SYMPOSIUM ON REMEDIES ON DEFAULT

Comment by

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My role is to speak briefly on the personal civil liabilities which may be vested upon company directors. And as you have been informed, the particular context concerns the provision of information by the directors of a borrower company, including the contents of accounts and reports, at a time when the affairs and financial position of the company are a matter of some concern.

Under the general law, of course, directors are subject both to fiduciary duties and a duty of care. But, at least until recently, it has been considered that the standard of care required is minimal, that the duties are owed only to the company, and that breach gives rise to a liability only in favour of the company. At this point it seems unclear whether, and if so to what extent, the decision of the High Court in Walker and Wimbourne (1976) 137 CLR 1 indicates a judicial willingness to reconsider the orthodox misconception which underlies the established view, namely, that those dealing with the company, including its creditors, have in general no legally recognizable interest in its activities.

However that may be, it is apparent that modern notions of legal responsibility are expanding other areas of legal duty and liability, which although not specifically related to company directors, will necessarily apply to their activities. Thus, for example, both principal and agent have always been liable for fraudulent misrepresentation, that is to say statements which are either deliberately or recklessly untrue.

There is also a widening liability in respect of negligent mis-statements and, at least in Australia, it may not be too great an over-simplification to say that the passing of information gives rise to a duty, where the informer knew, or ought to have known, that the recipient would act upon the information. That requirement is ordinarily satisfied when information is supplied in the course of business dealings.

While the damages recoverable for negligent mis-statements are narrower than those recoverable for fraudulent mis-representations, no such problems arise where the error in the information relied upon is misleading or deceptive conduct under

section 52 of the Trade Practices Act. Information may be misleading or deceptive either because of what is contained in the statements or because of what is omitted, and all loss or damage suffered by misleading or deceptive conduct is recoverable under section 82 of the Act.

Further, it is not only the company which is liable, but any person involved in the conduct. That phrase is given a wide meaning by section 75B of the Act and includes any person who has been in any way, directly or indirectly, knowingly concerned in or a party to the contravention. There is obvious scope for the disappointed lender who relied on an overly optimistic picture presented by a borrower to seek redress against the directors as well as the company.

More conventionally, there are the Companies Codes of the various states and territories. Breaches of some of the Code provisions give rise to civil liabilities, but again only in favour of the company; for example, section 229 which requires that directors act honestly and with reasonable care and diligence in the discharge of their duties.

Similarly, there is a liability upon a director under section 542 of the Code for fraud, negligence, default, breach of trust or breach of duty. Again, it is a liability only to the company. However, it is obvious that benefits received by the company from the directors may in due course inure for the benefit of the company's creditors.

In practice, of course, liabilities which are owed only by directors to the company are usually only enforced when the company passes to outside control, for example to a liquidator.

There is another group of sections in the Codes, sections 554 to 557, which only apply after a company is in difficulties, including when it has ceased to carry on business or is unable to pay its debts, phrases which are given a restricted meaning by sub-section 2 of section 553. Of course, although applicable only after the company is in trouble, the provisions relate to prior conduct by the directors.

In summary, the effect of these provisions may be stated as follows: under section 2 of section 557, on conviction of a director of an offence against sub-section 5 of section 557, the court may order the director to pay to the company "the amount required to satisfy so much of the debts of the company as the court thinks proper". Obviously that is a wide phrase which is not related to any particular act of misconduct.

More direct proceedings are available to a creditor against directors by sections 556(1) and 557(1), where debts are incurred by a company without reasonable expectation that they will be able to be paid when they fall due. Proceedings may be commenced by a creditor against the directors in respect of such a debt under section 556(1) and, under sub-section (1) of section 557, upon conviction of a director, the creditor may request the court for an order that the director pay the debt.

There is a defence given to directors under sub-section 2 of section 556, which requires the director to prove that the debt was incurred without his express or implied authority or consent, and, that at the time when it was incurred, he did not have reasonable cause to suspect that the company would not be able to pay all its debts as and when they became due, or that, if the company incurred the debt, that it would not be able to pay all its debts as and when they became due.

In the circumstances, the appropriate advice that could be given to the directors of Hold Co. would be short and to the point. Even if unimaginative and you might say uncommercial, one would be inclined to advise the directors that, so far as their personal position was concerned, they should tell the truth.