



Conflicted directors: What is required to avoid a breach of duty?

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Directors with a conflict of interest or conflict of duties may be subject to different requirements. These include disclosure of the conflict, disclosure of further information relevant to the particular transaction and taking positive action to protect the company's interests, which may include the director preventing the transaction from proceeding. The authors analyse the relevant case law to identify the factors that lead to courts imposing these requirements. They show that the cases are best analysed as a continuum of required action, with increased action by the director being required where the company needs protection and the director is in the best position to take protective action. The authors also demonstrate that the relevant duty under which these requirements are imposed varies, with duties such as the duty to act in good faith in the interests of the company and the duty of care applying in addition to the duty to avoid conflicts.

1 Introduction

Directors with a conflict of interest or a conflict of duties are confronted with a dilemma in terms of what action is needed to avoid a breach of duty. This is because courts have not always clearly articulated the relevant factors or requirements. In some cases, disclosure of the nature of the interest, together with informed consent, has been sufficient to avoid a breach of duty. In others, directors have been required to disclose not only the nature of the interest but also information relevant to the decision being made by the other directors. Other cases have required directors to take positive steps to prevent a transaction going ahead.

There are judicial statements that the nature of what is required where a director is in a situation of conflict depends on the circumstances. The following statement of Owen J in *Fitzsimmons v R* is instructive:

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. This is simply part of, or an extension of, the statutory obligation that a director who is in any way 'interested' in a contract or proposed contract with the company must declare the nature of the interest at a meeting of the directors . . . 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 possible outcome, the exigencies and commercial reality of the situation and so on. It may 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

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damage . . . But this does not mean that the director is obliged to resign his office. That may, in particular circumstances, be the only course open but it would not necessarily follow.¹

In light of current uncertainty this article analyses critically the relevant case law to provide guidance for directors as to what is likely to be required in such situations. It does so by outlining the relevant categories of required action by directors, examining the facts of the reported cases in each category and pinpointing the duty under which the requirements were imposed. In particular, the article identifies the factors that are likely to give rise to more stringent requirements.

We suggest that it is helpful to analyse the cases as a continuum of required action, ranging from cases in which courts require disclosure of the interest, to cases in which courts require heightened disclosure because of special factors, to cases in which courts require the director to take positive action beyond disclosure to protect the interests of the company because of special factors. This positive action may require the director to prevent the relevant transaction which has led to the conflict of interest from proceeding. Moreover, the relevant duty under which these requirements are imposed also varies. In some cases it is the duty to avoid conflicts, in others the duty to act in good faith in the interests of the company (often coupled with the duty to act for proper purposes) and in others the duty of care.

General principles relating to the duty to avoid conflicts, ratification and disclosure are first outlined to provide context.

2 General principles

The duty to avoid unauthorised conflicts requires directors to avoid conflicts between their duty to the company and their personal interests, and between their duty to the company and other duties owed by them. The duty was initially applied strictly, extending to any possible conflict. The stringency of the duty has, however, been relaxed over time to require a ‘real sensible possibility of conflict’.² There is debate as to whether the operation of the duty to avoid conflicts is further confined in the corporate law context so that liability is triggered by the pursuit of a conflict rather than the mere existence

1 (1997) 23 ACSR 355 at 358; (1997) 15 ACLC 666; BC9700935 (*Fitzsimmons*); see also *Centofanti v Eekimitor Pty Ltd* (1995) 65 SASR 31 at 33 per King CJ; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601 at [665] per curiam; *Adler v ASIC* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670 at [539] per Giles JA (with whom Mason P and Beazley JA agreed).

2 See, eg, *Boardman v Phipps* [1967] 2 AC 46 at 124 (HL) per Lord Upjohn; [1966] 3 All ER 721; [1966] 3 WLR 1009 (HL). Note also the use of objective factors (such as activities of the company and extent of the interest) to determine the existence of a real sensible possibility of conflict of interest and duty (see, eg, H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law*, LexisNexis, at [9.070.3]–[9.070.6]) and the pragmatic approach of courts where directors are benefiting as shareholders (see, eg, Ford, Austin and Ramsay, *ibid*, at [9.060.6]; *Howard v Commissioner of Taxation* (2014) 309 ALR 1; (2014) 88 ALJR 667; [2014] HCA 21; BC201404440 at [34] per French CJ and Keane J).

of a conflict.³ Attenuation of the duty to avoid conflicts is particularly evident in relation to competing directorships.⁴

It is possible for directors as fiduciaries to escape potential liability for breach of fiduciary duty by obtaining the fully informed consent of shareholders. However, the extent and sufficiency of the requisite disclosure in terms of avoiding breach of the duty to avoid conflicts are not always clear, as examined in Section 3 below. This consent may occur via prior approval, or subsequent ratification, by shareholders. The effectiveness of ratification is not, however, guaranteed as limits have been imposed on the availability of ratification in certain circumstances.⁵ Ratification is not effective as concerns breaches of statutory duty.⁶

Disclosure is therefore a step towards gaining informed consent.⁷ Indeed, a prevalent view is that this is the only true role for disclosure in the fiduciary context.⁸ However, disclosure plays a much more extensive role in the corporate law context. In particular, failure to disclose may itself constitute a breach of the duty to act in good faith in the interests of the company. In other

3 See *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1; 70 ACSR 1; [2008] WASC 239; BC200809492 at [4504] per Owen J; *Gemstone Corporation of Australia Ltd v Grasso* (1994) 62 SASR 239 at 255 per Olsson J; (1994) 13 ACSR 695; (1994) 12 ACLC 653; BC9405572; *Fitzsimmons* (1997) 23 ACSR 355 at 357–9 per Owen J; (1997) 15 ACLC 666; BC9700935; *Streeter v Western Areas Exploration Pty Ltd (No 2)* (2011) 278 ALR 291; (2011) 82 ACSR 1; [2011] WASCA 17; BC201100094 at [69] per McLure P; *Chan v Zacharia* (1984) 154 CLR 178 at 198 per Deane J; (1984) 53 ALR 417; [1984] HCA 36; BC8400496; *Dempster v Mallina Holdings Ltd* (1994) 13 WAR 124; (1994) 15 ACSR 1; BC9401956; *Howard v Commissioner of Taxation* (2014) 309 ALR 1; (2014) 88 ALJR 667; [2014] HCA 21; BC201404440 at [85] per Hayne and Crennan JJ; but cf *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 98 ACSR 615; (2014) 285 FLR 121; [2014] WASC 102; BC201402755 at [265]–[268] per Edelman J.

4 See, eg, *On the Street Pty Ltd v Cott* (1990) 101 FLR 234; (1990) 3 ACSR 54; (1990) 8 ACLC 1050; BC9001959; *Links Golf Tasmania Pty Ltd v Sattler* (2012) 213 FCR 1; (2012) 292 ALR 382; [2012] FCA 634; BC201204508 at [562]–[564] per Jessup J.

5 See, eg, *Cook v Deeks* [1916] 1 AC 554; [1916-17] All ER Rep 285; (1916) 27 DLR 1; (1916) 85 LJPC 161 (HL); *Daniels v Daniels* [1978] Ch 406; [1978] 2 All ER 89; [1978] 2 WLR 73; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722; (1986) 10 ACLR 395; (1986) 4 ACLC 215.

6 See *Forge v ASIC* (2004) 213 ALR 574; (2004) 52 ACSR 1; [2004] NSWCA 448; BC200408634 at [381] per McColl JA; *Angas Law Services Pty Ltd v Carabelas* (2005) 226 CLR 507; (2005) 215 ALR 110; [2005] HCA 23; BC200502370 at [32] per Gleeson CJ and Heydon J; Ford, Austin and Ramsay, above n 2, at [8.385].

7 Bryan and Vann note that '[i]t is convenient to refer to informed consent as a defence but the correct analysis is that the beneficiary's informed consent prevents any liability for breach of fiduciary obligations from arising': see M W Bryan and V J Vann, *Equity and Trusts in Australia*, Cambridge University Press, Cambridge, 2012, pp 170–1 [10.36].

8 See, eg, *Breen v Williams* (1996) 186 CLR 71 at 125 per Gummow J; (1996) 138 ALR 259; [1996] HCA 57; BC9604086; *P&V Industries Pty Ltd v Porto* (2006) 14 VR 1; (2006) 24 ACLC 573; [2006] VSC 131; BC200601896 at [24]–[25] per Hollingworth J; *Dresna Pty Ltd v Linknarf Management Services Pty Ltd (in liq)* (2006) 156 FCR 474; (2006) 237 ALR 687; [2006] FCAFC 193; BC200610702 at [132] per Gyles J; *Wilden Pty Ltd v Green* (2009) 38 WAR 429; (2009) 2 ASTLR 143; [2009] WASCA 38; BC200900620 at [106] per McLure JA, [241] per Pullin JA; but see *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200; BC201208415 at [2324] per Jagot J; *Jacques v Forte Enterprises* [2012] NSWSC 1241; BC201209196 at [51] per Rein J; *Commonwealth v David Samuel Pty Ltd (No 7)* (2013) 282 FLR 1; (2013) 35 ACSR 258; [2013] ACTSC 146; BC201311476 at [327]–[333] per Refshauge J.

words, a director who fails to make adequate disclosure may be found to have breached that duty (and in some cases the duty to act for proper purposes or the duty of care), quite apart from breaching the duty to avoid conflicts due to the ineffectiveness of consent because of inadequate disclosure. This role of disclosure is examined in more detail in Section 3 below.

It is common for company constitutions to attenuate the duty to avoid conflicts, allowing a director to act despite having a conflicting interest or conflicting duties provided the director discloses the nature of his or her interest.⁹ Such provisions generally require disclosure to the other directors rather than to shareholders and allow the relevant director to vote and to proceed with the relevant transaction.¹⁰ To avoid breach of duty any such provision must be strictly complied with.

Added to the equitable principles are ss 191 and 195 of the Corporations Act 2001 (Cth). These statutory provisions operate in addition to, and not in derogation of, the general law duty to avoid conflicts.¹¹ Section 191 of the Corporations Act 2001 (Cth) requires a director of a company who has a material personal interest in a matter that relates to the affairs of the company to give the other directors notice of the interest. This section potentially operates differently to the duty to avoid conflicts because the term 'material personal interest' is not synonymous with 'real sensible possibility of conflict' and may not include a conflict of duties.¹²

There are a number of exceptions to s 191, outlined in s 191(2). These include interests relating to contracts (or proposed contracts) with a related body corporate arising merely because the director is a director of the related body corporate; interests arising because the director is a guarantor or has given an indemnity or security for all or part of the loan or proposed loan to the company; and (in the case of proprietary companies) where the other directors are aware of the nature and extent of the interest and its relation to the affairs of the company. There is also provision for standing notice.¹³

The purpose of s 191 is not to remove the power of companies to relax the general prohibition on conflicts by the constitution, but to impose a binding safeguard on that power.¹⁴ Contravention of s 191 may result in a fine or imprisonment¹⁵ but does not affect the validity of any act, transaction, agreement, resolution or other thing.¹⁶ Any additional or alternative

9 See Ford, Austin and Ramsay, above n 2, at [9.120], which outlines a typical provision; see also Corporations Act 2001 (Cth) s 194.

10 Note, however, the operation of s 195 of the Corporations Act 2001 (Cth) as concerns public companies. Note also that there are a number of Listing Rules of the Australian Securities Exchange that preclude directors of listed companies with an interest from voting.

11 See Corporations Act 2001 (Cth) s 193.

12 See *McGellin v Mount King Mining NL* (1998) 144 FLR 288 at 304 per Murray J; BC9801129; *Grand Enterprises Pty Ltd v Aurium Resources Ltd* (2009) 256 ALR 1; (2009) 72 ACSR 75; [2009] FCA 513; BC200904208 at [69] per Barker J; ASIC, Regulatory Guide 76, *Related Party Transactions*, March 2011, p 11 [76.37].

13 See Corporations Act 2001 (Cth) ss 191(1)(d) and 192.

14 See Ford, Austin and Ramsay, above n 2, at [9.130].

15 See Corporations Act 2001 (Cth) Sch 3.

16 See Corporations Act 2001 (Cth) s 191(4).

requirements in a company's constitution must be satisfied in addition to the disclosure requirement in s 191.¹⁷

There are extra requirements for directors of public companies. Section 195 provides that a director of a public company who has a material personal interest that is being considered at a directors' meeting must not be present while the matter is being considered at a meeting or vote on the matter unless s 195 allows the director to be present or the interest does not need to be disclosed under s 191. There are exceptions to s 195, namely, where the other directors pass a resolution that they are satisfied that the director should not be disqualified from voting or being present¹⁸ and where the Australian Securities and Investments Commission (ASIC) allows the director to be present and vote.¹⁹

It is also noteworthy that a company's constitution may contain restrictions on a director's ability to vote and be present at a meeting beyond those in s 195. However, the constitution cannot permit a director to vote or be present where the prohibition in s 195 applies.²⁰ Contravention of s 195 is a criminal offence (resulting in a potential fine) but does not affect the validity of any resolution passed by the directors.²¹ Although the focus of this article is on the requirements at general law, these statutory requirements are important as they are complementary to the general law requirements.²²

3 Required action by directors

As mentioned above, courts do not always clearly articulate what is required of directors facing a conflict in order to avoid a breach of duty. This section

17 Section 193 provides that s 191 has effect in addition to, and not in derogation of, any provisions in a company's constitution that restrict a director from having a material personal interest in a matter or holding an office or possessing property involving duties or interests that conflict with their duties or interests as a director. See further *Centofanti v Eekimitor Pty Ltd* (1995) 65 SASR 31 at 43 per Olsson J; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037.

18 Section 195(2) provides that a director who has a material personal interest to be considered at a directors' meeting may be present and vote if the directors who do not have a material personal interest in the matter have passed a resolution that identifies the director, the nature and extent of the director's interest in the matter and its relation to the affairs of the company and states that those directors are satisfied that the interest should not disqualify the director from voting or being present.

19 Section 195(3) provides that a director who has a material personal interest in a matter to be considered at a directors' meeting may be present and vote if the director is entitled under a declaration or order made by ASIC under s 196. Section 195(4) provides that if there are not enough directors to form a quorum for a directors' meeting due to s 195(1), then one or more of the directors (including those who have a material personal interest in the matter) may call a general meeting and the general meeting may pass a resolution to deal with the matter.

20 See Ford, Austin and Ramsay, above n 2, at [9.150].

21 See Corporations Act 2001 (Cth) s 195(5).

22 There are other statutory provisions in the Corporations Act 2001 (Cth) dealing with conflicts, including ss 182 and 183. In particular Ch 2E of the Act regulates financial benefits to related parties of public companies and their controlled entities. Section 208 provides that, unless an exception applies, for a public company or an entity that the public company controls to give a financial benefit to a related party of the public company, the public company must obtain the approval of its members (in a specific way which involves ASIC) and give the benefit within 15 months after the approval.

critically examines the continuum, which ranges from disclosure of the interest to positive action to prevent the relevant transaction from proceeding.

3.1 Disclosure as baseline

In some cases it has been held that disclosure of the interest, together with informed consent, was sufficient to absolve the relevant director from breach of duty. An example is *Centofanti v Eekimitor Pty Ltd*.²³ In that case, the appellant was involved in an attempt to rescue the relevant company with the agreement of his fellow directors.²⁴ The court found that the director was required to advise the board of the nature of his interest and that he intended to continue the business with a view to making a commercial profit. He was not, however, required to spell out to the board the inherent risks in the proposed commercial activities and the possible financial consequences.²⁵ This was because, as outlined below, the company's articles of association required the director to 'declare the nature of his interest' (and no more), which was found to determine the content requirement for disclosure in discharging the duty to avoid conflicts. The director was not in breach of duty as he had declared the nature of his interest.²⁶

That disclosure of the interest is a key baseline requirement in the context of informed consent is undoubted.²⁷ Accordingly, in some cases directors who have failed to disclose their interests have been found to be in breach of duty due to non-disclosure. For example, in *Darvall v North Sydney Brick & Tile Co Ltd* the managing director was involved in making a takeover bid for the company.²⁸ He absented himself from the room so the board could discuss a proposal of heads of agreement and vote accordingly. President Kirby said:

Normally the departure of an officer from the room in such circumstances would signify a personal interest in the subject matter of the vote. If there is such a personal interest it is the obligation of the director candidly to disclose it. It is not enough to

23 (1995) 65 SASR 31; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037 (*Centofanti*).

24 The respondent company was a trustee, the trust's only asset being a commercial property. The tenant of the property did not pay the rent and the respondent became liable as guarantor for the debts of the tenant, thus leading to serious financial difficulties. Mr Centofanti, who was a director of the respondent, agreed to participate in a rescue operation, which involved the incorporation of a company for the purpose of taking over the lease after the tenant ceased trading. The second company did not trade profitably and was wound up. The respondent's property was subsequently sold and Mr Centofanti obtained judgment for the funds lent to the respondent.

25 See (1995) 65 SASR 31 at 45 per Olsson J; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037.

26 After discussing a number of factors which may operate to require action beyond disclosure (outlined in Section 3.3 below) King CJ found that the plaintiff's fiduciary duty was fully and properly discharged by making disclosure to the board and that the resolution of the board operated to absolve him from breach of duty. Justice Olsson referred to the fact that the director had declared his interest and also had not voted on the relevant decision: *ibid*, at SASR 45, 46.

27 See, eg, *Holyoake Industries (Vic) Pty Ltd v V-Flow Pty Ltd* (2011) 86 ACSR 393; (2011) 213 IR 55; [2011] FCA 1154; BC201107881 at [92] per Tracey J; *R v Byrnes* (1995) 183 CLR 501 at 517 per Brennan, Deane, Toohey and Gaudron JJ; (1995) 130 ALR 529; [1995] HCA 1; BC9506451.

28 (1989) 16 NSWLR 260; (1989) 15 ACLR 230; (1989) 7 ACLC 659 (*Darvall*).

refrain from voting. Particularly where (as here) the director has taken an active part in canvassing options, mere withdrawal, without explanation, from the act of voting may be an empty gesture.²⁹

It is, however, unclear in such cases whether disclosure alone would have been sufficient to absolve the relevant director from breach of duty given that disclosure was not made. Statements in the cases in relation to what is required of directors facing a conflict can be divided into those in which no (or inadequate) disclosure was made (and the court opined on what would be required in the circumstances)³⁰ and those in which (adequate) disclosure was made but the director was nevertheless in breach of duty because further steps were required.³¹

A related issue is the requisite quality of disclosure. Courts have at times opined on the extent of the disclosure required of directors who are in a situation of conflict. Although the extent of the requisite disclosure has been said to depend on the circumstances, disclosure must generally be of the nature and extent of the interest.³² Disclosure must be sufficient to enable the other directors to give informed consent.³³ In *Woolworths v Kelly*, Samuels JA quoted the following from the judgment of Lord Radcliffe in *Gray v New Augarita Porcupine Mines Ltd*:

There is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest . . . The amount of detail required must depend on the nature of the contract or arrangement proposed and the context in which it arises . . . His declaration must make his colleagues ‘fully

29 Ibid, at NSWLR 270; see also *Fitzsimmons* (1997) 23 ACSR 355 at 364 per Parker J; (1997) 15 ACLC 666; BC9700935. In this respect see also *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs appted) (in liq) (controllers appted) (No 3)* [2013] FCA 1342; BC201315842 at [218]–[228], [250] in which Murphy J opined that the conflicted directors also needed to ensure that their abstention was seen and recorded as such, rather than simply remaining silent without announcing their abstention. At [296] Murphy J indicated that proper consideration by the board (rather than mere ‘rubber stamp[ing]’) of the conflict is required; see also *R v Byrnes* (1995) 183 CLR 501 at 517 per Brennan, Deane, Toohey and Gaudron JJ; (1995) 130 ALR 529; [1995] HCA 1; BC9506451.

30 See, eg, *Short v Crawley (No 30)* [2007] NSWSC 1322; BC200711857; *Sigma Chemicals (1986) Pty Ltd v Brown* [2001] WASC 39; BC200100292; *R v Byrnes* (1995) 183 CLR 501 at 517 per Brennan, Deane, Toohey and Gaudron JJ; (1995) 130 ALR 529; [1995] HCA 1; BC9506451; *Groeneveld Australia Pty Ltd v Nolten (No 3)* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; see also *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935.

31 See, eg, *Permanent Building Society (in liq) v McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376; *Re QLS Superannuation Pty Ltd*; *ASIC v Parker* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507; *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601.

32 See, eg, *Short v Crawley (No 30)* [2007] NSWSC 1322; BC200711857 at [692] per White J; *Imperial Mercantile Credit Association v Coleman* (1873) LR 6 HL 189 at 200, 202 per Lord Chelmsford; *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 at 14 per Lord Radcliffe; *Centofanti* (1995) 65 SASR 31 at 45 per Olsson J; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; Ford, Austin and Ramsay, above n 2, at [9.110].

33 See *Woolworths v Kelly* (1991) 22 NSWLR 189 at 211 per Samuels JA; (1991) 4 ACSR 431; (1991) 9 ACLC 539 (*Woolworths*); *Groeneveld Australia Pty Ltd v Nolten (No 3)* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742 at [57] per Davies J.

informed of the real state of affairs' . . . If it is material to their judgment that they know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed.³⁴

3.1.1 Constitutional provisions

As mentioned in Section 2 above, a provision in the company's constitution will be relevant in determining what action is required of a director, as was the case in *Centofanti*.³⁵ In that case, the court was influenced by a provision in the company's articles of association which allowed directors to vote in relation to contracts in which they were interested if they complied with s 228 of the Companies Code.³⁶ Interestingly, the article in question related only to voting, rather than extending to allowing the making of a contract in which a director was interested. Chief Justice King referred to *Woolworths*, in which it was held that an article prohibiting a director from voting in respect of a contract in which he was interested assumed that a contract of that kind might be dealt with by the board and therefore impliedly authorised the board to do so.³⁷ His Honour held that a provision authorising the interested director to vote must have the like effect.³⁸

However, compliance with such an article will not always be determinative of what is required of a director in a situation of conflict. This can be seen in the case of *Groeneveld Australia Pty Ltd v Nolten (No 3)*.³⁹ In that case, a director was found to be in breach of the duties to avoid conflicts and to act in good faith in the interests of the company and for proper purposes in not disclosing certain wrongdoing relevant to, and in voting on, the decision of the board to exercise certain put and call options in his favour.⁴⁰ Although the company's articles of association allowed a director to vote subject to disclosure, the disclosure of the conflict did not affect his duties to act in good faith and for a proper purpose.⁴¹ By contrast, in *Centofanti* it was found that the director had acted in good faith in the interests of the company and that the

34 [1952] 3 DLR 1 at 14, quoted in *Woolworths* (1991) 22 NSWLR 189 at 211; (1991) 4 ACSR 431; (1991) 9 ACLC 539; see also *VBN v Australian Prudential Regulation Authority* (2006) 92 ALD 475; (2006) 44 AAR 231; [2006] AATA 718; BC200606561 at [542] per Forgie DP; *Camelot Resources Ltd v MacDonald* (1994) 14 ACSR 437 at 443 per Santow J; BC9402987.

35 See also *R v Byrnes* (1995) 183 CLR 501 at 517 per Brennan, Deane, Toohey and Gaudron JJ; (1995) 130 ALR 529; [1995] HCA 1; BC9506451.

36 Section 228 of the Companies (South Australia) Code contained a general requirement that a director in a conflict of interest situation was required, as soon as practicable after the existence of the relevant conflict came to his or her knowledge, to declare the nature of his or her interest at a meeting of the directors of the company: see (1995) 65 SASR 31 at 43 per Olsson J; 15 ACSR 629; (1995) 13 ACLC 315; BC9503037.

37 *Woolworths* (1991) 22 NSWLR 189; (1991) 4 ACSR 431; (1991) 9 ACLC 539.

38 See *Centofanti* (1995) 65 SASR 31 at 33; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; see also *Adler v ASIC* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670 at [539] per Giles JA (with whom Mason P and Beazley JA agreed). Justice Olsson thought that the significance of the article was that, given that the statutory obligation was limited to disclosure to the directors (and not the members) it even clearly envisaged the right of the interested director, actively, to participate in the entry into transactions in which there was a disclosed interest: see (1995) 65 SASR 31 at 44; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037.

39 (2010) 80 ACSR 562; [2010] VSC 533; BC201008742 (*Groeneveld*).

40 *Ibid*, at [57] per Davies J.

41 See *ibid* at [59] per Davies J. Justice Davies referred to the comments of King CJ in

transaction was clearly for the benefit of and in the best interests of the company.⁴²

These cases show the interaction of the duty to avoid conflicts and the duty to act in good faith in the interests of the company (and also the duty to act for proper purposes). A director may avoid breaching the duty to avoid conflicts by making full disclosure and obtaining informed consent, but he or she is still subject to the duties to act in good faith in the interests of the company and for proper purposes. In *Groeneveld*, the director was found to have breached these duties (as well as the duty to avoid conflicts). Likewise in the case of *Fitzsimmons* (which is examined more fully below) the basis of the legal action was the duty to act in good faith in the interests of the company.⁴³

From these cases it can be seen that a provision in the company's constitution relating to conflicts will be relevant to, but not determinative of, the steps required of directors facing conflicts.

3.2 Disclosure and abstention

In some cases courts have said that a director faced with a conflict will be required to disclose the conflict and also to refrain from taking part in decisions. This was the view of Perry J in *South Australia v Clark*.⁴⁴ In that case, Mr Clark did not disclose a conflict of interest in a transaction being entered into between two companies of which he was a director, which turned out to be financially detrimental to one of those companies. Justice Perry found that Mr Clark's duty extended not only to disclosing the conflict but also to refraining from taking part in the deliberations which led to the decision to proceed with the transaction.⁴⁵ His Honour found that Mr Clark was not in charge of the transaction and did not present the proposal or take steps necessary to give effect to the board's resolution but that he did take part in discussion, and communicated to managers a strong desire to conclude the agreement, as well as voting in favour of the transaction. Justice Perry also found that Mr Clark deliberately withheld the existence of the conflict.⁴⁶ Mr Clark was held to be in breach of the fiduciary duty to avoid conflicts.

Cases mentioning abstention are not uniform in terms of whether abstention must be from voting,⁴⁷ or from taking part in deliberations,⁴⁸ or both.⁴⁹

Centofanti (1995) 65 SASR 31 at 33; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037 (extracted below) and of Owen J in *Fitzsimmons* (1997) 23 ACSR 355 at 358; (1997) 15 ACLC 666; BC9700935 (extracted above); see *ibid*, at [57]–[58].

42 (1995) 65 SASR 31 at 33 per King CJ, 47 per Olsson J; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037.

43 (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935.

44 (1996) 66 SASR 199; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526 (*Clark*).

45 *Ibid*, at SASR 210.

46 *Ibid*, at SASR 214, 216, 219. Likewise in *Links Golf Tasmania Pty Ltd v Sattler* (2012) 213 FCR 1; (2012) 292 ALR 382; [2012] FCA 634; BC201204508 at [721], Jessup J found that a director (or his alter ego) was contracting with his own company, giving rise to a clear conflict of interest. The director should have put the matter before the board and absented himself from its deliberations in relevant respects.

47 See, eg, *Centofanti* (1995) 65 SASR 31 at 45 per Olsson J; 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; 31 ACSR 213; [1999] SASC 97; BC9902601 at [667] per curiam; *Adler v ASIC* (2003) 179 FLR 1; (2003)

Moreover, there do not appear to be clearly identifiable factors indicating which type of abstention will be appropriate, given that there is not detailed consideration given by courts to this issue. Importantly, it will be shown below that directors who are best placed to protect the company in relation to a particular course of action will not necessarily avoid breaching their duties by withdrawing from involvement.

The case of *Re QLS Superannuation Pty Ltd; Australian Securities and Investments Commission v Parker*⁵⁰ also demonstrates that a director cannot always avoid his or her fiduciary obligations merely by declaring an interest in the transaction being approved and by absenting himself or herself from the board when it discusses the proposal.⁵¹ In that case, despite complying with the company's constitutional provision in relation to disclosure of conflicts, a director was found to have breached a number of duties in relation to an imprudent loan that he proposed to the board and in relation to which he stood to gain a success fee.⁵²

3.3 Special factors leading to additional requirements on the director

In addition to disclosure (and possible abstention) the presence of certain factors may lead to further steps being required of a director in a situation of conflict. This can be seen from the judgment of King CJ in *Centofanti*:

Having made proper disclosure to the board was the plaintiff under any further fiduciary obligation? The nature and extent of any obligation remaining on an interested director after making disclosure must depend upon the circumstances. If he votes, he must exercise his vote with due regard to his obligation to exercise his powers for the benefit of the company. If he does not vote the circumstances may be such that he can deal at arm's length with the company, consulting his own interests and leaving to the other, apparently competent and fully informed, directors the assessment of any risks and the merits of the proposal from the standpoint of the company. Where, however, the director conducts the day-to-day operations of the

46 ACSR 504; [2003] NSWCA 131; BC200303670 at [539] per Giles JA (with whom Mason P and Beazley JA agreed); cf *Permanent Building Society (in liq) v McGee* (1993) 11 ACSR 260 at 289 per Anderson J; (1993) 11 ACLC 761; BC9301376.

48 See, eg, *Clark* (1996) 66 SASR 199 at 210 per Perry J; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526; *Links Golf Tasmania Pty Ltd v Sattler* (2012) 213 FCR 1; (2012) 292 ALR 382; [2012] FCA 634; BC201204508 at [721] per Jessup J.

49 See, eg, *Fitzsimmons* (1997) 23 ACSR 355 at 364 per Parker J; (1997) 15 ACLC 666; BC9700935. In *R v Byrnes* (1995) 183 CLR 501 at 517; (1995) 130 ALR 529; [1995] HCA 1; BC9506451, Brennan, Deane, Toohey and Gaudron JJ spoke in terms of 'tak[ing] no part in the decision of the board on the transaction' (as may be authorised by a company's constitution.) In that case this principle was applied to voting.

50 (2003) 21 ACLC 888; [2003] FCA 262; BC200301507 (*QLS*).

51 *Ibid.*, at [102].

52 These were the duty of care and diligence in s 232(4) of the Corporations Law (now in s 180 of the Corporations Act 2001 (Cth)), the duty to act honestly in s 232(2) of the Corporations Law (now the duty to act in good faith in the interests of the company in s 181 of the Corporations Act 2001 (Cth)) and the duty not to make improper use of position in s 232(6) (now in s 182 of the Corporations Act 2001 (Cth)). Justice Drummond referred to *Centofanti* (1995) 65 SASR 31; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037 and to *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797 (discussed in Section 3.5 below).

company or is otherwise possessed of knowledge relevant to the decision, which his co-directors do not possess, he may not be free to act in that way but may be obligated to act in a way which protects the interests of the company.⁵³

In this case the relevant director did not vote and was not responsible for the day-to-day operations of the company. Chief Justice King found that he was in no better position than the other directors to assess the risks and that he was at all times acting honestly and for the purpose of salvaging the trust property from the threatened loss and not with a view to gaining an advantage at the expense of the company from his position as a director.⁵⁴

It will be shown below that where directors are in charge of the day-to-day operations of the company or possess relevant knowledge in relation to the transaction that is not possessed by their co-directors, higher requirements will be imposed in a situation of conflict. Managing directors and chief executive officers should be particularly vigilant for this reason.⁵⁵ It will also be shown that where the company is entering into a potentially detrimental transaction there will be a higher burden on the conflicted director. In *Centofanti*, the transaction was advantageous to the company, which distinguishes this case from many of the others in this area. Chief Justice King's reference to the fact that the director was not acting with a view to gaining an advantage at the expense of the company from his position as a director also points to the fact that a higher standard may be imposed where the relevant director stands to gain a personal benefit from the relevant transaction.

Chief Justice King also noted that if the director proceeded to vote he must exercise his vote with due regard to his obligation to exercise his powers for the benefit of the company. This requirement is a feature of a number of the cases in this area. Directors must be careful in exercising their powers to make sure they comply with the duties to act in good faith in the interests of the company and for proper purposes.

3.4 Heightened disclosure as a result of special factors

Although cases such as *Centofanti* and *Woolworths* have held that disclosure of the interest is sufficient, in other cases directors have been required to disclose more than this. They have been held to be in breach of duty for not disclosing matters relevant to the decision being made by the company. This can be seen in cases such as *Fitzsimmons* and *Groeneveld*.

In *Fitzsimmons*, Mr Fitzsimmons was a director of both Duke Holdings Ltd and Kia Ora Gold NL. Duke's financial situation was precarious. Kia Ora made a payment to Duke and Duke purchased shares in Kia Ora in breach of the statutory financial assistance prohibition. Mr Fitzsimmons was found to have breached the statutory duty to act honestly (which was a predecessor duty to the duty to act in good faith in the interests of the company in s 181 of the Corporations Act 2001 (Cth)) in failing to disclose to the board of Kia

⁵³ (1995) 65 SASR 31 at 33; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037.

⁵⁴ *Ibid.*

⁵⁵ Note, however, that non-executive directors will still be subject to requirements in this respect (particularly by virtue of the duty to act in good faith in the interests of the company): see *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601 at [676] per curiam.

Ora what he knew about Duke's financial position. The court rejected Mr Fitzsimmons' argument that he could not disclose such information because he was under a positive duty to Duke not to disclose information he acquired by virtue of his directorship of Duke.

Justice Owen indicated that what will be required of a director in Mr Fitzsimmons' position will vary according to the circumstances. Justice Parker expressed a similar view and opined that in these circumstances action beyond disclosure would be required. His Honour said:

When material conflict arises the circumstances will be important in determining what action is called for to discharge the duty of acting honestly. At the very least . . . the present circumstances would have required the applicant to disclose to the board that he was in a position of conflict in respect of the matter being considered by the Kia Ora board and that, as a consequence, he could neither participate in the deliberations nor vote. I have said 'at the very least' because I do not wish to be taken as suggesting this would necessarily satisfy the duty of honesty created by [the predecessor to s181] in the circumstances that existed.

Indeed, it is my present view that more was required of the applicant to discharge the duty he owed to Kia Ora . . . It may well have required that he identify what he knew to be the risk previously identified to Kia Ora to the Kia Ora board. At the least it required the action by him which I have previously identified. He did not so act.⁵⁶

Fitzsimmons demonstrates that a director faced with a conflict of interest may have to take action beyond disclosure and abstention under the duty to act in good faith in the interests of the company.⁵⁷ As mentioned, Mr Fitzsimmons was convicted of breach of a predecessor to s 181, which required directors to act honestly.

The case of *Groeneveld* illustrates that the disclosure required of directors facing a conflict may extend to disclosure of other factors relevant to the decision, such as wrongdoing. In that case, Davies J found that Mr Nolten had breached his duty in exercising his power to approve the issue of shares to him due to his conflict of interest.⁵⁸ It was found that Mr Nolten needed to make full disclosure to the board of the matters of which the other directors needed to be advised to enable them to give informed consent to the proscribed conduct. Although Mr Nolten had declared his interest in relation to certain options he had not disclosed that he had engaged in conduct that would constitute a 'proscribed circumstance' in terms of the call option agreement,

56 (1997) 23 ACSR 355 at 363–4 (Murray J agreed with Parker J); (1997) 15 ACLC 666; BC9700935. Note that Owen J framed his discussion in terms of the duty to avoid conflicts: see at ACSR 357–8. An outline of the role of each of the duties is presented below.

57 See also *Commonwealth v Davis Samuel (No 7)* (2013) 282 FLR 1; (2013) 35 ACSR 258; [2013] ACTSC 146; BC201311476 at [901] per Refshauge J; but cf *Duncan v ICAC* (2014) 311 ALR 750; [2014] NSWSC 1018; BC201405924 at [197]–[209] per McDougall J and for discussion see R T Langford, *Directors' Duties: Principles and Application*, Federation Press, Sydney, 2014, p 81.

58 (2010) 80 ACSR 562; [2010] VSC 533; BC201008742 at [54]. *Groeneveld* concerned a multinational group of companies, including GA and GBV. Mr Nolten was managing director of GA. Mr Nolten exercised put and call options over shares in GA. He had a contractual right to call for shares in GA and to put such shares to GBV. He exercised the two option calls prior to his dismissal. GA issued shares pursuant to the first call but refused to issue shares pursuant to the second call and GBV refused to comply with its purchase options.

thus meaning that the call option was not exercisable.⁵⁹ The disclosure required therefore went beyond disclosure of the nature of his interest to disclosure of wrongdoing affecting the decision being made by the board.⁶⁰

The heightened disclosure requirement in *Groeneveld* was linked to the requirement (outlined in cases such as *Centofanti*, *Permanent Building Society (in liq) v Wheeler*⁶¹ and *Fitzsimmons*) that directors who conduct the day-to-day operations of the company or who are otherwise possessed of special knowledge may have to protect the interests of the company. In this case, Mr Nolten was managing director. Justice Davies found that it was Mr Nolten's duty to protect the interests of the company by disclosing to the board the matters that were relevant to the company's decision to issue shares to him, not just to declare his personal interest in the share issue.⁶²

In summary, in certain situations directors will be required to disclose more than the nature (and extent) of the relevant conflict. Cases such as *Fitzsimmons*, *Groeneveld* and *Centofanti* show that particular indicators of such a heightened requirement include where the company is entering into a financially disadvantageous transaction and where the director is in charge of the day-to-day running of the company or has greater understanding of the relevant transaction or decision than the other directors.

3.5 Duty to take action as a result of special factors

Some judges have suggested that directors may be obliged to take positive action beyond additional disclosure, such as preventing a transaction going ahead. This was mentioned by Owen J in the extract from *Fitzsimmons* above. Likewise in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)*, Owen J said that in certain situations part of the duty to protect the interests of the company may require the director to prevent the company from entering into the transaction or to ensure that it is not followed through to completion.⁶³ The cases that are particularly illustrative of this requirement are *Permanent Building Society (in liq) v McGee*⁶⁴ and *Wheeler*⁶⁵ which stem from the same litigation (*McGee* being the first instance judgment and *Wheeler* being the appeal judgment).

59 As mentioned above, the company's constitution allowed a director to vote on a transaction in which the director had a personal interest subject to disclosure of that personal interest. Although such disclosure had been made, the court found this to be inadequate. The director had committed multiple breaches of duty which had resulted in him obtaining financial benefits that he would not otherwise have obtained. Disclosure of this 'conduct as a defaulting fiduciary' may have entitled the company to terminate his employment, which would have resulted in the expiry of the options.

60 A requirement to disclose wrongdoing as part of the duty to act in good faith in the interests of the company is accepted in the United Kingdom but is controversial in Australia: see Langford, above n 57, at 145–6 n 68, 187–8.

61 (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797 (*Wheeler*) (discussed in Section 3.5 below).

62 (2010) 80 ACSR 562; [2010] VSC 533; BC201008742 at [57].

63 (2008) 39 WAR 1; (2008) 70 ACSR 1; [2008] WASC 239; BC200809492 at [4526] (*Bell*). Justice Owen referred to the judgment of Anderson J in *Permanent Building Society (in liq) v McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376, extracted below.

64 (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376 (*McGee*).

65 (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797. These

In *McGee*, the chairman (who was also an executive director) of a company was found to have a conflict of interest in relation to a loan being given by the company. In such circumstances, Anderson J held that it was insufficient for the chairman to disclose his interest and to abstain from voting at the meeting when the board decided to advance the loan. The chairman was held to have a positive duty (as part of the duty to act in good faith in the interests of the company) to protect the company's interests due to the fact that he had a better understanding than the other directors of the borrower's inability to service its obligations. The chairman was found to have breached the duty to avoid conflicts and was liable to make good the loss.⁶⁶ Justice Anderson said:

Under those circumstances, it was his duty to take positive steps to protect the interests of the plaintiff. At the very least, he was under an obligation to make full and frank disclosure of the extent of Capital Hall's financial incapacity at the time . . . 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' . . .⁶⁷

This principle was applied by the NSW Court of Appeal in *Adler v ASIC* in which the court (quoting Santow J at first instance) in outlining principles relevant to s 181 said:

In certain circumstances, such as a director in 'a position of power and influence' over the board, mere disclosure of a conflict between interest and duty and abstaining from voting is insufficient to satisfy a director's fiduciary duty. The director may also be under a positive duty to take steps to protect the company's interest such as by using such power and influence as he had to prevent the transaction going ahead: *Permanent Building Society (in liq) v McGee* (1993) 11 ACSR 260 per Anderson J at 289.⁶⁸

The court in *Adler* also upheld Justice Santow's comments (based on those

judgments were referred to in *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601; and *Adler v ASIC* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670.

⁶⁶ (1993) 11 ACSR 260 at 290 per Anderson J; (1993) 11 ACLC 761; BC9301376.

⁶⁷ *Ibid*. Specifically, it was Wheeler's duty to inform the 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. This passage was applied in *ASIC v Sydney Investment House Equities Pty Ltd* (2008) 69 ACSR 1; [2008] NSWSC 1224; BC200810505 at [47] per Hamilton J; see also *Talbot v NRMA Ltd* (2000) 18 ACLC 600 at 605 per Hodgson CJ; (2000) 50 NSWLR 300; (2000) 34 ACSR 650; [2000] NSWSC 608.

⁶⁸ (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670 at [539] per Giles JA (with whom Mason P and Beazley JA agreed) (*Adler*). *Adler* involved a subsidiary (HIHC) of a public company (HIH) making a large undocumented payment to a company controlled by Mr Adler, who was a director of HIH. Adler initiated the payment, which was made with the agreement and direction of Mr Williams (also a director of HIH) but without the knowledge of the directors of HIH or the HIH investment committee. The money was used for reasons that benefited Adler. The court upheld Justice Santow's finding that the directors contravened s 181 in not taking steps such as having the payment and associated

of Owen J in *Fitzsimmons*) that what action, beyond disclosure, the director must make will depend on matters such as the degree to which the director has been involved in the transaction and the gravity of possible outcomes for the company.⁶⁹ This resulted in a distinction between the defendant directors.⁷⁰

An appeal from the decision in *McGee* was heard in *Wheeler*, although the appeal judgment did not impugn the correctness of Justice Anderson's propositions.⁷¹ In *Wheeler*, it was under the heading of reasonable care and skill that Ipp J discussed the obligation of the chief executive and managing director (who had a conflict of interest) to ensure that the other directors appreciated the potential harm inherent in the transaction and to point out steps that could be taken to reduce the possibility of that harm.⁷² Justice Ipp said:

In these circumstances . . . there was a heavy duty on the respondents generally and Hamilton in particular to scrutinise the proposed transaction with caution and thoroughness . . . In my opinion that duty was not affected by the fact that Hamilton believed that he had a conflict of interest and accordingly did not vote when the resolutions in question were taken. It was manifest that the transaction was capable of causing [the company] serious harm. In those circumstances, in my opinion, Hamilton could not avoid his duties . . . by asserting his perceived conflict of interest. It may be that, because of the conflict, he should not have spoken or voted in favour of the resolution. But as chief executive and managing director there was a responsibility on him to ensure that the other directors appreciated the potential harm inherent in the transaction, and to point out steps that could be taken to reduce the possibility of the harm. Hamilton could not avoid that duty by, metaphorically speaking, burying his head in the sand while his co-directors discussed whether [the company] should enter into such a potentially detrimental transaction . . .⁷³

Hamilton was therefore found to have breached his duty to exercise reasonable care and skill.⁷⁴ Cases in this area demonstrate that the duty of care may be heightened when directors are in a situation of conflict.⁷⁵

transactions considered by the investment committee or the board. This allowed subsequent unlisted investments and loans to be made with no properly approved mandate permitting this and no specific approval or ratification.

⁶⁹ *Adler* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670 at [539].

⁷⁰ *Ibid.*

⁷¹ See *Wheeler* (1994) 11 WAR 187 at 218 per Ipp J; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797; *ASIC v Sydney Investment House Equities Pty Ltd* (2009) 69 ACSR 1; [2008] NSWSC 1224; BC200810505 at [48] per Hamilton J.

⁷² See (1994) 11 WAR 187 at 240–1; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797.

⁷³ *Ibid.*; see also *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601 at [667].

⁷⁴ See *ibid.*, at WAR 241 per Ipp J. Justice Ipp found that the likelihood of rezoning was fundamental to the risk being assumed: it was elementary that the security should be sufficient, having regard to that risk. The risk could only be measured by a careful analysis of the information then available as to the likelihood of rezoning. Hamilton, as chief executive and managing director, should have ensured that appropriate information in this respect was available to the board. Hamilton should also have satisfied himself that adequate security was provided. These matters could not be delegated.

⁷⁵ See, eg, *ibid.*, at 241 per Ipp J; *Re HIH Insurance Ltd (in prov liq); ASIC v Adler* (2002) 168 FLR 253; (2002) 41 ACSR 72; [2002] NSWSC 171; BC200200827 at [372] per Santow J; *Diakyne Pty Ltd v Ralph* (2009) 72 ACSR 450; [2009] FCA 721; BC200905829 at [84] per Jagot J; *Re Idylic Solutions Pty Ltd; ASIC v Hobbs* [2012] NSWSC 1276; BC201208171 at

This passage has been applied in a number of cases. One example is *Duke Group Ltd (in liq) v Pilmer*.⁷⁶ In that case, Kia Ora completed a successful takeover for Western United, which turned out to be financially detrimental for Kia Ora. A director of Kia Ora had a conflict of interest in relation to this transaction in that he was a director of both companies (and also owned substantial shareholdings in Western United) and therefore knew the true financial position of Western United and that the transaction was not in Kia Ora's interests. The court found that if there had been no suggestion of Kia Ora entering into an improvident transaction, the proper course for the director would have been to declare his interest in, and take no further part in, implementing the takeover. However, different considerations applied because the transaction was contrary to Kia Ora's interests, as was known by the director. The director could therefore not avoid his duty to Kia Ora and remain silent simply because Western United's shareholders might profit from the takeover.⁷⁷

The court held that there had been a breach of duty because there was no record of the director disclosing any conflict of interest. The director (and another director) should also have informed the shareholders of Kia Ora of the fact that it was not in the best interests of the company to proceed with the takeover at the Extraordinary General Meeting of shareholders convened to consider the takeover. In other words disclosure of the conflict of interest would not have been sufficient in these circumstances — further action was required due to the knowledge the director had of the fact that the takeover was not in the best interests of Kia Ora.

These cases require directors who face a conflict of interest to take action to protect the company's interests. This requirement has been imposed under a number of duties. In summary, the requisite action has included:

- 1 Using power and influence with the other directors to prevent the transaction going ahead (as seen in cases such as *McGee and Adler*);
- 2 Pointing out to the other directors the steps to reduce potential harm (as seen in *Wheeler*); and
- 3 Advising shareholders who are voting to approve a transaction that the transaction is not in the best interests of the company (as seen in *Duke*).

These cases go further than those outlined in Section 3.4, which have generally required directors with special knowledge to point out the harm of the transaction to other directors but not to do any more.

3.6 Resignation

It was suggested by Owen J in *Fitzsimmons* that resignation would not always be necessary in order to avoid a breach of duty.⁷⁸ Conversely, as noted by

[1477] per Ward J; *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs appted) (in liq) (controllers appted) (No 3)* [2013] FCA 1342; BC201315842 at [600] per Murphy J.

⁷⁶ (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601 at [667] per curiam (*Duke*).

⁷⁷ *Ibid*, at [670] per curiam.

⁷⁸ Justice Owen said at (1997) 23 ACSR 355 at 357; (1997) 15 ACLC 666; BC9700935:

Barrett, resignation is not a clear-cut solution — the duty of confidentiality does not suddenly evaporate upon resignation.⁷⁹ Resignation is not necessarily effective for the purposes of avoiding breach of the duty not to obtain unauthorised profits either.⁸⁰

3.7. Summary

Based on detailed analysis of Australian case law, it has been shown that the presence of one or more of the following factors is likely to give rise to requirements beyond disclosure of the nature of the conflict:

- 1 The company is engaging in something new or with which it is unfamiliar.⁸¹
- 2 The entity with which the company is transacting is in financial difficulty.⁸²
- 3 The company is likely to suffer loss as a result of the transaction.⁸³
- 4 The director is the one who put the proposal to the board or who is driving the transaction.⁸⁴
- 5 The director has a higher degree of knowledge and/or experience in relation to the transaction or in relation to the relevant area than the other directors.⁸⁵

It might seem from these statements that a director would have no alternative other than to resign from office where a conflict of interest existed. However, if that were the case, commercial life would become very difficult, particularly for professional directors.

⁷⁹ See R I Barrett, 'Resolution of Directors' Conflicts' (1997) 71 *ALJ* 677 at 679.

⁸⁰ See *Streeter v Western Areas Exploration Pty Ltd (No 2)* (2011) 278 ALR 291; (2011) 82 ACSR 1; [2011] WASCA 17; BC201100094 at [370] per Murphy J.

⁸¹ See, eg, *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935; *Wheeler* (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797; see also *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507.

⁸² See, eg, *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935; see also *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507.

⁸³ See, eg, *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935; *Wheeler* (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797; *Bell* (2008) 39 WAR 1; (2008) 70 ACSR 1; [2008] WASC 239; BC200809492; *Duke* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601; see also *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507. Note, however, the following statement of Samuels JA in *Woolworths* (1991) 22 NSWLR 189 at 211; (1991) 4 ACSR 431; (1991) 9 ACLC 539, as quoted in *VBN v Australian Prudential Regulation Authority* (2006) 92 ALD 259; [2006] AATA 710; BC200606560 at [542] per Forgie DP:

The requirement for disclosure seems therefore to be intended not to protect the company against bad bargains or the consequences of arrangements into which they enter as a result of the partisan interest of a director, but simply to ensure that the honesty and integrity which should inform corporate dealings and, in particular, the internal management of corporations is scrupulously observed.

See also *Castlereagh Motels Ltd v Davies-Roe* (1867) 67 SR(NSW) 279 at 284, 287; *Duke* (1999) 73 SASR 64; 31 (1999) ACSR 213; [1999] SASC 97; BC9902601 at [666] per curiam.

⁸⁴ See, eg, *Wheeler* (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797; *Darvall* (1989) 16 NSWLR 260; (1989) 15 ACLR 230; (1989) 7 ACLC 659; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; *Clark* (1996) 66 SASR 199; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526; see also *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507.

⁸⁵ See *Adler* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670; *McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376; *Wheeler* (1994) 11 WAR

- 6 The director is in a position of power and influence over the board.⁸⁶
- 7 The director conducts the day-to-day operations of the company.⁸⁷
- 8 The director is negligent as well as having a conflict.⁸⁸
- 9 The director stands to gain personally.⁸⁹
- 10 The director demonstrates reckless disregard or deliberate dishonesty.⁹⁰

These requirements are imposed under the duty to act in good faith in the interests of the company (sometimes combined with the duty to act for proper purposes),⁹¹ the duty to avoid conflicts,⁹² the duty of care⁹³ or a combination of the duties⁹⁴ at general law and under ss 180–184 of the Corporations Act 2001 (Cth).⁹⁵ A constitutional provision relating to conflicts may be relevant but will not be determinative.

In particular, directors should be vigilant to exercise their powers in accordance with the duties to act in good faith in the interests of the company and for proper purposes if allowed to vote on, or participate in, the relevant decision or course of action despite the conflict. Such duties may also be the source of requirements to disclose information relevant to the transaction or decision and even to take positive steps to warn fellow directors or to prevent a transaction proceeding.

187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797; *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742.

86 See *Adler* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670; *McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376; *Centofanti* (1995) 65 SASR 31; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; *Wheeler* (1994) 11 WAR 187; 14 ACSR 109; (1994) 12 ACLC 674; BC9406797.

87 See *Centofanti* (1995) 65 SASR 31; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742.

88 See *Wheeler* (1994) 11 WAR 187; (1994) 14 ACSR 109; (1994) 12 ACLC 674; BC9406797; *Clark* (1996) 66 SASR 199; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526; see also *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507.

89 See *Clark* (1996) 66 SASR 199; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; see also *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507.

90 See *Clark* (1996) 66 SASR 199; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526.

91 See, eg, *Fitzsimmons* (1997) 23 ACSR 355; (1997) 15 ACLC 666; BC9700935; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; *Adler* (2003) 179 FLR 1; (2003) 46 ACSR 504; [2003] NSWCA 131; BC200303670; *McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376; *Darvall* (1989) 16 NSWLR 260; (1989) 15 ACLR 230; (1989) 7 ACLC 659; *Duke* (1999) 73 SASR 64; (1999) 31 ACSR 213; [1999] SASC 97; BC9902601; *Bell* (2008) 39 WAR 1; (2008) 70 ACSR 1; [2008] WASC 239; BC200809492.

92 See, eg, *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; *Centofanti* (1995) 65 SASR 31; (1995) 15 ACSR 629; (1995) 13 ACLC 315; BC9503037; *Clark* (1996) 66 SASR 199; (1996) 19 ACSR 606; (1996) 14 ACLC 1019; BC9601526; *McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376.

93 See, eg, *Wheeler* (1994) 11 WAR 187; 14 ACSR 109; (1994) 12 ACLC 674; BC9406797.

94 See, eg, *QLS* (2003) 21 ACLC 888; [2003] FCA 262; BC200301507; *Groeneveld* (2010) 80 ACSR 562; [2010] VSC 533; BC201008742; *McGee* (1993) 11 ACSR 260; (1993) 11 ACLC 761; BC9301376.

95 Section 180 of the Corporations Act 2001 (Cth) imposes a duty of care and diligence, s 181 imposes duties to act in good faith in the interests of the company and for proper purposes, s 182 prohibits improper use of position and s 183 prohibits improper use of information acquired from position. Section 184 imposes criminal liability in relation to breaches of ss 181–183.

It is submitted that the key underlying consideration in relation to whether extra steps above and beyond disclosure (and possibly abstention) will be required is whether the company needs protection and whether the director concerned is in the best position to provide such protection or at least to warn the other directors of the need for such protection. The requirement to prevent the transaction going ahead is more likely to be imposed where more than one of the above-enunciated factors is present or where the transaction is likely to be disastrous (rather than merely disadvantageous) to the company.

In situations of conflict the standard required under the duty of care may be heightened, requiring directors (and, in particular, chief executives and managing directors) to be particularly vigilant in relation to transactions in which they have a conflict and especially as concerns making sure their fellow directors are sufficiently informed to make a decision.

In this respect it is also noteworthy that the remedies available for breach of the relevant duties vary, the main distinction being between the duty of care and fiduciary duties such as the duties to avoid conflicts and to act in good faith in the interests of the company and for proper purposes. Transactions may be set aside and third party liability imposed based on breach of the latter duties but not the former.⁹⁶

4 Conclusion

In light of prevailing uncertainty this article has examined Australian authorities concerning what is required of directors facing a conflict. It has been shown that a number of duties come into play in these circumstances. Each of the duty to act in good faith in the interests of the company, the duty to act for proper purposes, the duty of care and the duty to avoid conflicts has required action of directors. The operation of the duty of care and the duty to act in good faith in the interests of the company to require positive action on the part of directors in this context is particularly noticeable.

In our view, the cases are best analysed as a continuum, commencing with those where courts require disclosure of the interest, to cases in which the courts require heightened disclosure because of special factors, to cases in which courts require directors to take positive action beyond disclosure because of special factors.

The factors likely to lead to increased requirements have been enunciated and illustrated. It can be concluded that mere disclosure (or disclosure and abstention) may not be enough, particularly where the director is involved in the day-to-day affairs of the company or in the relevant transaction. Constitutional provisions attenuating the duty to avoid conflicts are relevant but not determinative due to the interplay of other duties. Directors who conduct the day-to-day affairs of the company or who have more knowledge of the relevant transaction than their fellow directors should be especially vigilant.

Although each of the factors outlined may play a part in determining the standard required of the relevant director, it has been suggested that the core

⁹⁶ Failure to deal with conflicts may also give rise to oppression: see *Jenkins v Enterprise Gold Mines NL* (1992) 6 ACSR 539; (1992) 10 ACLC 136.

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factor is whether a company requires protection as concerns the particular transaction (in relation to which the director has a conflict) and whether the conflicted director is best placed to warn the other directors or to take other steps to protect the company.