



BUSINESS GUIDE SERIES: **DIRECTORS DUTIES IN AUSTRALIA**

GENERAL DUTIES OF DIRECTORS

Directors govern a company on behalf of the shareholders of that company. The Corporations Act s 198A states that “the business of a company is to be managed by or under the direction of the directors”. All directors have certain basic legal duties and responsibilities imposed upon them by the Corporations Act. These duties and responsibilities apply to many different organisational structures, such as public companies, proprietary companies, NFP and Government Organisations.

Identifying who the Directors are in a company

The term “director” is defined in s 9 of the Corporations Act:

- A person validly appointed as a director or an alternate director.
- A person, even though not validly appointed as a director, if that person acts in the position of a director (‘de facto’ director).
- A person, even though not validly appointed as a director, if the directors are accustomed to act in accordance with that person’s instructions or wishes (‘shadow director’).

Sources of Director’s duties in Australia

The laws governing director’s duties and responsibilities arise from:

- (a) the common law (judge- made law);
- (b) Statute law, under the Corporations Act 2001 (Cth) Corporations Act); and
- (c) a company’s Constitution

Requirement of companies to appoint directors

The Corporations Act requires an Australian proprietary company to have at least one director that ordinarily resides in Australia (s 201A).

An Australian public company must have at least three directors, of which at least two must ordinarily reside in Australia.

COMMON LAW DUTIES

✓ **Duty to act in good faith and in the interests of the company as a whole**

Directors must act in what they honestly believe to be the best interests of the company, and they must use their power for their intended purpose, not a collateral purpose. This is a subjective test of honesty and good faith.

Directors breach the duty where they fail subjectively to give proper consideration to the company's interests. This will occur where, for example, a director assumes the company's interests correspond with their own interests, and does not consider the company or its members' best interests.

This subjective test is qualified by an objective standard which requires the assessment of whether an intelligent and honest person in the position of a director of the company concerned could have reasonably believed that the transactions were for the benefit of the company of the members as a whole.

✓ **Duty to act for a proper purpose**

✓ **Duty to retain discretion**

✓ **Duty to avoid conflicts of interest**

✓ **Duty not to disclose confidential information**

✓ **Duty not to abuse corporate opportunities**

To whom are directors' duties owed?

The general rule is that directors owe a duty to the members of the company as a whole.

However, directors and other officers also have a duty to take account of the interest of creditors. This is so particularly where the company is insolvent or in financial difficulties.

What is a 'Fiduciary Duty'?

Directors have what are known as fiduciary duties which are owed to the company.

This is an important legal relationship, and is a duty of trust and utmost good faith. In this context, directors must put the interests of the company ahead of their own.

Are there directors' responsibilities under other laws?

Every company is involved in activities which are regulated by other laws e.g. workplace relations, renting an office, marketing etc. There are over 600 State, Federal and Territory laws under which a director can be personally liable.

STATUTORY DUTIES:

The Corporations Act specifies four main general duties for directors:

- ✔ **Care and diligence Section 180**

This is a duty to exercise your powers and duties with the care and diligence that a reasonable person would have, which includes taking reasonable steps to ensure you are properly informed about the financial position of the company and ensuring the company doesn't trade if it is insolvent.
- ✔ **Good Faith**
- ✔ **Proper use of position**

This is a duty not to improperly use your position to gain an advantage for yourself or someone else, or to cause detriment to the company.
- ✔ **Proper use of information**

This is a duty not to improperly use information obtained through your position to gain an advantage for yourself or someone else, or to cause detriment to the company.
- ✔ **Duty to keep books and records**

This duty imposes on a company the requirement to keep adequate financial records and to correctly record and explain transactions and the company's financial position and performance.

Statutory Duties

Directors' statutory duties are contained in Chapter 2D of the Corporations Act, and include duties of care and diligence, good faith, improper use of position and information and criminal offences.

Other provisions related to directors' duties are those regarding insolvent trading, disclosure of material personal interests, financial benefits to related parties, financial reporting, reliance on delegates and others, the company constitution and the Replaceable Rules which are set out in the Corporations Act.

Duty to not trade while insolvent

As well as general director's duties, a director also has a positive duty to prevent the company trading if it is insolvent.

The company must not incur a new debt if there are reasonable grounds to suspect that the company is or will become insolvent as a result of incurring the debt.

A director must always be aware of the company's financial position.

THE BUSINESS JUDGEMENT RULE S 180 (2)

The Corporations Act provides that a director will be found to have complied with the duty of care and diligence under s 180 if they:

- (a) make their judgment in good faith for a proper purpose;
- (b) do not have a material personal interest in the subject matter of the judgment;
- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationally believe that the judgement is in the best interests of the corporation.

This rule is qualified by stating that the judgement must be in the “best interests of the corporation” and is a “rational one” unless the belief is one that “no reasonable person in their position would hold”.

Asic v Rich (2009) 236 FLR 1 further embeds this statutory rule as a defence in some cases that would otherwise amount to a breach of a director’s duty. However, this Rule doesn’t give directors the green light to act in a manner that is directly contradictory to their position.

Penalties:

Directors who breach their s 180 duties can attract fines of up to \$200,000 as well as facing other penalties such as paying compensation to any affected entities and even prison.

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