

# Conflicts of duties for directors on multiple boards

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## 1 Introduction

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### 1.1 Market acceptance of directors being on multiple boards

Many very highly regarded directors of prominent ASX listed companies have multiple directorships, including across companies whose interests are likely to conflict from time to time. Criticism of this concentration of directorships is more typically heard on diversity or over-commitment grounds rather than concerns about conflicts.

The prevalence of “common directors” (that is, common to two or more companies) across ASX listed companies, and the many billions of dollars’ market capitalisation of the companies with those directors, suggest that shareholders find multiple directorships acceptable.

### 1.2 Pragmatism within a fiduciary context

The idea of fiduciaries taking on other duties which conflict with their duties to the protected person is anathema to the law of fiduciary relationships generally. However, many companies’ constitutions contemplate this – and even permit their directors to profit from transactions with the company. Again, this suggests that shareholders accept that model in preference to directors being dis-incentivised from joining boards on the basis that to do so may curtail their other commercial activities.

In that context, the courts have been quite commercially pragmatic in permitting directors to manage their conflicts of duty across multiple directorships within a fiduciary framework.

But the courts have not given those directors an easy path with any “bright line” tests or specific rules on how not to breach fiduciary obligations across multiple boards. The High Court principle that the fiduciary duties must be moulded to the particular relationship and circumstances<sup>1</sup> is active here. Common directors need to bear in mind the underlying policy of fiduciary duties and ensure that they do what is required in the circumstances to adequately protect each company to which they owe a duty. There is not a “check-list” they can follow to be sure that they are safe.

The courts have, understandably, been unsympathetic to common directors who seek to exploit one company to benefit another and potentially themselves. Directors have not been permitted to shield behind, say, a duty of confidentiality to another company in those circumstances.

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<sup>1</sup> For example in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 121.

However, comments made by judges in that context need not cause undue alarm in relation to non-exploitative, arm's length commercial transactions between companies with common directors.

### 1.3 Scope

In this paper, I examine what a director on multiple boards needs to do to safely manage conflicts of duty which arise. The two key sources of the directors' duties underlying the discussion in this paper are:

- the fiduciary duties of directors – which are expressly preserved by section 185 of the Corporations Act; and
- the statutory duties in the Corporations Act, particularly section 181 (acting in good faith in the best interests of the company and for a proper purpose) and 182 to 184 (using position or information to gain an advantage for someone else or cause detriment to the company).

I do not address the duties of directors of multiple companies within a wholly-owned group. Nor do I address other types of duties which can conflict with a director's duties – for example statutory duties which a director may owe to non-shareholders under insurance, superannuation or managed investment scheme legislation. Professor Pamela Hanrahan will consider those in her presentation.

## 2 Can a director be on boards of competing companies?

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### 2.1 Not a breach of itself, but caution is required

It is not, of itself, a breach of fiduciary duty to be on the boards of two companies which compete with one another. As Bathurst CJ said in *Australian Careers Institute*.<sup>2</sup>

*It is well established that the fiduciary duties owed by a person to a company of which he or she is a director include an obligation not to place himself (or herself) in a position of conflict where there is a real or substantial possibility of conflict between the director's interests and the director's duty to the company ...*

*However ... different minds may reach different conclusions as to the presence or absence of a real possibility of conflict between duty and interest or duty and duty and the doctrine cannot be inexorably applied without regard to the particular circumstances of the relationship... Thus it is not inevitably the case that a director who occupies board positions in competing companies is*

<sup>2</sup> [2016] NSWCA 347, 340 ALR 580 at [3-4] 340 ALR 580; See also *On the Street Pty Ltd v Cott* (1990) 101 FLR 234; *Links Golf Tasmania Pty Ltd v Sattler* (2012) 213 FCR 1.

*in breach of his or her fiduciary obligations to one or other of them merely by reason of that fact*<sup>3</sup>.

However, a director in that position will have to take particular care to avoid breach of fiduciary duty, which is likely to require the director to exclude himself or herself from board deliberations of at least one company - and potentially both - on matters where there is a conflict. They also need to take particular care in the light of competition law requirements. If there is a likelihood of ongoing competition and conflict the director's risk may be best mitigated by resigning from at least one board.

Austin and Ramsay in *Ford, Austin & Ramsay's Principles of Corporations Law*<sup>4</sup> note:

*[I]t might appear logical that a director cannot either compete with the company or take a position on the board of a competing company. To do so appears to go clearly beyond a "real sensible possibility" of conflict, and expose the director to the risk of conflict at every board meeting at which the competitive position of either company is raised. Yet courts have permitted this."*

The authors note that older cases such as *London v Mashonaland Exploration Co Ltd*<sup>5</sup> and *Bell v Lever Bros Ltd*<sup>6</sup> contain dicta to the effect that a director is not in breach of duty by being a director of a rival company as long as confidential information is not disclosed.

It seems odd that the old dicta were focused on disclosure of information, when surely use of the information for competitive purposes and the risk of favouring one or other company may be of even greater concern? In the light of several more recent authorities discussed below, it would not be safe for a director to proceed on that basis today.

## 2.2 The position of conflict versus pursuit debate – does it matter?

There is academic debate as to whether the breach of duty arises at the point of "real sensible possibility of conflict" or only when the conflict is pursued.<sup>7</sup> A related question is whether it is a "counsel of prudence" or a "rule of equity" that a fiduciary ought avoid placing himself or herself in a position of conflicting duties.<sup>8</sup>

<sup>3</sup> [2016] NSWCA 347 at [3-4].

<sup>4</sup> LexisNexis at [9.41].

<sup>5</sup> [1891] WN 165.

<sup>6</sup> [1932] AC 16.

<sup>7</sup> *Directors' conflicts: Must a conflict be pursued for there to be a breach of duty?* Langford and Ramsay (2015) 9 Journal of Equity 108.

<sup>8</sup> See Edelman J in *Agricultural Land Management Ltd v Jackson* [2014] WASC 102 at [266]-[267].

The decisions in *Agricultural Land Management Ltd v Jackson*<sup>9</sup> and *Re Colorado Products Pty Ltd (in prov liq)*<sup>10</sup> have been described as being on opposite sides of this debate<sup>11</sup>.

Analysis of the case law suggests that this debate may be more about terminology than substantive differences of opinion when actually applied to fact scenarios. For example, in *Agricultural Land Management Ltd v Jackson*<sup>12</sup>, Edelman J expressed the view that breach arises when there is a “real and sensible possibility of conflict”. However, the conduct of concern was that “[b]y acting to cause both *Agricultural and Bunbury Centro* to enter into the Contract they were acting in a position of owing duties to parties with directly conflicting interests.” That is, there was no suggestion that by simply being a director and officer of companies which might transact with one another the directors were in breach. It was the steps taken by directors to cause them to transact with one another which caused concern.

In *Re Colorado Products*, Black J rejects the idea that “*the bare fact*” that the defendant was a director of companies which had interests which would inevitably come into conflict would establish a breach of the rule against conflict of interest.<sup>13</sup> Black J noted:

*[T]he rule against conflicts prohibits a fiduciary acting in a manner inconsistent with that rule, rather than simply occupying a position of conflict or potential conflict.*<sup>14</sup>

His honour then said:<sup>15</sup>

*To the extent that Clare was the principal and controlling mind of Sorrento China, Sorrento Kitchens and BL/GLCo ..., it also does not seem to me that would in itself establish a breach of the rule against conflict of interest which would have been established by her being a director of both Colorado and those companies, unless it was also established that Clare had exercised her powers as a director or officer of Colorado for the benefit of those companies without disclosure of the competing interest and informed consent. [emphasis added]*

While that paragraph, read in isolation, might suggest that that there would only be a breach if the director actually favoured the other companies, on the facts themselves the director had benefited personally from the

<sup>9</sup> See note 5 above.

<sup>10</sup> [2014] 101 ACSR 233.

<sup>11</sup> See note 4 above.

<sup>12</sup> See note 4 above.

<sup>13</sup> 101 ACSR 233 at 346. <sup>13</sup> Note that several cases characterise or describe conflict of duty as a conflict of interest.

<sup>14</sup> [360]; 101 ACSR 233 at 346

<sup>15</sup> [360]; 101 ACSR 233 at 346-7

transactions concerned, so whether that was a necessary element in breach was not a point in contention.

The following extract from *Chan v Zacharia* which was cited by Black J:<sup>16</sup>

*The equitable principle governing the liability to account is concerned not so much with the mere existence of a conflict between personal interest and fiduciary duty as **with the pursuit of personal interest by, for example, actually entering into a transaction or engagement “in which he has, or can have, a personal interest conflicting with the interests of those whom he is bound to protect ... or the actual receipt of personal benefit or gain in circumstances where such conflict exists or has existed.*** [emphasis added]

This suggests that the interest is taken to be “pursued” for this purpose by taking action to facilitate a transaction in respect of which there is a conflict<sup>17</sup> – not that “pursuit” requires preference of one party’s interest. Certainly *Re Colorado* itself does not suggest that disclosure is not required so long as the fiduciary does not prefer the interests of the other company. The need for disclosure was central to that case, albeit in the context of the constitution and course of dealing between the companies.

### 3 Corporations Act – conflict of duties the “poor cousin” of material personal interest?

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#### 3.1 Corporations Act

In terms of the attention devoted to them in the Corporations Act, conflict of directors’ duties<sup>18</sup> seems to be the “poor cousin” of material personal interest.

Section 191 of the Corporations Act requires a director who has a material personal interest to give the other directors notice of that interest, subject to certain exceptions.

Section 191 has a slightly odd carve-out – section 191(2)(viii). It applies where the interest: *“is in a contract, or proposed contract, with, or for the benefit of, or on behalf of, a related body corporate and arises merely because the director is a director of the related body corporate.*

This exception seems odd for three reasons:

1. Being a director of a company would not ordinarily be sufficient to give that director a material personal interest in the contracts of the

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<sup>16</sup> (1984) 154 CLR 198; ALR 433 per Deane J (with whom Brennan and Dawson JJ agreed)

<sup>17</sup> See also the extract from, *R v Byrnes* cited in section 4.1 below.

company. It generally requires something additional to confer a material personal interest – such as a shareholding or executive relationship with the relevant company. But where there is that something extra, the “merely” in section 191(2)(viii) suggests that the carve-out does not apply. In that case, this exception has no work to do because nothing will fall within it.

2. If for some reason “merely” being a director of that related body corporate does confer a material personal interest, then there seems no policy reason why the director should not have to disclose the interest as a director of that company.
3. It relates to related bodies corporate, not to wholly owned subsidiaries. So there could be very substantial minority interests in companies where the common director has the benefit of this carve-out. It would be easier to see the logic for this exception if it related only within wholly owned groups.

Like section 191, section 195 is silent on conflicts of duty – but provides that a director of a public company who has a material personal interest being considered at a board meeting must not:

- be present while the matter is being considered at the meeting; or
- vote on the matter.

There is an exception. If those directors who do not have a material personal interest pass a resolution confirming that they are satisfied that the interest should not disqualify the director from voting or being present, then the director with the material personal interest can be present, participate in the board discussion and vote.<sup>19</sup>

### 3.2 Why don't they apply to conflicts of duty?

It is not clear why these rules should not equally apply to directors with a conflict of duty. For example, a director may be a “nominee” in that he or she is nominated by a shareholder to serve on the board. There will likely be times where the director's duties to his or her appointing shareholder may conflict with the duties to the company. Why should that director not be restricted from voting just as if the director had a material personal interest?

Is it that someone can be trusted more to balance the interests of two different companies to whom that person owes duties than to balance the company's interests with the director's own interests? Perhaps with the assumption is that with material self-interest off the table if it possible for a director to apply fair judgement between competing interests.

In practice, many listed company directors – and the policies of many listed companies – treat conflicts of interest in the same way as material

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<sup>19</sup> Corporations Act section 195(2).

personal interests, with full disclosure of the conflict being expected, and conflicted directors excluding themselves from deliberations and voting unless the non-conflicted directors are comfortable that they should participate.

As discussed below, the case law reaches the same point at least in relation to disclosure – and may (depending on the circumstances) require that the common director abstain from attending and voting on the relevant matter in a case of conflict of duty.

## 4 Disclosure is the minimum requirement

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### 4.1 Case law requires disclosure

Despite the lack of an equivalent to section 191 of the Corporations Act for breach of duty, it seems to be universally accepted that disclosure is required by the rules of equity. See for example, *R v Byrnes*<sup>20</sup>:

*A company is entitled to the unbiased and independent judgement of each of its directors... A director of a company who is also a director of another company may owe conflicting fiduciary duties... Being a fiduciary, the director must not exercise his powers for the benefit or gain of the second company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent...*

*However, the articles of a company may permit – they frequently do permit – a director who is interested in a proposed transaction to take the benefits of the transaction if he discloses his interest to the other members of the board and takes no part in the decision of the board on the transaction... If the director makes that disclosure and abstains from taking part in the decision, the validity of the transaction is not impaired. **But a director who takes part in a decision to enter into a transaction in which the director or a third party in whom the director has an interest or to whom the director owes a fiduciary duty stands to gain an advantage or benefit but who does not make an adequate disclosure of his interest acts improperly.** [emphasis added]*

### 4.2 At what point is disclosure of the interest required?

The disclosure should be made before the director takes any action in a position of conflict. As discussed above, it would not be safe, nor supported by the case law, for a director to disclose only where the director intends to prefer the other interest.

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<sup>20</sup> [1995] HCA 1; 183 CLR 501, Per Brennan, Deane, Toohey and Gaudron JJ at [30]; 183 CLR at 516-517

## 5 What else is required?

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### 5.1 No “bright line” test

A classic statement which demonstrates the lack of a “bright line test” as to what is required of common directors is this statement by Owen J in *Fitzsimmons v R*:<sup>21</sup>

*Each case will depend on its own facts. A director who is confronted with a possible conflict must assess his or her position. The minimum requirement will be disclosure of the interest... What action, above and beyond mere disclosure, the director must take will vary from case to case depending on the subject matter, the state of knowledge of the adverse information, the degree to which the director has been involved in the transaction, whether the director has been promoting the cause, the gravity of the potential outcome, the exigencies and commercial reality of the situation and so on. It may not be enough for the director simply to refrain from voting or even to absent himself or herself from the meeting during discussion of the impugned business. The circumstances may require the director to take some positive action to identify clearly the perceived conflict and to suggest a course of action to limit the possible damage.”*

This might seem to provide limited guidance to directors, but some clues are given in the facts of that case - as well as others considered in section 8 below - which makes it clear why the Courts do not want to state hard and fast rules.

Common directors disclosing their conflicts, excluding themselves from voting and, as a last resort, resigning will in all usual circumstances be sufficient.

However, there have been notorious situations where, due to other actions of the directors themselves which were potentially exploitative of the company, the usual measures (disclosure the interest, exclusion from voting and potentially deliberations) will not be sufficiently protective. The Courts will not allow those directors to require a “point in time” assessment that they cannot take steps to protect the company because of a conflicting duty, when the directors painted themselves into that corner by their previous actions – or failure to act – earlier.

There can be other, likely quite rare, circumstances where even though the director did not take any action to exploit the company, the input of the director is required to prevent harm to the company and it is not sufficient for the director to simply exclude himself or herself.

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<sup>21</sup> (1997) 23 ASCR 355 at 358



Langford and Ramsay<sup>22</sup> analyse the cases and describe situations like those in the two paragraphs above as categories of “special factors” which impose additional obligations on conflicted directors beyond disclosure and potentially abstention. As well as the cases discussed in section 8 below, the authors point to the example of a conflicted managing director, whose involvement is required because there is no one else in that position to assist the company.<sup>23</sup>

Where a particular director has a role or skill set which is required to protect the interests of the company despite the conflict, the board could consider permitting that director's ongoing involvement and participation by analogy with section 195(2) of the Corporations Act. It would still be prudent – in the interests of the company and the conflicted director – to set protocols to manage the conflict, and to mitigate the risks arising from that conflict.

## 6 Importance of the company's constitution

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### 6.1 Constitution affects scope of the duty

A key document which ameliorates the strict application of the fiduciary rules is the relevant company's constitution. In *R v Byrnes*,<sup>24</sup> the High Court said:

*A director of a company who is also a director of another company may owe conflicting fiduciary duties. Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit or gain of the second company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent. Nor, of course, can the director exercise those powers for the director's own benefit or gain without clearly disclosing his or her interest and obtaining the company's consent. A fiduciary must not exercise an authority or power for the personal benefit or gain of the fiduciary or a third party to whom a fiduciary duty is owed without the beneficiary's consent.*

*[30] However, the articles of a company may permit - they frequently do permit - a director who is interested in a proposed transaction to take the benefit of the transaction if he discloses his interest to the other members of the board and takes no part in the decision of the board on the transaction. In such a case, the quorum of the board required to deal with the transaction will*

<sup>22</sup> *Conflicted directors: What is required to avoid a breach of duty?* (2014) 8 *Journal of Equity* 108

<sup>23</sup> Such as Mr Hamilton in the *Wheeler* appeal case.

<sup>24</sup> [1995] HCA 1; 183 CLR 501, per Brennan, Deane, Toohey and Gaudron JJ at [29] to [30]

*ordinarily be interpreted as excluding directors whose interests preclude them from voting. If the director makes that disclosure and abstains from taking part in the decision, the validity of the transaction is not impaired.*

In *Re Colorado*,<sup>25</sup> Black J pointed to the significance of the constitution in setting the scope of the fiduciary obligations in the particular circumstances.<sup>26</sup> His honour rejected the argument that containment of the scope of the fiduciary duty through the terms of the constitution is contrary to public policy.<sup>27</sup>

In that case, it was effectively argued that, in any commercial dealings between the company and the other company of which she was a common director, the director needed to subjugate her other duties to the interests of the company. For example, that she must:

- As a director of the company's landlord, consider the interests of the company as tenant, including keeping any rent payable for the premises to a minimum;
- If the tenant company fell behind in any rental payments, support the tenant company's proposal for an extension of time to make the rental payments.<sup>28</sup>

Black J did not accept those arguments. His honour indicated that where, to the knowledge of all parties including of the common directorship, the tenant company entered into a lease with the landlord company, it could "scarcely be argued" that claiming the payments due under the lease would be a breach of fiduciary duty.

The constitution formed part of that reasoning – as did a course of dealing over a period of time where it had clearly been accepted by all parties that a director would negotiate certain agreements with the company.

The course of dealing was that, over time, the director concerned had negotiated for another company as counterparty to transactions with the company. Black J stated:<sup>29</sup>

*[T]he arrangements which the parties had entered into as between Colorado and Sorrento China necessarily accepted Clare's interest in, and control of, Sorrento China and the fact that she would act on behalf of Sorrento China in dealing with Colorado (the interests of which would be represented by Helen and Kenneth) and the scope of her duties to Colorado were narrowed to reflect that matter.*

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<sup>25</sup> [2014] 101 ACSR 233,

<sup>26</sup> [2014] 101 ACSR 233 at 347

<sup>27</sup> [2014] 101 ACSR 233 at 349.

<sup>28</sup> At [373].

<sup>29</sup> At [367]; 101 ACSR 233 at 350

In *Levin v Clark* [1962] NSW 686, two nominee directors of a lender were appointed to the board of a company to exercise their powers only if the terms of the security were broken. They duly enforced it. This was found to be acceptable. The company's constitution allowed the creditor to nominate directors, which was viewed as a waiver by shareholders of any right to have a board which only considered their interests.

A modern listed company constitution might say something like:

1.1 *Directors may contract with the company and hold other offices*

- (a) *The Board may make regulations requiring the disclosure of interests that a director, and any person deemed by the Board to be related to or associated with the director, may have in any matter concerning the company or a related body corporate. Any regulations made under this constitution bind all directors.*
- (b) *No act, transaction, agreement, instrument, resolution or other thing is invalid or voidable only because a person fails to comply with any regulation made under rule 1.1(a).*
- (c) *A director is not disqualified from contracting or entering into an arrangement with the company as vendor, purchaser or in another capacity, merely because the director holds office as a director or because of the fiduciary obligations arising from that office.*
- (d) *A contract or arrangement entered into by or on behalf of the company in which a director is in any way interested is not invalid or voidable merely because the director holds office as a director or because of the fiduciary obligations arising from that office.*
- (e) *A director who is interested in any arrangement involving the company is not liable to account to the company for any profit realised under the arrangement merely because the director holds office as a director or because of the fiduciary obligations arising from that office, provided that the director complies with the disclosure requirements applicable to the director under rule 1.1(a) and under the Act regarding that interest.*
- (f) *A director may hold any other office or position (except auditor) in the company or any related body corporate in conjunction with his or her directorship and may be appointed to that office or position on terms (including remuneration and tenure) the Board decides.*
- (g) *A director may be or become a director or other officer of, or interested in, any related body corporate or any other body corporate promoted by or associated with the*

*company, or in which the company may be interested as a vendor, and, with the consent of the Board, need not account to the company for any remuneration or other benefits the director receives as a director or officer of, or from having an interest in, that body corporate.*

- (h) *A director who has an interest in a matter that is being considered at a meeting of the Board may, despite that interest, vote, be present and be counted in a quorum at the meeting, unless that is prohibited by the Act. No act, transaction, agreement, instrument, resolution or other thing is invalid or voidable only because a director fails to comply with that prohibition.*
- (i) *The Board may exercise the voting rights given by shares in any corporation held or owned by the company in any way the Board decides. This includes voting for any resolution appointing a director as a director or other officer of that corporation or voting for the payment of remuneration to the directors or other officers of that corporation. A director may, if the law permits, vote for the exercise of those voting rights even though he or she is, or may be about to be appointed, a director or other officer of that other corporation and, in that capacity, may be interested in the exercise of those voting rights.*
- (j) *A director who is interested in any contract or arrangement may, despite that interest, participate in the execution of any document by or on behalf of the company evidencing or otherwise connected with that contract or arrangement.*

The constitution imposes limits either by factually containing the subject area in respect of which the duties are owed, or by acting as informed consent to particular actions, including potentially profit-making by common directors.

However, a constitution provision such as this does not open carte blanche for dealings between the company and its directors. They need to be read in the context of the directors' duties generally.

As was noted in *PBS v Wheeler*, informed consent that a director may transact with a company permits arm's length dealing :

*He came within the rule which absolutely requires a fiduciary to deal with his principal at arm's length upon a consent obtained after full disclosure of all relevant facts: Murphy v O'Shea [1845] 2 Jones & Lat 422 per Sugden LC at 425 Consul Development Pty Ltd v DPC Estates Pty Ltd (1975) 132 CLR 373 per Gibbs J at 396; Green & Clara v Bestobell Pty Ltd [1982] WAR 1.*

General constitution provisions such as those set out above permit arm's length dealings between the company and another company with a common director. However, they do not authorise directors to exploit the company through uncommercial transactions. If that is legally possible, it would at least require specific disclosure of the proposed form of exploitation and informed consent of shareholders to that particular exploitation.

What is permitted are transactions on terms which would be appropriate between parties dealing at arm's length. Those constitutional provisions will not over-ride the director's duty to act in the best interests of the company to the extent of allowing it to enter into a transaction which is contrary to its best interests.

No constitutional provision will save directors who seek to undertake a transaction which exploits the company to benefit someone else, and particularly to benefit the director. Nor will a general power in a constitution permit other actions which are fundamental to fiduciary duties, such as taking a corporate opportunity of the company.

## 7 Generally, conflicted directors excluding themselves from deliberation and voting is the safest path

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### 7.1 Common practice

Despite there being no equivalent to section 195 of the Corporations Act for conflicted directors, it is common practice in major listed companies for directors with a conflict of duty to excuse themselves from at least the vote, and often on the board's deliberations, on the matter in relation to which the conflict arises.

### 7.2 Safe approach

It is generally safe because, if the director does not vote and limits their involvement in deliberations, there will not be scope later for someone to challenge their motivation in reaching the relevant decision – whether the director was driven by the interests of the company or the other party to whom the director owed a duty. If it is a “rule of equity” that they not put themselves in a position of conflict, to vote would be over the line. If it is a “counsel of prudence” to avoid someone later inferring that they preferred the interests of the other party, abstaining is a smart thing to do.

Austin and Ramsay say at [9.430] that:

*“it is recognised that directors cannot be expected to approach their tasks with a mind free from concern for other interests. The do not, for example, have to shut out of their minds any interest*

*they may have as shareholders: Mills v Mills (1938) CLR 150; 11 ALJ 527”.*

However, as a practical matter with potentially sceptical regulators and judges who have the benefit of hindsight, any hint that the director had regard to any interest or duty other than to the company itself, is likely to be very damaging in an assessment of the director’s actions. It is safer to excuse themselves unless there is a “special factor”<sup>30</sup> present which makes that insufficient in the circumstances.

## 8 ... unless excusing themselves will itself leave the company exposed

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### 8.1 Where duty requires disclosure of confidential information

As noted above, there is a line of authority – which on a first read may sound concerning – but when read with the facts raises significantly less concern, for a common director looking for guidance on how to stay safe. It concerns situations where common directors were found to be in breach of duty by not disclosing confidential information of other companies of which they were directors.

Unsurprisingly, the directors concerned sought to resist findings of breach by the fact that they owed a duty of confidentiality over the relevant information to someone else, so that the court should not find them in breach of one duty by upholding another.

However, analysis of these cases shows that, overwhelmingly, they were situations where some form of transaction was proposed, not to benefit the company but to take advantage of it, in most cases with a view to fixing a problem of the other company or benefiting the common director personally. The common directors had typically promoted the transaction or otherwise had active involvement ahead of the point where the question of disclosure arose. While the courts make statements about the director having to disclose the information, it is inevitably in circumstances where anyone with full information would not have considered it to be in the best interests of the company concerned to enter into the transaction.

For example:

- *Jenkins v Enterprise Gold Mines NL*<sup>31</sup> (primarily an oppression case) – Common directors influenced one company to enter into a series of transactions so as to maintain another company’s control of it rather than considering the benefit, if any, to the company of participating in the transactions;

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<sup>30</sup> Langford and Ramsay – see note 22 above.

<sup>31</sup> ACSR at 554, 557, Full Court

- *R v Byrnes* – common directors secretly caused the company to guarantee and provide security for a third party loan to facilitate a subscription for convertible notes in another company of which they were directors;
- *Permanent Building Society (in liq) v McGee (1993) 11 ACSR 260*; *Permanent Building Society (in liq) v Wheeler (1994) 11 WAR 187* – loan to company with common directorships which was clearly not able to repay it<sup>32</sup>;
- *Fitzsimmons v R*<sup>33</sup> – company lent funds to, and assumed liabilities of, a financially distressed company with common directors to facilitate a prohibited self-acquisition;
- *Duke Group v Pilmer* – company made a takeover bid at a gross overvalue. The common directors knew that it was not in the best interests of the bidder;
- *Duncan v ICAC [2016] NSWCA 143* – company entered into “improvident”<sup>34</sup> transaction and common directors acted to prevent independent board committee discovering information they were seeking which they thought, if disclosed, would prevent the transaction from proceeding;

It is worth taking another look at the wording of Owen J set out in section 5.1 above in this context. Some of the factors which his honour considered relevant to what steps were required to resolve the conflict were the degree to which the director has been involved in the transaction, whether the director has been promoting the cause, the gravity of the potential outcome, and the exigencies and commercial reality of the situation. These factual scenarios represent some quite extreme circumstances where the director generally had promoted the transaction. There were invariably other steps which the common director could have taken to try to protect the company which they did not take – typically because they wanted the transaction to proceed. As noted above, the Courts are not willing to assist directors who have painted themselves into this corner by then allowing them to shield behind their duty of confidentiality to the counterparty company.

This is illustrated by extracts from the relevant cases:

*Permanent Building Society (in liq) v McGee (1993) 11 ACSR 260*,<sup>35</sup>

***“Under those circumstances, it was his duty to take positive steps to protect the interests of the plaintiff. At the very least,***

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<sup>32</sup> ACSR at 289.

<sup>33</sup> (1997) ACSR 355 – Supreme Court of Western Australia.

<sup>34</sup> [442]

<sup>35</sup> (1993) 11 ACSR 260 at 290 (Anderson J); see also *Permanent Building Society (in liq) v Wheeler* 91994) 11 WAR 187.

**he was under an obligation to make full and frank disclosure of the extent of Capital Hall's financial incapacity at that time. There is nothing to show that he did that. However, I think his duty went further than that. He was in a position of power and influence in respect of both companies. There was no doubt he could have prevented the transaction proceeding. One word from him would have been enough. He should have done so.** He could not escape from his continuing duty to act bona fide in the interests of the society as a whole "by the simple expedient of leaving the room": *Darvall v North Sydney Brick and Tile Co Ltd* (1989) 15 ACLR 203, per Kirby P at 250 . In my opinion he did, throughout, remain in a position of conflict and it was not overcome by his merely abstaining from participating in the formal resolutions. It was his duty to inform the plaintiff's board that Capital Hall was not in a position to repay an advance of \$1.5m should it be made, nor was it in a position to fulfil its obligations as to payment of interest, and that should the advance be made, there was a high risk that none of it would be recovered. As the loan was to be made to a company which was, in effect, his company, he cannot claim honesty of purpose.

In *Fitzsimmons v R*,<sup>36</sup> Owen said:<sup>37</sup>

*It is not, then, the existence of the conflict that constitutes the mischief with which the law is concerned. It is the pursuit of that interest which renders the conduct objectionable and improper. The case against the applicant was that he pursued the conflict by failing to disclose the true financial position of Duke to the directors of Kia Ora. It is not for me to say what he should have done to avoid a breach of duty. There may have been some disclosure or recommendation that he could have made, short of resignation, that might have complied with his obligations to Kia Ora without infringing the duty of confidentiality that he owed to Duke. On the other hand, he might have come to the conclusion that the conflict was irreconcilable and that resignation was the only option. It was a matter for him.*

*All of that is hypothetical. He took no such steps. ... [T]he mere fact that he owed conflicting duties did not render him immune from the consequences of breach of those duties to one or other of the companies... [emphasis added]*

The reasoning above makes it clear that other steps to prevent the transaction may have addressed the conflict, and the references to the

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<sup>36</sup> (1997) 23 ACSR 355.

<sup>37</sup> (1997) 23 ACSR 355 at 359 (Owen J).



need to disclose confidential information of the other company must be read in that context.

If anything the suggestions in these cases that disclosure would have been sufficient are somewhat rhetorical, in that the company, properly informed, would never have entered into the transaction at all.

In *Duncan v ICAC*, Bathurst CJ said:<sup>38</sup>

*[C]ontrary to what was implied in some of the submissions made by the individual applicants, this was not a case of conflict between the duties owed by the directors to White Energy and duties owed to Cascade. **By contrast, in the present case, the conflict was between their duties as directors or White Energy and their interests as sellers of their shares in Cascade to that company. It follows that if they were of the view that disclosure of the Obeid involvement would be detrimental to Cascade, they could have avoided a conflict by simply withdrawing from the transaction. [emphasis added]***

...

*[I]t was open to find that in **seeking to proceed with the transaction without disclosing the true position**, the directors contravened their obligation to act in good faith in the interests of White Energy.*

His honour made clear that it was not the non-disclosure of itself, but causing (or not preventing) the transaction to proceed without making disclosure, which constituted the breach. There was no need for the directors to disclose Cascade's confidential information, they could have simply persuaded White Energy not to proceed with the transaction.

## 8.2 What else could the common director do?

Other options in this scenario could be:

- urge the counterparty company to make proper disclosure. By withholding financially adverse information from party with which it is negotiating a transaction, that company is likely to be opening itself up the risk of claims; or
- without disclosing any confidential information, tell the company that the director does not consider the proposed transaction to be in its best interests, and urge his fellow directors not to approve the transaction. In the *Wheeler* case, the court appears to have been influenced by the fact that the defendant controlled both companies. But even where that is not the case, if a common director on a listed company board says the he or she cannot disclose confidential information of the other company but does not consider a transaction between them to be in

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<sup>38</sup> at [441]

the interests of the company considering it – and urges fellow directors not to support the proposed transaction – it is hard to imagine the board approving the transaction.

## 9 Resignation

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### 9.1 Is resignation always sufficient?

If there can be a factual scenario where nothing short of disclosing another company's confidential situation will adequately protect the company, the director would be in a very difficult position. Resignation may be one option – and overwhelmingly should be sufficient to prevent risk of breach of duty.

It is difficult to think of a scenario where resignation would not prevent a breach unless the director had itself taken some earlier action which put the company at risk. For example, assume if in the cases considered in section 8 above, the director concerned had resigned rather than withdrawn from the meeting room just before the vote. It seems likely the same conclusion would have been reached by the courts, that resignation was not sufficient. But again, that does not seem unduly harsh where the pre-resignation conduct of the directors exposed the company to the relevant risk. The common directors have painted themselves into that corner.

## 10 Practical guidance from the cases

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As a practical matter, the guidance directors can take from the cases is clear:

- If there is a potential for conflict, disclose the interest.
- Where there is an actual conflict, comply with the constitution.
- Where relying on the constitution for permission to enter into a transaction with another company of which the director is also a director, ensure that the transaction is on arm's length terms.
- It is generally safest for a conflicted director to abstain from both sides on areas of conflict. Next safest is to abstain on one side with the informed consent of that company to be involved on the other side.
- While it is safest for a common director not to negotiate directly with the company, that may be permissible if acceptable to the company itself and the constitution gives sufficient flexibility.

- A director who acts in a position of conflict and takes any steps as a director of the company in that circumstance is not excused from the duty to act in the best interests of the company.
- A director who chooses to continue to be involved as a director in a position of conflict should assume later sceptical judgement as to whose interests the director has preferred. The director may well be better able to mitigate risk by excluding himself or herself from considering and voting on the transaction.
- The courts have proven pragmatic in relation to ordinary commercial transactions within the parameters of reasonable terms.
- A director will not be permitted to undertake a transaction which takes advantage of the company to benefit the director or someone else. No constitutional provision, voting abstention or late resignation will save directors who seek to undertake a transaction which exploits the company to benefit someone else, and particularly to benefit the director.