Corporate Governance and the Regulation of Conglomerates

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Introduction

The duties of directors to the corporations to whose boards they have been appointed are governed by two main sources of law – rules of common law and equity which define and regulate fiduciary relationships; and by legislation – principally, in Australia, the *Corporations Act 2001* (the ***Corporations Act***) and the equivalent New Zealand statutory provision, the *Companies Act*.[1] There is considerable overlap in the way in which these sets of rules operate.

There are many professional persons who stand in a fiduciary relationship to their colleagues whether they operate in a partnership, some other association or in a company. Relevant rules governing the relationships have informed or may influence the rules which govern the duties of directors. This paper will discuss some recent developments in relation to some of these rules as they impact on professionals and, in particular, on the so-called operation of chinese walls in professional partnerships. It will then discuss the major corporate law issues and developments.

1. Professional partnerships

1.1 Introduction

Central to the law regulating the conduct of fiduciaries are the rules prohibiting a fiduciary from placing himself or herself in any position where there will be a conflict between the fiduciary's obligations to the company (in the case of a director) or to the client (in the case of a solicitor or other professionals[2]), and his or her personal interests; or, in a similar vein, in a position of having conflicting duties, for example, to two companies with competing or conflicting interests, or to two clients with different interests in the same matter or related matters.

In this paper I will first discuss the situation of professional persons who find themselves faced with potential conflicts.

Because Australia and New Zealand are both small countries (in terms of population) with increasingly concentrated centres of commercial activity – the major cities in each state and territory or province – there are, regrettably in one respect, an inadequate number of sufficiently qualified professional partnerships able to provide skilled services to many of the clients (which are usually large corporations or conglomerates). Persons will find themselves having to serve two (or more) masters in certain situations and this is particularly relevant in the context of directors who may be appointed to the boards of other companies (a matter I will deal with in greater detail below). But it does also arise, of course, in the context of the

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1 I will be referring to the Australian legislation as the *Corporations Act*. I will where necessary, refer in full to the New Zealand legislation.

2 The issues that arise may be different depending on whether or not the professional person is a fiduciary, and the operation of any other regulatory regime to which that person may be subject.

advice that lawyers, accountants and others have to provide their clients. This issue has recently been at the heart of difficulties facing auditors. I will not be addressing this very interesting issue except in passing.

1.2 When can a professional person change sides?

Professional persons, including lawyers, sometimes face conflicts when they are asked to act for one client against another client. Or, because of mergers between firms they may find that suddenly clients of the merged firms have different interests which the professional persons have to evaluate. This conflict arises not only for solicitors but of course for other professionals. In that context, the recent House of Lords decision in *Prince Bolkiah v KPMG*[3] (***Bolkiah)*** raised the issue very dramatically. The facts of the case are no doubt well known to you but let me set them out to ensure this part of my paper can be seen in an historical perspective.

The case concerned the work done by the international accounting and audit firm, KPMG, first for Prince Bolkiah (the youngest son of the Sultan of Brunei), and later for the Brunei Investment Agency (***BIA***) which was investigating whether Prince Bolkiah had misappropriated funds for himself during the period of his chairmanship of the agency. KPMG had considerable experience in forensic accounting and it was substantially for this reason that the BIA retained KPMG, even though it knew of the conflict that potentially existed with respect to KPMG's previous work for Prince Bolkiah. Because the work that KPMG did for Prince Bolkiah involved 'the provision of extensive litigation support services ... [and other] tasks usually undertaken by solicitors', it was particularly relevant to the situation of solicitors who find themselves in a position of conflict.

The case examined whether, and if so in what circumstances, a firm of accountants which had provided litigation support services to a former client and in consequence has in its possession information which is confidential to the client can undertake work for another client with an adverse interest. This question has, of course become of increased importance with the emergence of huge international firms with enormous resources that operate on a global scale and offer a comprehensive range of services to clients.

The answer to the question in this case turned on the importance that the law placed on protecting confidential information when it is imparted to an adviser in the course of a retainer. *Bolkiah* is unusual in that, because of the particular kind of work that KPMG was doing, it stated principles applicable to solicitors although KPMG is primarily an accounting services firm which also offers legal services.

In holding that the defendants had failed in their obligations and that the steps that they had taken to establish 'chinese walls' to deal with the potential conflicts were inadequate, Lord Millett, who delivered the major judgment in *Bolkiah*, noted:

> [A] fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position. A man cannot without the consent of both clients act for one client while his partner is acting for another in the opposite interest. His disqualification ... is based on the inescapable conflict of interest which is inherent in the situation.[4]

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3 [1999] 1 All ER 517.
4 Ibid at 526.

In his Lordship's view, a professional person may be able to enter into what would otherwise be a conflict of interest where the clients grant their fully informed consent for this to occur. Where the matter involved is not contentious, or where the clients have confidence in the capacity of the professional person in a firm to maintain 'chinese walls' between different parts of the firm, or for other reasons such as the desire to continue to work with professional people with which the client has an established relationship, clients will often be willing to give their consent.

The readiness of clients to consent to a professional person or his (or her) firm acting simultaneously for one of its competitors either in a related matter or in a matter affecting their business where there is at least potential for conflict to emerge in future, is critical. There is comparatively little case law on how satisfied the courts are likely to be regarding so-called chinese wall arrangements. But such statements as there are less than encouraging for professional firms that seek to act for more than one substantial client in the same industry, without the consent of the relevant clients. Chinese walls are discussed further below: suffice it to say for the moment that the standard of procedures required to satisfy the courts of the effectiveness of chinese wall arrangements is set quite high, and appears to be set higher for solicitors than for other professionals such as accountants and auditors.

1.3 Successive conflicts

Australian law appears to set a higher standard for legal firms than does English law. Under English law it appears that a firm will only be enjoined from acting against a former client where it is in possession of confidential information communicated to the solicitors in the course of a previous retainer. Thus, in *Bolkiah*, Lord Millett noted that

> "it is incumbent on a plaintiff who seeks to restrain his former solicitor from acting in a matter for another client to establish (i) that the solicitor is in possession of information which is confidential to him and to the disclosure of which he has not consented and (ii) that the information is or may be relevant to the new matter in which the interest of the other client is or may be adverse to his own."[5]

However, Lord Millett also observed that the importance of protecting confidential information was the only basis for restraining the professional from acting against a former client: 'The court's intervention is founded not on the avoidance of any perception of possible impropriety but on the protection of confidential information'.[6] He added:

> The court's jurisdiction cannot be based on any conflict of interest, real or perceived, for there is none. The fiduciary relationship which subsists between solicitor and client comes to an end with the termination of the retainer. Thereafter the solicitor has no obligation to defend and advance the interests of his former client. The only duty to the former which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence.[7]

1.4 The *Spincode* case

These issues and related matters were also discussed in the very recent Victorian Court of Appeal decision of *Spincode Pty Ltd v Look Software Pty Ltd*[8] (***Spincode***). In that case, Brooking JA, on behalf of the court, reviewed the leading cases on this question. He

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5 Ibid at 527.
6 Ibid at 526.
7 Ibid at 527.
8 [2001] VSCA 248 (21 December 2001).

suggested that the particular problems facing solicitors (and one assumes other professionals) arise in these circumstances (which he described as the most common circumstances):

* where a solicitor acts simultaneously for clients with conflicting or potentially conflicting interests;
* where a solicitor has discharged himself or herself from a previous retainer in order to act for a new client in a matter where the solicitor is now acting against the former client; and
* where a solicitor agrees to act for a client against a former client in a matter where there is no conflict as a matter of fact, but where the appearance of impropriety may lead a court to restrain the solicitor from acting for the new client.

The first of these categories involves cases of current conflict, while the second and third are different categories of successive conflict. In any of these circumstances the former client may seek an injunction from the court restraining the solicitor from acting in the matter on any of several bases, including that, in the case of a current conflict, the solicitor's action was to place himself or herself in a position in which he/she had a current conflict of interest which would be in breach of the fiduciary duty owed by the solicitor.

In the case of both current and successive conflicts, the client may seek restraint on the basis that:

* the client communicated confidential information to the solicitor in the course of the previous retainer;
* that it was an implied term of the contract of retainer that the solicitor would not act against the client, or against the client's interests, in the same or a related matter; or
* that the solicitor had what has been termed a 'duty of loyalty' to the former client, which would require the solicitor not to act against the former client.

The last of these bases in seeking restraint appears to be a comparatively recent development, and has important implications for company directors with potential conflicts of interest or duties.

2. Differences in Australian and English law

In *Spincode,* Brooking JA noted that Australian law had developed from English law in this area. He also suggested that the misuse of confidential information was not the only basis for intervention. He identified two other grounds – the duty of loyalty and an implied term of a contract of retainer. I will deal briefly with each of these bases.

2.1 Duty of loyalty

Brooking JA was inclined toward the view that a duty of loyalty forms part of the duties of a solicitor to his or her client, though the basis for this duty remains somewhat uncertain. He was also inclined to find[9] that a duty of loyalty arose as an equitable obligation. Without disagreeing directly with the view of the House of Lords in *Bolkiah* that once the term of a retainer has finished 'the solicitor has no obligation to defend and advance the interests of his former client,' Brooking JA asked:

> But why should we not say that 'loyalty' imposes an abiding negative obligation not to act against the former client in the same matter? The wider view, and the one which commends

> itself to me as fair and just, is that the equitable obligation of 'loyalty' is not observed by a solicitor who acts against a former client in the same matter.[10]

Several considerations support the 'proposition that fiduciary duties can survive the termination of the fiduciary relationship'.[11] One of these is the analogy with a trustee who faces 'disqualification as a purchaser of trust property [when the trustee releases himself from his duty to the beneficiary] by retiring from his fiduciary office'.[12] A trustee who resigned from his or her office in order to purchase trust property would be prevented from doing so either because 'the decision to effect that purpose has been taken during the period of his trusteeship when he was actually performing the duties of a trustee'; or because he has 'all the advantage of the information and knowledge which comes to him as trustee and which he should use in no way for his own benefit'.[13] The effect of finding that a solicitor has a duty of loyalty to a former client is that, upon commencing the new retainer and assuming the duties of a fiduciary toward the new client, the solicitor is placed in a position of having a conflict of duty and duty.

Brooking JA also referred to United States and Canadian cases[14] in which a fiduciary duty of loyalty has been recognised either implicitly or expressly. The Court of Appeals for the District of Columbia has referred to

> the well-established rule of public policy that where an attorney has acted for a client he cannot thereafter assume a position hostile to the client concerning the same matter, or use against the client knowledge or information obtained from him while the relation existed.[15]

The US District Court in *EF Hutton* placed emphasis on the fact that not only do clients disclose confidential information to their solicitors, but 'they also repose confidence in them'.[16]

Brooking JA also noted that the Ontario Court of Appeal[17] has held that a solicitor must both respect the confidences disclosed by a client and also 'exhibit loyalty' to the client, including refraining from subsequently taking an adversarial position against the client in the same matter.[18]

In other areas Australian courts have shown reluctance to follow, in particular, the trend in Canadian jurisprudence which has led to the finding of fiduciary relationships in novel fact situations (ie, beyond the established categories). In this area of the law, however, it may be that Australian courts are tending to find new categories of fiduciary relationship or new elements of traditional categories of fiduciary relationship. If so, then this tendency, if it develops further, may have implications for other fiduciaries such as company directors,

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9 Ibid at para 54.
10 Ibid at para 53.
11 Ibid at para 56.
12 Ibid.
13 Ibid. (Such considerations as this are directly relevant to the position of a company director who resigns in order to appropriate an opportunity open to the company: several leading cases deal with this and it is an issue to which I will return. See, for example, *Industrial Development Consultants v Cooley* [1972] 1 WLR 443.)
14 For example, *Gesellschaft fur drahtlose Telegraphie MBH v Brown* (1935) 78 F 2d 410; *EF Hutton & Co Inc v Brown* (1969) 305 F Supp 371 (***EF Hutton***); *Re Regina and Speid* (1983) 43 OR (2d) 596.
15 *Gesellschaft fur drahtlose Telegraphie MBH v Brown* (1935) 78 F 2d 410 at 412; see also *Spincode* at para 57.
16 *EF Hutton* at 394; see also *Spincode* at para 57.
17 *Re Regina and Speid* (1983) 43 OR (2d) 596.
18 *Spincode* at para 57.

particularly where public policy considerations prove influential – for example when standards of corporate governance are the subject of close scrutiny.

The public policy aspect of the 'duty of loyalty' has been referred to in other Australian cases prior to *Spincode*, though without extensive discussion. In *McVeigh v Linen House Pty Ltd*[19] (*McVeigh*) Batt JA (with whom Callaway JA agreed) in the Victorian Court of Appeal stated that

> a court will restrain a solicitor from acting for a litigant not only in order to prevent disclosure of confidences of a client or former client, but also to ensure that the solicitor's duty of loyalty to the former client is respected, notwithstanding termination of the retainer, and to uphold as a matter of public policy the special relationship of solicitor and client.[20]

Batt JA referred to similar statements in 1992 in the Federal Court by Burchett J in *Wan v McDonald*[21]. In this case his Honour spoke of a solicitor's 'duty of loyalty' as a duty that was not 'extinguished by the mere termination of the period of his retainer', and of the 'special quality to the relationship of solicitor and client that the law will not generally permit to be stained by the appearance of disloyalty'. Batt JA also cited a statement by Gummow J in the Federal Court where his Honour said that: 'Even among fiduciaries, solicitors stand in a special position'.[22] It was in light of these statements that Batt JA (Callaway JA agreeing) concluded that 'the appearance of disloyalty and considerations of public policy' required that the solicitors with the conflict of duty should not act.[23]

In *Spincode* Brooking JA observed that there is an inherent jurisdiction of the court to control the conduct of its officers. In his view, if no other basis existed for restraining solicitors who were engaged to act against a former client in the same matter, the conduct could be regarded as so 'offensive to common notions of fairness and justice that they should, as officers of the Court, be brought to heel'.[24] In this regard, his Honour was probably addressing the public policy interest of maintaining confidence in the legal profession and the process of the court, though these considerations cannot readily be separated from the 'special quality of the relationship of solicitor and client'.

2.2 Implied term of the retainer

In *Holdsworth v MR Anderson & Associates*[25] — a case in which no issue of confidential information arose, but in which a solicitor who had previously acted for two parties together later was engaged to act for one of them against the other — J D Phillips J noted:

> It is surely part of the contract of retainer that the solicitor will use his best endeavours in the interests of his client and he does not do that by placing his own particular knowledge of events in which he took part as an agent of both at the disposal of one to the exclusion of the other.[26]

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19 [1999] 3 VR 394.
20 Ibid at para 23.
21 (1992) 33 FCR 491 at 512-513.
22 (1989) 22 FCR 209 at 228-229.
23 See also the unreported decision of Mandie J in the Supreme Court of Victoria, *Westend Entertainment Centre Pty Ltd v Equity Trustees Ltd* [1999] VSC 514 (10 December 1999), where the 'solicitor's duty of loyalty and the need to avoid the appearance of disloyalty' was referred to without discussion.
24 *Spincode* at para 58.
25 [1994] 7022 SCVIC (26 August 1994).
26 Ibid at 17.

In *Spincode* Brooking JA did not consider at length the question of whether such an implied term could be found in the ordinary contract of retainer, as he was inclined toward the view that a duty of loyalty — or a negative equitable obligation — existed to prevent the solicitor in that case from acting against a former client. Nevertheless it remains a possible basis on which a court may enjoin a solicitor from continuing to act against a former client. Like the inherent jurisdiction of the court over its officers, however, it is specific to the legal profession while the development of a 'duty of loyalty' as an element of the duties of a fiduciary may have implications beyond the legal profession including, among others, for company directors.

Given that there is a trend in Australian superior courts toward holding that solicitors (and, one assumes, others in a similar position) owe fiduciary obligations on what appears to be a wider range of bases than occurs in English law, or than has occurred in Australia in the past, what measures are available to solicitors or firms of solicitors to minimise any concerns? This is especially relevant when advisers accept instructions that may result in either a potential present conflict of interest and duty, or duty and duty, or a successive conflict. Such steps are obviously appropriate to avoid the fiduciaries being restricted from acting in a matter and so as to enable clients to have the choice of retaining their preferred advisers.

The main device that has been contemplated is that of the 'chinese wall' (or, a firewall, as it is sometimes called) — a procedural device for ensuring that the knowledge and information imparted to solicitors in one part of the firm does not travel to those solicitors within the firm who now intend to act for another client whose interests potentially conflict with those of the first client.

3. How adequate are chinese walls?

3.1 *Bolkiah*

The House of Lords addressed the question of whether chinese walls could be an effective safeguard against the dangers of conflicts of interest in *Bolkiah*. The facts of the case were set out above.

In finding that the accountants were in fact in breach of their obligations and that the steps that they had taken were inadequate, the Law Lords held that the duty to preserve confidence was unqualified. Lord Millett (on behalf of the Lords) noted (in terms relevant to both lawyers and accountants) that

> the former client is entitled to prevent his former solicitor from exposing him to any avoidable risk; and this includes the increased risk of the use of the information to his prejudice arising from the acceptance of instructions to act for another client with an adverse interest in a matter to which the information is or may be relevant.[27]

The staff acting on the matter for which Prince Bolkiah had originally retained KPMG were for the most part different from those who acted for BIA, though there was some overlap. The court accepted that KPMG had made a sincere attempt to maintain confidentiality between the staff involved in the two projects, and that those staff who had had some involvement with both projects had only a peripheral involvement and were in possession of no sensitive information. However the Law Lords were not satisfied with the steps that KPMG had taken.

27 [1999] 1 All ER 517 at 527.

Lord Millett said that the court 'should intervene unless it is satisfied that there is no risk of disclosure'.[28] The risk must be a real one, but it need not be substantial. In considering the effectiveness of measures taken to eliminate the risk, the starting point must be that information moves within a firm. Referring to the UK Core Conduct of Business Rules of the Financial Service Authority, he noted that chinese walls, to be effective, must include some combination of:

* physical separation of various departments in order to separate them from each other, extending to such details as dining arrangements;
* an educational or compliance program to emphasise the importance of protecting confidential information;
* strict procedures for dealing with situations for when the wall may be crossed, and record keeping in relation to this;
* monitoring by compliance officers of the effectiveness of the wall; and
* disciplinary sanctions for non-compliance with the procedures.

In short, established institutional procedures are required to prevent the flow of information between departments if a chinese wall is to be effective. In contrast, KPMG's arrangements were ad hoc and erected within a single department. The number of personnel involved, and the rotating membership of the work groups, combined to emphasise the difficulty that would have existed of maintaining strict confidentiality of information. The court was not satisfied that KPMG could show that it had taken steps sufficient to remove the risk of the circulation of confidential information, and enjoined the firm from continuing to act for BIA.

Bolkiah reaffirmed the importance of protecting confidential information provided by a client to persons in the position of an adviser – in this case the adviser was legal or quasi legal. In English law it appears that this is the only basis for restraining a firm from acting against a former client. In Australia the jurisdiction to grant an injunction is broader and would appear likely to be exercised even where there was no real risk of the disclosure of confidential information. As a result of the decision in *Spincode* which is discussed above, and earlier cases (to which I will refer), it can be said that the existence of the duty of loyalty owed by a solicitor (or other similar advisers in appropriate cases) to a former client or the finding of an implied term in the contract of retainer, or the public policy interest in maintaining confidence in the legal profession and the process of the courts, may lead to a result where the existence of an effective chinese wall may not prevent a firm of solicitors (or other advisers) from being enjoined against continuing to act against a former client. If these principles apply in the case of successive conflicts, then they would seem to apply with even greater force in the case of concurrent conflicts in the absence of the fully informed consent of the relevant clients for the firm continuing to act.

3.2 Chinese walls - Australian cases

The issue of the acceptability of chinese walls has in fact been considered in several Australian cases. The first of the comparatively recent cases is *Mallesons Stephen Jaques v KPMG Peat Marwick (MSJ v KPMG)*[29], a decision of Ipp J in the Supreme Court of Western

[28] Ibid at 528.
[28] (1990) 4 WAR 357.

Australia. The decision was, however, that of a single judge and the facts involved a criminal proceeding, so that the case's authority and applicability in relation to the ordinary situation of solicitor conflict is limited. Mallesons Stephen Jaques (*MSJ)* had acted for a partner of KPMG and, later, for the Commissioner of Corporate Affairs in an investigation into the conduct of that partner. Ipp J held that an injunction against the solicitor continuing to act will lie where:

> there is a real and sensible possibility that [the solicitor's] interest in advancing the case of a new client might conflict with his duty to keep information given to him by a former client confidential, or to refrain from using that information to the detriment of the former client.[30]

Ipp J also held that the former client would be prejudicially affected by the knowledge that his or her solicitor was now acting against the former client. Finally, in what appeared to be a significant rejection of the possibility of using chinese walls, Ipp J said (in dicta) that the knowledge of one partner in a firm was to be imputed to other partners in the firm. He observed:

> It would offend against established principle and, indeed, the public interest in the proper administration of justice if a scheme could be countenanced whereby a group of partners within a firm of solicitors was able to represent a prosecutor in criminal proceedings, in conflict with the duties owed by other partners to the accused person, to the mutual financial profit of all.[31]

However, in 1997 in *Unioil International Pty Ltd v Deloitte Touche Tohmatsu*[32] (*Unioil*) Ipp J retreated from this position, saying that his remarks in *MSJ v KPMG* were too broad, and that the better view was that 'there should be a rebuttable presumption that the knowledge of one partner is to be regarded as the knowledge of his or her partner'[33]. Ipp J was influenced by a decision of Sopinka J in the Supreme Court of Canada in which Sopinka J considered that the 'concept of imputed knowledge' was 'unrealistic in the era of the mega-firm', though it would be necessary to satisfy a court that there was 'clear and convincing evidence that all reasonable measures have been taken to ensure that no disclosure will occur by the "tainted" lawyer' to other members of the firm. In *Unioil* Ipp J considered that this approach should be followed.[34] In the 1999 case *Newman v Phillips Fox (a firm)*[35] (*Phillips Fox*), Steytler J also held that there may be circumstances where chinese walls would be acceptable, and expressed approval of the approach of the House of Lords in *Bolkiah*.[36] To this extent, a 'chinese wall' may be an acceptable device for protecting the confidentiality of information imparted by a client to a solicitor in the course of a retainer (it should be noted that *Unioil* did not concern criminal proceedings (as with *MSJ v KPMG*) and that the standard for criminal cases may not be the same).

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30 Ibid at 363.

31 Ibid at 375.

32 (1997) 17 WAR 98.

33 Ibid at 108.

34 Ibid at 107-08. The Canadian case discussed by Ipp J was *MacDonald Estate v Martin* (1990) 77 DLR (4th) 249.

35 (1999) 21 WAR 309.

36 Though Steytler J was not satisfied with the arrangements made to protect confidential client information.

In the Victorian case, *Farrow Mortgage Services Pty Ltd (In liquidation) v Mendall Properties Pty Ltd and Others* (*Farrow*)[37] (decided in 1994, between the two decisions of Ipp J discussed), Hayne J rejected as inadequate a limitation on the retainer of a firm of solicitors to the effect that they would not use any confidential information imparted to the firm by a client in a previous retainer in the course of acting for the new client. Hayne J said that similar considerations as those which had 'moved courts to reject the reliance on "Chinese walls"' applied (citing *MSJ v KPMG*). He added that the relevant test was that of whether 'a real and sensible possibility of the misuse of confidential information' existed.[38] Similarly, in the unreported 1998 decision, *Yunghanns and Ors v Elfic Ltd.*[39] Gillard J expressed little confidence in the adequacy of a chinese wall to protect a longstanding client of a firm against the possibility of disclosure of confidential information in a matter where the firm, having first acted for the former client in conjunction with other persons, now intended to act against the former client. Gillard J said that the device more closely resembled a 'Dutch dyke' susceptible to leakage than a chinese wall, and expressed concern that even though every effort might be made to maintain confidentiality respecting information imparted by the former client, the long relationship between the client and the firm meant that the firm had much general knowledge of the client's personality and affairs that might work against the client, and that many members of the firm had dealt with the client.[40]

While the House of Lords in *Bolkiah* appeared prepared to recognise chinese walls as a device to protect confidential information imparted to a firm by a former client, the weight of authority in Australian cases appears to be against the effectiveness of chinese walls (though the present survey has not been exhaustive).[41] In New Zealand there has been some judicial support for the use of chinese walls, as in *Russell McVeigh McKenzie Bartleet & Co v Tower Corporation*,[42] though parts of that case were criticised by the House of Lords in *Bolkiah*. That said, both *Farrow* and *Yunghanns* involved situations where a firm had sought to act against a client with which it had had a long or detailed relationship, and where the matters now in dispute were matters in which the firm had advised the former client (albeit with other parties) so that a chinese wall was seen by the court as unlikely to be effective. It is possible that a different result would ensue in a matter where the effectiveness of a chinese wall could be more readily relied upon.

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37 *Farrow Mortgage Services Pty Ltd (In liquidation) v Mendall Properties Pty Ltd and Others* [1995] 1 VR 1.

38 Ibid at 8.

39 *Yunghanns and Ors v Elfic Ltd (formerly known as Elders Finance and Investment Co Ltd) and Ors [1999] VSC291.*

40 Ibid at 28-29. In *Yunghanns* the orders restrained the client from retaining the solicitor.

41 See also *Fruehauf Finance Corp Pty Ltd v Feez Ruthning [1991] 1QdR 558*; *Macquarie Bank Ltd v Myer* [1994] 1 VR 350; and *Carindale Country Club Estate Pty Ltd v Astill and Others* (1993) 115 ALR 112.

42 *Russell McVeagh McKenzie Bartleet & Co v Tower Corporation* [1998] 3 NZLR 641. The approach in this case, of balancing the need to protect confidential information against the need to ensure that clients could retain suitable advisers, was adopted by the UK Court of Appeal in *Bolkiah* but rejected by the House of Lords.

3.3 Conclusion

It may be that after *Bolkiah*, *Unioil* and *Phillips Fox*, an Australian court would endorse institutional chinese wall procedures that could be relied upon to protect a client's confidential information, though the decisions in *Farrow* and *Yunghanns* make it all but impossible to make this prediction with any confidence. In any case, as noted above, the jurisdiction to restrain a solicitor from acting against a former client, or from acting with a conflict of interest, rests on a broader basis than the protection of confidential information, such that chinese walls may be rejected as a protective device regardless of their factual effectiveness.

There are arguably countervailing policy issues to consider in Australia and New Zealand where highly concentrated commercial centres have developed in what, overall, are relatively small market economies. There is considerable potential for large corporate clients to progressively 'conflict out' one legal firm after another in relation to continuing matters or kinds of work. The result would be that legal (and other professional) firms would be unable to pursue a large range of work that they were otherwise well equipped to do, while clients would be denied the opportunity to engage the firm of their choice and, where clear superiority of expertise in a given area existed in a particular firm, from obtaining the highest quality advice. In *Bolkiah* the House of Lords rejected the consideration that, if standards are set too high or are too stringent, then there would be 'unjustified impediments in the way large international firms conduct their business',[43] though Ipp J in *Unioil* and Steytler J in *Phillips Fox* accepted that the practical implications of setting too high a standard could not be ignored. However, it remains to be seen how the more onerous standards apparently imposed in Australian law will be adapted to deal effectively with the commercial and business exigencies of the kinds of small concentrated markets described.

4. The position of directors in a corporate group/conglomerate

4.1 Introduction

With this background in mind, it is now appropriate to 'evaluate' the position of directors in corporate groups or conglomerates appointed to represent another company, a group of shareholders or creditors, or persons who believe they 'represent' a particular community interest . In that context, I note an article on similar issues which Tim Lane and I have published in the *Company and Securities Law Journal* some years ago.[44] There have been a number of developments since that article was published.

For the balance of this paper I would like to concentrate on the problem that arises where directors in a corporate group receive confidential or sensitive (or quasi confidential) information which they would like to make use of for the 'person' or interest they represent. This is particularly well illustrated by the recent decision of the New South Wales Court of Appeal in *NRMA Limited v Geeson & Ors*[45] which I will discuss later.

Before I delve into these issues it is probably useful to provide the general overview of the duties of directors and to whom they are owed. Whilst some might regard the situation as fairly obvious, in my view an understanding of how the law has developed, highlighted by the

43 [1999] 1 All ER 517 at 525.
44 Baxt, R & Lane, T, 'Developments in Relation to Corporate Groups and the Responsibilities of Directors – Some Insights and New Directions' (1998) 16 C&SLJ 628.
45 (2001) 40 ACSR 1.

Australian High Court decision in *Spies v R*[46] and other statutory initiatives, suggest that there are still a number of assumptions which may be wrongly informing both directors and those advising them.

4.2 Is/was there a duty to creditors/others?

The role of company directors, and the question of to whom they owe their duties, raise broad issues that are too often dealt with glibly and without reference to the tension between the expectations of the community and the requirements of the law. The question of to whom directors owe their duties is critical, because it is at the heart of some of the problems that I believe directors have faced and will continue to face in this area especially if political pressure for change continues.

Traditionally the law has been that directors' duties are owed to their company. The company has been interpreted to mean the hypothetical shareholder (although future shareholders have sometimes been included in that particular context). As a result of recent cases commencing with *Walker v Wimborne*,[47] a duty to creditors was said to exist in certain circumstances. The High Court has arguably 'corrected' that particular approach to the question in *Spies v R*.

But in addition to this development, there has been another development in relation to the possible duties owed by directors to individuals. The New South Wales Court of Appeal, in what many regarded as a powerful judgment in *Brunninghausen v Glavanics*,[48] supported an argument that a director may owe a duty to individual shareholders (whether directors or not) in specific circumstances.[49] This decision is one in a line of cases (including those of the New Zealand Court of Appeal in *Coleman v Myers*[50] and the English Court of Appeal in *Peskin v Anderson*[51] and, to some degree, in *Stein v Blake*[52]) which have moved away from the general proposition, espoused in *Percival v Wright*,[53] that a director's fiduciary duties were owed to the company and not to individual shareholders.

4.3 Should employees be treated as a special class to whom duties are owed?

To some extent there has been a quite recent push, at least in Australia, to make directors directly accountable to employees. But employees are in many circumstances (where these claims for reform of the law are made) creditors, although creditors with special interests. It is in that context that we need to be careful in expanding the law.

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46 (2000) 173 ALR 529.

47 (1976) 137 CLR 1.

48 (1999) 32 ACSR 294.

49 Such a duty may arise where directors are brought into close contact with shareholders, (for example through negotiations, dealings or other direct contact between directors and shareholders), or where the relationship is inherently capable of giving rise to fiduciary obligations (for example an obligation to use confidential information, obtained by directors acting in that office, for the benefit of shareholders).

50 [1977] 2 NZLR 225 (Woodhouse, Cooke and Casey JJ).

51 [2001] 1 BCLC 372 (Brown, Mummery and Latham LLJ, affirming the decision at first instance of Neuberger J: [2000] 2 BCLC 1).

52 [1998] 1 All ER 724 (Lord Woolf MR, Millett and Mummery LJJ); see especially [1998] 1 All ER 724 at 727d and 729g per Millet LJ.

53 [1902] 2 Ch 421.

It is questionable whether any duty is owed by directors to employees despite the enactment of the *Corporations Law Amendment (Employee Entitlements) Act 2000* (the *Employee Entitlements Act*) in 2001.[54]

In a sense this is the most troublesome area of this part of the law because of pressures on the Australian Federal Government to strengthen the rights of employees.

The amendments to the *Corporations Act* brought about by this legislation might be seen as a mere expansion of the statutory duty to avoid insolvent trading. These provisions increase protection for employees in two ways. First, the law now extends the existing duty on directors not to engage in insolvent trading. Second, a new criminal offence is created that targets agreements and transactions entered into for the purpose of avoiding payment of employee entitlements. A breach of the second branch of this new provision can result in a court ordered payment of compensation by those involved.

Already, there is a possibility for the liquidator to seek recovery from directors as a result of insolvent trading. In addition, the director may be liable in certain circumstances (especially if an uncommercial transaction — see section 588FB of the *Corporations Act* — is involved). By linking the *Employee Entitlements Act* to the duty not to engage in insolvent trading in section 588G, all the Federal Parliament has done, arguably, is to ensure that employees can be treated as creditors in the context of the relevant stakeholders. The Australian approach in that regard might be contrasted to the position in the UK, which has a rather more widely drawn statutory provision with respect to employees.[55]

As a result of the spectacular collapse of One.Tel, where it appears that employees had no entitlement to redundancy payments following the collapse of that company, the Prime Minister and the State Premiers have called for the insolvent trading provisions to be further amended to ensure that particular issue is addressed. No legislation or suggested legislation has yet been released for comment.

The second 'protection' for employees is arguably through section 1324 of the *Corporations Act* which is discussed later in this paper.

Whether directors can actually make gifts to employees or charities is a matter in respect of which there has been a good deal of litigation and a number of reported cases. Traditionally,

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54 See Celia Hammond, 'Insolvent Companies and Employees: The Government's Year 2000 Solutions' (2000) 8 *Insolvency Law Journal* 86. This legislation is yet to be tested in the courts but already there are calls for amendments to it or additions to it as a result of the One.Tel collapse in particular. Such calls are unwarranted. Legislation needs to be tested either directly or indirectly. If, as a result of litigation in related matters, defects in the current legislation are identified, then some moves for legislative amendments are appropriate. In any event, the proposed changes to the legislation as announced by the politicians will further amend the law relating to insolvent trading discussed below.

55 See the *UK Companies Act 1985* section 309(1), which states:

> The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.

But note the qualification in section 309(2).

the position in the Australian/UK law is that you measure the capacity of directors to favour employees or charitable organisations by reference to whether the action on the part of the directors is in the best interests of the company as a whole.[56]

4.4 Do directors have wider (legal) obligations?

In dealing with these various issues, that is whether the duties of directors might be said to be owed to a wider range of stakeholders potentially including creditors (and employees as creditors) and others, where do we draw the line? Will they have a duty to the community or certain sections of the community or society as a result of other statutory initiatives such as the recently 'failed' Australian Corporate Code of Conduct Bill (the *Code Bill)*?

In dealing with this particular issue I am indebted to some very interesting comments made by Professor Bryan Horrigan of the University of Canberra in a paper entitled 'Teaching and Integrating Recent Developments in Corporate, Public, and International Law and Practice' delivered at the 2001 Conference of Corporate Law Teachers held at Victoria University in Melbourne in February 2001.

Horrigan refers in turn to interesting observations made by Robert Hinkley, an Australian based partner in the US law firm Skadden Arps Slate Meagher & Flom in an article published in the *Australian Financial Review* on 7 April 2000. This article was itself based on a chapter in his book *Human Rights and Corporate Responsibility 2000.*[57] Hinkley made some observations that are worth repeating in the context of this paper.

> Corporations ... exist only because laws have been enacted that provide for their creation and give them a licence to operate. When these laws were enacted, no attempt was made to endow corporations with the characteristics of individuals that make living in society possible.
>
> ... The corporate law establishes rules for the structure and operation of corporations. The keystone of this structure is the duty of directors to preserve and enhance shareholder value – to make money. Under this structure, the objective of stockholders – making money – becomes the duty of directors which, in turn, becomes the marching orders for the corporation's officers, managers and other employees. ... Most corporate decisions are made by people who have little incentive to promote corporate citizenship or social responsibility (which in some measure requires corporate sacrifice) unless such promotion also can be shown to improve profitability ... Nothing in the system encourages (let alone requires) corporations to be socially responsible or to contribute, cooperate or sacrifice for the benefit of the community or the common good (that is, be a good citizen). ... To the extent that there is any restraint on the duty of directors to

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See also Jennifer Hill, 'At the Frontiers of Labour Law and Corporate Law: Enterprise Bargaining, Corporations and Employees' (1995) 23 *Federal Law Review* 204 at 214.

56 See *Hutton v West Cork Railway Company* (1883) 23 ChD 654 at 673, and *Parke v Daily News Ltd* [1962] 2 All ER 929. There are, of course, many other cases in which these issues have been considered. In the US there have been a number of interesting decisions, the most famous of which are *Dodge v Ford Motor Company* 204 Mich 459; 170 NW 668 (1919), where the court struck down the actions of Henry Ford who wanted to make his cars more accessible to the public as a whole, and *Theodora Holding Corporation v Henderson* 257 A 2d 398 (Del Ch, 1969). The US corporation codes generally allow donations to be made: see for example section 122(9) of Delaware's General Corporate Law.

> make money, it comes in the form of government regulations. This presents corporate managers with a basic conflict of interest: how to comply with the regulation (which can increase their costs) while at the same time remaining primarily responsive to their duty to make money (which is generally thought to require reduced costs). ...
>
> The duty of directors to make money drives all corporate actions. This makes it the point of highest leverage. Corporations will take on the obligations of citizenship only when the duty to make money becomes balanced by something that simulates the human conscience. This balancing factor should be implanted in corporations in a manner that tempers – but does not destroy – their drive to achieve profits ... It is time to amend corporate law to encourage corporations to be good citizens as well as make money.

In his paper Horrigan also comments on remarks I made in evaluating political pressure placed on company directors, especially of high profile companies such as banks and insurance companies, in order to meet community needs. My comments in the Australian Institute of Company Directors Journal *The Director* were these:

> Many people believe directors of large corporations, including banks, insurance companies, telecommunications companies etc, should have regard to a broader set of community obligations. However, if that is the way society wants to regulate such companies (I do not agree this is the best way of dealing with the problems that may face the community, but it is an option that is favoured by some), then legislation governing the duties of the directors of such companies should be clarified.
>
> ... If directors are expected to run the activities of their companies with the interests of the community at the forefront of their obligations, then they must have adequate protection in law (and from the courts), that should shareholders feel they are not receiving the same level of dividends they had been accustomed to, the directors will not be in breach of those duties.[58]

It is vital that in evaluating the duties of company directors in the context of the law we do not forget the fact that it is so easy to affect those community standards; community expectations can be raised but no legal rights arise and as far as directors are concerned, the position is far from clarified.

In addition, the strains that would be placed on directors by any expanded obligation on their part in evaluating to whom they owe their duties would be unreasonable, and, as noted by the Cooney Committee in its 1989 report on company directors' duties, would expose the directors to too much internal conflict. These comments are particularly relevant:

> To require directors to take into account the interest of a company's employees, its creditors, its customers, or the environment, as well as its shareholders, would be to require them to balance out what would on occasions be conflicting forces. To make it optional for directors to take into account the interests of a company's employees, its creditors, its customers, or the environment, as well as its shareholders, again would mean that directors would be in the position of weighing up the various factors. It would also limit the enforceability of shareholders'

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57 Pluto Press.

58 January 2001 at 42.

> rights if directors were able to argue that, in making a certain decision, they had been exercising their option to prefer other interests.
>
> If contemporary public policy requires either of these approaches, then a re-think of some fundamentals of company law would be required.[59]

Whilst Emeritus Professor Len Sealy suggested a little earlier that this problem of good corporate citizenship was 'one of yesterday's problems' — he based his claim on the standard argument that good corporate citizenship had long term, derivative benefits for shareholders — he was speaking from an English perspective where there has been far less statutory intervention (in general terms) in this context.[60]

If Australia chose to adopt his approach, or one similar to that enunciated in the 'failed' Code Bill, we would be guaranteeing, in my opinion, the creation of greater tensions and difficulties for company directors. These could not be satisfactorily answered by any glib amendment to the statutory business judgment rule or similar legislative initiatives along the lines of those which we have seen introduced over the last few years.

I would suggest that the time has come (it probably arrived a number of years ago) for there to be a halt to the rather irrational reliance by governments on the introduction of what appear to be at times inconsistent and contradictory statutory amendments. Such a move by the Government, whilst enabling them to boast — 'Look, we are looking after your interests' — often leads to implications not thought through by governments. The potential for uncertainty that arises from section 1324 of the *Corporations Act* illustrates this kind of difficulty in my view.

4.5 How does section 1324 of the *Corporations Act* affect this issue?

As the High Court has recently indicated in *Spies v R* that directors do not owe a duty to creditors, it is questionable whether the consideration of these further interest groups which directors may take into account in carrying out their obligations is warranted. In my view they do matter for a reason that has not been dealt with by the courts directly. Section 1324 of the *Corporations Act* (and its predecessor) raise directly, in my view, issues that are highly relevant in this context.

For the benefit of our trans-Tasman participants in particular, let me set out the terms of section 1324 of the *Corporations Act* (or rather, the most relevant parts of it).

> 1324(1) **[Court may grant injunction restraining]** Where a person has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute:
>
> (a) a contravention of this Act;
>
> (b) attempting to contravene this Act;
>
> (c) aiding, abetting, counselling or procuring a person to contravene this Act;

59 The report is Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties* (1989) paras 2.20 to 2.21 – known as the Cooney Report.

60 LS Sealy, 'Directors' Wider Responsibilities – problems conceptual, practical and procedural' (1987) 13 *Monash University Law Review* 164 at 170.

(d) inducing or attempting to induce, whether by threats, promises or otherwise, a person to contravene this Act;

(e) being in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of this Act; or

(f) conspiring with others to contravene this Act;

the Court may, on the application of the Commission, or of a person whose interests have been, are or would be affected by the conduct, grant an injunction, on such terms as the Court thinks appropriate, restraining the first-mentioned person from engaging in the conduct and, if in the opinion of the Court it is desirable to do so, requiring that person to do any act or thing.

In addition to this subsection, it is also appropriate to note section 1324(10) which provides

> **1324(10) [Damages]** Where the Court has power under this section to grant an injunction restraining a person from engaging in particular conduct, or requiring a person to do a particular act or thing, the Court may, either in addition to or in substitution for the grant of the injunction, order that person to pay damages to an other person.

As can be seen from the language of this section, it appears to create some form of right in shareholders (and others who may establish they have an interest in pursuing a particular matter) to enforce statutory duties and indeed, to obtain damages in appropriate cases. So far, there have been a limited number of cases interpreting section 1324 (and its predecessor) and in my view, these cases support the proposition that I am putting forward. Let me deal with these cases briefly.

The first case of note is *Broken Hill Proprietary Co Ltd v Bell Resources Ltd.*[61] In that case Hempel J held that the relevant section (the predecessor to s1324) 'was intended to enable interested persons to obtain injunctions to prevent actual or proposed contraventions of the [relevant Law]'.[62] Consequently he read 'interest' in the relevant section as referring to 'interests of any person (which includes a corporation) which go beyond the mere interest of a member of the public'.[63]

Hempel J's approach was endorsed by Hayne J in *Allen v Atalay.*[64] Hayne J noted that

> it is in my view arguable that a creditor having a right to prove in the liquidation of a company may be a person whose interests are affected by a contravention which is alleged to have led to the diminution in the value of his claim against the company.[65]

Hayne J's qualification that the creditor would have a right to prove in liquidation may be important in ensuring that this provision is not extended too far in the future. The decision is an important one, in my view.

The attempt by Young J in *Mesenberg v Cord Industrial Recruiters Pty Ltd*[66] to limit the use of s1324 to the regulator or someone appointed by the regulator was rejected by Einfeld J in

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61 (1984) 8 ACLR 609.
62 Ibid at 613.
63 Ibid; quoted by Einfeld J in *Airpeak Pty Ltd v Jetstream Aircraft Ltd* (1997) 15 ACLC 715, at p720 (***Airpeak***).
64 (1993) 12 ACLC 7.
65 Ibid at 10.
66 (1996) 14 ACLC 519.

Airpeak Pty Ltd v Jetstream Aircraft Ltd.[67] In that case Einfeld J noted in *Airpeak* that the 'court has the ultimate discretion in these matters as to whether to grant an injunction, in that it can choose to award damages instead of an injunction, or even refuse relief altogether if it considers the circumstances to be unworthy of relief'.[68] I share that confidence in the ability of our courts to sift through those claims which are clearly specious and those that seek genuine remedy to protect the interests of persons whose interests are affected by appropriate breaches.

In addition Mandie J, in the recent Victorian case of *Vanmarc Holdings Pty Limited v PW Jess & Associates Pty Ltd*[69] indicated, whilst he did not have to decide this issue in the relevant case, that s1324 of the *Corporations Act* may well be appropriate to allow persons 'whose interests were affected by conduct of directors in contravention of the ... Law not only to seek an injunction (s1324(1)) but also damages (s1324(10)) ...'.[70]

The approach taken by Young J was, as I have noted, rejected in later cases. Therefore it is unnecessary to go into detail in discussing his judgment. It is fair to say that at this time, whilst the section is not being utilised a great deal, it will become more relevant if rights are entrenched in legislation for employees and others who will use contingency of the lawyers to initiate litigation. Bearing in mind the powers of the court in section 1324(10) of the *Corporations Act*, it will not be surprising to see employees and others whose interests tend to be protected by the new duties of directors seeking appropriate action.

Whilst I am pleased with the dicta of Gaudron, McHugh, Gummow and Hayne JJ in the High Court decision of *Spies v R*,[71] to the effect that it was extremely doubtful that Mason J had intended to create a new duty owed by directors to creditors in *Walker v Wimborne*, I do not believe that these comments effectively remove the rights that are available to creditors (and employees will be creditors in my view) in seeking remedies under section 1324.

5. How has the law dealt with the rights of directors to represent specific interest groups within a corporate group or a conglomerate?

It is now appropriate to examine the cases that have dealt with the ability of directors to properly represent the interests of persons either appointing them to the board or for whom they believe that they should also act. There are two New South Wales cases, two New Zealand cases and of course the remarks of Lord Denning in an earlier House of Lords decision which offer the most useful insights.

67 (1997) 15 ACLC 715.
68 Ibid at 721.
69 (2000) 34 ACSR 222.
70 Ibid at 227.
71 (2000) 173 ALR 529; 18 ACLC 727.

5.1 The *Scottish Co-op* Case

My starting point is the House of Lords decision in *Scottish Co-op Wholesale Society Limited v Meyer.*[72] A claim that the nominee directors of a particular company were not acting in the interests of the nominee company but rather the interests of the majority shareholder whose interests they were representing was upheld on the basis of the oppression remedy.[73]

Lord Denning made some very interesting comments in dealing with the specific question:

> So long as the interests of all concerned were in harmony, there was no difficulty. The nominee directors could do their duty by both companies without embarrassment. But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position. Thus, when the realignment of shareholding was under discussion, the duty of the three directors to the company was to get the best possible price for any new issue of its shares: ... whereas their duty to the Society was to obtain the new shares at the lowest possible price – at par, if they could. Again, when the Society determined to set up its own rayon department, competing with the business of the company, the duty of the three directors to the company was to do their best to promote its business and to act with complete good faith towards it; and, in consequence, not to disclose their knowledge of its affairs to a competitor, and not even to work for a competitor, when to do so might operate to the disadvantage of the company: see *Hivac Ltd v Park Royal Scientific Instruments Ltd* [1946] 1 All ER 350, whereas they were under the self-same duties to the Society. It is plain that, in the circumstances, these three gentlemen could not do their duty by both companies, and they did not do so. They put their duty to the Society above their duty to the company in this sense, at least, that they did nothing to defend the interests of the company against the conduct of the Society. They probably thought that, 'as nominees' of the Society, their first duty was to the Society. In this they were wrong. By subordinating the interests of the company to those of the Society, they conducted the affairs of the company in a manner oppressive to the other shareholders.
>
> It is said that these three directors were, at most, **not** guilty of inaction – of doing nothing to protect the company. But the affairs of a company can, in my opinion, be conducted oppressively by the directors doing nothing to defend its interests when they ought to do something – just as they can conduct its affairs oppressively by doing something injurious to its interests when they ought not to do it. The question was asked: What could these directors have done? They could, I suggest, at least on behalf of the company, have protested against the conduct of the Society. They could have protested against the setting up of a competing business. But then it was said: What good would that have done? Any protest by them would be sure to have been unavailing, seeing that they were in a minority on the board of the Society. The answer is that no one knows whether it would have done any good. They never did protest. And it does not lie in their mouths to say it would have done no good, when they never put it to the test: ... Even if they had protested, it might have been a formal gesture, ostensibly correct, but not to be taken seriously.
>
> Your Lordships were referred to *Bell v Lever Bros Ltd* [1932] AC 161 at 195, where Lord Blanesburgh said that a director of one company was at liberty to become a director also of a rival company. That may have been so at that time. But it is at the risk now of an application under s210 [see section 232 of the *Corporations Act*] if he subordinates the interests of the one company to those of the other.[74]

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72 [1958] 3 All ER 66.
73 See now section 232 of the *Corporations Act.*
74 [1958] 3 All ER 66 at 87–88.

5.2 *Levin v Clark*

The matter was approached from a different perspective, and with a more favourable point of view as far as nominee directors were concerned, by Jacobs J in the NSW Supreme Court in *Levin v Clark.*[75]

In this case Levin had purchased the majority shareholding in a proprietary company and simultaneously mortgaged the shares to the vendor to secure the future payment of the purchase price. Prior to the sale, the company's articles of association had named Clark and Rappaport as governing directors and conferred extensive powers on them. Under the sale agreement, the articles of association were amended to make the powers of Clark and Rappaport exercisable only in the event of Levin's default under the mortgage agreement.

When Levin defaulted under the mortgage, Clark and Rappaport attempted to exercise their powers as governing directors. Levin sought to restrain them from doing this on various grounds, one of which was that they had breached their fiduciary duty by acting in the interests of the mortgagee rather than the company as a whole. Jacobs J, then sitting as a member of the New South Wales Supreme Court (he later became a member of the High Court of Australia) rejected this argument, holding that the articles of association provided for the interest of the mortgagee being protected upon default by Levin on the mortgage. Hence, the articles of association expressly provided for the breach of fiduciary duty to be narrowed. In this context Jacobs J stated:

> I consider that Clark and Rappaport did act primarily in the interests of the mortgagee once they resumed the exercise of the powers as governing directors. However, I consider that it was permissible for them so to act. It is of course correct to state as a general principle that directors must act in the interests of the company. There is no necessity to refer to the large body of authority which supports this as a general proposition. However, that leaves open the question in each case – what is the interest of the company? It is not uncommon for a director to be appointed to a board of directors in order to represent an interest outside the company - a mortgagee or other trader of a particular shareholder. It may be in the interests of the company that there be upon its board of directors one who will represent these other interests and who will be acting solely in the interest of such a third party and who may in that way be properly regarded as acting in the interest of the company as a whole. To argue that a director particularly appointed for the purpose of representing the interests of a third party, cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle, governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed, by agreement amongst the body of the shareholders. The fiduciary duties of directors spring from the general principles, developed in courts of equity, governing the duties of fiduciaries – agents, trustees, directors, liquidators and others – and it must be always borne in mind that in such situations the extent and degree of the fiduciary duty depends not only on the particular relationships, but also on the particular circumstances. Among the most important of these circumstances are the terms of the instrument governing the exercise by the fiduciary of his powers and duties and the wishes, expressed directly or indirectly, by direction, request, assent or waiver, of all those to whom the fiduciary duty is owed...[76]

On the basis of this quote it may be agreed that, to some extent, the commercial tensions faced by the directors in *Levin* were alleviated by the direction, found in the company's articles

75 [1962] NSWR 686.
76 [1962] NSWR 700.

of association, that the interest of the mortgagee was elevated upon a particular event occurring, namely a default on the mortgage repayments.[77]

5.3 The *Radio 2GB* case

Two years later in the *Radio 2GB* case,[78] Jacobs J reached similar conclusions in emphasizing how directors were 'bound' to act in a particular fashion as representatives of a certain group of shareholders in the company. He held that directors must act in the best interests of the company to which they were appointed as directors. However, he noted that directors may also consider the interests of the group of shareholders they represent, unless to so act would not be in the best interests of the company of which they were directors. In this context his language is again interesting:

> I am satisfied that [these additional directors were] to all intents and purposes, the nominees of the Fairfax companies who would be likely to act and who would be expected by the Fairfax interests to act in accordance with the latter's wishes. At this point I feel that a crucial stage in the analysis is reached. It is my view that conduct of the kind which I have related is not reprehensible unless it can also be inferred that the directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of the company. This is not a conclusion which can lightly be reached and I see no evidence in the case upon which I can reach that conclusion. It may well be, and I am included to regard it as the fact, that the newly appointed directors were prepared to accept the position that they would follow the wishes of the Fairfax interests without a close personal analysis of the issues. I think that at the board meetings of early August that is what they did, but I see no evidence of a lack in them of a bona fide belief that the interests of the Fairfax company were identical with the interests of the company as a whole to have each director approach each company problem with a completely open mind, but I think that to require this of each director of a company is to ignore the realities of company organisation. Also, such a requirement would, in effect, make the position of a nominee or representative director an impossibility ...[79]

5.4 Berlei [80]

Mahon J in the High Court of New Zealand in dealing with a dispute between joint venturers, after referring to the two New South Wales cases previously discussed, made these interesting and telling remarks:

> As a matter of legal theory, as opposed to judicial precedent, it seems not unreasonable for all the corporations [shareholders] to be able to agree upon an adjusted form of fiduciary liability, limited to circumstances where the rights of third parties vis-à-vis, the company will not be prejudiced. The stage has already been reached, according to some commentators, where nominee directors will be absolved from suggested breach of duty to the company, merely because they act in furtherance of the interests of their appointors, provided that their conduct accords with a bona fide belief that the interests of the corporate entity are likewise being advanced.[81]

77 The question of to what extent the shareholders/ members may modify the general law (common law) rules was also considered by the High Court in *Whitehouse v Carlton Hotel Pty Ltd* (1988) 162 CLR 285 discussed below.
78 *Re Broadcasting Station 2GB Pty Ltd* [1964 – 1965] NSWR at 1648.
79 Ibid at 1663.
80 *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150 at 166.
81 [1980] 2 NZLR 150 at 168.

In reaching his conclusions, Mahon J cited with approval comments in Finn's book *Fiduciary Obligations*.[82] This approach was also recently embraced by Thomas J in the New Zealand case of *Dairy Containers Limited v NZI Bank Limited*.[83] In this later case, Thomas J noted that nominee directors would not necessarily have to approach company problems with an "open mind" and that they, in certain circumstances, may pursue the interests of their appointors provided they did not prefer the interests of the nominating company in conflict scenarios. Thomas J suggested that in such a case the breadth of the fiduciary duties had been narrowed by an agreement amongst the incorporators.[84]

6. When can directors safely act in the commercial interests of the so-called group?

On the surface there may be no good reason why, as a matter of principle, in a particular case, directors could not favour one group as opposed to another if this in turn turned out to be in the best interests of the company. A number of cases in which the position of groups of companies have been considered have shown a willingness on the part of judges to allow directors some latitude in carrying out activities which are clearly in the interests of the corporate group even though, in a strict sense, the directors owe their duty to a specific company. But, as the decision in *Walker v Wimborne,* referred to earlier, clearly illustrates, directors who do take into account the interests of a corporate group do so at their peril where specific duties of companies need to be pursued with more vigour and attention than directors might otherwise apply.

The particular issue was considered in the very interesting English case *Charterbridge Corporation Ltd v Lloyds Bank Ltd.*[85] That case has been endorsed in a number of later decisions. However, the most recent decision, a decision of the New South Wales Supreme Court, raises some very real doubts as to the safety of directors favouring the interests of the group. In *Maronis Holding Ltd v Nippon Credit Australia Ltd*[86] Bryson J in the New South Wales Supreme Court held that directors were in breach of their duty because they had unfortunately put in the forefront of their concerns the interests of companies in the group rather than the specific company whose financial constraints were of particular relevance. It is useful to review that decision in order to appreciate some of the critical questions that arise in this context.

Girvan Australia Ltd (*Girvan*) was a member of the Girvan group of companies that included Girvan Corp (NZ) Ltd (*Girvan NZ*). Girvan's directors included Petersen, Duncan and Ambler, the latter two being also the only directors of Girvan NZ. The directors all lived in Australia, although they visited New Zealand from time to time. Through a chain of subsidiaries, Girvan NZ indirectly controlled one of its subsidiaries, Maronis Holdings Ltd (*Maronis*). Girvan controlled 74% of the shares in Maronis, the remaining 26% of the shares being held by members of the New Zealand public. Maronis' principal asset was the Liverpool truckstop site in New South Wales, which the group intended to develop as a transport terminal.

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82 (1977), Law Book Company, at para 114.
83 *Dairy Containers Limited v NZI Bank Limited* [1995] 2 NZLR 30.
84 See discussion earlier and note in particular the impact of section 1324 of the *Corporations Act*.
85 [1969] 2 All ER 1185.
86 (2001) 38 ACSR 404.

In 1989 Duncan and Ambler caused Maronis to mortgage the site to Nippon Credit Australia Ltd (*Nippon*) to secure a loan of A$15m to Girvan. Maronis had no business or affairs other than ownership of the site, had no revenue and no capacity itself to service the borrowings. The directors did not consider giving security or protection to Maronis or Girvan NZ against the risk of Girvan defaulting. Girvan NZ additionally executed a deed of guarantee and indemnity. The guarantee document was incorrectly signed and imperfectly sealed, there was no quorum at the relevant meeting and no notice was given to the other directors. Duncan asserted that he had been appointed under a power of attorney allowing him to execute the guarantee.

At the time of executing the securities, the directors of Maronis were aware that Girvan was experiencing serious cash flow problems and that there was a real possibility it might not be able to discharge the proposed loan. Clayton Utz, solicitors for Girvan, acted for Girvan in handling various related matters including the loan transaction. Clayton Utz did not have instructions from Maronis, but the firm did correspond with the Land Title Office as if it acted for Maronis.

In 1990 Maronis lodged a caveat (that is a document restraining registration of legal title) which would prevent the company dealing with the truckstop site. In the caveat document it claimed that it had certain title rights to the relevant land and that its rights were not in any way restricted by a mortgage. The same day Maronis issued a summons seeking a declaration that the mortgage was void or unenforceable. Nippon filed a cross-claim seeking an order for removal of the caveat.

The court disposed of the proceedings by ordering that the summons be dismissed and the caveat removed. Subsequently, Maronis issued the present proceedings seeking equitable remedies against the directors, the relevant solicitors and Nippon. Bryson J ruled in favour of the plaintiff against the directors but otherwise ruled that the plaintiff failed against the other parties.

The case raised a number of issues, but the one that is of particular relevance is whether directors who decided to borrow funds using the assets of the group in dealing with the problems facing the Maronis company were in breach of their duties.

> Bryson J noted that normal commercial practice within a group of companies was to use mortgage funding to ensure that all development projects could be progressed appropriately. The group's aims would be to ensure that maximum borrowing facilities could be obtained. It was not unusual for payment to have to be made from time to time reflecting the nature of the loan and also the fact that the development of the projects would vary depending on the relevant circumstances. The mere fact that new financing arrangements had to be obtained from time to time, to pick up the 'slack' that was occurring within the group's activities, was not indicative that a crisis was looming and the directors were acting in a 'panic' mode or were trying to favour one company or another.

In determining whether the directors were acting appropriately and were not breaching their duties one asks the question whether they were acting honestly in the discharge of their powers and in the best interests of the company. If it could be shown that the directors acted for any other reason than the interests of the company then this usually amounts to an abuse of power on the part of the directors; it would in certain circumstances also amount to a breach of the directors' duty to act with appropriate care. Bryson J, however, felt that where there was a breach of the relevant duty on the part of the directors it usually had no practical impact on the transaction if the transaction, when viewed as a whole, could be seen to be in the best interests of the company. Generally speaking, notwithstanding the comments made in *Walker v Wimborne* to which I have referred earlier, Bryson J took the view that if the directors were trying to achieve the best result for the group of companies then, if the particular transaction or in this case the borrowings, could be viewed as in the best interests of the company as well then no breach of duty would be said to arise. But this would depend on the facts of the particular case. If it could be shown that the behaviour of the directors was such that they did not give appropriate attention to the interests of the company (in this case the plaintiff) in evaluating the relevant transactions, this would amount to a breach of duty.

In Bryson J's view of the facts in this case, the two directors, Duncan and Ambler, needed to differentiate between the interests of the Maronis company, on the one hand and Girvan NZ and Girvan on the other. After examining the facts in some detail, and referring to the fact that in his view the law did permit directors to take into account the interests of a group in appropriate circumstances, Bryson J noted:

> In my finding directors who were rational adults and who gave any consideration whatever to the interest of Maronis in entering into the transaction could not have decided to give the mortgage. The transaction was momentous for Maronis, and reasonable directors had to address the interest of Maronis in some way which involved reviewing the operation of the transaction on Maronis, addressing conditions such as those ... proposed, or some other array of considerations, and obtaining some recorded commitment by Girvan Australia which could in some way operate for Maronis' protection. In the due exercise of their powers as directors of Maronis there is a very wide range of considerations which Mr Ambler and Mr Duncan could have had regard to and of judgments which they could have formed about what was appropriate; but in no actual address to how they should exercise their powers could they decide to do nothing.[87]

The analysis by Bryson J in *Maronis* (which I believe does not adequately deal with the issues thrown up by the implications of *Walker v Wimborne*) highlights the fact that the directors did owe their primary duty to the Maronis company and not to other companies within the group. The directors were held to be in breach of their duty. It is my view that if you extended that scenario to one involving the use of information or documents that belonged to the Maronis company in pursuing the interests of others within the group, you would reach the same conclusion.

7. The duty not to disclose

This is a critical issue and one that was highlighted in the recent *NRMA* cases which I will discuss and which is clearly relevant in all conglomerate corporate group structures. I should indicate that I have advised NRMA Limited in relation to this matter and so you will no doubt see some 'bias' in the position that I take.

7.1 The *NRMA* cases

The decisions in the *NRMA* cases[88] can in fact be distinguished on the facts. But they do raise some fascinating issues.

The NRMA sought an injunction restraining the four defendants (Stewart Geeson, Anne Keating, Jane Singleton (who were directors of the company) and John Fairfax Publications)

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87 (2001) 38 ACSR 404 at para 311.

88 [2001] NSWSC 832, affirmed on appeal in (2001) 40 ACSR 1.

from publishing or otherwise disclosing information in relation to an NRMA board meeting on 17 September 2001. During this board meeting, the President of NRMA (Nick Whitlam) sought an undertaking from the board members not to disclose certain information which the NRMA regarded as confidential.

The three defendant board members declined to provide that undertaking. NRMA applied to the Supreme Court of NSW for an injunction preventing the disclosure of all board papers or other papers read during the board meeting by the three directors.

At first instance, Bryson J refused the NRMA application. He held that by declining to give an undertaking the directors were not, in the circumstances, threatening to communicate such information. While he found that there were reasonable grounds to believe that Ms Keating would disclose part of the discussions relating to occupation of the chair at the meeting, it appeared that the NRMA Directors Code of Conduct (the *Code*) allowed Ms Keating to do so.[89] Therefore, in his view, there was no proper ground on which she could be restrained. It would not be in breach of her general law fiduciary duties, nor would she be in breach of sections 182 and 183 of the *Corporations Act*. Furthermore, Bryson J found that there was no proper ground for restraining a third party from publishing information disclosed to it by a director in compliance with the Code.[90]

In discussing the NRMA's application for an injunction, his Honour also made several comments in relation to the nature of the NRMA as a company limited by guarantee, and the need for its directors as such to take into account public interest issues in carrying out their obligations. In particular, noting that the membership of the NRMA was large, he made this rather colourful statement which I regard as legally dangerous:

> ...[NRMA's] activities are so pervasive that it does not seem too much to say that the NRMA is part of the general organisation of society in New South Wales. In my view interests of NRMA as a whole would be positively served by making public, for the information of members and others, events and circumstances at a Board meeting ...The readiness of media to report such things is a reflection of real, well-based and widespread interest and concern in the community.[91] [emphasis added]

The NRMA applied for leave to appeal Bryson J's judgment. Its application was dismissed by the Court of Appeal. The judgment was handed down by Ipp AJA (Mason P and Giles JA concurred). The Court of Appeal also reflected on the nature of the NRMA. The view of Ipp AJA was that it was in the interests of a very large mutual association for members to be fully informed, and that sometimes the only way of doing this was through the press. Ipp AJA held that there was also insufficient evidence to suggest that the information, the subject of possible dissemination, was confidential. In reaching this view, he also relied on the constitutional freedom of communication:

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89 The implications of a code or similar agreements aimed at overriding or limiting the duties of directors are discussed below.

90 In his judgment, Bryson J discussed the general principles in relation to the law on confidential information and considered in particular the requirement of detriment in the disclosure of confidential information, finding that it was necessary in this case to show detriment. He also held that protection given by the law of confidential information is not given on a blanket basis.

91 [2001] NSWSC 832 at para 35.

> ...in light of the extent to which the affairs of the applicant are of direct and immediate concern to the members of the public, it is arguable that considerations analogous to those involving *freedom of communication* in relation to public affairs apply. [emphasis added][92]

The facts of the *NRMA* case may well have given the judges the opportunity to dismiss the application for an injunction. I will not be discussing the merits of their decisions further except to deal with specific issues. It was the nature of the comments made by the judges in this case, which invite the opportunity for other courts to impose on directors a broad and at times undefined responsibility, which I believe need consideration. I am concerned that they may invite other judges to expand on the obligations of directors in an unacceptable way. This creates considerable concern in my view, for directors generally and for those advising them.

7.2 Directors' duty of confidentiality and the need to protect corporate information

It is undisputed that directors owe a duty of confidentiality to the company. This is so not only under the common law, but also by virtue of sections 182 and 183 of the *Corporations Act*. The position in New Zealand is similar.

But what is the position of a director who has been appointed to represent another organisation or group of persons on the board of the company with respect to the information that the director obtains? To what extent can the directors pass on the information obtained to those they represent? To what extent can directors make that information available more generally?

A number of recent cases deal with these relevant issues. In my view these cases were not dealt with in the *NRMA* discussions but as noted the interlocutory nature of the litigation in the *NRMA* cases may have made this inevitable. They provide some very important guidelines in evaluating these questions. I will deal with the leading cases on the specific question raised in the *NRMA* litigation. Can directors disclose information which is regarded as confidential, to interests they believe they represent or to the members generally?

7.3 Bennetts v Board of Fire Commissioners of NSW [93]

In *Bennetts* the board in charge of the organisation was constituted by statute and comprised a President and four other members, each elected by a separate constituency. One of the members was elected by the members of the Fire Brigade Employees' Union (the ***Union***). The board had to consider, on the basis of the recommendation of a finance committee of the relevant organisation and after receipt of counsel's advice, whether to appeal an Industrial Commission decision relating to the Union's application for a new award. When the board met to receive and consider this recommendation Bennetts, who had been elected by the permanent firemen to the board, sought a copy of counsel's advice. The chairman agreed to supply the advice but only if Bennetts provided an undertaking not to disclose its contents to the Union. Bennetts refused to give this undertaking.

The main question Street J in the NSW Supreme Court had to consider was what was Bennetts' right to view the advice received from counsel. The right to view the advice was

92 [2001] NSWCA 343 at para 48.
93 (1967) 87 WN (Part 1) (NSW) 307.

affected because Bennetts declared his intention to disclose the details of the advice to the Union.[94]

Street J answered the question in these words:

> By terms of their statutes, boards such as this comprise a number of persons nominated or chosen by various groups, each of which nominating or choosing groups has a direct interest in the public undertaking controlled by the board. Each of the persons on such a board owes his membership to a particular interested group; but a member will be derelict in his duty if he uses his membership as a means to promote the particular interests of the group which chose him...
>
> His position as a board member is not to be used as a mere opportunity to serve the group which elected him. In accepting election by a group into membership of the board, he accepts the burdens and obligations of serving [the shareholders] through the board. This demands constant vigilance on his part to ensure that he does not in the smallest degree compromise or surrender the integrity and independence he must bring to bear in board affairs ...
>
> [T]he predominating element which each individual must constantly bear in mind is the promotion of the interest of the board itself. *In particular, a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interest for which the board exists.* He is most certainly not a mere channel of communication or listening post on behalf of the group that elected him. There is cast upon him the ordinary obligation of respecting the confidential nature of board affairs where the interests of the board itself so require. [emphasis added][95]

Street J acknowledged Bennetts' bona fides in recognising that he was subject to conflicting loyalties, and that he owed the higher duty to the persons appointing him. Street J concluded that notwithstanding these bona fides, the principle governing this issue was the *overriding* duty of Bennetts to the board and that that duty could not be compromised in any degree whatsoever.[96]

As exemplified by *Bennetts*, in considering the duty of confidentiality, consideration of directors' rights to gain access to company information necessarily arises. In this case, counsel for the defendants, with whom Street J agreed, denied that a board member has an absolute right to inspect a document that is clearly confidential, and contended that the right to inspect was a right essentially and fundamentally linked to the execution of a duty cast upon a board member.[97] Hence, Bennetts' declaration of his intended disclosure of the confidential legal opinion to the Union resulted in him being denied access to the confidential legal opinion.

Street J, in delivering his judgment, referred with approval, to various observations made in *Edman v Ross*.[98] This was a case concerning the common law right of directors of a company to inspect and take copies of documents. In the judgment, delivered by a different member of the famous Street family, it was noted:

> The right to inspect documents, and if necessary, to take copies of them is essential to the proper performance of directors' duties, and, though I am not prepared to say that the court

94 Ford *Principles of Corporations Law* at para 9.430 states that *Bennetts* is an example of a case of actual conflict between duty and a wrongly perceived extraneous duty. Reinforcing the principle that a director owes a duty to the company first and foremost, Ford notes Street J's comment that: '... a Board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the Board exists.'

95 (1967) 87 WN (Part 1) (NSW) 307 at 310.

96 Ibid at 312.

97 Ibid.

98 (1922) 22 SR (NSW) 351.

> might not restrain him in the exercise of this right if satisfied affirmatively that his intention was to abuse the confidence reposed in him and materially to injure the company, it is true, nevertheless, that its exercise is, generally speaking, not a matter of discretion with the court and that he cannot be called upon to furnish his reasons before being allowed to exercise it. In the absence of clear proof to the contrary the court must assume he will exercise it to the benefit of his company.[99]

Bennetts makes it clear that the right to access company information will be denied if directors intend to breach their duty in disclosing confidential information they have had access to. But there will always be difficulty in showing that directors are not acting with the appropriate bona fides in seeking the relevant information. The onus will be on those who wish to prevent access in most cases. This particular matter is discussed by Beaumont J in the next case.

7.4 *Molomby v Whitehead*

In *Molomby,*[100] Beaumont J in the Federal Court of Australia had to consider a director's right to access relevant corporate information where that director was in effect representing a particular 'interest' group in the organisation.

Molomby was a law graduate and a barrister, and at the time he brought this case, a director of the Australian Broadcasting Corporation (the *ABC)*. He was appointed to the board on the nomination of the Minister, in consequence of an election held by the staff of the ABC.

The reason for the action was that Molomby sought access to ABC corporate documents relating to claims for legal fees and other matters. Whitehead, the managing director of the ABC at the time, denied Molomby access to these documents. Accordingly, Molomby, in seeking access to the relevant corporate documents, asserted that Whitehead had committed an error of law, arguing that as an incident of his office as director he had a prima facie right or power to see the corporate documents and that no reason existed in his case for displacing that prima facie right.[101]

Molomby was successful in his action, with Beaumont J holding that, prima facie, Molomby was entitled to the information relating to the management and affairs of the ABC. As a director of the ABC, Molomby enjoyed prima facie access to corporate material, to assist him in the proper execution of his fiduciary obligation to advance the interests of the ABC. No initial burden of proof rested upon Molomby to show any particular reason for, or utility in, the grant of access.[102] The evidentiary burden rested upon the ABC to show why his right of access to information should be restricted, or even denied.

Whilst Beaumont J identified a general rule that a director of a company has the right or power to inspect corporate material to advance the interests of the relevant company, he also noted that there were some exceptions to the general rule;[103] two relevant exceptions highlighted by him were that access may be limited:

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99 Ibid at 361.

100 (1985) 63 ALR 282; (1985) 7 FCR 541.

101 Note, by couching his argument in these terms, Molomby acknowledged that there may be occasions where a director's right of access will be denied.

102 It should also be noted that Beaumont J stated that even if Molomby had to make out a case for access, the matters which he was questioning were relevant to the affairs and management of the ABC especially from his standpoint as a lawyer and therefore would have been granted access.

103 *Molomby* at 292. See also Ford at para10.380 where he states that *Edman v Ross* is the Australian authority recognising that the Court will grant the right to inspect only to such an extent as is necessary for the particular occasion.

(a) if the director is not a member of the relevant committee dealing with a particular matter[104]; or

(b) if evidence illustrates that the director's aim was not to fulfil the proper execution of appropriate fiduciary obligations, but rather, to pursue conduct which might be to the detriment of the company.

As noted earlier, there was no initial burden of proof upon Molomby to show any particular reason for, or utility in, the grant of access. Beaumont J endorsed the comments of Street CJ in *Edman v Ross*.[105] In this context Street CJ had stated:

> The right to inspect documents and, if necessary, to take copies of them, is essential to the proper performance of a director's duties and, though I am not prepared to say that the court might not restrain him in the exercise of this right if satisfied affirmatively that his intention was to abuse the confidence reposed in him and materially to injure the company, it is true, nevertheless, that its exercise is, generally speaking, not a matter of discretion with the court and that he cannot be called upon to furnish his reasons before being allowed to exercise it. In the absence of clear proof to the contrary, the court must assume that he will exercise it for the benefit of the company.[106]

Beaumont J also considered[107] the comments of Slade J in *Conway v Petronius*[108] that a director's right of inspection could be rendered more or less nugatory, at least for many months if it could be shown the director's actions were to injure the company or for other improper motives. But in this instance the facts did not require him to rule against the director.

In my view, the judgment of Beaumont J in *Molomby* is consistent with Street J's judgment in *Bennetts*. In *Molomby* there was no evidence that Molomby was pursuing information other than in the discharge of his fiduciary duty. In *Bennetts*, the aim of the director was to elevate the interest of his appointor above that of the Board: he intended to disclose the contents of an important confidential legal opinion, disclosure of which would cause harm to the Fire Commissioners of NSW.

7.5 Harkness v Commonwealth Bank of Australia [109] (Harkness)

This is, in my view, the most important of the three cases which form the key authorities in the area. It most closely deals with a commercial situation and contains very useful comments by the judge on how the relevant principles should be evaluated.

Spedley Securities Limited (*Spedley)* operated in the short term money market. The State Bank of Victoria (of which the Commonwealth Bank of Australia Limited (the *Bank*) became owner) provided a bill facility to Spedley for $4 million. The Bank received bills maturing on 6 December 1988 to the value of $4 million. Later Spedley went into liquidation and the liquidator claimed the $4 million as a preference. The Bank argued that the payment was received in good faith and in the ordinary course of business. Austroclear Pty Ltd (*Austroclear)* cleared transactions in the short term money market by requiring payment from the participating banks (setting out their net position) at the end of each day. Each of the banks (including the Bank) had appointed representatives to the disputes committee of

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104 *Birmingham City District Council v O* [1973] AC 578.
105 *Molomby* at 293.
106 Ibid at 293, quoting from *Edmund v Ross* at 361.
107 Ibid at 293.
108 [1978] 1 All ER 185 at 201.
109 (1993) 12 ACSR 165; 32 NSWLR 543.

Austroclear. The committee dealt with situations where a participating bank refused to clear its position. Condron was the Bank's representative and as a member of the committee, obtained knowledge of an incident on 9 November 1988 in which Spedley's obligation in respect of the sum of over $880,000 was not met. Condron mentioned this incident to other officers of the Bank. It was argued that the Bank had become aware of this fact, thus it had lost the protection available to it under the relevant insolvency rules. In effect, the Bank knew that the payment was a preference.

Counsel for the liquidator argued that Condron should be assumed to have passed on the information to the Bank because, as a representative on the board of another entity, the knowledge of that nominee should be attributed to the appointer. In this context Young J had to consider the nature of the duty of confidence owed by Condron. The liquidator relied on the following passage in *Bowstead on Agency*:

> When any fact or circumstance, material to any transaction, business or matter in respect of which an agent is employed, comes to his knowledge in the course of such employment, and is of such a nature that it is his duty to communicate it to his principal, the principal is deemed to have notice thereof as from the time when he would have received such notice if the agent had performed his duty.[110]

Whilst acknowledging the general application of this rule, Young J noted that there could be situations where by consent of both companies, a nominee director could be requested to report back to the company appointing that director. But this was not the situation which applied as a rule of thumb.[111]

Young J relied particularly on *Bennetts* case and noted:

> Nomination of the individual members and their election to membership by interested groups ensures that the board as a whole has access to a wide range of views, and it is to be expected within this wide range of views that inevitably there will be differences in the opinions, approaches and philosophies of the board members. But the predominating element which each individual must constantly bear in mind is the promotion of the interests of the board itself. In particular a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the board exists. He is most certainly not a mere channel of communication or listening post on behalf of the group which elected him. There is cast upon him the ordinary obligation of respecting the confidential nature of board affairs where the interest of the board itself so requires.[112]

In his view, *Bennetts* case provided the relevant principle, although the decision did refer to confidential proceedings of the board. After reviewing a series of cases including *Bennetts* and *Molomby*, Young J concluded:

> While ordinarily there will be a duty to communicate knowledge received, where a director is functioning within another corporate organisation and information comes to the director in the course of that work with the other organisation, his duty of confidentiality to that other organisation will subsume any duty he might otherwise owe to the company which appointed him to that organisation. The use of the word 'representative' does not take the matter any further. Whether a person is elected by a special interest group, considered to be a

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110 *Bowstead on Agency*, 15th ed (1985) art 102(2) at 412.
111 (1993) 32 NSWLR 543 at 551.
112 Ibid at 552.

> representative of one group or another group, or a nominee director, does not alter the fact that the person owes the duty of confidence to the board to which he or she has been appointed.[113]

This statement by Young J not only reinforces that directors owe a duty of confidentiality to the company on whose board they sit, but this duty of confidentiality subsumes any duties they may owe to the company that appointed them as director.[114]

In relation to obligations relating to confidential information, Young J made certain other relevant observations which are particularly pertinent to the *NRMA* situation:

> There is sometimes difficulty in classifying what is confidential and what is not, and indeed, different board members may have different views on *borderline* items. It is quite clear that a resolution unanimously supporting the public utterance of the Chairman [of the Board] could not be confidential. On the other hand, a resolution authorising the general manager to negotiate for the purchase of another company would obviously be confidential. In between are situations where judgment is called for. Some Board members may consider that selective leaking of information and gaining reaction may be for the benefit of the company but this is always a dangerous attitude to adopt. The *safest course to take is to obtain approval from the Board by resolution to the communication of any information outside the Board so that the director knows where he or she stands.* Sometimes, however, it does not occur to a director to ask for such approval until well after the meeting has concluded. What is confidential is not to be found merely by looking to see whether someone has marked 'confidential' against an item. The obligation of directors is to keep secret any matter which is discussed, the communication of which might detrimentally affect the company; indeed, even the issuing of information as to who voted in what way on a particular resolution may detrimentally affect the working of a company if it is breezed abroad. The duties of a person whether a director or an executive who serves on a committee of an organisation will be much the same. (emphasis added)[115]

Young J also reconciled the earlier views expressed in *Bowstead* by citing commentary at article 102 of that work where it is stated that:

> If a person is a secretary of two companies, knowledge acquired by him as secretary of one of the companies will not be imputed to the other company, unless the knowledge was acquired in such circumstances as to make it his duty to communicate it to such other company.[116]

He added that if directors were to obtain information which was important to the affairs of the company, there would be a duty both to communicate the information to the company and also to receive it.[117] However, whilst ordinarily there was a duty to communicate knowledge received, where directors were functioning within another corporate organisation and information comes to them in the course of that work with the other organisation, their duty of confidentiality to that other organisation would subsume any duty they might otherwise owe to the company which appointed them to that organisation.[118]

7.6 Endresz[119]

One other interesting case dealing with this issue that is worth noting is *Endresz*. In this case the Full Court of the Victorian Supreme Court accepted the reasoning in *Harkness*. The

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113 Ibid at 555.
114 Ford, at para 9.050, supports this view by stating that any duty to the appointor is subject to the duty of confidentiality to the company of which the person is a director, citing *Harkness*.
115 *Harkness* (1993) 32 NSWLR 543 at 552–553.
116 Ibid at 553.
117 Ibid at 555, citing Justice Von Doussa in *Beach Petroleum NL v Johnson* (1993) 115 ALR 411 at 566.
118 (1993) 32 NSWLR 543 at 553.
119 *Endresz v Whitehouse* (1997) 139 FLR 359; [1998] 3VR 461; (1997) 24 ACSR 208.

appellant, Endresz, was found guilty by a magistrate of eight charges contrary to the *Companies (Acquisition of Shares) (Victoria) Code*. The offences arose out of Endresz's activities whilst acting on his own behalf and on behalf of a company controlled by him (CTC Nominees Pty Ltd (*CTC*)) in obtaining control of a mining company (Emu Hill Gold Mines NL (*Emu Hill*)).

> Various issues were raised on appeal, including whether representations made by Endresz to the Australian Stock Exchange (*ASX*) contained a statement that was false or misleading in a material particular and was likely to have the effect of maintaining or stabilising the market price of securities, namely shares in Emu Hill. Endresz's contention was that the answers given by him in the letter to the ASX were given by him as chairman of the board of directors of Emu Hill and not in his capacity as director of CTC, and that the duty of confidentiality which he owed to CTC precluded him from being required to answer a letter to Emu Hill on the basis of any knowledge which he had gained purely as an officer of CTC.

Ormiston JA, who delivered the judgment of the Full Court, acknowledged the correctness of the judgment of Young J in *Harkness*. He noted that Young J referred to the principle as being that 'the obligation of directors is to keep secret any matter which is discussed, the communication of which might detrimentally affect the company'.[120] Ormiston JA also referred to academic commentary on the issue, *Ford's Principles of Corporations Law*,[121] where it is stated:

> A distinction has to be drawn between the case where the director is a controller of two companies and where the director is only one of several directors of two companies. In the former case each company will know what the other knows because they have the same directing mind and will: attribution of the director's knowledge to each company does not depend on the existence of duty but on the director being identified with each company as its directing mind and will.
>
> The authors appear to have regarded the question of *duty* not to disclose as paramount in this situation. Where a director is only one of several directors on a board, that person's knowledge will not be imputed to the company or companies the director represents unless the facts clearly require such a conclusion.[122]

7.7 Conclusion

These cases have made it clear that persons who believe that they need to provide information to their 'constituency' must reflect carefully on the fact that their primary obligation is to the company to which they have been appointed. Of course, where directors are appointed 'at large', as it were, and do not represent any particular constituency or group, then it goes without saying that the principles that have been laid down in these cases apply equally to them. Is there any justification on the part of any directors to suggest that because of public interest issues they must report what is happening within a company to the public at large? Apart from the fact that much of what is happening may be confidential, the directors also run the risk that if they use the information they could be using what is generally known

120 Ibid at 228.
121 Ford at para 16.220.
122 Ibid 172.

as inside information which may create other problems under the provisions of the *Corporations Act*.[123]

8. Statutory innovations – section 187 of the *Corporations Act* and section 131 of the *New Zealand Companies Act*

Briefly I want to discuss these provisions which, in their own way, provide some relief for directors who are required to act on behalf of a group enterprise (the conglomerate) rather than individual companies. Section 187 of the *Corporations Act* was modelled on section 131 of the *New Zealand Companies Act*. However, in New Zealand, the modification of the duties of directors extends beyond the wholly owned subsidiary scenario (which section 187 covers) to partly owned subsidiaries and, indeed, even joint venture companies. The conditions that directors must satisfy in each case are quite similar and I do not need to discuss these, as they are probably well known to you. It is interesting to note that so far the Australian government has not accepted recommendations of what was the Companies and Securities Advisory Committee (now known as CAMAC) in its final report on corporate groups.

The Australian committee did not, however, extend their recommendations to cover the position of the joint venture company. This might be seen to be just a little too 'rich' for some law reformers because of the considerable problems that can be thrown up by the scenarios that face directors in the joint venture situation. In that context (again, I do not have time to go into this in detail but one can imagine the difficulties that can arise) the recent decision of the Western Australian Supreme Court in *Japan Abrasive Materials Pty Ltd v Australian Fused Materials Pty Ltd* is relevant.[124] In this case, the question was whether directors appointed to a joint venture entity should be able to take into account the interests of their appointer in pursuing their tasks. Templeman J adopted what some would see as a commercially practical approach, reflected in the earlier decisions of Jacobs J in the New South Wales Supreme Court, in committing the directors to pursue the interests of their appointors (see sections 5.2 and 5.3 above). The relevant Shareholders' Agreement in this case, however, permitted the directors to vote in accordance with the wishes of their joint venturers.

I have already raised the question whether the drafting of relevant documents such as a code, might give the directors a type of 'comfort' in such situations. Certainly Jacobs J was attracted to this approach. The High Court of Australia has also provided some comfort in that scenario. In *Whitehouse v Carlton Hotel Pty Ltd*[125] the court accepted the proposition that the articles of association or, indeed, a separate document or agreement, etc:

> may be formed so that they expressly or impliedly authorise the exercise of the power [in that case the allotment of unissued shares] for what would otherwise be a vitiating purpose.[126]

But, with great respect to the High Court and to the judgment of DeBelle J in *Pascoe Limited (in liquidation) v Lucas*,[127] the ability of shareholders to ratify breaches of duty of directors (prospectively or retrospectively) does not take proper account of the impact of section 1324 of

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123 See in particular sections 1002G and 1013 of the Act which deal with the prohibition against dealing with inside information.

124 (1998) 16 ACLC 1172. See also the interesting observations of Barrett J in *Hopkins Professional Services Pty Ltd & Ors v Foyster Holdings Pty Ltd & Ors* (2001) 39 ACSR 519.

125 (1987) 70 ALR 251.

126 (1987) 162 CLR 285 at para 6.

127 (1998) 16 ACLC 1247.

the *Corporations Act,* which I have discussed earlier (see section 4.5) and which, to my mind, creates a significant hurdle for persons who suggest that they can escape the wrath of dissatisfied shareholders or others. In that context, I also refer you to an interesting judgment of Santow J in *Miller v Miller & Miller.*[128]

Santow J rejected the approach that was later taken by DeBelle J. Whilst he did not refer to any authority for his statements, he noted that ratification can never be a blanket indemnification or exception of the duties of directors on a prospective basis. In his view, ratification could not cure a breach of statutory duty (such as is imposed by sections 180 and following) especially those which impose criminal liability. As Santow J noted in that case, the most that ratification or a document of the kind we are discussing can do is:

> Remove from the scope of technical dishonesty such actions as issuing shares for a purpose which is not a proper one, in the sense of not being for the benefit of the company as a whole.[129]

My views are supported further by the existence in the legislation of specific statutory provisions which empower the court to forgive directors for breaches of the several penalty provisions contained now in sections 180 and following. Sections 1317S and 1318 of the *Corporations Act* (previously section 1317JA) provide clear examples of how the directors should seek to avoid liability in circumstances of these kinds.

In the event of conflict, directors cannot rely on the constitution or any of the kinds of agreement that existed in some of the cases discussed.

9. Solutions – what should a director do?

It is clear from the statements made in a number of cases (*Scottish Co-op* and other cases) that directors do in fact 'enjoy' a number of options when cases of conflict arise. The issue was particularly well canvassed, in my view, by Justice Owen (now sitting as the Royal Commissioner in the HIH enquiry, which of course involves issues of conflict of interest, amongst other issues). His observations may therefore be even more significant.

In *Fitzsimmons v R*[130] the question was quite specific as to what directors could do in cases of conflict when in effect they had to serve two masters. Owen J put forward these views.[131]

> The minimum requirement will be a disclosure of the interest. This is simply part of, or an extension of, the statutory obligation that a director who is in any way 'interested' in a contract or proposed contract with the company, must declare the nature of the interest at a meeting of the directors [see now section 231 of the *Corporations Act*]. What action, above and beyond mere disclosure, the director must take will vary from case to case, depending on the subject matter, the state of knowledge of the adverse information, the degree to which the director has been involved in the transaction, whether the director has been promoting the cause, the gravity of the possible outcome, the exigencies and commercial reality of the situation and so on. It may not be enough for the director simply to refrain from voting or to even absent himself or herself from the meeting during discussion of the impugned business. The circumstances may

128 (1995) 16 ACSR 73.
129 Ibid at 89.
130 (1997) 23 ACSR 355.
131 Ibid at 358-359.

> require the director to take some positive action to identify clearly the perceived conflict and to suggest a course of action to limit the possible damage.[132]

Owen J referred with approval to remarks of Ipp J in *Permanent Building Society (in liq) v Wheeler.*[133] In that case Ipp J noted that the director could not simply sit on his hands and do nothing where the director knew that a potential investment being pursued by a company on whose board he was serving, and in respect of which he had a conflict of interest, was a poor investment. In his view, the responsibility facing the director was to ensure that the other directors appreciated the potential damage to the company inherent in the transaction and to point out steps that could be taken to reduce the possibility of that damage. Or, as the judge put it, the director could 'not avoid that duty by, metaphorically speaking, burying his head in the sand while his codirectors discussed the potentially detrimental transaction'.[134]

What else did Owen J suggest that the relevant director could do? He noted that this did not mean that the director could simply resign his office. But, in the particular circumstances resignation may have been the only course open. Owen J observed that it had been a long commercial practice for persons (whether as professional directors or on a casual basis) to take up directorships in several companies. He also noted that the law suggested that this might lead to some great difficulties for directors. In that context he referred to the High Court decision in *R v Byrnes*[135] where the High Court accepted that whilst disclosure was a very important first step, it might not be the only thing a director could do.

Unfortunately, Owen J, after making the earlier comments quoted above, did not offer conclusive advice on what a director could do. He added:

> It is not for me to say what he should have done to avoid a breach of duty. There may have been some disclosure or recommendation he could have made, short of resignation, that might have complied with his obligations ... without infringing the duty of confidentiality that he owed [to the other company]. On the other hand, once he had realised the gravity of the situation, he might have come to the conclusion that the conflict was irreconcilable and that resignation was the only option. It was a matter for him.[136]

Resignation or something similar was also considered relevant in certain insolvent trading cases. Directors of a company which was about to engage in a transaction that might breach the equivalent of section 588G of the *Corporations Act* might do what Hodgson J suggested in *Standard Chartered Bank of Australia Ltd v Antico.*[137] In this case Hodgson J, in considering the plight of directors who did not wish the company to incur a debt but who felt powerless to try to stop the company from engaging in the relevant activity, said that the director might at least consider the following steps.[138]

> [The] single director [could] seek to persuade a managing director not to incur a debt, or to call a directors' meeting with a view to stopping the occurring of debts, or to resign, or to seek to have the company wound up...

These statements were repeated with approval by Simos AJA in *Byron v Southern Star*[139].

132 Ibid at 358-359.
133 (1994) 14 ACSR 109.
134 Ibid at 160.
135 (1995) 183 CLR 501.
136 (1997) 23 ACSR 355 at 359.
137 (1995) 38 NSWLR 290.
138 Ibid at 366.
139 (1996) 22 ACSR 553.

What other steps not discussed by the judges in these cases are available to the director in cases of this kind?

(a) The director could, in appropriate circumstances, refer the matter to the auditors of the company, indicating that there were issues that needed to be addressed. The director may be able to do little more than simply alert the auditor to the problem. This would be particularly relevant if the director was under a duty of confidentiality to the company.

(b) The director could approach the Australian Securities and Investments Commission and suggest to it that certain steps needed to be taken.

(c) Should the director go to the press in such circumstances? This was chosen by the directors, in a different context, in the *NRMA* case which I have discussed earlier. Such a step is one that I believe is fraught with danger. Going to the regulator, in contrast, may be an obligation that the director has to accept because of the role of the regulator in overseeing the activities of companies generally.
(1990) 4 WAR 357.

It is clear, from the comments made by Owen J in *Fitzsimmons* and the sentiments expressed by the High Court in *R v Byrnes*[140] that the acceptance of appointment to numerous boards, especially where potential conflicts might arise, is a dangerous and unattractive option, especially at this time with so much emphasis being placed on conflict of interest and related matters.

I hope this discussion has been of some assistance to you. If I have done no more than highlight the gravity of the problems, and the need to ensure that directors do not allow themselves to get into difficulty (or that you advise your clients to avoid getting into such difficulties), I feel I have done enough.

Far too often professionals and directors treat as trite the proposal that they should not allow a conflict to occur. The implications of some of the decisions I have discussed suggest that these are not trite issues. To continue to adopt this approach is to bury one's head in the quicksand that this area of the law has developed.

140 (1995) 183 CLR 501.