CRITIQUE AND COMMENT

DIRECTORS' DUTIES AND A COMPANY'S CREDITORS

THE HON JUSTICE K M HAYNE AC*

Questions about directors' duties and a company's creditors have again become topical. Those questions have been asked and answered by reference to a theory that the directors of a company must have regard to the interests of the company's creditors. And that theory may be seen to have been given particular content by the decision of the Court of Appeal of Western Australia in what has come to be known as 'the Bell Group litigation'. One of the principal purposes of this paper is to explore the foundations and limits of 'the consider-creditors theory'. It does so by referring to directors' duties to the company and the notion of the 'interests of the company'. And it concludes that 'the consider-creditors theory' is properly to be understood as a solution in search of a problem.

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* Justice of the High Court of Australia. This lecture was originally presented by the author as 'Directors' Duties and a Company's Creditors' (Speech delivered at the Harold Ford Memorial Lecture, Melbourne Law School, 19 August 2014).

I Introduction

My topic — 'Directors' Duties and a Company's Creditors' — is deliberately expressed very generally. I have done that in order to provoke consideration of what are the right questions to ask and to avoid framing debate in a way which makes assumptions that should be challenged. In this area, as in most other areas of the law, identifying the right questions to ask is the most important step. I hope to show that, in this area, framing the right questions depends upon a proper understanding of some basic principles and upon recognising when and why the questions arise.

Questions about directors' duties and a company's creditors have again become topical. They have been the subject of recent articles.[1] They are questions which were asked and answered in the litigation that came to be known as 'the Bell Group litigation'.[2]

It is convenient to say something very briefly about the facts that gave rise to that very protracted litigation, if only because it will provide some context for the issues which I wish to deal with in this paper.

Between January and July 1990, The Bell Group Ltd and a subsidiary, Bell Group Finance Pty Ltd, granted a consortium of banks certain securities to secure repayment of about $260 million which had previously been advanced and was then payable on demand. (I am not sure whether the headnote to the

1 See, eg, Andrew Keay and Hao Zhang, 'Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors' (2008) 32 *Melbourne University Law Review* 141; Andrew Keay, 'Directors' Duties and Creditors' Interests' (2014) 130 *Law Quarterly Review* 443. (Both of these articles should be read with Andrew Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' (2001) 25 *Melbourne University Law Review* 315.) See also L S Sealy, 'Directors' "Wider" Responsibilities — Problems Conceptual, Practical and Procedural' (1987) 13 *Monash University Law Review* 164; L S Sealy, 'Directors' Duties — An Unnecessary Gloss' (1988) 47 *Cambridge Law Journal* 175; D D Prentice, 'Creditor's Interests and Director's Duties' (1990) 10 *Oxford Journal of Legal Studies* 265; Sarah Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention' (1991) 18 *Melbourne University Law Review* 121; Sarah Worthington, 'Corporate Governance: Remedying and Ratifying Directors' Breaches' (2000) 116 *Law Quarterly Review* 638.

2 *Bell Group Ltd (in liq) v Westpac Banking Corporation [Nos 9 and 10]* (2009) 39 WAR 1; *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1.

report of the Court of Appeal decision is right to say that the sums were then 'immediately due and owing'.[3] Demands, if made, may have been withdrawn.)

The Bell Group Ltd went into liquidation in April 1991 and various of its subsidiaries also became subject to external administration. The banks realised their securities. In 1995, the liquidators of The Bell Group Ltd, some companies in the Bell Group of companies and the trustee for some bondholders commenced proceedings against the banks to set aside the securities and to recover the proceeds of realisation for the benefit of unsecured creditors. The major unsecured creditors were bondholders who, at the time the securities were granted to the banks, had claims totalling more than $500 million. Some bonds had been issued by The Bell Group Ltd and by Bell Group Finance Pty Ltd; some had been issued by a foreign subsidiary of The Bell Group Ltd, Bell Group NV.

At trial, in the Supreme Court of Western Australia, Owen J set aside the securities and ordered the banks to pay the amounts that had been realised together with interest.[4] The banks' appeal to the Court of Appeal of Western Australia was dismissed and cross-appeals by the Bell Group interests were allowed in part.[5]

The headnote to the decision of the Court of Appeal records that a majority of that Court held that '[t]he dealings by the directors [in undertaking the restructuring of debts] could not be justified in equity and constituted misconduct from which a finding of breach of fiduciary duty should follow'.[6] The headnote further records that the Court of Appeal held that the banks had sufficient knowledge of the directors' breaches of fiduciary duty (and of the fact that the Bell Group was insolvent or nearly insolvent) to find the banks liable under both limbs of *Barnes v Addy*:[7] for knowing receipt of property to which fiduciary obligations attach and for knowing assistance in breach of fiduciary duties.[8]

The banks were granted special leave to appeal to the High Court against the orders made by the Court of Appeal.[9] Leave was granted in respect of

[3] *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 3.

[4] *Bell Group Ltd (in liq) v Westpac Banking Corporation [Nos 9 and 10]* (2009) 39 WAR 1, 952 [112].

[5] *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1.

[6] Ibid 7.

[7] (1874) LR 9 Ch App 244.

[8] *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 8.

[9] Transcript of Proceedings, *Westpac Banking Corporation v Bell Group Ltd (in liq)* [2013] HCATrans 49 (15 March 2013).

some, but not all, of the issues which the banks sought to agitate. The proceedings were compromised before the case was heard in the High Court.

I should say at once that what I have to say in this paper must not be understood as expressing any opinion about how the proceedings in the High Court might have been decided. First, of course, I do not speak for the Court. Second, argument is a necessary step for the proper distillation of concluded views about any case, and this case was never argued. Third, the fair-minded observer might reasonably apprehend that I might not bring an impartial mind to the resolution of the questions presented in the matter.[10] The judgments, both at first instance[11] and on appeal to the Court of Appeal,[12] record that the events with which the case was concerned occurred so long ago that, as a barrister, I gave some advice to the banks about transactions of a kind at least generally similar to those that were ultimately undertaken.

II 'The Consider-Creditors Theory'

For many years before the decisions in the Bell Group litigation, the editors of the seventh and later editions of *Ford's Principles of Corporations Law* had said that

> [i]n recent years Australasian and English courts have developed the theory that in discharging their duty to act in good faith for the benefit of the company as a whole, the directors must have regard to the interests of the company's creditors, especially where the company is nearing insolvency.[13]

The decision of the Court of Appeal in the Bell Group litigation may be seen as giving particular content to this theory. One of the principal purposes of this paper is to explore the foundations and limits of the theory. The editors of *Ford's Principles of Corporations Law* will, I hope, forgive me if I refer to the theory they describe as 'the consider-creditors theory'.

[10] See *Ebner v Official Trustee in Bankruptcy* (2000) 205 CLR 337, 350 [33] (Gleeson CJ, McHugh, Gummow and Hayne JJ).

[11] *Bell Group Ltd (in liq) v Westpac Banking Corporation [Nos 9 and 10]* (2009) 39 WAR 1, 74 [403] (Owen J).

[12] *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 410 [2231(ii)] (Drummond AJA).

[13] See, eg, H A J Ford and R P Austin, *Ford and Austin's Principles of Corporations Law* (Butterworths, 7th ed, 1995) 262 [8.100]. In some editions, the editors used the phrase 'in the interests of the company' rather than 'for the benefit of the company as a whole': see, eg, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, 15th ed, 2013) 432 [8.100].

A *Development of the Theory*

Although the history of the development of the consider-creditors theory is well-known, it is necessary for the purposes of this paper to trace it again in a little detail. In the course of doing so, it will be important to recognise not only what was said in some of the decided cases but also the context in which those statements were made. Statements made in reasons for judgment must be read and understood in their proper context. They cannot be shorn from that context and treated as if they were statutory provisions.

In Australia, at least, the consider-creditors theory is often traced to the statement by Mason J in *Walker v Wimborne* that 'the directors of a company in discharging their duty to the company must take account of the interest of its shareholders and its creditors'.[14] It will be recalled that Mason J went on to say that '[a]ny failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them'.[15]

Together, these few words are sometimes accorded the status of a golden passage constituting a canonical statement of the law. And, divorced from the context in which they were made, they may readily provide a foundation for the consider-creditors theory as it has been stated in successive editions of *Ford's Principles of Corporations Law*. But statements made in reasons for judgment should *never* be divorced from their context.

Walker v Wimborne was an appeal by a liquidator against the dismissal of a misfeasance summons brought by the liquidator under s 367B of the *Companies Act 1961* (NSW) against former directors of a company. The summons sought orders that the directors pay the amount of losses sustained by the company as a result of the company making certain payments authorised by the directors. The company was part of a group of companies of which the respondents were also directors. The company was owed a large amount for work that it had done in connection with the construction of the Chevron Hotel at Kings Cross. Chevron Sydney Ltd was unable to pay what it owed the company and this led to a shortage of funds within the group. With the approval or acquiescence of all of the directors, funds were moved between the companies within the group to meet exigencies as they arose.

The point which Mason J was making in *Walker v Wimborne* was that the directors of a company must act according to the interests of the particular company concerned, not according to the interests of other companies within

[14] (1976) 137 CLR 1, 7.

[15] Ibid.

a group of which the company forms part. The statement that the directors of a company must take account of the interest of its shareholders and its creditors must be read as giving emphasis to the word 'its'.

At the time that it was decided, and for at least most of the decade that followed, those practising in company law saw *Walker v Wimborne* as a case about corporate groups. It was seen as a case emphasising the need for directors to consider the interests of the particular company which was to undertake any transaction, rather than to act by reference only to benefits which might accrue to other entities in the corporate group. It was not seen (at least generally) as a case enlarging the then understood content of directors' duties.[16] It was certainly not understood as holding that directors owe duties to some or all of the creditors of the company.

The first real flowering of the consider-creditors theory occurred in 1985, in New Zealand. In *Nicholson v Permakraft (NZ) Ltd* ('*Permakraft*'),[17] Cooke J, then a member of the Court of Appeal of New Zealand, said:

> The duties of directors are owed to the company. On the facts of particular cases this may require the directors to consider inter alia the interests of creditors. For instance creditors are entitled to consideration, in my opinion, if the company is insolvent, or near-insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency.
>
> … Balance sheet solvency and the ability to pay a capital dividend are certainly important factors tending to justify proposed action. But as a matter of business ethics it is appropriate for directors to consider also whether what they do will prejudice their company's practical ability to discharge promptly debts owed to current and likely continuing trade creditors.
>
> To translate this into a legal obligation accords with the now pervasive concepts of duty to a neighbour and the linking of power with obligation. It is also consistent with the spirit of what Lord Haldane said [in *Attorney-General (Canada) v The Standard Trust Co of New York*[18]]. In a situation of marginal commercial solvency such creditors may fairly be seen as beneficially interested in the company or contingently so.[19]

Several points may be made about the *Permakraft* case. First, the statements made by Cooke J were plainly obiter dicta. Second, the other members of the

[16] Cf H A J Ford, *Principles of Company Law* (Butterworths, 2nd ed, 1978) 345 [1507].

[17] [1985] 1 NZLR 242.

[18] [1911] AC 498, 503–5.

[19] *Permakraft* [1985] 1 NZLR 242, 249.

Court, Richardson J and Somers J, expressly reserved their position on the propositions which Cooke J advanced. Richardson J described the question which Cooke J asked and answered as 'a difficult amalgam of principle, policy, precedent and pragmatism'.[20] Third, injecting concepts of duty to a neighbour seems to take the then imperial march of negligence into wholly new fields for conquest. These three points, though very important at the time to the proper application and development of the law, may be put aside from further consideration.

Instead, it is necessary to focus upon two further points about *Permakraft* which are central to an understanding of the issues examined in this paper. The first turns on the nature and content of the duty identified. The duty was said to be an aspect of the directors' duties to the *company*. It was described as a duty to *consider* the *interests* of creditors. The relevant creditors were said to be 'current and likely continuing trade creditors'.[21] As will later be demonstrated, this positive expression of the duty (as a duty requiring directors to do something) does not sit easily with a proper understanding of directors' duties.

The next point is that the determinative issue in *Permakraft* was whether the directors had acted in breach of their duties to the company in authorising the payment of a large dividend out of what was described as a 'capital profit'[22] resulting from restructuring the company. All the shareholders of the company had agreed not only to the restructuring but also to the payment of the dividend. Cooke J concluded that the unanimous assent of shareholders would not have been enough to justify a breach of duty to consider the interests of creditors.[23] It seems that this conclusion was founded in the proposition that the relevant creditors were 'fairly [to] be seen as beneficially interested in the company or contingently so'.[24] That is a proposition which I do not accept, and it is one to which I will return.

Within a few months of the delivery of judgment in *Permakraft*, argument was heard in the Court of Appeal of New South Wales in *Kinsela v Russell Kinsela Pty Ltd (in liq)* ('*Kinsela*').[25] Street CJ, speaking for the Court of

[20] Ibid 255.

[21] Ibid 249 (Cooke J).

[22] Ibid.

[23] Ibid 250.

[24] Ibid 249.

[25] (1986) 4 NSWLR 722.

Appeal, adopted what Cooke J had said in *Permakraft*.[26] But Street CJ went further, and said that '[t]he obligation by directors to consider, in appropriate cases, the interests of creditors has been recognised also in the High Court of Australia' and set out what I have called the 'golden passage' from the reasons of Mason J in *Walker v Wimborne*.[27]

Again, it is useful to consider the facts of the *Kinsela* case. The directors of a company which was in severe financial difficulties took a lease from the company of its business premises at a rent substantially below the real value. All of the shareholders approved the lease. Street CJ said:

> In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration.[28]

Again, the notion that the creditors, 'in a practical sense', have some interest in a company's assets was used to support the conclusion about directors' duties. But is that a statement of law or is it simply an unduly compressed allusion to the consequences of external administration?

The shareholders had ratified what was done and their assent was found not to excuse or validate what was done.[29] But was that a conclusion about the limits on the exercise of shareholders' powers, or a statement about directors' duties? A conclusion that ratification by all shareholders will not always suffice to authorise what would otherwise be a breach of directors' duties does not necessarily mean that the directors owe any duty to persons other than the company and does not say anything at all about the content of the duties directors do owe to the company.

[26] Ibid 731–2.

[27] Ibid 732.

[28] Ibid 730.

[29] Ibid 732.

Before further considering these questions, reference must be made to the decision of the High Court in *Spies v The Queen* ('*Spies*').[30]

Spies concerned the power of the Court of Criminal Appeal of New South Wales to substitute for a conviction entered at trial a conviction for a different offence. The charge of which Mr Spies was convicted at trial alleged that he had defrauded the creditors of a company of which he was one of two directors. As the joint reasons record, there was evidence that Mr Spies, by the transactions on which the prosecution relied at trial, intended to prevent the company (and any liquidator of the company) recovering from him a debt that he then owed to the company.[31] But the creditors of the company had no claim on Mr Spies. The suggestion that Mr Spies was concerned with the rights that creditors of the company had against the company was described in the joint reasons as 'a product of the imagination of the prosecution lawyers, *anxious to bring the case within a line of authority operating in a very different area of law*'.[32]

The joint reasons then referred to what had been said by Mason J in the 'golden passage' in *Walker v Wimborne*,[33] noted other cases in which similar statements are to be found,[34] and, most importantly, concluded that in so far as remarks in one of the decided cases[35] 'suggest that the directors owe an independent duty to, and enforceable by, the creditors by reason of their position as directors, *they are contrary to principle and later authority*[36] *and do not correctly state the law*'.[37]

This decision, of four members of the Court, could not be expressed more emphatically. It is not the law in Australia that 'directors owe an independent duty to, and enforceable by, the creditors by reason of their position as directors'. Debate about what the law *is* must proceed from this premise. Debate about what the law *should be* may not be so confined.

[30] (2000) 201 CLR 603.

[31] Ibid 635 [90] (Gaudron, McHugh, Gummow and Hayne JJ).

[32] Ibid (emphasis added).

[33] Ibid 635–6 [93].

[34] Ibid 636 [93] n 121.

[35] *Grove v Flavel* (1986) 43 SASR 410 (and what were described as the 'remarks' in *Permakraft*: *Spies* (2000) 201 CLR 603, 636 [95] n 125 (Gaudron, McHugh, Gummow and Hayne JJ)).

[36] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187; *Re New World Alliance Pty Ltd (rec and mgr apptd); Sycotex Pty Ltd v Baseler [No 2]* (1994) 51 FCR 425. See also John H Farrar and Brenda Hannigan, *Farrar's Company Law* (Butterworths, 4th ed, 1998) 382–5.

[37] *Spies* (2000) 201 CLR 603, 636–7 [95] (Gaudron, McHugh, Gummow and Hayne JJ) (emphasis added).

Any discussion of what is said to be a particular aspect of directors' duties must proceed from a proper understanding of those duties. In the course of considering *Permakraft* and *Kinsela* I have already suggested that a duty to consider the interests of creditors may not sit easily with a proper understanding of directors' duties. I need to explain why that is so.

III The Foundations of Directors' Duties

Harold Ford's great book on company law, now corporations law, is into its 15th edition.[38] Reading the development of the discussion of directors' duties over successive editions of that work shows how much attention has been paid to that subject both by the courts and by legislatures.

We have now become used to starting our consideration of directors' duties in what are now ss 180 and 181 of the *Corporations Act 2001* (Cth). Statutory prescriptions of duties of care and diligence, and of good faith, have been with us for a very long time. And we are used to statutory proscriptions of particular forms of conduct, including the proscriptions implicit in the various voidable transaction provisions of div 2 of pt 5.7B (ss 588FA–588FJ) and, in particular, the provisions about uncommercial[39] and insolvent[40] transactions and unreasonable director-related transactions.[41] We are now also used to the provisions of s 588G, which impose a duty on directors to prevent insolvent transactions: a duty which, if breached, will found proceedings under div 4 of pt 5.7B.

But the foundations of directors' duties were laid in judge-made law. It was 90 years ago, in *Re City Equitable Fire Insurance Co Ltd* ('*City Equitable*'), that Romer J described the duties of a director in terms of honesty, skill and diligence.[42] Duties in like terms were not given statutory force until the enactment of s 107(1) of the *Companies Act 1958* (Vic).[43] This provision required directors 'at all times [to] act honestly and use reasonable diligence in the discharge of the duties of [their] office'.

38 Austin and Ramsay, above n 13.

39 *Corporations Act 2001* (Cth) s 588FB.

40 Ibid s 588FC.

41 Ibid s 588FDA.

42 [1925] 1 Ch 407, 427.

43 W E Paterson and H H Ednie, Butterworths, *Australian Company Law*, vol 2 (2nd ed, at 12 April 1976) [124/2] suggest that s 107 of the *Companies Act 1958* (Vic) was the first statutory specification of directors' duties of care and diligence in the English-speaking world.

This formulation of directors' duties reflected the dominance of the notion of honesty in the discussion of directors' duties in the late 1950s and 1960s.[44] But, as *City Equitable* showed, those analyses depended (and still depend) upon the notion of the fiduciary.

A *Fiduciaries*

As Dixon J said, in *Mills v Mills* ('*Mills*'), '[d]irectors of a company are fiduciary agents'.[45] Hence, they owe fiduciary duties.[46] But three points must then be made.

First, it is important to recall what Romer J said in *City Equitable*:

> It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading.[47]

Describing and understanding the content of directors' duties requires more than using the word 'fiduciary' with or without some unthinking appeal to the law of trusts and trustees.

Second, as fiduciaries, directors are bound not to obtain any unauthorised benefit from the relationship with the company and not to be in a position of conflict.[48] But these are proscriptive, not prescriptive, obligations.[49]

Third, because directors are 'fiduciary agents', 'a power conferred upon them cannot be exercised in order to obtain some private advantage or for any purpose foreign to the power'.[50] And, as Dixon J pointed out in *Mills*, this is no more than one application of the general doctrine that 'a person having a

[44] See, eg, Sir Douglas Menzies, 'Company Directors' (1959) 33 *Australian Law Journal* 156; Zelman Cowen, 'Company Directors: Their Powers, Duties and Responsibilities' (1967) 2 *University of Tasmania Law Review* 361.

[45] (1938) 60 CLR 150, 185.

[46] See, eg, *Furs Ltd v Tomkies* (1936) 54 CLR 583, 592 (Rich, Dixon and Evatt JJ). Cf P D Finn, *Fiduciary Obligations* (Law Book, 1977) 11 [20].

[47] [1925] 1 Ch 407, 426. See also *Breen v Williams* (1996) 186 CLR 71, 137 (Gummow J); *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504, 516–17 (Finn J); L S Sealy, 'The Director as Trustee' (1967) 25 *Cambridge Law Journal* 83.

[48] *Howard v Commissioner of Taxation (Cth)* (2014) 309 ALR 1, 17 [56] (Hayne and Crennan JJ).

[49] *Breen v Williams* (1996) 186 CLR 71, 113 (Gaudron and McHugh JJ).

[50] *Mills* (1938) 60 CLR 150, 185 (Dixon J).

power, must execute it bona fide for the end designed, otherwise it is corrupt and void'.[51]

B *Proscriptive Duties*

The central idea that emerges from *Mills* is *negative*: directors' duties guide action by defining an area of impermissible conduct. What is said in the cases should not be permitted to distract attention from this observation.

It has often been said that powers given to directors 'must be exercised … bona fide for the benefit of the company as a whole'.[52] Sometimes, the same thought is expressed by saying that the directors must exercise powers 'in the best interests of the company'. In *Mills*, Dixon J said that, although the latter expression 'is an indefinite phrase, its meaning admits of little doubt'.[53]

These and other similar phrases can be found in many reported cases. Almost always, however, they are used as the antithesis of what a party says was the (or sometimes, a) purpose or object of an impugned exercise of power. And because the focus of attention in the litigation is what *was* the actuating purpose or object of the impugned decision, it should not be surprising to find the comparison being drawn with an idea expressed in 'an indefinite phrase'. Nor should it be surprising that reference is made to 'the company' or to 'the company as a whole' without any elaboration of what those references mean. Because the focus of the cases is upon what is alleged to be a wrong or impermissible reason for action, reference to what would be right or permissible is incidental. As Dixon J said in *Peters' American Delicacy Co Ltd v Heath*, '[t]he reference to "benefit as a whole" is but a very general expression *negativing* purposes foreign to the company's operations, affairs and organizations'.[54] In these cases, as others, what is written in reasons for judgment must be read in the context in which it appears.

The cases about the exercise of directors' powers are consistent with the view that, apart from the statutory duties of care, diligence and good faith, directors' duties may be best understood, at least for the most part, as pro-

[51] Ibid, quoting *Aleyn v Belchier* (1758) 1 Eden 132, 138; 28 ER 634, 637 (Lord Northington).

[52] *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, 671 (Lindley MR). See also *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 135 (Latham CJ); *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 480 (Latham CJ); *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483, 492 (Barwick CJ, McTiernan and Kitto JJ).

[53] (1938) 60 CLR 150, 188.

[54] (1939) 61 CLR 457, 512 (emphasis added).

scriptive. That is, most duties of directors are cast in terms of what directors should *not* do rather than in terms of what they *should* do.

In this respect, the specification of directors' duties accords with equity's specification of fiduciary duties proscriptively rather than prescriptively.[55] And the specification of directors' duties in this way also accords with what is, and must be, the courts' reluctance to second-guess commercial decisions.

C *A Statutory Space*

The statutory duties and proscriptions which have been mentioned do not[56] (and never have been intended to[57]) supplant the judge-made law about directors' duties. The consider-creditors theory has developed in a space apparently left clear by the legislature. But, in that space, is there — can there be — a duty to consider the interests of creditors? What would be the content of that duty?

D *A Duty to Consider?*

The suggested duty presents many questions. Those questions include whether the interests of future, or prospective, creditors must be considered[58] and what financial state the company must be in for the duty to be 'triggered'.[59] Those questions are important, but it is convenient to put them aside in favour of three more fundamental considerations.

[55] *Breen v Williams* (1996) 186 CLR 71, 113 (Gaudron and McHugh JJ); *Howard v Commissioner of Taxation (Cth)* (2014) 309 ALR 1, 17 [56] (Hayne and Crennan JJ). See also R P Austin, 'Moulding the Content of Fiduciary Duties' in A J Oakley (ed), *Trends in Contemporary Trust Law* (Clarendon Press, 1996) 153, 156; Matthew Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121 *Law Quarterly Review* 452, 477; Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010) 39–40.

[56] *Corporations Act 2001* (Cth) s 185.

[57] See, eg, *Companies (Victoria) Code* s 229(10).

[58] See, eg, *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, 1516 (Lord Templeman).

[59] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors', above n 1.

E *Interests of the Company*

First, the suggested duty puts great pressure on the notion of 'the interests of the company'. The notion of 'the interests of the company' may be protean. But, if it is, that is because of the way it is used in deciding particular cases. As the reasoning in *Mills* reveals, 'the interests of the company' is used as an explanatory device: explaining why a particular decision taken by one of the organs of the company was or was not within power.

Because 'the interests of the company' is used as an explanatory device, it may well be right, in the context of a debate about the powers of the company in general meeting, to say (as Evershed MR did in *Greenhalgh v Arderne Cinemas Ltd*) that a reference to the interests of the company is better understood as a reference to the interests of the shareholders as a general body rather than 'the company as a commercial entity'.[60] But that may not be universally true. It is to be accepted that '[t]he best interests of the company will depend on various factors including solvency'.[61] In considering decisions made at times of financial distress, the interests of the company may be better explained by (and, in effect, tested against) the notion of the company surviving as a solvent commercial entity. But in that case, too, the focus would remain, as it must, upon whether the relevant organ of the company acted within its powers 'bona fide for the end designed'.[62]

As Professor Prentice has observed:

> It has long been a central tenet of company law that directors owe their duties to the company and not to the company's shareholders or to its creditors. As was stated more than a quarter of a century ago by the Jenkins Committee when commenting on the effect of *Percival v Wright*[63], 'no fiduciary duty is owed by a director to individual members of his company, but only to the company itself, and a fortiori that none is owed to a person who is not a member'. This principle is now under a considerable degree of strain. What is of interest is the conceptual device used to undermine it: the courts have used the concept of the 'interests of a company', one of the most problematical concepts in com-

[60] [1951] 1 Ch 286, 291. See also *Ngurli Ltd v McCann* (1953) 90 CLR 425, 438 (Williams ACJ, Fullagar and Kitto JJ).

[61] *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 226 CLR 507, 532 [67] (Gummow and Hayne JJ).

[62] *Aleyn v Belchier* (1758) 1 Eden 132, 138; 28 ER 634, 637 (Lord Northington). See also *Mills* (1938) 60 CLR 150, 185 (Dixon J).

[63] [1902] 2 Ch 421.

> pany law, as the basis on which to build protection for the interests of a company's creditors.[64]

That is, the duty which I have been considering, and the more generally expressed consider-creditors theory, both depend upon what Professor Worthington has rightly called a 'manipulation of the concept of "interests of the company"' in an effort to 'protect the interests of outside parties'.[65]

If the 'interests of the company' is used in a way that includes, or requires reference to, the interests of creditors, the 'indefinite phrase' is asked to do more legal work than it can support.

F *From Acting to Considering*

Second, something must be said about the logic of the argument advanced in support of the existence of a duty to consider the interests of creditors. The argument has two premises: first, that 'the interests of the company' include the interests of creditors; and second, that directors owe a duty to act 'in the best interests of the company'. It is said to follow that directors have a duty to consider the interests of creditors.

The first premise — that 'the interests of the company' include the interests of some creditors — is asserted but not demonstrated. The second premise — that directors owe a duty to act 'in the best interests of the company' — may be accepted. But the suggested conclusion — that in making a decision, directors must consider the interests of some creditors — does not follow from the premises.

In its terms, the suggested duty is an obligation about the process of decision-making, not an obligation framed by reference to the kinds of decision that may or may not be made. It says that, in some circumstances, directors must consider the interests of the company and that *those* interests include the interests of some creditors. But no explanation is proffered for why acting in the best interests of the company requires a particular process of decision-making in which the interests of a particular group are 'considered'. And the stated premises do not entail that conclusion.

The supposed duty, in its terms, is not directed to limiting the way in which directors may exercise their powers. Rather, it is expressed as no more than a counsel of prudence. But if something more is meant, the emollient

[64] Prentice, above n 1, 273 (citations omitted).

[65] Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention', above n 1, 121.

statement that creditors' interests should be 'considered' is masking an obligation radically different from those conventionally understood to attach to the office of director. As Professor Worthington has observed, directors' duties are to be understood as requiring 'the directors to ensure that "the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves"'.[66] These duties 'may be breached regardless of prejudice to the creditors: it is irrelevant whether the company remains solvent and the creditors are paid in full'.[67]

Third, the expression of the suggested duty both reveals and invites error. The requirement to take into account the interests of another person — whatever content is given to that expression — must be kept conceptually distinct from the existence of an enforceable obligation towards that person. Otherwise, there risks arising the 'curious result' that 'there is a duty of imperfect obligation owed to creditors':[68] that is, an 'obligation' which 'creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator'.[69] Such an obligation is in truth no obligation at all, for a duty must be correlative with a right.[70] It is an 'obligation' which yields a remedy for a person to whom the obligation was not owed for loss which the company itself has not sustained. And the consequence of obtaining that remedy would be that creditors who were unable to obtain full payment from the company of the debts the company owed them would make good some or all of the deficiency from persons with whom the creditors had no contract.

If, then, the notion of the interests of the company provides no sure foundation for the consider-creditors theory, are there other foundations?

66 Ibid 138–9, quoting *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, 1516 (Lord Templeman).

67 Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention', above n 1, 139.

68 J D Heydon, 'Directors' Duties and the Company's Interests' in P D Finn (ed), *Equity and Commercial Relationships* (Law Book, 1987) 120, 131.

69 *Re New World Alliance Pty Ltd (rec and mgr apptd); Sycotex Pty Ltd v Baseler [No 2]* (1994) 51 FCR 425, 445 (Gummow J), citing Heydon, above n 68, 131.

70 Cf Wesley Newcomb Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 *Yale Law Journal* 16.

IV An 'Interest' in Assets and 'Risk'

A *A Proprietary Interest?*

The most persistent justification for the consider-creditors theory depends upon the proposition that in a situation of 'marginal commercial solvency', creditors 'may fairly be seen as beneficially interested in the company or contingently so'.[71]

Professor Keay, for example, has said of a provision in English law which subjects a director's duty to 'promote the success of the company'[72] to 'any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company'[73] that the 'theoretical reason' for its existence is that

> when a company is in financial straits the owners of the residual value of the company (the residual owners being those whose wealth directly rises or falls with changes in the value of the company), are no longer the shareholders; they have been replaced by the creditors, whose rights are transformed into equity-like rights.[74]

The 'transformation' said to be brought about by the company's financial distress is the creation of some proprietary or quasi-proprietary relationship between creditors and company. This relationship is said to justify imposing on the company's directors a duty to consider the interests of this new property holder.

Professor Worthington has rightly said that

> [s]uch an analysis, while superficially attractive, is fundamentally flawed. It is true that on winding-up the creditors acquire the right, for the first time, to participate directly in the administration of the affairs of the company. In addition, the liquidator, acting as the agent of the company, owes fiduciary duties to the creditors. This special position of the creditors, however, does not entail the concurrent acquisition of a proprietary interest in the assets of the company; moreover, it comes at a cost to the creditors: they are deprived of all their ordinary remedies against the company. For these reasons it is impossible to draw

[71] *Permakraft* [1985] 1 NZLR 242, 249 (Cooke J), quoted in *Kinsela* (1986) 4 NSWLR 722, 731–2 (Street CJ). Cf Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention', above n 1, 140–1.

[72] *Companies Act 2006* (UK) c 46, s 172(1).

[73] Ibid s 172(3).

[74] Keay, 'Directors' Duties and Creditors' Interests', above n 1, 447–8 (citations omitted).

> the analogies suggested: they are wrong when winding-up has commenced; they are inappropriate beforehand, even in a situation of marginal insolvency.[75]

Again, however, it is as well to unpack the analysis which is condemned. Its premise seems to be that the position of a creditor with respect to an insolvent company is analogous to the position of a shareholder with respect to a solvent company: both are said, in some sense, to have a proprietary interest in the company or its assets.

The premise cannot be accepted. A shareholder's property (the holder's shareholding) is usually transferable.[76] And rights attach to share 'ownership'[77] which are exclusive rights. But it by no means follows that the shareholder has any proprietary interest in the company's assets. To return to Professor Worthington:

> The early idea — now discredited — that the shareholders were the 'owners' of the company, and therefore had individual rights to regulate the disposition of 'their' assets, either directly or via 'their' agents, the directors, continues to cloud the truth. The company is at law a separate person with its own assets. Those assets do not belong to the shareholders. Moreover, the directors are not the agents of the shareholders. For some reason — perhaps simply because we have difficulty with the notion of a non-human 'person' — it seems to have been difficult to gain unqualified commitment to this idea. The theory that the company is an entity completely separate from its human organs is not always matched by the practice.[78]

To talk, even if only metaphorically, of effective ownership of the company shifting from shareholders to creditors when the company is insolvent may, then, lead to error. It is in light of these remarks that the observations of Gummow J in *Re New World Alliance Pty Ltd; Sycotex Pty Ltd v Baseler [No 2]* ('*New World Alliance*'),[79] endorsed by the High Court in *Spies*,[80] should be understood. In *New World Alliance*, Gummow J said that '[w]here a company is insolvent or nearing insolvency, the creditors are to be seen as having a

75 Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention', above n 1, 141 (citations omitted).

76 Cf *JT International SA v Commonwealth* (2012) 250 CLR 1, 49–50 [105]–[107] (Gummow J).

77 Cf McFarlane's argument that property law is concerned only with tangible things: Ben McFarlane, *The Structure of Property Law* (Hart Publishing, 2008).

78 Worthington, 'Corporate Governance: Remedying and Ratifying Directors' Breaches', above n 1, 648.

79 (1994) 51 FCR 425.

80 (2000) 201 CLR 603, 636 [94] (Gaudron, McHugh, Gummow and Hayne JJ).

direct interest in the company'.[81] The word 'interest' is apt to designate a range of legal relations: it is not limited to describing relations establishing or amounting to proprietary rights.

B *A Shift in Risk?*

Behind the idea that creditors of a financially distressed company have some interest in its assets there lies a more fundamental proposition which should be exposed. It is that there is, or should be, a shift in who bears risk as a company approaches insolvency. The argument is that, as a company nears insolvency, the company's assets may be 'at risk because the directors are tempted to embrace a lucrative deal from which the shareholders will gain … but which will cause loss to the creditors if the deal is not successful'.[82] In short: the shareholders have nothing, and the creditors have everything, to lose.

Arguments by reference to allocation of risk are often little more than an assertion of support for one of two or more competing possible outcomes. Saying that there has been, or should be, a shift in the way risk is allocated may be no more than a statement of desired conclusion. In the present context, what is the risk that is being shifted? There is no risk-free debt. Every creditor hopes that the debtor will not default, but every creditor runs the risk that the debtor will not pay what is due when it is due. For my own part, I tend to discount arguments by reference to shifting risk.

Whether or not that is right, if the concept of risk is to be invoked, it must be recalled that, involuntary creditors aside (the prime example being those tortiously wronged by the company), a person's status as creditor is established by contract. As Professor Sealy has said, 'creditors deal with a company as a matter of bargain, not of trust, and bargain involves risk'.[83]

Any analysis in terms of creditor risk — and the conclusions which are drawn from it — must confront the principles of limited liability and separate legal personality. *The* animating purpose for the creation of limited liability companies is to interpose an artificial entity between the corporators and the creditors which is an entity limiting the liability of the corporators. And, as Professor Sealy rightly said of one of the earlier and stronger formulations of the consider-creditors theory:

[81] (1994) 51 FCR 425, 444.

[82] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors', above n 1, 316–17.

[83] Sealy, 'Directors' "Wider" Responsibilities', above n 1, 176.

> It is not an exaggeration to say that if sentiments like this had prevailed over the past century and a half, the limited liability company would never have got off the ground.[84]

C *Other Possible Justifications?*

Two other justifications for the consider-creditors theory may be noticed but quickly dismissed. First, the assertion, made in *Permakraft*, that '[t]he recognition of duties to creditors' is 'justified by the concept that limited liability is a privilege'[85] should not be accepted. Second, as already indicated, the analogy drawn in *Permakraft* with the duty of care in negligence is fallacious.[86] It, too, should not be accepted.

V A Solution in Search of a Problem

The consider-creditors theory is properly to be understood as a solution in search of a problem. It is a solution which, if adopted, provides advantages to creditors. Those advantages are provided at the expense of others with whom the creditors had no contractual or other relationship.

The observations of the Delaware Supreme Court in the United States are instructive. That Court noted that recognising 'fiduciary duties to creditors' in circumstances of insolvency or near insolvency may involve

> using the law of fiduciary duty to fill gaps that do not exist. Creditors are often protected by strong covenants, liens on assets, and other negotiated contractual protections. The implied covenant of good faith and fair dealing also protects creditors. So does the law of fraudulent conveyance. With these protections, when creditors are unable to prove that a corporation or its directors breached any of the specific legal duties owed to them, one would think that the conceptual room for concluding that the creditors were somehow, nevertheless, injured by inequitable conduct would be extremely small, *if extant*. Having complied with all legal obligations owed to the firm's creditors, the board would, in that scenario, ordinarily be free to take economic risk for the benefit of the firm's equity owners, so long as the directors comply with their fiduciary duties

[84] Sealy, 'Directors' Duties — An Unnecessary Gloss', above n 1, 176, citing *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, 1516 (Lord Templeman).

[85] [1985] 1 NZLR 242, 250 (Cooke J).

[86] See ibid 249.

> to the firm by selecting and pursuing with fidelity and prudence a plausible strategy to maximize the firm's value.[87]

The Delaware Supreme Court's analysis of the issues presented by the consider-creditors theory repays emphasis and amplification in at least two respects.

First, notice that the analysis poses questions from the viewpoint of a board of directors looking forward, not from the viewpoint of a court or other observer who knows that the company later became insolvent. If directors' duties are to have content that is relevant to directors' decisions, the duties must be capable of application to the world of business, where few, if any, commercial decisions are free from risk.

Second, the analysis recognises and attaches importance to the existing law about fraudulent conveyances, preferences and the like. It speaks of directors '[h]aving complied with all legal obligations owed to the firm's creditors [being] free to take economic risk for the benefit of the firm's equity owners'. The reference to compliance with legal obligations is important.

If a board authorises a transaction which gives one or more creditors an undue preference, that transaction either can or cannot be undone in the liquidation. If a company trades while insolvent, creditors either do or do not have a remedy under pt 5.7B of the *Corporations Act 2001* (Cth). But if the transaction which is made is not a preference, and if the company is not trading while insolvent, does the consider-creditors theory say that the directors may, nonetheless, be in breach of their duties to the company? Why? Because they tried, unsuccessfully, to trade out of difficulty? Because they tried, unsuccessfully, to restructure debt in a way which would enable the company to continue trading? But the company was *not* insolvent at the relevant time and the transaction was *not* a voidable preference. Conversely, why should creditors have a remedy against persons other than the company if it can be shown (with all of the benefits of hindsight) that the company was on the path towards later insolvency and external administration?

Are the directors to be able to take no step towards saving the company from insolvency (and its winding up and dissolution) if it will later be said that, at the time they took that step, the company was 'close to' or 'heading towards' insolvency? How close is 'close to'? It surely does not mean *is*

[87] *North American Catholic Educational Programming Foundation Inc v Gheewalla*, 930 A 2d 92, 100 (Holland J) (Del, 2007) (emphasis in original), quoting *Production Resources Group LLC v NCT Group Inc*, 863 A 2d 772, 790 (Strine V-C) (Del Ct Ch, 2004).

insolvent. Presumably being 'close to' insolvency may be further away than the threshold for appointing an administrator,[88] but is it, and if it is, how far away?

VI Conclusion

Leaving aside the Bell Group litigation, about which I offer no comment, most, if not all, of the decided cases which give substance to the consider-creditors theory could and should have turned on the application of more conventional duties. For the reasons I have given, I do not think it easy to give substance to that theory without departing from fundamental precepts. If it is thought that directors should be held accountable in circumstances beyond those that are now found in the *Corporations Act 2001* (Cth) and, in particular, pt 5.7B, those are matters which the legislature can take up.[89]

But unless the legislature decides to resolve the issue, it will remain important to recognise how slight a foundation the consider-creditors theory has in the decided cases which lie at its roots. This is no new observation. It was made in 1988 by Professor Sealy when he said:

> If these judicial utterances are examined in their context, it will be seen that in most cases they are nothing more than extraneous words of censure directed at conduct which anyway comes within some well-established rule of law, such as the law imposing liability for misfeasance, the expropriation of corporate assets or fraudulent preference. The delinquent director is held accountable under the time-honoured principle, and in the circumstances a small homily from the bench about his 'duties' as a director is not out of place.[90]

So long as the decision of the Court of Appeal of Western Australia in the Bell Group litigation stands unaffected by subsequent consideration in an Australian intermediate appellate court, the Court of Appeal's discussion and application of the consider-creditors theory is the last judicial word on the subject.[91] Until the High Court decides the issue, the editors of Ford's great work will find it difficult to modify or discard their references to the consider-

88 See *Corporations Act 2001* (Cth) s 436A(1)(a) (emphasis added): 'in the opinion of the directors voting for the resolution, the company is *insolvent, or is likely to become insolvent at some future time*'.

89 Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention', above n 1, 142.

90 Sealy, 'Directors' Duties — An Unnecessary Gloss', above n 1, 175, quoted in *Spies* (2000) 201 CLR 603, 636 [93] (Gaudron, McHugh, Gummow and Hayne JJ).

91 See *Australian Securities Commission v Marlborough Gold Mines Ltd* (1993) 177 CLR 485, 492 (Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ).

creditors theory. But it is to be hoped that issues of the kind I have attempted to raise might continue to provoke discussion and consideration of their force. Fundamental issues of corporations law are at stake.