THE HONOURABLE T F BATHURST
CHIEF JUSTICE OF NEW SOUTH WALES
DIRECTOR'S, TRUSTEE AND FIDUCIARY DUTIES IN THE CONTEXT OF DOMESTIC CORPORATE ARRANGEMENTS
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1 I don't need to tell any of you that domestic financial arrangements commonly utilise corporate and trust structures.[1] At their most simple, they involve the incorporation of a family business with the parties to the relationship as directors and the shareholders possibly including their children. The purpose of such a corporation is usually to obtain the benefit of limited liability and perhaps to minimise tax. Slightly more complex is the use of a corporate trustee carrying on a business on behalf of a trust of which the members of the family have either a vested or contingent interest in the income and capital.

2 At the other end of the spectrum are structures which, depending on your point of view, are far more opaque or far more sophisticated. They can involve the conduct of myriad

[1] I would also like to acknowledge the assistance of my Research Director Julia Roy in preparing these remarks.

businesses through one or more trustees of discretionary trusts, the trustees usually being corporations and the beneficiaries, members of the family including unborn beneficiaries and corporations, themselves having complex structures, including different classes of shares, having preferential rights to dividends and return of capital. The object of such a structure is, of course, to maximise tax advantages and to preserve the control of the founder of the trust, both during his or her lifetime but also beyond the grave.

3 Now you may think these structures are complex enough today. Those few of you who are as old as me will remember Gorton schemes, where even more complex structures were used to avoid death and gift duties.[2] The object of those schemes was to ensure that the person who established them retained control of his or her assets during his or her lifetime without holding any beneficial interest in them.

[2] See *Gorton v FCT* (1965) 113 CLR 604.

4 There was an industry in the promotion of these schemes inspired perhaps by Lord Tomlin's famous but now possibly discredited remarks in *IRC v Duke of Westminster:*[3]

> "Every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result then however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be impelled to pay an increased tax."

5 In the United Kingdom in the 1930s, this quote was printed on the back of business cards of those marketing tax avoidance schemes, much to the consternation of Inland Revenue. In stark contrast were the words of Lord Templeman in 1993: "I regard tax avoidance schemes [such as this] … as no better than attempts to cheat the revenue." In any event, the abolition of gift and death duties and the imperial rise of Part IVA of the *Income Tax Assessment Act* has led to the diminution in the appetite for such schemes (although by no means their disappearance).

[3] (1936) AC 1.

6 But however complex the structure, the directors and trustees of such corporations or trusts have the same statutory and fiduciary duties at general law and under statute. It is these duties and the general law remedies for their contravention that I want to talk to you about today.

7 Now you may ask why it is relevant to talk to you about these matters having regard to the extensive powers of the family court in Part VIIIAA of the *Family Law Act*? The first reason I can give you, which really should be enough, is: the Chief Justice asked me to. The second is that in exercising any discretion under s 90AE or AF, the Full Court has held that there is a requirement to address the matters in subsections (3) and (4), which inevitably invite consideration of director's duties and rights of creditors and shareholders, and that failure to do so means the discretion miscarries. The third matter is that under s 1337C of the *Corporations Act* jurisdiction is conferred on the Family Court with respect to civil matters arising out of the corporations legislation. It may well be appropriate in certain cases to adjust parties' rights by use of this legislation rather

than by use of Part VIIIAA. That, of course, depends upon the method in which the proceedings are instituted by the parties.

8 So, this morning I will begin with a brief look at Part VIIIAA. I will then consider the director and fiduciary duties that are most relevant in domestic corporate arrangements, the manner in which they are breached and the general and corporations law remedies. I will conclude by setting out the facts of a recent Family Court case in which Part VIIIAA orders were sought, and consider what *Corporations Act* remedies may have been available in the alternative and show how orders made under Pt VIIIA interact with such remedies.

9 I would now like to say something, briefly, about Part VIIIAA of the *Family Law Act*. Given my audience, I am assuming this will be mostly for my benefit.

Part I: Family Law Act 1975, Part VIIIAA

10 Part VIIIAA was introduced into the *Family Law Act* at the end of 2004. Prior to its introduction, the Court had limited powers to

affect the rights of third parties.[4] As you will no doubt know, equivalent provisions were introduced in relation to de-facto couples in 2008, relying on the States' referral power provided by part 51(xxxvii) of the Constitution.[5] To avoid confusion however, I will confine myself to a discussion of Part VIIIAA.

11 The key operative provisions of Part VIIIAA are found in subsections (1) and (2) of s 90AE. Subsection (1) provides for specific orders relating to creditors, directors and companies. Subsection (2) provides that the Court may make any other order under s 79 directing a third party to do a thing or otherwise altering the rights, liabilities or property interests of a third party in relation to a marriage, provided certain threshold criteria are met. Each of the orders set out in subsection (1)

[4] Section 106B, then as now, provided that the court could set aside or restrain the making of an instrument or disposition which is or would be a sham, made to defeat an existing or anticipated order in proceedings under the Act. In relation to the powers under s 79 and s 114, it was held in 1981 in *Ascot Investments*[4] in 1981 that the precursor to s 79 and s 114 did not permit an order to be made if it would deprive a third party of an existing right or impose on a third party a duty which the party would not otherwise be liable to perform. In that case, Gibbs J held: "it would be unreasonable to impute to the Parliament an intention to give powers to the Family Court to extinguish the rights, and enlarge the obligations, of third parties, in the absence of clear and unambiguous words." Flash forward to 2004 and enter Part VIIIAA, which is titled clearly and unambiguously: **Orders and Injunctions Binding Third Parties.**

[5] *Family Law Act* 1975 Part VIIIAB, in particular s 90AT; see also Justice Watts, "De Facto Property Under the Family Law Act (Family Court of Australia Paper, 19 December 2008) available at http://www.familycourt.gov.au/wps/wcm/connect/FCOA/home/about/publications/Papers/Papers+and+Reports/FCOA_DeFacto_property.

would appear also to be available under the more broadly drawn subsection (2).[6]

12 Section 90AF provides a similar power to s 90AE in relation to s 114 injunctions, in relevantly similar terms and with identical threshold criteria.

13 The threshold criteria for making an order affecting third parties are found in subsections (3) and (4). These provide that the court may only make an order affecting third parties if the conditions set out therein are made out. As you are aware there are four mandatory preconditions – for my purposes I will only refer to two.

14 Subsection (3)(b) provides that "if the order concerns a debt, it is not foreseeable at the time the order is made that that it would result in the debt not being paid in full", while subsection 3(c) mandates that "the third party is accorded procedural fairness".

[6] See *Christie v Christie* [2007] FamCA 125, in which s 90AF(2) was held to be wide enough to cover the action of a creditor against a party to a marriage, in circumstances where the limiting language of subsection (1) made it unclear whether the subsection (1) forms of orders in relation to creditors could apply in the circumstances.

15 Pursuant to subsection (4), it is also a mandatory requirement to take a number of matters into account. I need only to refer to the matters referred to in (4)(e),(f) and (g). These require consideration of the following:

> (e) where the order concerns a debt, the capacity of a party to the marriage to repay the debt after the order is made;
>
> (f) the economic, legal or other capacity of the third party to comply with the order; and
>
> (g) other matters raised by the third party as a result of the third party being accorded procedural fairness.

16 The explanatory memorandum to s 90AE states that

> "The range of orders [under this section] is intended to be broad and includes substitution of the party liable for a debt, adjusting the proportion of a debt that each party is liable for or ordering the transfer of shares between the parties to the marriage.
>
> [However] the provision is intended to apply only to the procedural rights of the third party it is not intended to extinguish or modify the underlying substantive property rights of third parties."

17 It was also noted in the second reading speech that Part VIIIAA does not "affect the underlying substantive rights of creditors and provide[s] creditors with procedural rights."

18 Speaking from a corporations law perspective, I am not sure I would agree. On its face, s 90AE seems sufficiently broad to affect the underlying substantive rights of creditors and other persons having an interest in the corporation or trust in question; at the least, it would give me pause if I were a creditor considering lending to a family run corporation or trading trust.

19 To give one example, s 90AE(1)(a) would empower the court to adjust loan accounts within a family company or, indeed, change the identity of the debtor to an independent company from, for example, the wife to the husband. Now there is protection for the creditor in sub 3(b), but that does not mean the debt is as well secured. For example, if the novated debtor, whilst having the capacity to pay at the time of the transfer, has less assets than the original debtor. Further, what happens to a guarantee of the debt? It is well established that a change in the

debtor/creditor relationship generally discharges a guarantee. But it is not necessary to go even this far, as the change in debtor presumably will lead to the extinguishment of the original debt and the extinguishment of the guarantee.

20 As I read it, that type of problem is not contemplated by the section and I would be interested in knowing if it has yet arisen and how the court has or would deal with it. A like problem arises when the original debtor has given security for his or her debt.

21 But back to Part VIIIAA. Section 90AC provides protection to third parties who would otherwise fall foul of a law as a consequence of complying with a Part VIIIAA order. That section provides that Part VIIIAA has effect despite anything to the contrary in any other written or unwritten law in Australia, or anything found in a trust deed or other instrument and that nothing done in compliance with a Part VIIIAA order by a third party is to be treated as resulting in a contravention of any other laws or instruments.[7]

[7] Two other provisions of Part VIIIAA are worth noting. Section 90AJ provides that the court may make such order as it considers just for the payment of the reasonable expenses of the third party incurred as a result of the Part VIIIAA order or injunction. And section 90AK rather superfluously provides that the court

22 The constitutional validity of Part VIIIAA was squarely challenged in *H v H.*[8] In that case, the wife sought orders setting aside a transfer of shares between two third parties.[9] In response, the third parties challenged the constitutional validity of the Part VIIIAA sections on the basis that they were "unlimited" as to the parties and "unrestricted" as to the nature of the alterations of the third parties' rights, to the effect that they purported to extend beyond the matrimonial powers provided by part 51 of the Constitution. In upholding the constitutional validity of those sections, his Honour Justice O'Ryan held:

> "[113] When s 90AE(2) is read in conjunction with s 90AE(3), s 79, and Pt VIIIAA generally, it is clear that what is contemplated is not some arbitrary invasion of the rights of a third party but an alteration of those rights where they are sufficiently connected to the division of the property between parties to a marriage.

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must not make a Part VIIIAA order or injunction that would result in the acquisition of property otherwise than on just terms in a way that would be invalid because of par 51(xxxi) of the *Constitution*.

[8] [2006] FamCA 167.

[9] The company in question had three shareholders: the husband, a Mr Lederer, and the estate of Mr Lederer's father. The wife sought to set aside the transfer of shares from the estate to Mr Lederer.

> [122] The scheme of Pt VIIIAA and the relevant impugned provisions is such as to ensure that the capacity of the court to make orders which affect third parties is carefully constrained and remains sufficiently connected to the marriage, divorce or matrimonial cause powers which support it."

23 His Honour also held, in the alternative, that where the relevant third party is a constitutional corporation, the s 90AE power is supported by the corporations power.

24 The facts of that case may be contrasted with the facts of the earlier case of *Samootin v Wagner.*[10] In that case the Full Court denied an injunction restraining creditors from instituting bankruptcy proceedings against the wife on the basis that the third parties had already properly and regularly obtained judgment, and the circumstances of the bankruptcy had "nothing to do with the proceedings pending before [that] Court or the relationship between the husband and wife…in any direct sense."[11]

[10] (2006) FLC 93-265.
[11] I have also been told of a recent unsuccessful application for an order pursuant to s 90AF, in which the parties' property was subject to a mortgage that neither party had paid in some time. The bank sought and

25 These and other Part VIIIAA cases demonstrate that despite the broad language of the section, the Court has to date endeavoured to be mindful and protective of the rights of third parties.

26 Having said that, while the Act provides procedural fairness to affected third parties and allows for their reasonable costs of compliance, the court is largely dependent on the parties and third parties bringing such issues to its attention. It is not difficult to foresee cases in which the inability or unwillingness of parties to explore fully the flow-on effects of such orders throughout their related corporate entities may result in Part VIIIAA orders which might unwittingly affect the rights of unrelated third parties.

27 I should make it clear that I am not suggesting that some form of amendment to the Act was not necessary to overcome the decision of the High Court in *Ascot Investments Pty Ltd v Harper* (1981) 148 CLR 337. In that case, as you will recall, the

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was granted a writ of possession from the Supreme Court. The husband then sought an order pursuant to s 90AF staying the Supreme Court judgment, or otherwise restraining the bank from prosecuting the Supreme Court proceedings, which was ultimately unsuccessful.

High Court held that the Family Court of Australia had no power to order directors of a company to register a transfer of shares from one party to a marriage to another. However, I do wonder whether the extensive amendments which were in fact made were necessary.

Part II: Statutory and Fiduciary Duties

28 In that context I would like to move now to consider the duties that statute and equity impose on directors, trustees and other fiduciaries. It is probably appropriate at the outset to say something about fiduciary obligations generally. As you know, a fiduciary relationship can arise in a host of circumstances. To the extent one can generalise, the critical feature of such relationships is that the fiduciary undertakes or agrees to act on behalf of or in the interest of another person or in the exercise of a power or discretion which will effect that person. Partly because the fiduciary exercise of power can adversely effect the interest of the person to whom the duty is owed the fiduciary came under the duty.[12]

[12] *Hospital Products v United States Surgical Corporation* (1984) 156 CLR 41, 454 per Mason J

29 Unlike some other countries in the common law world, the extent of the fiduciary obligations are limited. In *Breen v Williams*[13] and *Pilmer v Duke Group Ltd (in liq)*[14] it was emphasised that the duties were proscriptive - not to obtain an unauthorised benefit and not to be in a position of conflict.

30 Now neither of these cases concern the duties of directors which have traditionally included a prescriptive fiduciary obligation to act in the best interests of the company. How that approach can be reconciled with what the High Court has said is still unclear. However it may not matter because of the statutory embodiment of the traditional duties.

31 Statutory directors duties owed to corporations are contained in s 180 to s 183 of the *Corporations Act* and are generally co-extensive with fiduciary obligations owed in equity. Of particular relevance are director's civil obligations found in ss 181 and 182: to exercise powers in good faith for a proper purpose, and to not improperly use their position to gain an advantage for themselves or another person or to cause detriment to the corporation.

[13] (1996) 186 CLR 71, 289.

32 It is important to note that a director, no matter what the extent of his or her powers under the constitution, must not breach these obligations. In the context of companies established to control the assets of parties to a marriage, or to carry on a family business, these obligations are often breached at the time of the break up of the relationship, whether the directors and members are parties to a marriage or otherwise, or at times of financial difficulty. The party who has control of the corporation may issue a large number of shares to him or herself with a view to diminishing the assets of the other party. In family run corporations, the husband, who is very typically the controlling party, will seek to diminish the assets of the wife, children or of the family trust. Such an action will be in breach of his director's duties. This is what happened in *Whitehouse v Carlton Hotel Pty Ltd*.[15]

33 In that case, art 127 of the constitution of Carlton Hotel Pty Limited vested "all powers and authorities and discretions" ordinarily vested in the board of directors in Mr Whitehouse

[14] (2001) 207 CLR 165, 270-271.
[15] (1987) 162 CLR 285.

alone. He also held the only two A class shares, which held unrestricted voting rights. Mrs Whitehouse held two B class shares, which carried voting rights only on the event of Mr Whitehouse's death. The remaining shares were C class, held for the benefit of their children. They alone carried rights to share in profits and surplus capital, but had no voting rights.

34 On the Whitehouse's separation, the daughters aligned themselves with their mother, and the sons with their father. In an attempt to ensure that his daughters and their husbands would not gain control over the company on his death through the voting power which would attach to Mrs Whitehouse's shares, Mr Whitehouse purported to allot two B class shares each to his two sons.

35 However, things did not proceed as Mr Whitehouse planned. Mrs Whitehouse predeceased him, and internal family allegiances shifted. Mr Whitehouse then sought to dispute the validity of his purported allotment of B class shares to his sons.

36 The High Court majority held that ordinarily such a purpose "would be an impermissible and invalidating one for the exercise by directors of a company of a fiduciary power to allot shares in its capital." His sons argued that art 127 of the company's constitution authorised the exercise of the power of allotment of unissued shares for what would otherwise be a vitiating purpose. The majority disagreed, holding that art 127 merely vested the powers of the board in Mr Whitehouse; it did "not change the nature of those 'powers and authorities and discretions'", nor did it "convert what is a fiduciary power in the hands of the directors into a non-fiduciary power in the hands of Mr Whitehouse."

37 In the course of their judgment setting aside the allotment, their Honours noted that

> "in the ordinary case…it is likely that the directors will genuinely believe that what they are doing to manipulate voting power is in the overall interests of the particular company…In this as in other areas involving the exercise of fiduciary power, the exercise of a power for an ulterior or impermissible purpose is bad notwithstanding that the

motives of the donee of the power in so exercising it are substantially altruistic."

38 Now suppose the case had taken place in the lifetime of Mrs Whitehouse and Mr Whitehouse's intention was to deprive his wife of any control of the company because he believed it was in the interests of the company to do so. Mrs Whitehouse could have brought proceedings at general law or under the *Corporations Act* seeking to set aside the allotment. The Family Court could also make such an order, either exercising the corporations power it has under s 1337C or its power under Pt VIIIA of the *Family Law Act*. This is a case where the *Family Law Act* and the regulation of directors' fiduciary obligations could operate in tandem; all the more so if the intention of the party instituting the transaction was to delude his or her spouse's economic interest in the corporation for his, hers or another person's advantage.

39 Similarly, if a shareholder exercises his or her power as a shareholder to expropriate shares, although there may not be any breach of fiduciary duties, the expropriation can

nevertheless be set aside as beyond power. This was the outcome of the landmark ruling of the High Court in *Gambotto v WCP Ltd.*[16] In that case, 99.7 per cent of the share capital in WCP was held by Industrial Equity Limited, who wanted to acquire the remainder. The articles of association of WCP were altered to permit the majority shareholders to acquire, within a specified period, any shares to which they were not entitled at a set price. The resolution was unanimously supported by the majority and minority shareholders, apart from the appellants. They held 0.01 per cent of the share capital and believed the share valuation did not take into account income tax benefits which would accrue to WCP after eliminating the minority shareholding.

40 The High Court majority held that, although the legal and regulatory requirements may have been complied with, additional criteria apply to the valid exercise of shareholder voting power in cases where what is involved is an alteration of the articles to allow an expropriation by the majority of the shares or valuable rights of a minority. The High Court majority held that:

[16] (1995) 182 CLR 432.

"Such a power can be taken only if (i) it is exercisable for a proper purpose and (ii) its exercise will not operate oppressively in relation to minority shareholders… Accordingly, if it appears that the substantial purpose of the alteration is to secure the company from significant detriment or harm, the alteration would be valid if it is not oppressive... [E]xpropriation would be justified in the case of a shareholder who is competing with the company… [or] if it were necessary in order to ensure that the company could continue to comply with a regulatory regime governing the principal business which it carries on. …[T]hat is not to say that the majority can expropriate the minority merely in order to secure for themselves the benefit of a corporate structure that can derive some new commercial advantage…

…To allow expropriation where it would [merely] advance the interests of the company as a legal and commercial entity…would…be tantamount to permitting expropriation by the majority for the purpose of some personal gain and thus be made for an improper purpose."

41 There being no suggestion that the appellants' continued presence as members of WCP put its business activities at risk, or that WCP sought 100 per cent ownership in order to comply with a regulatory regime, the majority held that the resolution was invalid and ineffective on the basis that it was not made for a proper purpose. However, it should be noted that shortly after the decision in *Gambotto* the Act was amended to provide that the holder of full beneficial ownership of 90 per cent of securities in a class or 90 per cent of the voting power in the company may compulsorily acquire the remainder of the shares in that class for fair value, provided the power is exercised within six months of reaching 90 per cent ownership or control.[17] Now *Gambotto* was controversial to say the least. It has been limited to corporations in the strict sense and does not extend to appropriation of a persons interest in a unit trust.[18]

42 It is also noteworthy that the majorities in *Whitehouse* and *Gambotto* observed that those cases may have been differently decided had the power sought to be exercised been clearly

[17] Pt 6A.2 Div 1 *Corporations Act* 2001.
[18] *Cachia v Westpac* (2000) 170 ALR 65 [87].

provided in the company's constitution *from the time of incorporation*.

43 The following principles can be distilled from the cases:

(a) Directors are bound to exercise their powers for a proper purpose. It is not a proper purpose to allot shares solely for the purpose of maintaining control over the company, much less to deprive shareholders of their economic interest;

(b) These principles apply even if the directors honestly believe that their actions are in the best interests of the company;

(c) Relief can be given at general law setting aside such transactions and requiring payment of compensation. Equivalent relief can be given for statutory contraventions under s 1317H and s 1324 of the *Corporations Act*;

(d) The provisions apply a fortiori where the directors' purposes are subjectively improper. Indeed, if the actions

are taken recklessly or dishonestly they attract criminal as well as civil penalty sanctions;

(e) Even at the shareholder level where fiduciary obligations do not arise, an appropriation could be set aside unless the limited pre-conditions set out in *Gambotto* are fulfilled.

44 In this area, orders under the *Family Law Act* effectively restoring the status quo do no more than correspond with the general law or complement the powers of courts under the *Corporations Act.* Indeed in some circumstances the exercise of power under the *Corporations Act* may be a safer course to adopt than the exercise of power under the *Family Law Act.*

45 What about circumstances in which, for example, a director believed that it was not appropriate in the interests of the company for his or her partner to maintain the same control or economic interest in the company as a result of circumstances surrounding the break-up of the relationship? In those circumstances, actions of the nature of which I have referred may not amount to a breach by a director of his or her fiduciary

obligations but they could well amount to oppressive conduct within the meaning ss 232 and 233 of the *Corporations Act* or a ground for winding-up the company on what is described as the just and equitable ground contained in s 461 of the Act.

46 Sections 232 and 233 of the *Corporations Act* provide specific remedies to shareholders who complain that the affairs of the company are being conducted in a manner oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members. In *Wayde v NSW Rugby League*, a decision was made in good faith by the board of the recently incorporated Rugby League to refuse the inclusion of the Wests rugby league club in the premiership competition, on the basis that a decision had been taken to reduce the number of competing teams from 13 to 12.

47 Two members of the company in their capacity as representatives of Wests sought relief against this decision on the basis that it was oppressive. The action was unsuccessful, put shortly, because the action complained of was contemplated by the Constitution of the company. However the Court, and particularly Brennan J who wrote a separate concurring

judgement, emphasised that the question was to be determined objectively.

48 Finally, as a last resort, s 461 provides that the Court may also order the winding up of a company, *inter alia*, on the following bases:

> (h) Where directors have acted in affairs of the company in their own interests rather than in the interests of the members of the whole, or in any other manner … that appears to be unfair or unjust to other members;
>
> (i) Where affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members or … is contrary to the interests of the members as a while; or
>
> (j) An act or omission… of the company, or a resolution… would be oppressive or unfairly prejudicial to or unfairly discriminatory against,

a member or members or… would be contrary to the interests of the members as a whole, or

(k) the Court is of the opinion that it is just and equitable that the company be wound up.

49 In *Ebrahimi v Westbourne Galleries Ltd,*[19] a family company was wound up on substantially the same just and equitable grounds as provided in s 461(k). Ebrahami and his business partner Nazar incorporated their carpet business, became directors and took equal shareholdings. Soon after, Nazar's son was also made a director and Ebrahimi and Nazar each transferred 100 shares to him. The company was profitable, but all profits were distributed as director's remuneration and dividends were never paid. Years later, after disagreement between Ebrahimi and Nazar, Nazar and his son who together held majority passed an ordinary resolution at a member meeting to remove Ebrahimi as a director.

50 The effect of this was that Mr Ebrahimi lost his right to profits through directors' remuneration, was at the mercy of his former

partner and his son as to what he should receive by way of dividends as a minority shareholder, and was unable to dispose of his interests in the company without the consent of Nazar and his son due to the restrictions in the company's articles of association.

51 In granting Ebrahimi's petition for winding up, the House of Lords drew a parallel between winding up on just and equitable grounds and the principles of equity applicable to partnerships. Lord Wilberforce, with whom the other Lords concurred, held:

> "The words [just and equitable] are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.
>
> [Nevertheless] the superimposition of equitable considerations [onto the operation of company law] requires something more [than that the company is small and private], which typically may include one, or probably

[19] [1973] AC 360.

more of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence – this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement or understanding, that all, or some … of the shareholders shall participate in the business; (iii) restriction upon the transfer of the members' interest in the company – so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere."

52 His Lordship held that Nazar and his son were not entitled, in justice and equity, to make use of their legal powers of expulsion and that the only just and equitable course was to dissolve the association.

53 I do not propose to discuss this morning how courts of equity deal with the position of third parties who either receive property as a result of a breach by a director of his or her fiduciary obligations or who are knowingly involved in such a breach. The

position is complex, still perhaps controversial and would be a topic in itself. However, it is important to bear in mind that courts will only grant relief against third parties if the third party received trust property or company property with a knowledge of the breach or is knowingly concerned in such breach. For those of you who wish to explore the difficulties and controversies which have arisen in this area, the best starting point is probably the decision of the High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*.[20] However, it is relevant to bear in mind the limited circumstances in which courts of equity will intervene against third parties in exercising the power under s 90AE of the Act.

The Broad Power in Part VIIIAA

54 So far I have discussed circumstances in which orders made by the Family Court go no further than could be made by courts of equity in respect of breaches of the *Corporations Act* or general law fiduciary duties. The power in Part VIIIA is, of course, not so limited. It is certainly conceivable that the Family Court could make orders in relation to a company's property involving

[20] (230) CLR 89.

transactions which if undertaken by directors would amount to a plain breach of their obligations.

55 I am particularly referring to ss 90AE and AF(2)(b). I am not quite sure what exactly the words in those sections“property of third parties in relation to the marriage” mean. Presumably the words “in relation to the marriage” are intended to provide a constitutional foundation for the section. But its reach, at least to an uneducated bystander like me, seems a little obscure. However, I will proceed on the assumption that it can be used to adversely affect the rights of a company or creditors to a company in which the parties to the marriage have a significant interest.

56 Let me give you a simple example of how an order under s 90AE(2)(b) could inevitably involve a breach of directors’ duties if carried out by the directors. Suppose the matrimonial home along with a number of other assets is in the name of a company. The court may, in those circumstances, order that the matrimonial home be transferred to a party to the marriage for nominal consideration. That is something which quite plainly

directors could not do consistent with the fiduciary obligations to which I have previously referred. In addition, if carried out by the directors it could involve them in breaching a number of their statutory obligations.

57 As to creditors' rights, they are protected in the *Corporations Act* by the prohibitions on insolvent trading and restrictions on the reduction of share capital, and personal remedies are available to creditors against directors who breach these provisions.

58 Reducing share capital is restricted as it would be unfair to creditors who have dealt with a limited liability company on the basis that the company has a certain level of capital to allow the company to freely reduce that level. Section 256B of the *Corporations Act* permits the reduction of share capital if it is fair and reasonable to the company's shareholders as a whole, if it does not materially prejudice the company's ability to pay its creditors, and if it is approved by the shareholders in accordance with the strict rules of s 256C.

59 The transfer of the matrimonial home to which I have referred above would amount to such a reduction of capital. In *Re CSR*

Ltd[21] the expression "material prejudice to a company's ability to pay its creditors" was said to relate to the creation of a material, as opposed to a theoretical, increase in the likelihood that the reduction of capital would result in a reduced ability to pay creditors.

60 It is now well established that directors do not owe a fiduciary duty to creditors of the company as distinct from the company. However, it is equally well established that there is an obligation to take the position of creditors into account in circumstances where a company is insolvent or approaching insolvency. In *Kinsela v Russell Kinsela Pty Limited (In Liq)*[22] the company granted a lease of its business premises to two of the directors. However the company was in dire financial straits, and was wound up three months later. Street CJ, with whom Hope and McHugh JJA agreed, described the essential facts:

> "This insolvent company, in a state of imminent and foreseen collapse, entered into a transaction which plainly had the effect, and was intended to have the effect, of placing its assets beyond the immediate reach of its

[21] [2010] FCAFC 34.
[22] (1986) 4 NSWLR 722.

creditors; it did this by means of a lease of its business premises entered into with the intention that two of its directors, as lessees, would use those premises for the purpose of continuing to conduct a business of the nature of that which the family of the directors and all of the shareholders had carried on for many years; …

it may be added, for what it is worth, that the terms of the lease were, to say the least, commercially questionable."

61 His Honour held:

"Once it is accepted… that the directors' duty to a company as a whole extends in an insolvency context to not prejudicing the interests of creditors the shareholders do not have the power or authority to absolve the directors from that breach."

62 There are many cases in which this principle has been reiterated, starting from the decision of the High Court in *Walker*

v Wimborne[23] and most recently in *Westpac Banking Corporation v The Bell Group Limited (in Liq) (No 3)*.[24]

63 The transfer of a matrimonial home from a company in that position would plainly constitute a contravention of the fiduciary duties of the directors.

64 The duties of trustees are not so different from those of directors, although it must be emphasised directors are not trustees. Primary among a trustee's duties are the duty to adhere to the terms of the trust, a duty to preserve the trust property and the duty to act impartially among beneficiaries. Even in a discretionary trust, which has only potential beneficiaries, a trustee has duties to consider the rights of potential beneficiaries, and a potential beneficiary has the right to have his or her bare legal right protected. Discretionary trusts are extremely common in family business arrangements, offering flexibility, tax minimisation and some protection from creditors.

[23] (1976) 137 CLR 1.
[24] (2012) 89 ACSR 1.

65 Prior to the 2010 High Court decision in *Kennon v Spry,*[25] it was thought that as the object of a discretionary trust has merely a chose in action - being property of little practical worth when it comes to matrimonial property adjustment - discretionary trusts were generally an effective shield against the "estranged spouse" and the "long arm of the Family Court".[26]

66 However, it was held in *Kennon v Spry* that "property of the parties to the marriage or either of them" as set out in the Act was to be broadly understood, such that it included a discretionary trust of which the husband was trustee and the wife a potential beneficiary. In such cases, the Court held, the trustee's interest is valuable, "because it is in his or her power to procure a distribution of the whole of the trust assets, if not to himself or herself, then to the other spouse, and thus to make it property of one or other of the spouses available for division between them."

67 The statutory and fiduciary duties owed by directors and trustees are often at risk in family business arrangements,

[25] (2008) 238 CLR 266.
[26] Justice Brereton, "The High Court and Family Law – Two Recent Excursions", Address to the Family Court and Federal Magistrates Court Concurrent Conference (Canberra, 16 October 2010), as to the latter citing Michael Brown "His, Hers or Their?" (2009) 47 *Law Society Journal* 60.

particularly at the point of relationship breakdown. I would like to conclude today's address by setting out the facts of a recent Part VIIIAA Family Court case, which I hope will demonstrate the risks to director and fiduciary duties in family business situations, the broad powers of the Family Court under the Family Law and Corporations Acts in relation to family businesses, and the statutory and equitable duties and regulations that the Court should have in mind when exercising these powers.

Part III: A Recent Application of Part VIIIAA

68 In *Storrer v Storrer,*[27] the husband was the beneficiary of a discretionary trust which held 12 per cent of the ordinary shares in the proprietary company that employed him. He was also sole shareholder and director of the trust's corporate trustee. The remainder of the ordinary shares in the company were held by four other corporate trustees, which held them on trust for the four founding members of the proprietary company. It is important to note that this was not a family company in the literal sense. The husband was not a founding member, but was offered the shareholding as part of his employment package.

69 The wife sought orders compelling her husband to cause the corporate trustee holding shares for his benefit to hold sixty per cent of those shares for her benefit up to the conclusion of a "No Sale Period" set by the proprietary company's Shareholder's Agreement. She then sought orders against the director, the corporation and the shareholders, to cause the company to register the transfer of those shares to her at the conclusion of the "No Sale Period".[28]

70 The orders were resisted by the third parties, *inter alia*, on the following bases:

1. that the shareholding about which the wife sought orders was not owned by parties to the marriage, and that she was in effect seeking to increase the pool of assets.

2. That the orders sought were not just or equitable on the basis that the shares of the corporation had always been held by the employees. The wife had never been an employee, and as she

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[27] [2012] FamCA 448

[28] Her original application (which was in the form of a "Response to the Husband's Initiating Application" sought orders only against the director, without joining him, the corporation or the shareholders. As the rights relating to the transfer of shares were contained in the Shareholder's agreement, she sought leave to

was not party to the shareholders' agreement, she might be empowered to take actions that conflicted with the interests of other shareholders. It was complained that she would have rights at law that might be contrary to the best interests of the other shareholders, that the other shareholders did not want her and would not voluntarily approve any proposed transfer of shares to the wife, and that the order would negatively impact the "continued motivation of the founding shareholders to drive the company forward", thereby impacting "the viability of the business and in turn the jobs of existing employees."

3. Finally, it was submitted that the orders as formulated were not reasonably necessary or appropriate and adapted to effect a division of property between the parties to the marriage, because in personam orders could be made against the husband.

71 The Shareholders Agreement provided that during the "No Sale Period", shares could only be transferred to a bona fide third party purchaser if they had first been offered to the other

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amend her application to join the parties to the proceedings. It was this application (to join the parties and relevantly amend the orders sought) that was resisted by the third parties.

shareholders on a pro rata basis and not accepted, if the transfer was then approved by at least a seventy-five per cent majority of the remaining shareholders (which entailed at least three of the four remaining shareholders), and if the new shareholder agreed to become a party to the Shareholders Agreement.

72 Justice O'Reilly ordered pleadings, specifically to the extent the wife would be seeking to rely upon s 90AC. You will recall that s 90AC provided that Part VIIIAA has effect despite anything in a trust deed or other instrument. His Honour noted, to that end, his "doubt that s 90AC(1)(b), whatever else it means, and if constitutionally valid, could possibly be used, in effect, to set aside a contract which gives third parties specific rights, particularly the rights in the nature of those in the Shareholders Agreement…Moreover, courts traditionally do not interfere with personal relations [such as those of the founding shareholders in this case]." He forecast that the director, company and trustees might challenge "its constitutional validity insofar as it purports to affect private contract law and the private contracts of third parties."

73 If the wife were successful, what rights, duties and obligations would be overridden by the Part VIIIAA orders, assuming the objections made by the company, shareholders and director were well founded? For a start, as his Honour noted the Shareholder's Agreement would be overridden. However, any consequent liability might be barred by the operation of s 90AC.

74 The director's duty to act in the best interest of the corporation would presumably include causing the corporation to comply with court orders, even if this was believed to be otherwise against the interests of the company, and so he would not be in breach of his duties on this basis. However absent a court order, registration of such a transfer may well be a breach of certain duties and oppressive to the other employee shareholders.

75 The husband, on the other hand, as sole director and shareholder of the corporate trustee, would, for the duration of the "No Sale Period", owe trustees duties to his former spouse, while at the same time being an employee of and beneficial

owner of shares in, the company that rejects her ownership. The conflict in that position is apparent.

76 And what would the consequences be if the wife eventually succeeded in having the shares transferred to her? Would she be in a different category to the other shareholders, not having entered into the Shareholders Agreement, and thereby able to sell her shares as and to whom she pleased, with no regard to the agreement? Might the orders of the Court make the transfer of her shareholding conditional upon her entering into the agreement? On the converse, if she did not wish to sell her shares, the other shareholders would likely not be able to expropriate them.

77 Having said that, it is not clear how the rule in *Gambotto* would operate in circumstances where a person has acquired shares as the result of a Family Court order that effects a transfer otherwise prohibited by the Shareholders Agreement and possibly also the Articles of Association. As was noted above, the Court in *Gambotto* and *Whitehouse* suggested that the powers provided in the company's constitution from the time of its founding were important to determining the validity of a

purported expropriation. In circumstances where the nature of the company's ownership clearly evident in the Shareholders Agreement has been altered by a Court order, might the Court be more understanding of a resolution permitting expropriation; particularly in circumstances where the shareholding sought to be expropriated is less than 10 per cent of the share capital?

78 Alternatively, it is foreseeable that the remaining shareholders could approve the sale of their shares to a single corporate trustee (continued to be held for their respective benefits), and that trustee owning more than 90 per cent of the shareholding would then be placed to take advantage of the share expropriation provisions provided in the *Corporations Act*. Would such a move survive a *Gambotto* challenge from the wife? This is mere speculation, of course, but hopefully gives pause for thought.

Conclusion

79 I hope this has not been too tedious a start to the day. Can I just say this in conclusion. Duties of directors to which I have referred are critical to proper governance of corporations which is in the interests of all directors and shareholders. It is

fundamental that people be able to invest in and deal with limited liability companies on the basis that the directors will honour their obligations and that the assets of a company will be available for the payment of debt. Sections 90AE and AF provide, in subsections (3) and (4) that a Court must take into account the likely effect of any order on a creditor to a party. However, even if the Act did not provide it, Courts should still remain mindful. Can I suggest that one way of evaluating the effect any orders you make on third parties is to be put yourself in the position of the hypothetical director carrying out exactly the same transaction and ask the question “Would it be consistent with my fiduciary obligations and if not is it because it operates adversely to some third party?” In those circumstances even if you decide to make the order sought, you will have done so taking into account the interests of third parties in a very real sense.