

THE HON TF BATHURST
CHIEF JUSTICE OF NSW*

IT TOLLS FOR THEE: ACCESSORIAL LIABILITY AFTER *BELL v WESTPAC*

BANKING AND FINANCIAL SERVICES LAW ASSOCIATION ANNUAL
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1. Prior to the decisions in *Bell Group v Westpac*,¹ the following principles concerning the fiduciary duties of directors and accessorial liability were, I would suggest, relatively clear.
2. First, it was widely accepted that in some but not all cases of breach of directors' duties, one or more of the two limbs of what has been described as "the rule in *Barnes v Addy*"² could render a third party dealing with a company accountable or liable. The third party could be held to account for company property or be held liable to pay equitable compensation for knowing participation.
3. I say some but not all cases of breach, because, at least since *Breen v Williams*,³ it was generally considered that *Barnes v Addy* liability could only arise in what I will describe as cases of breach of fiduciary obligation *in the strict sense*. That is, *Barnes v Addy* liability arose in cases of breach of the proscriptive obligations imposed on fiduciaries not to place interest in conflict with duty or to derive an unauthorised profit from their position, and did not go beyond those obligations.
4. The proposition that fiduciary duties are limited to the proscriptive "no profit" and "no conflict" rules was endorsed in unqualified terms by Justices Gaudron and McHugh in *Breen*. Their Honours stated:

In this country, fiduciary obligations arise because a person has come under an obligation to act in another's interests. As a result, equity imposes on the fiduciary proscriptive obligations - not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not otherwise

* I express my thanks to my Research Director, Ms Sienna Merope, for her assistance in the preparation of this paper.

¹ *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239, (2008) 70 ACSR 1; *Westpac Banking Corporation v the Bell Group Ltd (In Liq) (No 3)* [2012] WASCA 157, (2012) 89 ACSR 1.

² *Barnes v Addy* (1874) LR Ch App 244.

³ [1995] HCA 63, (1996) 186 CLR 71

impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed.⁴

5. Their Honours also clarified the rationale for this restriction, stating:

The law of fiduciary duty rests not so much on morality or conscience as on the acceptance of the implications of the biblical injunction that "[n]o man can serve two masters". Duty and self-interest, like God and Mammon, make inconsistent calls on the faithful. Equity solves the problem in a practical way by insisting that fiduciaries give undivided loyalty to the persons whom they serve.⁵

6. Justice Gummow, somewhat more cautiously, described the limited scope of fiduciary obligations in the following terms:

Fiduciary obligations arise (albeit perhaps not exclusively) in various situations where it may be seen that one person is under an obligation to act in the interests of another. Equitable remedies are available where the fiduciary places interest in conflict with duty or derives an unauthorised profit from abuse of duty. It would be to stand established principle on its head to reason that because equity considers the defendant to be a fiduciary, therefore the defendant has a legal obligation to act in the interests of the plaintiff so that failure to fulfil that positive obligation represents a breach of fiduciary duty.⁶

7. This limitation of fiduciary duties to the proscriptive obligations articulated in *Breen* has been subsequently affirmed by the High Court, including in *Pilmer v The Duke Group Ltd (in liq)*⁷ and recently in *Friend v Brooker*.⁸

8. The cases in which the principles in *Barnes v Addy* have been applied in a corporate context to render third parties accountable have until recently been generally limited to a breach of such obligations. The obligations on directors in this context have been stated in various ways. They have been commonly divided into three categories: the conflict rule – a director must not in any matter falling within the scope of his or her engagement have a personal interest or an inconsistent engagement to third parties; the profit rule – directors must not use their position for their own or third parties' advantage; and the misappropriation rule – company directors must not misappropriate the company's property for their own or a third parties' benefit.

9. As can be seen, expressed in this way the obligations fall within the proscriptive duties. However, directors' fiduciary obligations have also been commonly expressed in different if not wider terms. The formula is

⁴ *Breen v Williams* (1996) 186 CLR 71 at 113.

⁵ *Breen v Williams* (1996) 186 CLR 71 at 108.

⁶ *Breen v Williams* (1996) 186 CLR 71 at 137-138.

⁷ [2001] HCA 31; (2001) 207 CLR 165 at [74] per McHugh Gummow Hayne and Callinan JJ and at [127]-[128] per Kirby J.

⁸ [2009] HCA 21; (2009) 239 CLR 129 at [84]-[85] per French CJ, Gummow, Hayne and Bell JJ.

well-known – a duty to act bona fide in the best interests of the company and a duty to exercise power for proper purposes.

10. It is difficult to conceive how any breach of the so-called proscriptive obligations could not constitute a breach of a duty to act bona fide in the interests of the company. However, there are instances of failure to act in the best interests of the company which at least possibly would fall outside such obligations. One is where the course of conduct adopted by the director was so extravagant that no reasonable person could consider it in the best interests of the company. Another significant area is in the context of a group of companies where there is a failure to consider the interests of individual corporations, as distinct from a conscious preference to prefer the interests of one company in the group over another.⁹ It has been held with some reservation that such conduct did not constitute a breach of a director's obligation in circumstances where an intelligent and honest man in the position of the director of the company concerned could have, in the existing circumstances, reasonably believed that the transaction was for the benefit of the company.¹⁰ This principle is commonly referred to as the "*Charterbridge* test".¹¹ In *Equiticorp*, the majority, noting that no party had suggested that the *Charterbridge* test did not apply, upheld the finding of the primary judge that there was no breach of duty in the particular circumstances of that case.

11. The majority however expressed doubts about the correctness of the *Charterbridge*, stating:

"The directors are bound to exercise their powers, bona fide, in what they consider is in the interests of the company and not for any collateral purpose. Whether they did so or not is a question of fact...Accordingly there seems to us to be difficulties in substituting an objective test (How would an intelligent and honest man have acted?) for the factual question raised in the proceedings...A careful analysis of the factual situation will usually reveal the answer to the factual question posed although no doubt on some occasions the problem may very well be a difficult one.

We are mindful of the fact that Pennycuik J was not substituting the objective test for the subjective one which had traditionally been applied. In his view the occasion to apply the objective test only arose when it was clear that the directors had not considered the interests of the relevant company at all. In a sense he proposed a legal test to be applied only in limited cases to avoid what he regarded as an absurd situation.

Nonetheless we have reservations about this means of resolving those difficulties. A preferable view may be that where the directors have failed to consider the interests of the relevant company they should be found to have committed a breach of duty. If, however, the transaction was, objectively viewed, in the interests of the company, then no consequences would flow from the breach. Such an inquiry would not require the court to consider how

⁹ See *Walker v Wimborne* (1976) 137 CLR 1 at 6-7.

¹⁰ *Equiticorp Finance Ltd v Bank of New Zealand* (1993) 32 NSWLR 50, following *Charterbridge Corporation Ltd v Lloyds Bank* [1970] Ch 62 at 74-75.

¹¹ *Charterbridge Corporation Ltd v Lloyds Bank* [1970] Ch 62.

the hypothetical honest and intelligent director would have acted. On the contrary it would accept that a finding of breach of duty flows from a failure to consider the interests of the company and would then direct attention at the consequences of the breach. However the approach adopted by the parties in this case both before Giles J and this Court requires that the *Charterbridge* test be applied and absolves the Court from further considering this tantalising question.”¹²

12. One difficulty with this approach is that a transaction entered into without a consideration of the interests of the company could result in loss, even if the transaction, at the time of its entry, could objectively be seen to be in the company’s interests. In those circumstances, consequences would flow from the breach.
13. Kirby P (as his Honour then was) reached a contrary view as to breach and having done so applied the second limb of *Barnes v Addy* to impose liability on the respondent.
14. *Equiticorp* was decided before *Breen v Williams* and Kirby P was in dissent. It is not binding authority that a failure to have regard to the interests of a company, as distinct from entering into a transaction to its detriment for the purpose of benefiting another company in the group, amounts to a breach of fiduciary obligations to which accessorial liability under *Barnes v Addy* principles would attach.
15. The second class of cases where a breach of directors’ duties has not fallen within the scope of the proscriptive obligations is where the directors exercised their powers for a purpose inconsistent with the purpose for which the power was conferred. Such an exercise of power has been held to be an exercise for an improper purpose regardless of whether the directors subjectively believed that the exercise of the power was in the best interests of the company. The most common example is the issue of shares for an improper purpose. This form of breach however has not been understood as attracting what I have called *Barnes v Addy* liability.
16. Further, whether cast as an equitable obligation or, at least since *Daniels v Anderson*,¹³ as a common law duty, it has been well accepted that directors owed a duty of care to the company. It has, however, never been suggested that the breach of this duty would give rise to rights against third parties, even if those third parties benefited from the breach.
17. Now, this is not to say that remedies against third parties were not available when a breach of directors’ duties, not falling within the so-called “proscriptive obligations”, occurred. No matter the bona fides of the directors, the exercise of a power to allot shares for a purpose other than the purposes for which the power was granted has long been held to constitute a breach of their duties. Unless the third party was a bona fide

¹² *Equiticorp Finance Ltd v Bank of New Zealand* (1993) 32 NSWLR 50 at 148.

¹³ *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (‘AWA Case’) (1995) 37 NSWLR 438.

purchaser for value without notice, the transaction was liable to be set aside.¹⁴ Indeed that is exactly what occurred in *Howard Smith Ltd v Ampol Petroleum Ltd*,¹⁵ where the Privy Council affirmed the finding of Street CJ in Equity (as his Honour then was) that the directors' power to issue shares had been exercised for the improper purpose of diluting the majority shareholder's voting power.¹⁶ Further, long before *Barnes v Addy* was decided, accessorial liability had been imposed for breach of trust, in circumstances falling outside the "two limb" formulation.¹⁷

18. In these circumstances, prior to the decision of the Western Australian Court of Appeal in *Westpac Banking Corporation v the Bell Group Ltd (In Liq) (No 3)* I venture to suggest the following propositions were generally accepted:

- i. Directors' fiduciary obligations were limited to those of a proscriptive nature. The breach of those obligations would render directors liable to the company and provided the preconditions in *Barnes v Addy* were satisfied, third parties who received company property or knowingly participated in breaches by the directors of their fiduciary obligations, could be held accountable to such breaches.
- ii. Although the equitable obligations of directors extended beyond those proscriptive obligations, a contravention of them would not lead to accessorial liability on *Barnes v Addy* principles. That is not to say that a transaction entered into for an improper purpose could not be set aside against a person who was not a purchaser for value without notice.
- iii. A transaction entered into by directors believing it to be in the best interests of the company and not in order to obtain an advantage for themselves or for a third party was not a breach of fiduciary obligations such to attract accessorial liability under *Barnes v Addy* principles. In particular, transactions entered into in breach of a duty of care by the directors or falling short of an objective standard considered appropriate by a court did not constitute a breach of a fiduciary obligation.

19. It must be remembered that this structure was founded on authorities that did not deal specifically with the position of directors. However, the High Court's expression of the principle in *Breen* to which I have referred was unequivocal and in general terms. In those circumstances it has been

¹⁴ see R P Austin, H A J Ford & I M Ramsay, *Company Directors: Principles of Law and Corporate Governance* (Lexis Nexis, 205) at 306.

¹⁵ (1974) 1 NSWLR 68.

¹⁶ (1974) 1 NSWLR 68 at 79-80.

¹⁷ see for eg *Fyler v Fyler* (1841) 49 ER 216; *Eaves v Hickson* (1861) 54 ER 840, discussed in *Farah Constructions Pty Ltd and Ors v Say-dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR at [161].

accepted as binding by courts of first instance and intermediate courts of appeal, as either ratio or seriously considered dicta.

20. This structure provided, I venture to suggest, a fairly well settled set of parameters under which persons dealing with companies and their advisers could operate. In particular, it generally meant that parties dealing at arms length with a company with apparently reputable directors did not have to enquire whether a transaction which the directors proposed to enter into was objectively in the best interests of the company, or whether the directors were acting for proper purposes.
21. It must also be remembered that the general law remedies were not, and are not, the only remedies available for a breach by directors of their duties. Directors will be liable for breach of the duties imposed upon them under Div 1 of Pt 2D of the *Corporations Act* 2001 and persons involved in such contraventions within the meaning of s 79 of that Act are also liable for breaches of directors' statutory duty of good faith and for contravention of the statutory provisions against misuse of power contained in s 181, s 182 and s 183 of the Act. Further, in the case of insolvent companies, there is also the power to set aside insolvent and uncommercial transactions contained in Div 2 of Pt 5.7B of the Act.
22. This structure, as it stood before *Bell v Westpac*, in my opinion adequately balanced the right of the company and through it, its members and creditors, to be protected against improper and improvident transactions and the rights of third parties dealing with the company.

The Bell Group Decisions

23. The question I want to address in the remainder of this paper is whether and to what extent the decisions in *Bell* have altered this structure. If *Bell* is correct, it has possibly altered the structure in the following ways: first, it has expanded liability under *Barnes v Addy* principles to circumstances going beyond breach of one or other of the proscriptive fiduciary obligations. Second, it has altered the content of a director's duty to act bona fide in the best interests of the company and for proper purposes. I say possibly because the opinion of the Primary Judge and the Judges who made up a majority in the Full Court are by no means uniform. I will consider findings made both by Justice Owen at trial, and by the majority of the Court of Appeal. On appeal, acting Justice Carr was of course in dissent on many of these issues.
24. I won't spend too much time going through the facts in *Bell*. They are no doubt familiar to many of you, and perhaps seared into the memory of some. I will however just give the briefest of outlines to set the scene for the issues I would like to discuss.
25. As you know, the proceedings arose from an attempted restructure by the directors of The Bell Group Ltd to avoid impeding liquidation. The Bell

Group Ltd (TGBL), was the parent company of the broader Bell group, which was made up of some 100 companies both in Australia and internationally. The companies were connected through interlocking loans. In the 1980s, the Bell group had raised significant finance, including through borrowings from a number of banks in Australia and the UK. Generally speaking the loan arrangements were as follows. The Australian banks, each of which had separate arrangements with the Bell group, lent money to the holding company, TGBL, and its subsidiary, Bell Group Finance Pty Ltd – which acted as the treasury entity of the group. These loans were unsecured. There were then a number of subsidiary companies that made both negative pledges and provided guarantees of indemnity to the banks. I should add however that not all the companies in the wider Bell group had entered into that arrangement. The UK banks, operating as the Lloyds syndicate, lent money to Bell Group UK, which was another of the subsidiaries of TGBL, and to Bell Group Finance. Those loans were also unsecured but were guaranteed by TGBL. No other Australian Bell company had exposure to the UK banks.

26. Under these arrangements, the banks were the group's major, but by no means only creditors. After the 1987 stock market crash, the banks that had lent to the Bell Group became increasingly concerned about repayment of their unsecured loans. By mid 1989 it became clear that the Bell group has insufficient funds to clear its debts. On that basis, the banks refused to grant further funding and threatened to call up their loans, unless a number of conditions were met, including that they be granted security for their loans. At the relevant time, the banks could have called for full repayment of their loans at any time. It was common ground that if one bank had made such a demand, the likelihood is that the other banks would also have done so and that the entire group would have been forced into liquidation, through a domino effect.
27. It was in that context that the directors entered in an agreement to refinance their debt. The essence of the refinancing arrangement was that every company in the group agreed to be liable for the loans from both the UK and Australian banks and to provide security for those loans. By that arrangement some subsidiary companies with no prior indebtedness to either the UK or Australian banks mortgaged their assets.
28. It is I think uncontroversial to say that the purpose of this arrangement was to buy TGBL some breathing space, in which the directors could try to restructure the companies' affairs in order to ensure TGBL's, and therefore the broader group's, ongoing survival. It was accepted by Justice Owen at trial that the primary executive director of TGBL, Mr Aspinall, thought that if he could "get the banks off his back" for 12 months, he could save the Bell group through a restructure. Indeed it was common ground between the parties that the directors were not acting for any dishonest or fraudulent reason, or to gain any personal advantage. As events transpired, there was no successful restructure and the companies in the Bell group were placed into liquidation. The banks realised their security and recovered \$283 million. Subsequently, the liquidators commenced proceedings

against the banks to recover those proceeds, on the basis of various claims, including *Barnes v Addy* liability.

29. The central complaint in the proceedings was that the restructure represented a breach of the directors' duties and that the banks had either participated in or received securities knowing of those breaches, therefore leaving them liable to disgorge the proceeds from realisation of those securities. In the most general terms, the breaches by both the UK and Australian directors were said to arise from their failure to consider the interests of each company in the Bell Group separately, including the interests of their non-bank creditors.
30. That is enough factual background for present purposes. Some 20 years, four judicial decisions and several thousand pages of legal reasoning later, how has the Bell group collapse affected the law in relation to accessorial liability? I should add of course that any thoughts on this topic must be provisional, as the case is currently listed before the High Court. That caveat in mind, there are at least two major issues emerging from the *Bell* case which I would like to consider. First, in what circumstances will a director breach their duty to act in the best interests of the company and for a proper purpose and, second, are those duties fiduciary in nature?

Are the Duties to Act Bona Fide in the Best Interests of the Company and for Proper Purposes Fiduciary?

31. Let me go to the second question first. In *Bell*, as many of you no doubt recall, both Justice Owen at trial and the majority on appeal held that the duties to act bona fides in the best interests of the company and for proper purposes are fiduciary. On appeal Justice Lee situated the best interests and proper purposes duties as part of a fiduciary's overall duty of loyalty and stated that prescriptive obligations could occur in fiduciary relationships, if they arose out of "the pledges of loyalty and trust in that relationship".¹⁸
32. Justice Drummond held that "as a general rule all powers vested in directors under a company's articles are fiduciary powers" and that the fiduciary nature of these powers is given "meaning and content" by requiring them to be exercised bona fide for the benefit of the company and for proper purposes, meaning that these duties were "necessarily fiduciary obligations".¹⁹ Justice Drummond further held that no binding decision existed limiting directors' fiduciary duties to their companies to the two proscriptive duties outlined in *Breen* and that directors may have to take positive action to fulfil their fiduciary obligations in certain circumstances.²⁰
33. Acting Justice Carr expressed doubts that directors' duties to act in the interests of the company and to exercise powers for proper purposes are

¹⁸ At [897]-[899]

¹⁹ At [1949]-[1956]

²⁰ At [1960][1962], [1969].

fiduciary but stated that on present authorities he was not prepared to hold that the duties were *not* fiduciary.²¹

34. These findings by the court represent, I suggest, a significant departure from orthodox understanding of fiduciary duties. I have already referred to the statements of Gaudron and McHugh JJ and of Gummow J in *Breen*, restricting fiduciary duties to the proscriptive rules of “no profit” and “no conflict”.
35. I have also referred to the rationale for these proscriptions. The fiduciary duties of “no conflict” and “no profit” protect the fiduciary’s obligation of loyalty to the beneficiary by ensuring that the fiduciary is not swayed by self-interest or by the interests of any other person. It is quite another thing however to impose a prescriptive obligation on a fiduciary to act in a certain matter. As stated by Justice Gummow in *Breen*, to recognise a prescriptive fiduciary obligation to act in the best interests of a beneficiary is to impose a “quasi tortious” duty on fiduciaries.²²
36. In light of the statements in *Breen*, which as I previously noted have been repeatedly affirmed by the High Court, and no matter what questions may have once existed about the scope of fiduciary duties, I do not believe there is any room in Australia for recognition of a broader prescriptive fiduciary duty on directors to act in the best interests of the company or for proper purposes – unless of course the High Court decides to reconsider the issue.
37. Justice Owen in fact acknowledged that fiduciary duties are limited to proscriptive obligations at trial in *Bell*.²³ His Honour sought to address this issue by framing the best interests and proper purposes obligations as proscriptive ones – that is, by stating that directors cannot exercise their powers “in the interests of someone other than the company or in a way that is not in the best interests of the company” and “are prohibited from exercising powers for an improper or collateral purpose”.²⁴
38. I fully accept that once directors determine to embark on any course of action, they have an obligation to do so in the best interests of the company and to exercise their powers for proper purposes. Those are both equitable and statutory duties. However, I do not think that Justice Owen’s reformulation of the duties as proscriptive adequately answers the objection to their being cast as fiduciary in nature. That is not to say that a breach by directors of their best interests or proper purposes duties will never constitute a breach of fiduciary obligations. In many circumstances, directors for example will have acted for an improper purpose precisely because they have acted to profit themselves or a third party or in a circumstance of conflict of interest. Indeed Justice Carr identified precisely this situation in the *Bell* appeal. His Honour reviewed five cases which had

²¹ At [2721]–[2733].

²² *Breen v Williams* (1996) 186 CLR 71 at 137

²³ At [4539]–[4542].

²⁴ At [4578]–[4582]

been relied on by the New South Wales Court of Appeal in *Kalls Enterprises Pty Ltd (in liq) v Baloglow* in determining that the first limb of *Barnes v Addy* can apply to breaches of fiduciary duty by a director,²⁵ noting that each of these cases involved derelictions of duty that also amounted to a breach of the “no conflict” and “no profit” rules enunciated in *Breen*.²⁶

39. I do not believe that what I have said is inconsistent with what the Full Court of the Federal Court has said recently in *Grimaldi v Chameleon Mining NL (No 2)*.²⁷ In dealing with the extent of directors’ fiduciary obligations, the Court there described the obligation of loyalty imposed on a fiduciary as being expressed in two overlapping proscriptive themes. The Full Court adopted the formulation of Deane J in *Chan v Zacharia* (1984) 154 CLR 178 at 198-199 in the following terms:

“The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage.”²⁸

40. It should be noted that immediately prior to that paragraph, the Full Court referred to what it described as two discrete parts to modern Australian fiduciary law. It referred first to the duty of loyalty, the focus of which is on conflicts and misuse of fiduciary position for personal gain or benefit. However, the Court stated that the second part was concerned with judicial review of the exercise of power, duties and discretions given to fiduciaries, where the beneficiary does not have the right to dictate how the power or discretion is exercised. In that context the Court made the following comments:

“Unsurprisingly, there is quite some similarity between the grounds of judicial review of the decisions and actions of fiduciaries entrusted with such powers etc – for example, trustees, company directors and executors – and the grounds of judicial review of administrative action”²⁹

41. It may be that what was said by the Full Court in *Grimaldi* provides an explanation for the rationale of decisions such as *Charterbridge*. However, in my opinion it is difficult to state, irrespective of whether fiduciary obligations are proscriptive or prescriptive, that there will be a breach of such obligations in circumstances where a director, acting in the absence

²⁵ (2007) 63 ACSR 557 at [157]-[159]

²⁶ At [2724]-[2732]

²⁷ (2011) 200 FCR 296

²⁸ *Grimaldi v Chameleon Mining NL (No 2)* (2011) 200 FCR 296 at [178].

²⁹ *Grimaldi v Chameleon Mining NL (No 2)* (2011) 200 FCR 296 at [174].

of conflict and not motivated by personal gain, bona fide believes what he or she is doing is in the best interests of the company.

42. A fiduciary duty “not to act other than in the best interests of the company” that goes beyond a proscription on personal advantage or third party advantage or conflict risks setting down a certain standard of conduct that the fiduciary must meet, thereby conflating the duty to act bona fides with a duty of care. Indeed, Justice Owen, despite framing the duty in a proscriptive way, effectively required positive action by the directors, particularly active consideration of available financial materials. Likewise, I do not think that, properly understood, a director’s duty to act for a proper purpose (or to refrain from acting for a collateral or improper purpose) is a fiduciary duty, although a breach may constitute a breach of the proscriptive fiduciary obligations. Indeed, the historical roots of the proper purposes duty in the concept of “fraud on a power”, point away from it being fiduciary in nature. The doctrine of fraud on a power is not founded on any duty of loyalty. Rather it is a “general doctrine concerned with limitations impliedly imposed with the grant of a limited power”.³⁰
43. Nor do I think, as was suggested in *Bell*, that because the power of a director is described as a “fiduciary power”, as for example the power to issue shares has previously been described,³¹ this means that any failure of a director to exercise that power in accordance with their equitable duties, including their duty to act for proper purposes, is a breach of fiduciary obligation. The words “fiduciary power” could equally be understood as denoting an obligation to which the fiduciary duties of “no profit” and “no conflict” apply. As was stated in *Permanent Building Society (in liq) v Wheeler*, “it is essential to bear in mind that the existence of a fiduciary relationship does not mean that every duty owed by a fiduciary to the beneficiary is a fiduciary duty”.³²
44. This understanding is also consistent with the often-endorsed statement that “the scope of the fiduciary duty must be moulded according to the nature of the relationship and the facts of the case”.³³ I take this to mean that depending on the relationship a fiduciary may have a number of different tasks or powers to discharge, each of which will be subject to the proscriptive duties of no conflict and no profit.
45. As Justice Campbell put it speaking extra-curially last year:

In the context where a fiduciary is exercising [a] power or discretion, “*acting in the interests of the beneficiary*” means not acting in a way that prefers his

³⁰ M. Conaglen, “The nature and function of fiduciary loyalty” (2005) 121 *Law Quarterly Review* 452 at 458. The term fraud on a power has been described as the exercise of a power “for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power”: *Vatcher v Paull* [1915] AC 372 at 378.

³¹ *Howard Smith Ltd v Ampol Petroleum Ltd* (1974) 1 NSWLR 68 at 76; *Harlowes Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co. NL* (1968) 121 CLR 483 at 492.

³² (1994) 14 ACSR 109 at 157

³³ *Hospital Products Ltd v United States Surgical Corp* [1984] HCA 64; (1984) 156 CLR 41 at 102 (Mason J)

own interest (or duty to a third person). When the judges in *Breen* and *Pilmer* denied that there was a positive legal duty to act in the interests of the person to whom the duty is owed they were saying that if a fiduciary exercises a power or discretion in a way that is less advantageous to the beneficiary than a different exercise of the power would be – eg if a fiduciary agent enters a contract that is not as profitable as another that was available would have been – but the fiduciary derives no personal advantage from his choice and is not in a position of conflict, then there is no breach of a fiduciary duty. In other words, any duty to exercise care and skill is not one that equity imposes as a fiduciary duty.³⁴

46. I should add that, in most circumstances, whether a breach by a director of their equitable duties also constitutes a breach of a fiduciary obligation will not be important. It only gained significance in the *Bell* litigation because it was necessary for the duties to be fiduciary in order for accessorial liability to be imposed pursuant to *Barnes v Addy* principles. In those circumstances it is also worth remembering that *Barnes v Addy* liability was never developed in the context of directors. It developed in circumstances of breach of trust – not fiduciary obligation, proscriptive or otherwise. What has happened since that time is that the principles in *Barnes v Addy* have been extended, some might say mechanically, to fiduciaries. That is not of itself problematic but it is important to bear in mind that directors are *not* trustees. In my opinion, it is wrong to treat every misuse by a director of their fiduciary powers – and by that I mean a power to which the proscriptive fiduciary obligations attach – as akin to a breach of trust and thereby impose *Barnes v Addy* liability.

In What Circumstances will the Duties to Act Bona Fide in the Best Interests of the Company and for Proper Purposes be Breached?

47. Leaving aside the characterisation of directors' duties to act bona fide in the best interests of the company and for proper purposes as fiduciary or otherwise, the decisions in *Bell* also raise a number of questions about the circumstances in which those duties will be breached.

48. In my view, the authorities uncontroversially establish that the duty to act bona fide in the best interests of the company is a subjective duty – that is, the duty will have been met when directors have acted in what they bona fide subjectively believe to be the best interests of the company, no matter how commercially unwise that opinion is. As was said in *Re Smith & Fawcett*, “[directors] must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose”.³⁵ That does not mean that objective considerations are irrelevant. A court is entitled to look to the objective effect of a transaction or of a director's decision, but only to test his or her claim to be acting bona fide. In other words, objective factors are relevant only to determine a question of fact – whether the directors were

³⁴ JC Campbell “Fiduciary Relationships in a Commercial Context” (Paper delivered to the 2012 Annual Supreme Court Corporate Law Conference) at 44.

³⁵ [1942] Ch. 304 at 306.

in fact acting bona fide. The focus of any enquiry is on the honest belief of the directors.

49. Likewise, I would argue that it is well settled that the proper purposes duty focuses on whether the subjective purpose for which the director was acting is a proper purpose. As was articulated by the Privy Council in *Howard Smith v Ampol Petroleum*, in order to determine whether a director has breached their duty to act for proper purposes, one needs to first look at the power whose exercise was in question - in that case the power to issue shares, in *Bell* the power to grant securities, guarantees and indemnities for debts owed. Once having ascertained the nature of power, the court should then consider the subjective substantial or causative purpose for which the directors exercised that power. Finally, the court must reach a conclusion as to whether that purpose was objectively proper, having regard to any limitations on the way in which that power can be legitimately exercised.³⁶ Respect will be given to the bona fide opinion and management decisions of directors in considering whether the subjective purpose was proper, or beyond the limitations on the exercise of that power.³⁷ However, bona fides is not itself a sufficient answer to an allegation of improper purpose. As the High Court has put it, “the exercise of a power for an ulterior or impermissible purpose is bad notwithstanding that the motives of the donee of the power in so exercising it are substantially altruistic”.³⁸ The ultimate question is what the directors’ subjective purpose was, and whether it falls within or outside the permissible purposes for the exercise of that power.

50. This formulation of the best interests and proper purposes duty was accepted by Justice Owen in *Bell*³⁹ and, in the broad terms I have stated, was largely endorsed on appeal. However in the application of these tests, I would argue that *Bell* represents a significant departure from orthodox notions of the best interests and proper purposes duties. I will consider those duties together, as this was the approach largely taken in *Bell*, with the impropriety of purpose said to be a failure to consider the interests of the company as a whole.

51. In *Bell*, the major complaint against the Australian directors was that they acted with the interests of the Bell Group as a whole in mind, rather than considering the interests of each individual company of which they were directors, including those companies’ creditors. At trial, Justice Owen described the essence of the breaches found as follows:

“First, they concentrated on the interests of the group and failed to look at the interests of individual companies. Second they effected the first step in a “plan” to restructure the financial position of the group without any or any sufficient idea about what the “plan” was, how it would be implemented, how long it would take do so and how the companies could survive in the

³⁶ *Howard Smith v Ampol Petroleum Ltd* (1974) 1 NSWLR 68 at 77-78.

³⁷ *Howard Smith v Ampol Petroleum Ltd* (1974) 1 NSWLR 68 at 78.

³⁸ *Whitehouse v Carlton* (1987) 162 CLR 285 at 293.

³⁹ At [4385]-[4386], [4459]-[4461], [4619].

meantime...They looked at the problem solely from a group perspective and said something to the effect: "We all survive or we all go down"...They did not identify what, if any creditors (external and internal) the individual companies had or might have and what, if any, effect a Transaction would have on the creditors or shareholders of an individual company...[the directors] did not consider the detailed information that would have necessary to enable them to decide whether and to what extent there was a corporate benefit to each individual company called upon to enter into a Transaction".⁴⁰

52. It has long been accepted that in situations of insolvency, to act in the interests of the company, directors must have regard to the interests of creditors.⁴¹ It is also uncontroversial to say that in a group context, a director must bona fide believe that what they are doing is in the best interests of each individual company relevantly affected, rather than simply in the group's interest, although in making that assessment the interest of the group can be considered, particularly in circumstances where the financial welfare of the company is dependent on the financial welfare of the group. But what the decision in *Bell* does is suggest certain objective standards must be met in considering these matters. What I mean by this is that directors must not only have honestly believed that it is, for example, in a subsidiary company's interest to enter into a risky transaction to avoid liquidation by mortgaging its assets. They must also show that in coming to that honest belief, they adequately considered the interests of each company, including by identifying all creditors, considering detailed financial information, and establishing a plan to protect the position of each separate company.
53. I am not suggesting any of those steps are undesirable, far from it. In fact each is likely required by directors' duty of due skill, care and diligence. However, what these requirements do is introduce a degree of objectivity into the determination of whether a director has fulfilled his or her duty to act bona fide in the best interests of the company. They shift the focus from the *bona fide belief* of the director, to whether that belief was reasonably arrived at, by reference to the steps taken and materials considered.
54. That this is the effect of *Bell* becomes even clearer when you consider the way the breaches by the UK directors were characterised. It was accepted that the UK directors had most certainly turned their minds to the interests of the particular companies of which they were directors and had taken legal and accounting advice to attempt to protect those companies' interests. Ultimately however they had entered into transactions based on the assurances of one of the Australian directors, without objective information on which to base their decision. As Justice Owen put it:

"The London-based directors did everything right – up until the last hurdle...They stumbled...by relying on assurances from officers of the Australian Bell group companies...They should have obtained...reliable

⁴⁰ At [6045].

⁴¹ *Walker v Wimborne* (1976) 137 CLR 1 at 7.

financial statements and information to verify that the letters of comfort on which they were relying...were worth powder and shot. This was a critical factors in determining whether or not it was in the best interests of the individual companies of which they were directors, rather than the interests of the wider group, to commit to the Transactions".⁴²

55. As such, Owen J held the directors could not have bona fide formed the view they were acting in the best interests of the company, because they did not have the objective information necessary to come to that conclusion.⁴³ The implicit criticism of the directors is not that they were dishonest, or that they did not turn their minds to the interests of the company and do what they thought was best, but that they did not come to that conclusion in a reasonable and prudent manner.
56. This formulation in my view blurs the line between a director's duty to act in the best interests of a company and his or her duty of care – which as I mentioned earlier, has not been understood to give rise to accessorial liability under *Barnes v Addy* principles.

Elevating Interests of Creditors

57. A related issue is the extent to which *Bell* may have altered the manner in which directors must consider the interests of creditors in the context of determining what is bona fide in the best interests of the company. As I mentioned a moment ago, it is well accepted that in circumstances of insolvency, creditors interests must be considered as part of a director's duty to make a decision about what is in the interests of the company as a whole.
58. However, as was made clear in *Spies v the Queen*, directors do not owe an independent duty to creditors.⁴⁴ As Justice Gummow remarked in *Re New World Alliance Pty Ltd; Sycotex v Baseler*, in a passage approved in *Spies*, the duty to creditors is an "imperfect obligation".⁴⁵ In my view, the authorities establish that what is required is for directors to give some consideration to the interests of creditors, as one of the relevant factors in their overall discretionary determination of what is in the best interests of the creditors. This formulation was accepted by Justice Owen at trial in *Bell*.
59. However, this does not resolve the question of what the duty to take into account the interests of creditors when considering the best interests of "the company" actually means in a given context. To take *Bell*, you have directors who are faced with a prospect, as they perceive it, of liquidation, which will involve assets being sold at undervalue. The directors also have a bona fide belief that if they can keep the principal creditors at bay by giving security to that group of creditors there is a possibility of salvaging

⁴² At [6096]

⁴³ At [5923].

⁴⁴ (2000) 201 CLR 603 at 636-637

⁴⁵ (1994) 51 FCR 425 at 445

the company, to the benefit of both creditors and shareholders. If they are unsuccessful however, the position of the bank creditors will be better than that of other creditors in an insolvency context. How is a director to adequately give regard the “interests of the creditors” in this situation?

60. I do not pretend for a moment that it is an easy question. The majority on appeal in *Bell* appear to have determined the issue by requiring that creditors be privileged above other stakeholders. Justice Lee, in finding that the directors had breached their best interests duty, held that in the circumstances of an insolvency directors will “fail to discharge their duty to act in the best interests of that company if they caused the company to prejudice the interests of its creditors”,⁴⁶ and that directors cannot hold a “rational belief” that it is in the best interests of a subsidiary company to mortgage its assets to avoid a broader group liquidation in circumstances where that company had to take account of and not prejudice its own creditors.⁴⁷ Justice Drummond went even further, stating that in circumstances of insolvency or near insolvency directors “must have regard *and give proper effect* to the interests of creditors” and that “courts will now intervene in an appropriate case, irrespective of the directors’ beliefs and business judgments, to ensure that creditors are properly protected”.⁴⁸ This seems contrary to what was said in *Spies*.

61. These formulations appear to suggest that if creditors are prejudiced, that ipso facto indicates directors breached their duties, introducing a measure of objectivity that in my view alters the recognised duty to take account of the interests of creditors. Rather than focusing on whether the directors *honestly believed* they were doing what was best for the company, the court will ask whether the director’s actions sufficiently protected the creditors, objectively speaking. Effectively, in insolvency or near insolvency contexts, this substitutes a duty to act in the interests of the company for a duty to act in the interests of the creditors, or at the least elevates creditors to being the primary stakeholders in the company.⁴⁹

62. There is another complicating issue. The Court of Appeal in *Bell* found that the directors had breached their duty to consider the interests of creditors in circumstances where at least some of the companies in relation to whom that determination was made were already indebted to the Australian banks. That indebtedness was by virtue of the guarantees that the subsidiary companies had provided, indemnifying TGBL’s loans. In effect, in relation to those companies the breach was found to be in prejudicing certain creditors, not in ignoring the interests of the creditors altogether.

63. Now, no one seems to have suggested that a director breaches any duty if they prefer one creditor over another in cases where they bona fide think

⁴⁶ At [952].

⁴⁷ At [993].

⁴⁸ At [2031], emphasis added.

⁴⁹ Anil Hargovan and Jason Harris “For Whom the Bell Tolls: Directors’ Duties to Creditors After *Bell*” (2013) 35 *Sydney Law Review* 433 at 447.

this is in the overall interests of the company. Indeed, at trial Justice Owen noted that a plan that takes into account the interests of the creditors does not inevitably have to “treat each and every creditor on an equal footing”.⁵⁰ As Anil Hargovan and Jason Harris put it recently in an article in the *Sydney Law Review*, is it not impermissible for “a director to advance the interests of a particular creditor so long as he or she believes in good faith that this action will be in the interests of creditors as a class”.⁵¹

64. How is this to be reconciled with the majority appellate decisions in *Bell*? What the Court of Appeal appears to have done is suggest that if the objective prejudice to one group of creditors is significant and the objective benefit to another sufficiently great, then favouring one creditor over another cannot be considered to be bona fide in the best interests of the creditors as a class and in turn of the company, no matter how honestly this is done. This of course begs the question, how great must the prejudice be and at what point does preferential treatment become unacceptable as a matter of law? It is an issue that involves difficult questions of degree relating to the objective effect on creditors. I do therefore question how appropriate it is that the duty to act in the best interests of the company enters into this kind of territory, when it is fundamentally a duty about subjective bona fides. This is particularly so when there are statutory mechanisms to protect the interests of creditors, to which I have referred above.

Impact on Third Parties

65. As is no doubt clear by now, I have some concerns about how the decision in *Bell* may have affected directors’ duties. However, I would suggest that where the decision has the biggest implications is for the third parties who stand at risk of accessorial liability pursuant to *Barnes v Addy* principles.

66. As you know, what is described as “the rule in *Barnes v Addy*” provides that third parties can be held liable for breaches of trust if they “receive and become chargeable with some part of the trust property” or “assist with knowledge in a dishonest and fraudulent design on the part of the trustees”. These two “limbs” are commonly referred to as “knowing receipt” and “knowing assistance” respectively. As noted by the High Court in *Farah v Saydee*, “[i]n recent times it has been assumed, but rarely if at all decided, that the first limb [of *Barnes v Addy*] applies not only to persons dealing with trustees, but also to persons dealing with a least some other types of fiduciary”.⁵² Thus, it is commonly accepted that if a third party receives property in the course of, or as a result of a breach by directors of their fiduciary obligations, and the third party knows of the relevant breach

⁵⁰ At [6080].

⁵¹ Anil Hargovan and Jason Harris “For Whom the Bell Tolls: Directors’ Duties to Creditors After *Bell*” (2013) 35 *Sydney Law Review* 433 at 435, citing *GHLM Trading Ltd v Maroo* [2012] EWHC 61.

⁵² *Farah Constructions Pty Ltd and Ors v Say-dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR at [113]

or breaches, that party can be held liable for “knowing receipt” under *Barnes v Addy* principles. I won’t go into the questions of whether it is desirable for *Barnes v Addy* to apply to non-trustee fiduciaries, the degree of knowledge that is required to constitute “knowing receipt” or issues about aggregation of knowledge.

67. Suffice to say that the situation I have just outlined is the one that was found to have occurred in *Bell*. That is, the banks were held to have had relevant knowledge that the directors were breaching their fiduciary duties by giving the banks security over the Bell group’s assets, and were therefore held liable under the first limb of *Barnes v Addy*. The banks’ knowledge was said to arise from awareness of the Bell group companies’ financial position, including suspicion that the companies were of doubtful solvency. At trial, Justice Owen found that the banks entered into the transactions “knowing there was a risk that the securities would be set aside on grounds that included lack of corporate benefit and breach of duty by the directors”.⁵³ Despite knowing these things the banks refrained from making further inquiries into the financial position of the companies, or the “propriety of the conduct of the directors in determining that there was a real and substantial benefit to each company entering into a Transaction”.⁵⁴ In those circumstances the banks were held to have known of circumstances pointing to a breach of duty, which was sufficient to meet the “knowledge” test imposed by *Barnes v Addy*.

68. I accept that *Bell* was a case where it was found that at least some of the banks had a great deal of knowledge about the companies’ circumstances and were heavily involved in designing the relevant transactions. Nonetheless, the finding that liability may be imposed on third parties on the basis that they had information about the poor financial state of a company but failed to make enquiries about the propriety of directors’ actions raises serious questions.

69. First, is the effect of *Bell* that third parties must second-guess the management decisions of directors? Consider this situation. A bank is approached by a company with a reputable board of directors. There is nothing to suggest that the directors are motivated by self-interest or any other improper motive, in the sense the word improper is usually understood. The bank therefore understandably assumes that the directors are acting in what they think are the best interests of the company. The bank however also knows that the transaction is risky and could have negative financial effects on the company. In those circumstances, is the effect of *Bell* that a third party bank must go through an exercise of second guessing the directors’ decision, in order to evaluate the reasonableness of the directors’ intention to enter a transaction? Must the third party itself consider the materials the directors have gone through in coming to their decision, to make an independent determination about

⁵³ At [8746].

⁵⁴ At [8746]

whether those materials are sufficient for a director to conclude that the transaction was in the best interests of the company?

70. Second, if this is in fact what is required, by what criteria is a third party to judge whether a transaction, which on its face appears to be made by the directors with the belief that it is in the company's best interests, or for that matter a transaction that appear to be within power is, because of certain circumstances in fact not? Must the third party consider whether the interests of different stakeholders, including creditors, are adequately taken into consideration? Must it evaluate whether one creditor is privileged over another and to what extent? How is it to undertake this process?
71. Without wanting to overstate these issues, I am concerned that the effect of *Bell* is to place an onerous and unclear obligation on third parties – whether banks or otherwise – effectively requiring them to assume some of the functions of directors, in order to protect themselves from accessorial liability. I am also concerned that an obligation of this kind may have undesirable policy consequences; namely, encouraging banks to either refrain from lending in situations of doubtful solvency, or to engage in pure asset lending, so as to avoid gaining knowledge by which accessorial liability could be imposed. These effects, which in my view flow at least in part from the approach taken to directors' duties in *Bell*, are significant and I would suggest, have not yet been fully grappled with.
72. The above discussion provides only the most simplified overview of two of the many issues arising from *Bell*. I apologise for all the nuances and issues I have inevitably skipped over. We could of course spend an entire conference discussing just these aspects of the case. In due course we will have the benefit of the High Court's decision on these issues. Until then, the possible changes wrought by the decisions to fiduciary obligations, directors' duties and accessorial liability will no doubt continue to generate much debate and discussion.