

# Directors’ “best interests” duty in practice

Australian directors have important fiduciary, statutory and common law duties. This AICD Practice Statement focuses specifically on the duty of directors to act in good faith in the best interests of the corporation. The AICD’s [Director Tool: General Duties of Directors](#) provides a broader overview of the suite of core duties in Australia.

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- Directors have a duty to act in good faith and the best interests of the corporation.
- Directors have considerable discretion to identify the best interests of the company, taking into account relevant facts and circumstances.
- While shareholders/members’ interests are central, directors can, and should, also consider a range of stakeholder interests - doing so is often necessary to protect an organisation’s reputation and ensure its sustainability.
- As a guiding principle, directors should take a long-term view of where the company’s interests lie.

In Australia, the statutory duty of directors to act in good faith in the best interests of the corporation came under close scrutiny in the Financial Services Royal Commission<sup>1</sup>.

Instances of corporate misconduct and governance failings have raised concerns about whether this duty is being fulfilled in practice. The extent to which directors under Australian law can, and should, factor stakeholder interests into directors’ decision-making when fulfilling their duty to act in good faith in the best interests of the corporation, has also been subject to debate in legal and governance circles.

The AICD’s mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. To support directors in understanding and meeting the best interests duty, the AICD commissioned barristers, Bret Walker AO SC and Gerald Ng, to examine its current interpretation by Australian courts ([Walker-Ng Legal Opinion](#)).

Drawing on the view reached by the Walker-Ng Opinion, this AICD Practice Statement provides guidance for directors on what it means to act in the best interests of a company in practice.

1. Royal Commission into Misconduct in the Banking, Financial Services and Superannuation Industry. Final Report (4 February 2019), available [here](#).

### Directors have discretion to identify the best interests of the company

Under Australian law, directors must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.<sup>2</sup>

The courts have confirmed that directors have considerable discretion in identifying the best interests of a company and its shareholders/members, and the courts will not second guess business decisions (unless they are manifestly unreasonable).<sup>3</sup>

Importantly, directors have discretion to determine:

- what are the best interests of a company;
- over what time horizon those interests are to be assessed; and
- the precise nature of interests that are to be advanced or protected – whether they be purely financial, reputational or otherwise.<sup>4</sup>

### Relevance of stakeholder interests

The duty requires directors to consider what is in the best interests of shareholders/members, as a whole. However, the law does not assume that shareholder/member interests are best served by having no regard to other stakeholders, particularly over the longer-term.

Rather, employees, customers, suppliers, creditors, Traditional Owners, the environment and broader community are legitimate concerns of company directors, tied back to the long-term interests of the company, including its interest in avoiding reputational harm.<sup>5</sup> Equally, this does not mean that there is a duty owed specifically to stakeholders, as distinct from the company.

Of course, for directors of a charity or not-for-profit organisation, the purposes of the organisation will necessarily be paramount in the application of the duty.

Directors find themselves in an era where shareholders/members as well as other stakeholders are demanding greater accountability from organisations and their boards than ever before. Whether that be demands for the organisation to prioritise the welfare of its workforce, reduce its environmental impact or address modern slavery risks in its supply chain – it is not difficult to see how the long-term interests of the company may readily intersect with employees, suppliers or more broadly, the community.

Commissioner Kenneth Hayne made similar observations in the Final Report of the Financial Services Royal Commission. Notably, that an assessment of what is in the best interests of a company “demands consideration of more than financial returns that will be available to shareholders in any particular period”.<sup>6</sup>

Although there may be some shareholders focused on short term financial return, there are often, as many, if not more, investors who take a long-term view aimed at sustainable value creation.

Commissioner Hayne also stressed that pursuit of the best interests of a financial services entity is a more complicated task than a binary choice between the interests of shareholders and the interests of customers, and that over time the interests of different stakeholders will converge.<sup>7</sup>

**“...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.”**

– Commissioner Kenneth Hayne, Financial Services Royal Commission Final Report (p403)

2. At general law and section 181(1)(a) of the Corporations Act 2001 (Cth) (Corporations Act). A similar duty is owed by directors of State-based incorporated associations and other non-Corporations Act entities. Responsible persons of registered charities also owe a similar duty under the Australian Charities and Not-for-Profit Commission’s (ACNC) Governance Standards.

3. Bret Walker SC and Gerald Ng, The Content of Directors’ “Best Interest” Duty, February 2022, at p.16.

4. Ibid, at p. 11.

5. Ibid, at p.16.

6. Final Report of the Royal Commission into Misconduct in the Banking, Financial Services and Superannuation Industry, Vol 1, at p. 402, available [here](#).

7. Ibid, at p.403.

Directors should also note that the law commonly imposes specific obligations on the company with respect to the interests of customers, employees, suppliers and the community, which may necessitate the prioritisation of those interests. For example, obligations relating to environmental protection or employee safety.

In these circumstances, directors are required to comply with those obligations in the course of decision-making, even if that jeopardises returns that might otherwise be enjoyed by shareholders/members.<sup>8</sup>

### Creditors' interests will weigh heavily in situations of potential insolvency

In the context of a company's potential insolvency, it is widely accepted that the best interests of the company and its shareholders/members will closely align with the interests of its creditors. Put differently, a failure by directors to take into account the interests of creditors will have adverse consequences for both the creditors and the company.

Directors will need to exercise careful judgment in deciding whether their organisation should accrue additional liabilities at a time when the ongoing solvency of the organisation is questionable.

This is not to say that making decisions in an insolvency setting means that creditors' interests should override those of the company.<sup>9</sup> Rather, directors should consider the interests of the company and its creditors as if they were on a spectrum - the closer that a company is to insolvency, the greater the weight should be given to the interests of creditors.<sup>10</sup>

Further, as a company approaches insolvency, there is a statutory duty to prevent insolvent trading which directors must comply with.<sup>11</sup>

### How does Australia compare internationally?

The AICD commissioned law firm, Allens Linklaters, to compare the best interests duty in Australia with the equivalent duty in comparative jurisdictions ([Allens Research](#)).

This research shows that Australia's approach to factoring stakeholder interests into decision-making is largely aligned in practice, even though not necessarily in legislative drafting.

Some jurisdictions, such as Canada and the United Kingdom (**UK**), have more expressly required under their equivalent legislation that stakeholder interests (such as employees, the environment and consumers) be considered when acting in the best interests of the company.<sup>12</sup>

However, the lack of prescription under the Australian statutory duty does not appear to make a marked difference in the practical operation of the duty. The courts in Australia consider it reasonable for directors to factor the interests of a range of stakeholders into decision-making when acting in the best interests of the company, and directors are in the practice of doing so as a matter of good governance.<sup>13</sup>

8. Walker Opinion, at p.16.

9. Above in 2, at p. 18.

10. Above in 2, at p. 19.

11. Section 588G of the Corporations Act. Under the insolvent trading safe harbour, directors have protection from personal liability where they are attempting to restructure and certain conditions are met - see section 588GA (1) and the associated AICD director tool available [here](#).

12. Allens Linklaters - 'Directors and Officers Duties: Evaluation of the 'Best Interests' Duty', May 2022, at p.16.

13. Ibid, p. 16.

### AICD encourages directors to consider the long-term interests of the company

Boards operate in an increasingly complex environment, and directors' decisions can have a significant effect on a range of stakeholders beyond shareholders.

Heightened expectations of corporate behaviour with respect to issues such as the environment, data protection, Traditional Owners' rights and workplace culture, to name a few, mean that the best interests of the company can rarely be isolated from the interests of its stakeholders.

To build long-term value for organisations, it is critical that the legitimate concerns of stakeholders are heard. The AICD's publication: *Elevating Stakeholder Voices to the Board* provides practical guidance on how such perspectives can be considered in decision-making.

It must be acknowledged that there will be times when the interests of shareholders and stakeholders will conflict, especially over the short term. Indeed, stakeholder views are rarely homogenous, and are sometimes irreconcilable with each other.

The AICD endorses the position under Australian law that directors:

- have considerable discretion in determining what is in the best interests of a company; and
- are permitted to consider a range of stakeholders beyond shareholders in deciding what is in the best long-term interests of those shareholders.

In a practical sense, doing so is often necessary to protect an organisation's reputation and ensure its sustainability over the longer term.

The Walker-Ng Legal Opinion should provide directors with comfort that stakeholder interests are a legitimate concern of directors, and that courts will not, except in egregious cases involving clear self-interest or acting contrary to the company's interests, seek to question their judgment with hindsight.

As a guiding principle, directors should take a long-term view of where the company's interests lie, while seeking to maintain as respectful and transparent a relationship as possible with stakeholder groups.

#### Further AICD resources

- AICD Director Tool: [General duties of directors](#)
- AICD Guidance: [Elevating Stakeholder Voices to the Board](#)
- Legal opinion by Bret Walker SC and Gerald Ng: ['The Content of Directors' "Best Interest" Duty](#)
- Allens Research: [Directors and Officers Duties: Evaluation of the 'Best Interests' Duty](#)

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