

Company Directors: Duties and Responsibilities

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With corporate failures on the rise, Kevin White provides a timely warning to company officers about their obligations to shareholders.

At a time when corporate failures have escalated by 27 per cent, on a national basis, over the number of companies subjected to liquidation in the same period last year, directors of companies are being rightly advised to pay particular care to the extent of their duties and responsibilities.

There will be few directors reading this article who can honestly aver that they have read thoroughly and carefully and understand fully the Memorandum and Articles of Association adopted by the company they are directing. Yet the propriety, even the legality, of their actions in the performance of their duties vis a vis contracting parties, creditors, debtors, employees and shareholders of the company will depend on that knowledge, on their knowledge of their responsibilities under the general law and companies and securities and environmental legislation and on their ability and willingness to respond to pertinent legal and accounting advice.

Duties

What does the office of director entail? Directors are persons having the direction, conduct, management and superintendence of a company's affairs; together they constitute a board of directors with power as such, within the scope of their authority, to bind the company in the conduct of its business. In a loose sense they are the managing partners of the business and affairs of the company under and in accord with its memorandum and articles of association and subject to the provisions of the Companies Code and the general law.

Directors must be over the age of 18 years (s.219) and if aged 72 years or more can only be appointed or act as directors of a public company subject to meeting certain additional requirements (s.226). Under section 5 of the Companies Code the term "officer" includes a "director" and the term "director" is defined as including:

- any person occupying or acting in the position of director of the corporation, by whatever name called and whether or not validly appointed to occupy or duly authorised to act in the position;
- any person in accordance with whose directions or instructions the directors of the corporation are accustomed to act.

However, a person is not regarded as a person "in accordance with whose directions or instructions the directors of a body corporate are accustomed to act" just because the directors act on advice given by that person in

the proper performance of the functions attaching to his professional capacity or to his business relationship with the directors of the body corporate: s.5(2).

A person who acts as a 'de facto' director, not having been formally appointed or being a person prohibited or disqualified from being a director, will have all the statutory duties and responsibilities imposed on directors by the Companies Code, quite apart from any liability arising out of his wrongful exercise of the office. This can easily occur where meetings are not properly held and minuted or where the 'meeting' at which an appointment is agreed has been held without a quorum or, for example, by a conference telephone hook-up.

A director in exercising his powers and carrying out his duties must act honestly (s.229). Under the general law he is required "to act with such care as is reasonably expected from him, having regard to his knowledge and experience. He is, I think not bound to bring any special qualifications to his office ... He is not, I think, bound to take any definite part in the conduct of the company's business; but so far as he does undertake it he must use reasonable care in its dispatch" (per Neville J in *re Brazilian Rubber Plantations and Estates Limited* 1911 1Ch 425 at 437).

The duty to act honestly or not to act dishonestly, precludes actions tainted by improper purpose and arising out of motives of personal gain or the gain of associates. Once a conflict of interest is shown and a director takes the opportunity to profit himself or another company of which he is also a director, the court will require him to account, whether or not his behaviour was fraudulent. He must act bona fide and in the best interest of the company. The fiduciary relationship of a director towards his company is such that he must account for any profit made when acting for the company. It has recently been held that a payment to a director which is not authorised breaches the equitable principle that a fiduciary shall not profit from his trust. Where the company's articles provided for special remuneration to be granted by the board, the House of Lords held that approval of the whole board, and not a committee of the board of directors, was required and a fee paid for advice and services on a takeover bid had to be repaid to the company: *Guinness plc v Saunders* (H.L. 9 February 1990). However, where a director had admitted receiving company funds as a constructive trustee but did not admit any breach of fiduciary duty and gave evidence of the application of money from his account to the use of and for the purposes of the company, the Court of Appeal, (UK) held that there was no obligation to repay the funds: *Pleasure-brews Ltd v Vickerstaff* (C.A. 17 November 1989).

Shareholders' protection

Shareholders and creditors need to be protected against fraudulent or reckless behaviour on the part of directors in

the use of a company's assets. They cannot, however, be completely insulated from risk, since directors acting honestly must have room to manoeuvre in their efforts to make the company successful. Indeed the South Australian Full Court has recently declared that a shareholder has "a personal right grounded upon equitable principles, to have the voting power of his shares undiminished by improper actions on the part of the directors." The Court declared that he had "locus standi to institute and prosecute proceedings to protect that right" (per King CJ in *Residues v Southern Resources* (No. 4) (1988) 14 ACLR 569 at 575).

Directors have a continuing duty to exercise care and diligence. They must in particular ensure that the company is solvent both at the end of the accounting period and when they sign the directors' statement:

- (1) that the accounts give a true and fair view of the company's financial affairs; and
- (2) that at the date of their statement there are reasonable grounds to believe that the company will be able to pay its debts as and when due.

Directors who are less than careful in this regard or in incurring debts at a time of doubtful viability may find themselves made personally liable for the debts of a company in an action for recovery of monies lost by creditors, in addition to the criminal penalties provided for offences by directors and officers of companies that become insolvent (ss. 553-557). The debt owed a creditor has been held to be provable under s.82 of the Bankruptcy Act 1966 against the bankrupt estate of a person who had been a director when the debt was incurred, when there were reasonable grounds to believe that the company would not be able to pay its debts as and when due. (*Re Adams (a Bankrupt)* Sup. Ct. Tas. Wright J 16 December, 1988, unreported.)

The recent recommendations of the Senate Standing Committee on Legal and Constitutional Affairs contained in its Report on the Social and Fiduciary Duties and Obligations of Company Directors include reference to a director's non-attendance at board meetings, the view being espoused that absence without reasonable excuse should be prima facie evidence that a director has failed to exercise reasonable skill, care and diligence in the discharge of duties as a director. A further recommendation is for the limitation of the extent to which directors may delegate their functions and duties of performance by others, in the absence of active supervision. This may result in some future legislative amendment.

Corporate law in Australia is in a state of flux, with the very recent accord between Commonwealth and States for the Commonwealth Corporations Act to be amended in conjunction with cognate State legislation. There is no lack of concern however on the part of both legislators and judicial authorities that directors of companies should behave in a proper manner under penalty of the law. It is believed that a code of conduct for directors proclaimed under consumer law legislation would materially assist

both the community and persons contemplating acceptance of corporate office. The public must be protected against corporate fraud, misleading and deceptive statements, dishonest and improper conduct and against loss due to negligence on the part of directors in failing to observe their duty of care. Recent events in the States of Victoria and Western Australia highlight the overall importance of public protection.

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