AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS
THE CONTENT OF DIRECTORS' "BEST INTEREST" DUTY

MEMORANDUM OF ADVICE

Introduction

1. We are instructed by the Australian Institute of Company Directors ("**the AICD**").

2. In April 2019, the AICD released a consultation paper entitled *Forward Governance Agenda: Lifting Standards and Practice* ("**the Governance Paper**") with a view to seeking the feedback of its members in relation to various issues pertaining to corporate governance. One of these concerned directors' duties – specifically, the duty to act in good faith in the best interests of the relevant company – and the position of "stakeholders". We understand the term "stakeholders" to refer to those persons, other than shareholders, whose interests or welfare may be affected by corporate conduct. These include customers or clients, employees and members of the local and broader communities in which the company's commercial and other activities take place.

3. The AICD's position, as expressed in the Governance Paper (at 15) is that:

> "the 'best interests' duty is sound, and … legislative change is not required. We endorse the widely accepted view that the current formulation allows consideration of stakeholders beyond shareholders, including customers and employees."

4. Nonetheless, having regard to recent high-profile instances of corporate misconduct and what it perceived to be "calls for changes to elevate stakeholder considerations", the AICD proposed in the Governance Paper to "lead a conversation on directors' duties to test the understanding and application of the best interests duty in practice."

5. It is against this background that we are asked to advise on the following questions:

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(a) What is the current meaning of "interests of the company" for the purposes of the best interests duty, as interpreted by Australian courts? Does the current interpretation require directors to take into account the purpose of the company, and the interests of stakeholders other than shareholders and creditors, such as customers, employees, suppliers, the local communities in which the company conducts business and the broader community?

(b) Does s 181(1)(a) of the *Corporations Act 2001* (Cth) accommodate evolving governance expectations?

(c) How wide is the discretion granted to directors to determine the best interests of the company? Can directors take into account possible impacts on the company's reputation?

(d) How does the best interests duty apply in an insolvency context?

6. We should state at the outset that like the AICD, we do not see any need for legislative amendment in order to ensure that the decision-making processes of company directors can accommodate consideration of the interests of such classes of persons as the customers of a company, or its employees, or members of the community in which the company conducts its business. This is not necessarily because, as some have suggested, the expression "the best interests of the corporation" in s 181(1) of the *Corporations Act* should be construed as referring to the interests of the corporation as a legal and commercial entity distinct from its shareholders. In our view, the debate as to whether that construction is correct does little to assist directors. Especially is this so because it obscures the fact that, having regard to ss 232 and 233 of the *Corporations Act*,[1] there is, as a practical matter, little scope for the directors of a company to argue that they are acting in its best interests when they are conducting the affairs of the company contrary to the interests of its members as a whole. Accordingly, even if the "best interests" duty were a duty to act in good faith in the best interests of a company as a commercial entity distinct from its shareholders, the interests of shareholders

[1] The combined effect of ss 232 and 233 is to confer upon the Court the power to make various orders, including orders that a company be wound up or that its existing constitution be modified, if, relevantly, the conduct or the company's affairs or an actual or proposed act or omission by or on behalf of the company or a resolution, or a proposed resolution, of members of a class of members of the company, is contrary to the interests of the members as a whole.

would be a central, if not the central, consideration to which the directors must have regard.

7. Nonetheless, both the general law and statute have allowed directors considerable latitude in identifying the best interests of a company and its shareholders, provided that their decision-making is rational, in the sense that it is not so unreasonable that no reasonable board of directors would have made the decision in question. Directors may thus consider the long-term interests of the company and its shareholders, as well as the potential impact of any reputational risks, given that such risks may constitute a very real threat to shareholder value. It is through the lens of these matters, which supply a link to the interests of shareholders, that directors may, in our opinion, have regard to the interests of customers, employees and the community at large in making decisions for and on behalf of companies. Whatever else might be said about the law of corporations in this country, Australian courts are not insensitive to the multiple interests affected by corporate conduct. As Middleton J remarked in *Australian Securities and Investments Commission v Healey*:[2]

> "A director is an essential component of corporate governance. Each director is placed at the apex of the structure of direction and management of a company. The higher the office that is held by a person, the greater the responsibility that falls upon him or her. The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors."

"The best interests of the company"

8. It is convenient to address questions (a) to (c) compendiously.

9. The directors of a company owe a duty to "exercise their discretion bona fide in what they consider – not what a court may consider – is in the best interests of the company".[3] That duty is expressed from time to time as a duty to act "bona fide for the benefit of the company as a whole".[4]

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[2] (2011) 196 FCR 291 at 297 [14].

[3] *Re Smith & Fawcett* [1942] 1 Ch 304 at 306.

[4] *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 438.

10. In *Greenhalgh v Arderne Cinemas Ltd*,[5] Lord Evershed MR, having observed that the validity of a special resolution passed at a general meeting of a company depends upon "the fact that those who passed it did so in good faith and for the benefit of the company as a whole", said:

> "the phrase, 'the company as a whole', does not (at any rate in such a case as the present) mean the company as a commercial entity, distinct from the corporators; it means the corporators as a general body."

11. This statement was subsequently approved by the High Court in *Ngurli Ltd v McCann*,[6] in the context of explaining the general proposition that "[v]oting powers conferred on shareholders and powers conferred on directors by the articles of association of companies must be used bona fide for the benefit of the company as a whole." Thus, the circumstance that *Greenhalgh* was a case concerned with the exercise of voting rights by shareholders was not seen as limiting the extent to which the observations of the Master of the Rolls might be taken as shedding light on the scope of the duties owed to a company by its directors under the general law.

12. This is not to say, of course, that the identification of a company's interests with those of its shareholders has since been accepted without qualification. In the course of describing the duties owed by the directors of a company within a larger corporate group, Mason J in *Walker v Wimborne* [7] remarked that "the directors of a company must take account of the interest of its shareholders *and its creditors*" (emphasis added). In *Kinsela v Russell Kinsela Pty Ltd*,[8] the NSW Court of Appeal held that "the directors' duty to a company as a whole extends in an insolvency context to not prejudicing the interests of creditors", with the result that the shareholders have neither the power nor the authority to ratify any breach of that duty. This rather suggests that, even setting aside any debate as to the correctness of what was said in *Ngurli v McCann* in adapting the observations of Lord Evershed MR in *Greenhalgh* to directors' duties, it is not correct to say that the interests of a company should be seen as being one and the same as the interests of its shareholders for all purposes and in all contexts.

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[5] [1951] Ch 286 at 291.
[6] (1953) 90 CLR 425 at 438.
[7] (1976) 137 CLR 1 at 7.
[8] (1986) 4 NSWLR 722 at 732.

13. Having said that, it does not follow from the requirement that directors have regard to the interests of creditors in an insolvency context that the general law has since embraced the notion of a clear separation between the interests of a company and those of its shareholders in giving content to the duties of directors. After all, it was in *Kinsela* that Street CJ also remarked that "[i]n 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".[9] Indeed, at least one commentator has suggested that any attempt to argue, by reference to authority, that the expression "the company as a whole" should not be taken, in the context of identifying the limits on the exercise of directors' powers, to mean "the corporators or shareholders as a general body", "will quickly be met by an almost insurmountable obstacle as far as the doctrine of precedent is concerned".[10]

14. Whether that almost insurmountable obstacle will persist remains to be seen. In *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)*,[11] Owen J said:

> "It is, in my view, incorrect to read the phrases 'acting in the best interests of the company' and 'acting in the best interests of the shareholders' as if they meant exactly the same thing. To do so is to misconceive the true nature of the fiduciary relationship between a director and the company. And it ignores the range of other interests that might (again, depending on the circumstances of the company and the nature of the power to be exercised) legitimately be considered. On the other hand, it is almost axiomatic to say that the content of the duty may (and usually will) include a consideration of the interests of shareholders. But it does not follow that in determining the content of the duty to act in the interests of the company, the concerns of shareholders are the only ones to which attention need be directed or that the legitimate interests of other groups can safely be ignored."

15. It would seem at least that the general law remains in a state of development, as courts have more recently expressed doubt as to the applicability of what was said in *Greenhalgh* to directors' duties.[12]

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[9] Id at 730.

[10] J J de Plessis, 'Directors' duty to act in the best interests of the corporation: "Hard cases make bad law"' (2019) 34 *Australian Journal of Corporate Law* 3 at 13.

[11] (2008) 39 WAR 1 at 534 [4395].

[12] *United Petroleum Australia Pty Ltd v Herbert Smith Freehills* (2018) 128 ACSR 324 at 474 [749], citing *Australasian Annuities Pty Ltd (in liq) (recs and mgrs apptd) v Rowley Super Fund Pty Ltd* (2015) 318 ALR 302 at [57] per Warren CJ and [221] per Garde AJA.

16. Reference should be made at this point to s 181(1) of the *Corporations Act*, which provides:

> "A director or other officer of a corporation must exercise their powers and discharge their duties:
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> (a) in good faith in the best interests of the corporation; and
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> (b) for a proper purpose."

17. An assertion of a contravention by a director of s 181 has been said to be "practically indistinguishable" from an assertion of breach of the general law duty to act in good faith in the best interests of a company.[13] There may, however, be subtle differences between the general law and statutory duties. For example, Owen J in *Bell Group*[14] remarked as follows in relation to the general law duty:

> "(1) The test whether directors acted bona fide in the interests of the company as a whole is largely (though by no means entirely) subjective. It is a factual question that focuses on the state of mind of the directors. The question is whether the directors (not the court) consider that the exercise of power is in the best interests of the company.
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> …
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> (7) The court can look objectively at the surrounding circumstances and at the impugned transaction or exercise of power. But it does so not for the purpose of deciding whether or not there was commercial justification for the decision. Rather, the objective inquiry is done to assist the court in deciding whether to accept or discount the assertions that the directors make about their subjective intentions and beliefs.
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> (8) In that event a court may intervene if the decision is such that no reasonable board of directors could think the decision to be in the interests of the company."

This may be contrasted with the observation by Allsop P, with whom Macfarlan and Meagher JJA relevant agreed, in *Downer EDI Ltd v Gillies*[15] that s 181 is to be "determined objectively" – that is, by reference to "the standards of conduct that would be expected of a person in the position by reasonable persons with knowledge of the

[13] *Gerace v Auzhair Supplies Pty Ltd (in liq)* (2014) 87 NSWLR 435 at 458 [79].
[14] (2008) 39 WAR 1 at 583 [4619].
[15] (2012) 92 ACSR 373 at 394 [76].

duties, power and authority of the position, and the circumstances of the case, including the commercial context".

18. We draw to attention the possibility of a difference in the content of the general law and statutory duties, as it has been suggested, with some force, that the *Corporations Act* distinguishes between the interests of shareholders and the interests of a corporation as a distinct commercial entity, and that therefore s 181 should not be construed as reflecting what was said in *Greenhalgh* concerning the interests of a corporation. In particular, s 232 refers to conduct "contrary to the interests of the members as a whole" or "oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity". Thus, it is said that if the Commonwealth Parliament had intended merely to codify the understanding of the interests of a corporation that was given expression in *Greenhalgh*, s 181 could readily have been drafted to require that directors or officers act in good faith in the best interests of the members as a whole.[16] That being so, to the extent that s 181 differs from the position under the general law, it "would prevail in the practical sense that the directors would have to regulate their conduct by reference to the statutory standard".[17]

19. Nonetheless, if, pursuant to ss 232 and 233 of the *Corporations Act*, conducting the affairs of a company contrary to the interests of the members as a whole affords a sufficient basis for a Court to make, say, an order winding up the company or modifying or repealing its constitution or regulating the conduct of its affairs in the future, then can it really be said that acting in the best interests of a corporation, as required by s 181, is an exercise wholly distinct from acting in the best interests of its members as a whole? In our view, as a practical matter, the combination of ss 181 and 232 of the *Corporations Act* leaves little scope for directors to contend that they are acting in good faith in the best interests of a corporation when, at the same time, they are acting contrary to the interests of its members as a whole. And if that were correct, then even if a company were to be regarded as a commercial entity distinct from its shareholders for the purpose of giving content to the duties of its directors, the position would be as described by a majority of the High Court in *Pilmer v Duke Group Ltd (in liq)*,[18]

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[16] N J Young QC, 'Must Directors Maximise Shareholder Value? The Australian Experience', Supreme Court Corporate Law Conference 2015, 8 September 2015 at [35].
[17] Id at 37.
[18] (2001) 207 CLR 165 at 178 [18].

namely, "that directors and other officers of a company must act in the interests of the company as a whole and that this will usually require those persons to have close regard to how their actions will affect shareholders."

20. To this may be added the observation that, at the risk of oversimplification, the modern corporation evolved, in part, out of the joint stock company, which in turn involved innovations upon the concept of a partnership. Accordingly, while the separate legal personality afforded the modern corporation distinguishes it from a partnership, the corporation is no less a legal structure by which persons may associate for the purpose of establishing and conducting a commercial enterprise. There is thus no reason to think that the close regard to shareholders' interests spoken of in *Pilmer* represents a distorted understanding of the best interests of a corporation. Put simply, the debate over the extent to which a company might be regarded as an entity with interests distinct from those of its shareholders is apt to obscure the fact that the interests of shareholders would likely still be a central consideration for directors even if one were to reject, as inapplicable to directors' duties, the remarks of the Master of the Rolls in *Greenhalgh*.

21. However, it does not follow from this that the directors of a company are obliged to take steps to maximise shareholder returns on a quarterly or other basis, ignoring all other considerations, not least of which are the long-term position of the company and compliance by the company with its various legal obligations.

22. In that regard, we make the following points. First, companies in Australia owe a range of legal obligations, compliance with which may often result in a diminution of the returns that might otherwise be enjoyed by shareholders. These extend beyond the familiar prohibitions of the criminal law or common law duties of care, and include obligations to report one's own possible breaches or contraventions of the law. For example, s 912D of the *Corporations Act* obliges the holder of an Australian financial services licence to lodge with the Australian Securities and Investments Commission a written report if it breaches, or is likely to breach, any of its obligations under s 912A or s 912B. These include the obligation, among other things, to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly, to comply with the conditions on the licence and to comply with financial services laws.

23. Reporting obligations are also to be found in laws relating to workplace safety and environmental protection. Section 148 of the *Protection of the Environment Operations Act 1997* (NSW) requires the giving of notification to all relevant regulatory authorities when a pollution incident occurs in the course of an activity and material harm to the environment is caused or threatened. Similarly, s 38 of the *Work Health and Safety Act 2011* (NSW) imposes on any person who conducts a business or undertaking a duty to ensure that Safework NSW is notified immediately after becoming aware that a "notifiable incident" arising out of the conduct of the business or undertaking has occurred. The expression "notifiable incident" is defined in s 35 to mean the death of a person, the serious injury or illness of a person or a dangerous incident.

24. At the risk of stating the obvious, there is nothing in the duty owed by directors to act in the bests interests of a corporation that would compel them to take steps to avoid these obligations or to authorise conduct by the corporation that would either constitute a criminal offence or involve breaches of duties, whether imposed by statute or arising under the general law. As Edelman J observed in *Australian Securities and Investments Commission v Cassimatis (No 8)*:[19]

> "A corporation has a real and substantial interest in the *lawful* or *legitimate* conduct of its activity independently of whether the illegitimacy of that conduct will be detected or would cause loss. One reason for that interest is the corporation's reputation. Corporations have reputations, independently of any financial concerns, just as individuals do. Another is that the corporation itself exists as a vehicle for lawful activity. For instance, it would be hard to imagine examples where it could be in a corporation's interests for the corporation to engage in serious unlawful conduct even if that serious unlawful conduct was highly profitable and was reasonably considered by the director to be virtually undetectable during a limitation period for liability."

25. It may be that regard to the interests of persons such as customers, employees, suppliers and the local community in which a company conducts business, at least insofar as these persons may be the subject of the company's legal obligations, is not merely permissible, but mandatory. Speaking in relation to the duty in s 180(1) of the *Corporations Act*, to which it will be necessary to return below, Edelman J in *Cassimatis* proceeded to say that:[20]

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[19] (2016) 336 ALR 209 at 301 [482].
[20] Id at 302 [483].

> "the foreseeable risk of harm to the corporation which falls to be considered in s 180(1) is not confined to financial harm. It includes harm to *all* the interests of the corporation. The interests of the corporation, including its reputation, include its interests which relate to compliance with the law."

His Honour's admonition that directors should be mindful of the risk of harm to all the interests of a company may be understood as suggesting that in meeting the standard of care and diligence expected of them, directors must consider at least all those interests to which a reasonable person might have regard as bearing upon, amongst other things, a company's reputation.

26. Secondly, as has already been observed, the general law duty requires that directors act in good faith in what they – and not the courts – consider to be in the best interests of the company, where curial intervention will only occur if the relevant decision is such that no reasonable board of directors could think it to be in the best interests of the company. And while the text of s 181 of the *Corporations Act* omits any reference to the directors' subjective understanding of the best interests of the corporation, it is difficult to understand why a Court might be any more inclined, in applying that provision, to intervene in the commercial decision-making of a company. In particular, s 181 of the *Corporations Act* cannot be read in isolation from s 180. That provision states:

> "(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
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> (a) were a director or officer of a corporation in the corporation's circumstances; and
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> (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.
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> (2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1) and their equivalent duties at common law and in equity, in respect of the judgment if they:
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> (a) make the judgment in good faith for a proper purpose; and
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> (b) do not have a material personal interest in the subject matter of the judgment; and
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> (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 judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person their position would hold.

(3) In this section:

business judgment means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation."

27. The so-called "business judgment" rule in s 180(2) deploys such concepts and expressions that also feature in s 181 as "good faith", "proper purpose" and "the best interests of the corporation". While there may be a limit to the use that might properly be made of s 180(2) in construing s 181, it is, in our view, telling that the "business judgment" rule reflects an assumption that company directors or officers may be taken to have acted in what they perceive to be the best interests of a corporation where they make decisions for which there is a rational justification, having regard to the interests of shareholders. This in turn reflects the reluctance of the Parliament to permit Courts to substitute their own commercial judgments for those of businesspeople. There is, in our opinion, no reason why that reluctance should not inform the application of s 181. In other words, there is no reason why s 181 should be read as requiring that directors do anything more onerous than to act, when exercising their powers or discharging their duties, in a manner that can rationally be justified by reference to the interests of shareholders and, at least in certain contexts, creditors.

28. Thirdly, given what is said in the preceding paragraph, company directors thus have considerable leeway in identifying the best interests of a company, including the time horizon by reference to which those interests are to be assessed and the precise nature of the interests sought to be advanced or protected, whether they be purely financial or reputational or otherwise. As was recognised in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*,[21] directors are the persons "in whom are vested the right and the duty of deciding where the company's interests lie and how they are to be served".

[21] (1968) 121 CLR 483 at 493.

29. In *Provident International Corp v International Leasing Corp*, Helsham J suggested that in discharging the duty to act in good faith in the best interests of a company, the directors of that company must consider the interests, not merely of existing shareholders, but also incoming or future shareholders.[22] Whether this is correct is a matter about which we do not propose to express a view beyond noting, as the learned editors of *Ford, Austin and Ramsay's Principles of Corporations Law* at [8.095.6] observe, that it sits "oddly with the fact that in most instances existing members can by special resolution decide to have the company wound up and have any surplus, after payment of liabilities, distributed among themselves." Nonetheless, it is not necessary to accept what was said by Helsham J in order to justify the availability to directors of a course that permits them to have regard to the long-term interests of a company and its shareholders.

30. As was said in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (at 402-403):

> "The best interests of [a] corporation cannot be determined by reference only to the current or most recent accounting period. They cannot be determined by reference only to the economic advantage of those shareholders on the register at some record date. Nor can they be judged by reference to whatever period some of those shareholders think appropriate for determining their results.
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> It is not right to treat the interests of shareholders and customers as opposed. Some shareholders may have interests that are opposed to the interests of other shareholders or the interests of customers. But that opposition will almost always be founded in differences between a short term and a longer-term view of prospects and events. Some shareholders may think it right to look only to the short term.
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> The longer the period of reference, the more likely it is that the interests of shareholders, customers, employees and all associated with any corporation will be seen as converging on the corporation's continued long-term financial advantage. And long-term financial advantage will more likely follow if the entity conducts its business according to proper standards, treats its employees well and seeks to provide financial results to shareholders that, in the long run, are better than other investments of broadly similar risk."

31. Moreover, it may be that in an era when information disseminates rapidly, both through the traditional news media and on social media, reputational risks loom particularly large as potential threats to long-term shareholder value. If that is correct, then one can

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[22] [1969] 1 NSWR 424 at 437.

readily envisage how the taking of steps to address such risks can be rationally justified by reference to the long-term interests of shareholders, even though they may not result in immediate profit and might be thought to confer more ascertainable benefits on persons other than shareholders, such as customers, employees or members of the community in which the company conducts its commercial and other activities.

32. The classic example of such a decision by a board of directors is a decision to settle well-publicised and costly proceedings brought by a claimant in circumstances where the board has been advised that the company has a reasonable to strong defence. Such decisions are made by companies, including public companies, on a frequent basis throughout the common law world, and there can be no suggestion than in so deciding, the directors of those companies have breached their duties.

33. Fourthly, the leeway afforded to company directors and officers by the conventional understanding of the "best interests" duty is, to no small degree, reflected in, and protected by, the circumstance that even though a director's duty to act in the best interests of a company requires, at the very least, that close consideration be given to the interests of shareholders, that duty is not expressed as being owed to, and is not ordinarily enforceable by, any individual shareholder.

34. The extent of the latitude afforded to directors in identifying and pursuing the best interests of a company may be illustrated by reference to circumstances involving a possible chance of control of the company. The matter is complicated somewhat by the possible engagement of the jurisdiction of the Takeovers Panel in such circumstances. Section 657A of the *Corporations Act* confers upon the Takeovers Panel the power to declare circumstances in relation to the affairs of a company to be unacceptable circumstances. That power is exercisable if it appears that such circumstances are unacceptable having regard to the effect that the Panel is satisfied that the circumstances have had, are having, will have or are likely to have on:

(a) the control, or potential control, of the company or another company; or

(b) the acquisition, or proposed acquisition, by a person of a substantial interest in the company or another company (s 657A(2)).

35. In determining whether to make such a declaration, the Takeovers Panel must have regard to, amongst other things, the purposes set out in s 602 of the *Corporations Act*. These include, at (c), ensuring that:

> "as far as practicable, the holders of the relevant class of voting shares or interests all have a reasonable and equal opportunity to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest in the company, body or scheme".

36. As is made clear in the Takeovers Panel's Guidance Note 12 ("**the Guidance Note**") at [8], the Panel's power to make a declaration of unacceptable circumstances, where, say, a takeover attempt is met by frustrating action such as a significant issuing of shares or entry into a joint venture, is not confined to circumstances involving a breach of directors' duties. That position is informed by a policy (described in the Guidance Note at [4]) that:

> "it is shareholders who should decide on actions that may:
>
> - interfere with the reasonable and equal opportunity of the shareholders to participate in a proposal or
> - inhibit the acquisition of control over their voting shares taking place in an efficient, competitive and informed market."

Thus, the current regulatory setting for takeovers is such that decisions by a board of directors in the face of a possible or actual takeover bid, however qualified or conditional, are no longer to be assessed merely asking whether they are in good faith and in the best interests of the company in question.

37. Nonetheless, as the Takeovers Panel itself said in *Re Pinnacle VRB Ltd (No 8)*,[23] if a target board, in obvious and blatant disregard of its duties, were to enter into a transaction of dubious benefit to the company simply to defeat or to delay a takeover offer, the Panel "could well declare unacceptable circumstances without being deflected from doing so by the target offering to refer the matter to members."

38. However, there is "a distinction in principle between a transaction for the purpose of defeating a take-over offer and one prompted by the take-over offer but, in the end, entered into because the directors believe it to be in the interests of the company as a

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[23] (2001) 39 ACSR 55 at 58 [10].

whole".[24] Thus, the decision by the directors of a company to conclude a joint venture agreement more quickly than would have been the case in the absence of a takeover may not afford a basis for impugning the joint venture agreement.[25] Underpinning this is an acceptance that a decision, honestly made, that entry into the joint venture agreement is in the best interests of the company, notwithstanding that it may yield the incidental result of causing the defeat of a takeover offer, belongs in the category of commercial decisions with which courts, having regard to what was said in *Harlowe's Nominees*, will not interfere.[26]

39. Of course, given the role and powers of the Takeovers Panel, it may be that the latitude thus enjoyed by directors has been diminished, at least where a bid or potential bid will give shareholders a genuine opportunity to dispose of their shares (see the Guidance Note at [19]). Nonetheless, it should be emphasised that any such diminution in the latitude enjoyed by directors arises, not because of some limitation flowing from the content of the "best interest" duty, but rather as the consequence of a statutory regime for the regulation of takeovers which emphasises as a central purpose the opportunity of shareholders to participate in the benefits of a takeover proposal.

40. We would accordingly answer questions (a) to (c) as follows:

(a) *What is the current meaning of "interests of the company" for the purposes of the best interests duty, as interpreted by Australian courts? Does the current interpretation require directors to take into account the purpose of the company, and the interests of stakeholders other than shareholders and creditors, such as customers, employees, suppliers, the local communities in which the company conducts business and the broader community?*

While the law in this area may be developing, there remains a compelling argument, based on the current state of High Court authority, that for the purposes of the general law duty of directors to act in good faith in the best interests of the relevant company, the interests of the company are the interests of shareholders as a general body. The position may be different under s 181(1)

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[24] *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260 at 330.
[25] Ibid.
[26] Id at 338.

of the *Corporations Act*. However, given ss 232 and 233 of that Act, it is difficult to understand how a director could simultaneously act in the best interests of the company while acting contrary to the interests of the shareholders as a whole.

Nonetheless, this conception of the duty permits directors considerable latitude in identifying the best interests of a company and its shareholders. There is no reason why directors could not have regard to the interests of customers, employees and the community more generally, provided that there is a rational justification for doing so by reference to the long-term interests of the company, including its interest in avoiding reputational harm. Indeed, insofar as the company owes obligations under statute or the general law that bear upon the interests or welfare of customers, employees or the community, it may be that directors are obliged to consider those obligations and those interests in making decisions on behalf of the company.

(b) *Does s 181(1)(a) of the* Corporations Act 2001 *(Cth) accommodate evolving governance expectations?*

Yes. In particular, we emphasise the observation in *Harlowe's Nominees* that there are, reposed in the directors of a company, "the right and the duty of deciding where the company's interests lie and how they are to be served".

(c) *How wide is the discretion granted to directors to determine the best interests of the company? Can directors take into account possible impacts on the company's reputation?*

The discretion is wide and bounded principally by the concept of that which is so unreasonable that no reasonable board of directors could approve it. In light of that, directors can take into account possible impacts on the company's reputation. See the answers to (a) and (b) above.

The interests of creditors in an insolvency context

41. Reference has already been made to what was said in *Walker v Wimborne* and *Kinsela* concerning the extent to which the interests of creditors should feature in the decision-

making of directors. We would also respectfully adopt the following statement by Owen J in *Bell Group*:[27]

> "In my view the true state of the law is this. A director has a duty to act in the best interests of the company. The duty is owed to the company and not to any third parties (including creditors). But in an insolvency context (and I will narrow that concept shortly) the duty entails or includes an obligation on the directors to take into account the interests of creditors. Why should this be so? The answer is, as Mason J said in Walker v Wimborne, any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for the creditors. What are those consequences? They are many, but they include threats to the very existence of the company: to its ability to continue as a going concern."

42. His Honour made two further points. This first concerned what was asserted to be the paramountcy of creditors' interests in an insolvency context:[28]

> "In my view the law is exactly as stated by Mason J [in *Walker v Wimborne*]: when a company is in an insolvency context, the directors must 'take into account' the interests of creditors. It does not necessarily follow from this that the interests of creditors are determinative. When directors are deciding what is in the best interests of the company one of the things that they must consider is the interests of creditors. But it would be going too far to state, as a general and all-embracing principle, that when a company is in straitened financial circumstances, the directors must act in the interests of creditors, or they must treat the creditors' interests as paramount, to the exclusion of other interests. To do so would come perilously close to substituting for the duty to act in the interests of the company, a duty to act in the interests of creditors."

43. The last sentence in this passage proceeds upon a recognition that, as Gummow J noted in *Re New World Alliance Pty Ltd (Receiver and Manager Appointed); Sycotex Pty Ltd v Baseler (No 2)*,[29] the duty to take into account the interests of creditors is a "duty of imperfect obligation … which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator."

44. Nonetheless, it should be emphasised that in an insolvency context, the interests of creditors will align closely with those of the company, such that "the plainer it is that it

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[27] (2008) 37 WAR 1 at 540 [4418].

[28] Id at 545 [4439].

[29] (1994) 51 FCR 425 at 445.

is the creditors' money that is at risk, the lower the risk to which the directors … can justifiably expose the company".[30]

45. Section 588G of the *Corporations Act* must also be borne in mind. That provision relevantly states:

> "(1) This section applies if:
>
> (a) a person is a director of a company at the time when the company incurs a debt; and
>
> (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
>
> (c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
>
> (d) that time is at or after the commencement of this Act.
>
> …
>
> (2) By failing to prevent the company from incurring the debt, the person contravenes this section if:
>
> (a) the person is aware at that time that there are such grounds for so suspecting; or
>
> (b) a reasonable person in a like position in a company in the company's circumstance would be so aware."

46. Accordingly, even if the duty to act in good faith in the best interests of a company does not render the interests of creditors a paramount consideration in an insolvency context, the obligation on company directors to avoid insolvent trading, in circumstances where the possibility of insolvency may reasonably be apprehended, is not subject to any such qualification. Thus, the circumstance that the "best interests" duty does not require directors to grant primacy to the interests of creditors does not necessarily mean that the duties on directors in circumstances of possibly impending insolvency are not onerous or do not require close attention to the ability of the company to meet its debts and liabilities.

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[30] *Kinsela* (1986) 4 NSWLR 722 at 733.

47. The second point made by Owen J to which we would draw attention is his observation that:[31]

> "a financial state short of actual solvency could be sufficient to trigger the obligation to take into account the interests of creditors. Again, in my view, this approach accords with principle. The basic principle is that a decision that has adverse consequences for creditors might also be adverse to the interests of the company. Adversity might strike short of actual insolvency and might propel the company towards an insolvency administration. And that is where the interests of creditors come to the fore."

48. Subject to the additional matters upon which we have remarked above, we would respectfully adopt the observations of Owen J as an authoritative statement of the law in this country.

49. Accordingly, we would answer question (d) by observing that the closer that a company is to insolvency, the greater the weight that must be accorded to the interests of creditors in the discharge of a director's duty to act in the best interests of the company, even though it would be going too far to suggest that the interests of creditors should, in such a context, be given primacy. Having said that, as a company approaches insolvency, the duty to avoid insolvent trading may become an even greater constraint upon the scope of action that may permissibly be taken by directors than the best interests duty.

50. We so advise.

24 FEBRUARY 2022

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[31] *Bell Group* (2008) 37 WAR 1 at 546 [4445].