (see chapter 11). Acts which would be fraudulent or oppressive if committed by a majority of the shareholders cannot be committed by the directors and ratified by the majority.

4.33 Subject to these limits, in situations of conflict of duty or interest,

> the director can be immunised from wrongdoing by the free and informed consent of the beneficiary, the company.[37]

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35. *Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at 178-9.*
36. *Evidence, p 172 (Professor Finn).*
37. *Evidence, p 172 (Professor Finn).*

Conflicts of interest and duty

4.34 If, for example, a director buys property from the company, he or she has a personal interest in getting a low price and a duty to secure a higher one. The rule preventing conflicts of duty and interest is

> based on the consideration that, human nature being what it is, there is danger of the person holding a fiduciary position being swayed by interest rather than duty, and thus prejudicing those whom he was bound to protect.[38]

4.35 Similar considerations apply where the problem is an inconsistent duty rather than personal interest. The presence of the inconsistent duty means that the fiduciary cannot be trusted to protect the beneficiary's interests.

Abuse of a position

4.36 Fiduciary law aims to ensure that someone holding a fiduciary position uses it in the interests of the person it is intended to serve and not in his or her own interests, or in the interests of a third party, without the informed consent of the beneficiary. For example, a person who in the course of his or her activities as a company director received information enabling a handsome profit to be made, and used that information for his or her personal gain rather than bringing it to the attention of the company, would be abusing his or her position. A fiduciary must use his or her office in the interests of the beneficiaries for whose benefit it is established.

Multiple directorships

4.37 It is common for people to hold directorships in two or

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38. *Bray v Ford [1896] AC 44 at 51 per Lord Herschell.*

more companies. This is particularly so with non-executive directors. This is widely seen as beneficial. It enables full use of the pool of available talent; it facilitates cross-fertilisation of ideas and experience; it helps companies secure people with specific skills or business connections to serve on their boards.

4.38 [I]f one's purpose in having external directors is to bring to bear a broader perspective, more background, a wider range of skills on a particular issue or indeed on the management of the company, I think to have people who are able to contribute views on that canvas they are advantaged if they have experience in other corporate or similar roles.[39]

4.39 Professor Finn said that 'given the available human resources in our society we accept it is inevitable'[40] that people with the qualities sought by companies will be asked to join the boards of several.

4.40 Holding multiple directorships can give rise to conflicts of interest which would breach fiduciary duties. If two companies are in direct competition, or if one is buying something from the other, a director cannot participate in the management of both without running into a clear conflict of duties. The companies' interests, and the director's duties to the companies, could also clash if their businesses were in related fields, or indeed in any situation where the activities of one company were likely to affect the interests of the other.

4.41 The usual response to this situation is for directors to absent themselves from boardroom discussions of matters in which they have a conflict of interest or a conflicting duty.[41]

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39. *Evidence, p 618 (Mr Loton).*
40. *Evidence, p 173. See also submission from BHP Ltd, para 30 (Evidence, p 611).*
41. *Eg submission from BHP Ltd, para 31 (Evidence, p 612); Evidence, p 618 (Mr Loton).*

(Disclosure of the conflicting duties to both companies, and their consent to the director continuing to participate, may also absolve the director from breaches of duty.[42])

4.42 For the director to leave the boardroom while a particular issue is being dealt with is a partial solution only. Avoidance of conflict in this situation will depend on the vigilance of the individual concerned and of his or her fellow directors.

4.43 A conflict of interest which should disqualify a director from acting might become apparent only after he or she has participated in a discussion and even voted on the issue. In some cases it is doubtful whether a conflict of interest or duty can be avoided by directors simply leaving the boardroom when the relevant matters come up for discussion. They might quite innocently influence their colleagues even though absent.

4.44 These problems raise the issue of what ethics ought to be adopted by directors (see chapter 10). They also raise the issue of what response is called for by the law.

4.45 Despite the dangers, it is unlikely that multiple directorships will become less common, especially given the relatively small pool of corporate 'talent' in Australia. Mr Loton of BHP Limited expressed the view that

> the advantages of having people with broadly-based backgrounds perhaps in other industries certainly outweigh the few occasions on which there are conflicts.[43]

4.46 The conflict between the law and practice can only be resolved by accepting some dilution of strict fiduciary

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42. *Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, pp 252-3 (esp note 10).*
43. *Evidence, p 618.*

standards. It is clear that some behaviour is unacceptable. For instance, in one recent case, the directors of a company set themselves up as another company and solicited the clients of the first in order to prevent profits of their business going to the heirs of a deceased fellow director and shareholder.[44] In that case, the court had no difficulty in finding the directors' behaviour beyond the pale. But, in situations where a conflict is indirect or not clear, or where the director has made a reasonable effort to minimise its effects, courts should turn a mildly indulgent eye to a director who attempts to serve two or more companies provided he or she does so with care and within reasonable limits.

4.47 Submissions to the Committee dismissed the idea of legislating to set arbitrary limits on the number of directorships a person could hold as a means of minimising the risk of conflict.[45] It was suggested that 'self-policed' limits[46] already operated. Some individuals have a greater capacity than others, and directorships of some companies require more time and energy than directorships of others.[47]

4.48 Directors need to understand the ethical considerations involved in multiple directorships and must embrace them. To this end the Committee urges directors' professional associations to educate directors in ethics and to assist them to make decisions responsibly.

4.49 It is not useful for the law to set limits on the number of directorships a person may hold. The wide differences in the capacity of directors and in the work required to direct different companies make it pointless to do so. The law should clearly set down the required standards of conduct, and directors must then judge for themselves whether their commitments allow

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44. *Mordecai v Mordecai (1988) 12 NSWLR 58.*
45. *Eg Evidence, pp 31 (Mr Richardson), 150 (Mr Harper).*
46. *Evidence, p 110 (Mr Peters).*
47. *Evidence, p 150 (Mr Harper).*

them to meet the standards. If ethics cannot deliver proper conduct, the law must. It should be enforced to remedy the harmful consequences of people holding too many directorships.

Business opportunities

4.50 It is settled law that a fiduciary may not take for personal gain a benefit which his or her fiduciary office requires be that of the beneficiary.[48] If the fiduciary is retained to do work of a certain kind, he or she must obtain the beneficiary's informed consent before doing the same kind of work for his or her own gain. The fiduciary must 'account' to the beneficiary for profits made in breach of the rule: that is, the fiduciary must deliver the profits to the beneficiary.

4.51 When a director is found to have exploited for personal gain a business opportunity which should have been offered to or pursued on behalf of the company, it is not relevant that the company would not have been able to pursue or secure the opportunity and has therefore not suffered by the director's actions.[49] The director is always under a duty to offer the opportunity to the company even though he or she might be aware that, for example, the company is unable to raise sufficient funds in time to take up the opportunity.

4.52 The law does not insist that every profit-making idea a director has belongs to the corporation. An engineering company might have a remedy if one of its directors won, on his or her own account, a major construction contract, but it would have no cause for complaint if the same director started dealing in fruit and vegetables. The difficulty lies in determining the area

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48. *Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, pp 231-3. See also Evidence, pp 171-2 (Professor Finn).*
49. *Furs Ltd v Tomkies (1936) 54 CLR 583; Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at 176 and cases there cited.*

within which opportunities taken by a director 'belong' to the company.

'Corporate opportunity' doctrine

4.53 United States courts have developed a 'corporate opportunity' doctrine which provides that a 'corporate fiduciary' may not, without consent, exploit for his or her own benefit 'an opportunity which is properly regarded as a corporate opportunity'.[50] The leading formulation is the 'line of business' test which was used in the case of Guth v Loft, Inc:

> The real issue is whether the opportunity ... was so closely associated with the existing business activities of Loft, and so essential thereto, as to bring the transaction within that class of cases where the acquisitions of the property would throw the corporate officer purchasing it into competition with the company ... Where a corporation is engaged in a certain business, and an opportunity is presented to it embracing an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business having regard for its financial position, and is one that is consonant with its reasonable needs and aspirations for expansion, it may properly be said that the opportunity is in the line of the corporation's business.[51]

4.54 Some courts have modified this rule to take greater account of the intended future activities of the corporation as well as its current activities.[52]

4.55 The American Law Institute, in its work on reform of

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50. *Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at 153.*
51. *23 Del Ch 255, 5 A 2d 503 (1939).*
52. *Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at 155-6.*

company law, has used this expanded 'line of business' test to define business opportunities which are not to be taken up by a director unless offered to and declined by the company.[53] Professor Austin has suggested that a doctrine along these lines, applying only to company directors and other 'corporate' fiduciaries (such as very senior managers), might be developed by courts in Australia.[54] The Committee endorses this view. It would welcome the development of a 'line of business' test by the Australian courts.

Disclosure and consent

4.56 The object of fiduciary law is not to prohibit certain conduct but rather to compel disclosure by a fiduciary of his or her activities so that a beneficiary can make an informed decision about them. Professor Finn described the problems which arise in relation to disclosure:

> to whom do you disclose in a company context and who can give consent? The law here is a real shambles, there is no doubt about that. The basic rule is that you disclose to the company in general meeting, but let us presume that the directors are shareholders. Can they vote as shareholders to ratify or to approve their conflict of interest as directors?[55]

4.57 Although the point has not been covered in any reported case in Australia, English authority suggests that the director

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53. *Principles of Corporate Governance, Tentative Draft No 7 (December 1985), para 5.05; discussed in Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at pp 156-8.*
54. *Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at p 161.*
55. *Evidence, p 175 (Professor Finn). See also cases cited in Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at p 183.*

may vote as a shareholder to approve his or her own actions.[56] The problem may be magnified if several directors, all shareholders, are involved in the activity which requires consent.

4.58 The requirement of disclosure to a general meeting can be displaced by the company's articles of association. Professor Finn has written that this 'invariably' happens.[57] The requirement may be reduced to disclosure to the board,[58] to the chairperson or, presumably, to no disclosure at all.

4.59 It is doubtful whether most investors in shares are aware that the duties of loyalty owed by directors can be reduced in this way. Section 228 of the Companies Code (Corporations Act, s231) requires a director to declare certain conflicting interests to the board, and requires a record to be kept of such disclosures. Professor Finn pointed out to the Committee[59] that the duty under section 228 does not cover all matters which general fiduciary law (if it is not displaced) requires to be disclosed. In some situations, then, the requirements of section 228 do not protect shareholders from a complete, or almost complete, abrogation of fiduciary duties of loyalty by the company's articles.

4.60 It appears to be normal practice, if not a legal necessity, that a director who needs approval for his or her activities does not vote on the issue when the board considers it. Professor Finn discussed the problems that could arise:

> assuming that the majority of your directors have an interest in a particular matter, do

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56. *North West Transportation Co Ltd v Beatty (1887) 12 AC 589 at 593, 601; Burland v Earle [1902] AC 83 at 94. See also Prudential Assurance Co Ltd v Newman Industries Ltd [1981] Ch 229.*
57. *Finn, PD, Fiduciary Obligations, Law Book Co Ltd, Sydney, 1977, p 227; and see Queensland Mines Ltd v Hudson (1978) 18 ALR 1 at 9-10, where approval of the board was considered sufficient.*
58. *Evidence, p 175 (Professor Finn).*
59. *Evidence, p 176.*

> you end up with a minority being the only disinterested ones who can give the decision; is this desirable?[60]

4.61 It is a questionable process for a minority of directors to approve on behalf of the company activities of the majority that need to be sanctioned.

4.62 It is difficult to formulate a general rule for disclosure and consent to activities which would otherwise be breaches of fiduciary duty. For some questions the involvement of shareholders is clearly warranted, while for others it would render decision making unnecessarily cumbersome. Different consent regimes may be appropriate for the various fiduciary rules.[61]

4.63 For misappropriation of assets, the unanimous consent of the shareholders would appear to be appropriate; breaches of the general 'conflict' and 'profit' rules could be consented to by an ordinary resolution of the shareholders; and questions of consent arising under a 'business opportunity' doctrine (which are essentially questions of business judgment rather than the standards expected of directors) could be decided by the board but probably should be referred to a general meeting if a majority of the directors have a personal interest in the matter. It would appear to be preferable for the affected director(s) to be prevented from voting in these decisions.[62]

4.64 Professor Austin takes a pessimistic view of the prospect of achieving a sensible and simple set of rules in this

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60. *Evidence, pp 175-6. See, also, an example cited by Professor Austin where all but one of a company's directors were involved in activities requiring the board's consent: Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at p 184, n 34.*
61. *Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at p 183.*
62. *Ibid at pp 183-4.*

area by way of judicial decision.[63] He suggests that perhaps the only solution is to amend the companies legislation to impose general rules for exoneration from breaches of directors' duties of all kinds.

4.65 The Committee agrees with Professor Austin and recommends that **the companies legislation be amended to set out requirements which must be met for exoneration of directors from what would otherwise be breaches of their fiduciary duties.**

A continuing duty

4.66 A former director continues to have a fiduciary duty to the company after his or her term of office has expired.[64] Where a business opportunity would otherwise come to a company it is wrong for a director to resign and take it up on his or her own account. Even where a director has resigned there are times where he or she should decline to take up an opportunity because to do so would breach a duty to the company. However, a retired director must at some time be allowed to act as a person no longer responsible to the company.

4.67 The extent to which a director is in breach of a fiduciary duty by reason of acts committed after resignation will depend on the rule being invoked and the specific circumstances of the case.[65] Confidential information may remain confidential for many years, and a former director could still breach his or her duty by misusing it. Conversely, a former director could cease to have a conflict of interest within a short time after he or she ceases to hold office.

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63. *Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at pp 184-5.*
64. *Evidence, p 180 (Professor Finn).*
65. *See generally Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at pp 180-2; Evidence, pp 180-1 (Professor Finn).*

4.68 The Canadian and English courts have held that a director could be liable to account for the profits of a business opportunity secured after resignation if: (i) the resignation was prompted by a desire to secure the opportunity for personal gain; or (ii) the opportunity arose from his or her position as a director (although probably not if the only connection is knowledge acquired in the course of the directorship which helps to secure the opportunity).[66]

4.69 Australian law already recognises and deals with some of the problems that can arise in these kinds of situations. There would appear to be scope for expansion to meet new situations where former directors take improper advantage of their relationship with a company.

The relationship of the companies legislation to equity

4.70 Professor Finn drew the Committee's attention to a difficult issue arising from the intersection of directors' fiduciary duties and the duties under section 229 of the Companies Code (Corporations Act, s232).[67] In the recent case of Australian Growth Resources Corp Pty Ltd v van Reesema[68] a director had hived off the company's business in a manner not found to be morally wrong or dishonest but held by the Supreme Court of South Australia to be in breach of his fiduciary duty to the company. By breaching his fiduciary duty, the director was also found to have breached section 229(1) of the Code by failing to 'act honestly in the exercise of his powers and the discharge of the duties of his office'. Breach of section 229 can result in criminal penalties (fine or imprisonment) and an order to pay

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66. *Canadian Aero Services Ltd v O'Malley (1973) 40 DLR (3d) 371 at 381; note also Island Export Financing Ltd v Umunna (unreported, discussed in Austin, RP, 'Fiduciary Accountability for Business Opportunities' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 141-85 at p 181).*
67. *Evidence, pp 168-9.*
68. *(1988) 6 ACLC 525.*

compensation to the company under section 229(6)-(7). In this way, breach of fiduciary duty became a criminal act. The South Australian and Western Australian Supreme Courts have also found breaches of section 229 in conduct which prejudices the interests of creditors (see paragraphs 5.52-5.57).

4.71 This amalgam of equity and common law causes some concern. Rules of law come into being as a means of applying particular remedies to particular situations. The equitable remedies available for breaches of fiduciary duty revolve around the avoidance of transactions which are entered into in breach of duty. Their rationale is not punitive. Fiduciary standards of behaviour reflect these remedies: they are quite high. For a breach of such strict standards of behaviour to result in a criminal conviction and an order to pay compensation (which may be greater than any illicit profit the director has made) would appear to be, as Professor Finn put it, 'pretty rugged'.[69] It is a problem which must now be dealt with by the courts. In the Committee's view, criminal liability should only result from behaviour genuinely of a criminal nature (see paragraphs 5.57, 13.13).

Conclusion

4.72 This chapter has emphasised some of the difficult and unclear areas of the law relating to directors' fiduciary duties. Yet, as Professor Finn told the Committee,

> much of [fiduciary law] in its day-to-day application is quite uncontroversial.[70]

4.73 In most situations facing a director, the requirements of fiduciary duty will be more or less identical to what the director will feel ought to be done from the point of view of

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69. *Evidence, p 169.*
70. *Evidence, p 176.*

ethics or good practice. Problems arise where the duty goes beyond the director's perception of what ethics require, and the director is unaware (as it appears many people are[71]) of what fiduciary duties entail.

4.74 Another criticism which can be directed at directors' fiduciary duties is that, like the Anglo-Australian corporate form as a whole, they are a creation of nineteenth century English law and cannot cope with the complexities of the modern corporate world. As Sealy put it,

> [t]he take-over bid, the shelf company, the multinational conglomerate, the comfort letter, the offshore nominee, and so on did not complicate the picture in Victorian days, nor did the all-pervasive intricacies of modern tax law.[72]

To this list could be added subsidiary companies, joint venture companies, close corporations and trading trusts. These phenomena create difficulties in the application of fiduciary standards.

4.75 The appointment of nominee directors gives rise to further difficulties: a nominee director is formally bound to act in the interests of the company but is expected to promote the interests of the body that appointed him or her to the board.[73]

4.76 While these problems certainly exist, fiduciary concepts of acting in the beneficiary's interests, and of loyalty and good faith, provide 'quite a powerful array' of weapons for keeping

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71. *Evidence, p 176 (Professor Finn).*
72. *Sealy, LS, 'Directors' "Wider" Duties - Problems Conceptual, Practical and Procedural' (1987) 13 Mon LR 164-88 at 169.*
73. *The Committee has not examined this matter in detail: see para 1.6.*

directors' conduct within acceptable bounds.[74] It was not suggested to the Committee that an alternative model existed which would do a better job.[75]

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74. *Sealy, LS, 'Directors' "Wider" Duties - Problems Conceptual, Practical and Procedural' (1987) 13 Mon LR 164-88 at 169.*
75. *In fact, quite the contrary - see, eg, Evidence, pp 170, 178-9, 180 (Professor Finn).*