Directors' Duties – Some Observations
Australian and Overseas Developments

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Chancery Chambers

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He has a keen interest in commercial arbitration and in all aspects of company law, especially insolvency and shareholder disputes and planning matters.

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A. A Fiduciary

1. It is trite law that directors owe fiduciary duties to their company. Why is this an important starting point in this paper? Because it highlights that directors are not merely servants of the company but that they owe duties above and beyond all others involved in a company's management and direction. Yet determining precisely what is a fiduciary duty is not so clear. Even formulating a general test for a fiduciary relationship is elusive. Professor Finn (as he then was before his appointment to the Federal Court) expressed the important question as whether "*...the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests in and for the purposes of the relationship*" and characteristics of the like described are "*important only to the extent that they evidence a relationship suggesting that entitlement.*"[1]

2. Perhaps the place of a fiduciary as a legal concept is now simplified in terms of core attributes:

[1] "*The Fiduciary Principle*" in "*Equity, Fiduciaries and Trusts*" (Youdan ed.) (1989) Carswell, Toronto, at 46.

"*A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty.*"[2]

3. Somewhat cleverly, Sir Anthony Mason has observed that "the fiduciary relationship is a concept in search of principle".[3] Associate Professor John Glover[4] advocates that equity provides four fiduciary characteristics; undertaking[5], property[6], reliance[7] and power[8]. Glover emphasises that none of these four characteristics alone is the decisive answer, and argues that much depends on such factors as policy considerations, a social purpose and the level of conduct expected in each case.

4. So being a company director, whether in Australia, the US or UK, brings with it a requirement to act in a very special way so as to always prefer, project and protect the interests of the company.

RECENT FOREIGN AND AUSTRALIAN EXPERIENCES AFFECTING THE ROLE OF DIRECTORS

B. US experience

5. In recent times we have witnessed worldwide scrutiny of the role of directors. Enron and its aftermath have enlivened corporate governance debates in the Australia as well as in the USA.[9] It is accepted market lore that Bull markets encourage transgressions and Bear markets reveal them. Well in either market what are the duties of directors in the US?

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2 *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18, per Millet LJ.

3 Sir Anthony Mason, "Themes and Prospects", in P.D. Finn, ed., *Essays in Equity* (1985) at 246.

4 Glover J, "The Identification of Fiduciaries", Birks P, (ed) *Privacy and Loyalty*, Clarendon Press, Oxford, 1997 at 270.

5 An undertaking by the fiduciary to act in the interests of the beneficiary. Ibid at 272.

6 The entrusting of something by the beneficiary. Ibid.

7 The beneficiary relies upon the fiduciary, often from a position of vulnerability or inequality. Ibid at 273.

8 Where by exercise of discretion, the fiduciary can alter the interests of the beneficiary. Ibid at 274.

9 See e.g. in the USA the Sarbanes-Oxley Act 2002 and the SEC made rules thereunder applicable to lawyers in the USA and overseas, impact on their fiduciary duties to clients.

US Directors

6. Theoretically, directors oversee management's decisions, which includes regularly evaluating its performance and monitoring the strategy and policies the officers seek to employ for the growth and performance in the corporation. The composition of the board, however, prevents the board from being a critical or contributing force in the formation of policy and strategy. On average, a corporate board in the United States is composed of twelve directors.[10] In the past thirty years, inside directors (the management team) have dominated the board, who are chosen by the CEO in the absence of informed shareholder nomination and voting power.[11] Even when a board has outside directors, these directors are usually not truly independent because they are in some way affiliated with management as former employees, acquaintances, or relatives. Thus, management's interests on the board have had a significant impact on the functioning of the board.

7. In addition, a director owes "shareholders" (I will discuss the Australian/UK position below) fiduciary duties of due care, loyalty, candour, and obedience. Although subject to personal liability for a breach of their fiduciary duties, directors have been insulated from liability through the judicially created "business judgment rule," which creates a presumption that a director exercises due care when making business decisions, unless proven otherwise[12]. Therefore, the board of directors has essentially been insulated from liability absent some egregious error[13] or the lack of due care with respect to the decision making process[14].

US Shareholders

8. Shareholders are the owners of the corporation, making them primarily responsible for electing the directors. Because shareholders exercise ultimate control over the board of directors through board elections, shareholders also

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10 Investor Responsibility Research Center, *Study Finds Dot--Com Boards Are Less Independent, in Conflict with Governance Principles, at* http://www.irrc.org/press_releases/01102000dotcom.html. In 1991, 77% of the CEOs were also chairmen of the board of their companies.

11 Stephen Prowse, *Corporate Governance in an International Perspective: A Survey of Corporate ControlMechanisms Among Large Firms in the U.S., U.K., Japan and Germany*, Fin. Markets, Institutions & Instruments 1, (1995). at 29.

12 *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984).

13 *Litwin v. Allen,* 25 N.Y.S.2d 667, 699 (N.Y. Sup. Ct. 1940).

control management. In reality, however, individual shareholders have often been unable to perform the role of monitor and final decision-maker because of collective action problems.

9. It is axiomatic that the board of directors and shareholders should check management's powers and activities. In reality, however, they have typically failed. Board members elected at the direction of the management by passive shareholders feel beholden to management and too frequently see no problems, shy away from tough questions, and, in some cases, just do not work very hard[15]. Shareholders similarly exercise little protection from abusive management. Historically, the sole means to directly alter the management of a firm involved the use of the proxy fight. The collective action problem attendant to mobilising a vast number of shareholders for such a contest, however, is well documented[16]. Moreover, the proxy rules promulgated by the SEC are complex and frequently expensive[17]. The ineffectiveness of proxy contests as a monitoring device is evidenced by the fact that approximately "99.65% of corporate boards are elected in uncontested proxy solicitations."[18]

Distributing Roles and Responsibilities between US Management and Directors

10. The corporate governance model requires CEOs and directors to redefine their relationship. With increased director involvement in strategy and policy of corporations, the division of roles and responsibilities can become unclear. The new corporate governance requires directors to take an active role in strategic policymaking in addition to overseeing the management. In theory, the division

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14 *Smith v. Van Gorkom,* 488 A.2d 858, 872 (Del. 1985).

15 Noted in Edward S. Adams, *Corporate Governance after Enron and Global Crossing: Comparative Lessons for Cross—National Improvement*, 78 Ind. L.J. 723 (2003). For example, where was the board during RJR Nabisco's dark years? For all practical purposes, nowhere. The board played a passive, rubber stamp role at RJR Nabisco----a role made more comfortable by generous perquisites granted by management. *See* Daniel Wise, *The Ethics of 'Barbarians': Should Dual Roles be More Closely Scrutinized?*, N.Y.L.J., Aug. 30, 1990, at 5. CEO Johnson extended lucrative consulting and service contracts to several directors, and sent company business to a bank run by another. Although such arrangements are generally legal, and can even benefit a corporation, they are also frequently subject to the discretion of the CEO. *See id.* In the case of RJR, the perquisites may have pacified board members and made them less critical of managements' behaviour.

16 Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 862--63 (1993); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 543--44 (1990).

17 Black, *supra* note 56, at 531--32.

18 Grundfest, *supra* note 56, at 862.

between management and the board should emphasise that the board deals with strategic long--term strategising and the management handles the formulation, implementation, and supervision of that strategy. To make the governed corporation work, the management and the board must work together as a team, but with mutual respect and an awareness of the parameters of each other's duties[19]. Therefore, as some commentators suggest, an attempt to make bright--line, one--size--fits--all demarcation between these two spheres' responsibilities is neither necessary nor helpful. Instead, the lines of authority should be drawn according to each company's respective needs and structure.

Enron - Sarbanes-Oxley Act

11. As a result of the Enron catastrophe US legislation now dictates how Australian-based multinationals with a US listing must deal with many of the issues of governance. The Sarbanes-Oxley Act of 2002[20] and the New York Stock Exchange's recent rule changes on corporate governance determine the role of the Auditors and the scope of non-audit work, the role of the Audit Committee, the independence of non-executive directors, how often they meet as a separate body and many other governance issues. Such Australian-based multinationals can in theory cancel their US listings but in reality none is likely to be able to withdraw from the US capital markets.

12. The US Congress enacted the Sarbanes-Oxley Act to create financial transparency for public companies so as to boost investor confidence in capital markets. Congress created new laws that now require US public companies to implement systems and procedures requiring more accountability by upper-level management and the board of directors.

13. The following list provides a quick checklist of many issues directors should understand about the Act as it has impact beyond the US. In Australia we have seen the consequences with the rapid demise of the big accounting firm MDPs of PwC Legal and KPMG Legal.

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[19] *See* Jay W. Lorsch, *Empowering the Board*, HARV. BUS. REV., Jan.--Feb. 1995, at 107--08.

[20] http://news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf

The Audit Committee Controls the Company's Financial Reporting.

14. The Sarbanes-Oxley Act requires the audit committee to pre-approve non-audit services provided to the company. All critical accounting policies and practices that are used in the financial reporting process must be reported to the audit committee. In short, the audit committee (and its individual directors) have increased liability as a result of their obligation to oversee the financial reporting activities of the company.

Senior Executives Must Certify the Company's Financial Statements.

15. Top executive officers must certify that periodic reports filed with the Securities and Exchange Commission do not contain any untrue statements of material facts or omit any material facts. The chief executive officer is now legally required to establish and maintain internal controls permitting him to make sure that accurate and reliable financials are filed with the Securities and Exchange Commission. In short, the executive leadership of companies can no longer claim that they were not aware of misconduct by lower level employees.

The Statute of Limitations Period is Increased.

16. The Sarbanes-Oxley Act lengthens the statue of limitations for securities fraud to two years from discovery of the fraud or five years from the fraud. The previous statute of limitations period was one year after discovery of the fact constituting the violation and within three years after the violation was established.

Director and Officer Insurance Policies are at Risk.

17. There are many reasons why directors might not have director and officer insurance coverage when they believe that they do. For example, if a lawsuit alleges intentional fraud or dishonesty, the D&O insurance policy might exclude coverage even if intentional wrongdoing is merely alleged. Additionally, the policy might have inadequate policy limits. For example, defending costs incurred in a Security and Exchange Commission investigation can count against policy limits and reduce the amount of coverage available to officers and directors.

"Attorney-Client Privilege" Issues Remain Unresolved.

18. The Sarbanes-Oxley Act requires a lawyer to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company to the chief legal counsel or the chief executive officer of the company. If the counsel or officer does not appropriately respond to the evidence the lawyer may be required to report a breach of fiduciary duty to the board of directors.

Companies Must Have a Code of Ethics.

19. The Sarbanes-Oxley Act requires companies to create a code of ethics for senior financial officers. The code of ethics has standards designed to promote honesty and ethical conduct in reporting financial transactions and complying with government rules and regulations. If a code of ethics is in place, there will be situations in which the code of ethics is not followed. A breach of ethics could be damaging if revealed in civil litigation.

Document Retention and Destruction Policies.

20. In light of the Arthur Anderson prosecution for obstruction of justice, companies are revising their document and computer retention and destruction policies. Companies are now retaining documents and electronic data for longer periods of time. This, of course, means that there is now more opportunity to obtain information in discovery if information is not destroyed. This must be contrasted with recent Australian authority in this area in the *McCabe Cases*.[21]

Companies Must Have a Corporate Compliance Plan.

21. After Enron, companies are required to create compliance plans designed to ensure that employees comply with the law and company policies. The United States Federal Sentencing Guidelines impose lighter penalties on companies that have adopted a corporate compliance plan. Unfortunately, many companies adopt formal compliance programs and then fail to follow the programs. Additionally, the monitoring and audits that are required under compliance plans to detect criminal conduct and a breach of company policies may provide fertile grounds for discovery requests.

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21 *McCabe v British Tobacco Australia Services Ltd* [2002] VSC 73 and on appeal at (2002) 7 VR 524

The Sarbanes-Oxley Act could become the Standard of Care for Directors.

22. It is arguable that Sarbanes-Oxley could become the new standard of care in the US (and by extension in some US connected company cases in Australia) for executives and members of the board of directors. Currently, most US states follow the Model Business Corporate Act[22] which establishes the degree of care for directors as "the care an ordinarily prudent person in a like position would exercise in a similar circumstances". However, in light of Sarbanes-Oxley, it is possible that the Act or at least certain provisions of the Act, could become the standard by which state and federal courts determine whether or not a director or officer has met his duty of care. In light of this possibility, even proprietary corporations are likely to consider implementing a "best practices" as soon as possible.

C. UK experience

23. Turning now to the other side of 'The Pond', John Powell QC has noted[23] the role of directors, especially non-executive directors, has received increasing scrutiny by government in the UK,[24] as has the role of professional advisers, especially analysts.[25]

24. That a company is owed fiduciary duties by its directors is an important factor in constraining transgressions, not least diversion of corporate opportunities from the company either to the errant directors or to persons and entities related to them.

25. Similarly as in Australia, investors who have been misled to invest in a company will generally not be able to avail themselves of a claim against the directors for breach of fiduciary duty because the directors do not owe fiduciary duties to the company's shareholders or potential investors. In such circumstances investors may be able to sue directors in respect of fraudulent misrepresentations in

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22 *Model Business Corporation Act:* The American Bar Association's Committee on Corporate Law released a *Model Business Corporation Act* in 1969, a *Revised* version in 1984 and at least one more revised version in 1999.

23 At the 13th Commonwealth Law Conference in Melbourne in April 2003.

24 See the Higgs Review of the role and effectiveness of non-executive directors (January 2003). This is available on the Department of Trade and Industry's website: www.dti.gov.uk/cld/non_exec_review .

25 See the FSA's Consultation Paper 171: "*Conflicts of Interest: Investment Research and Issues of Securities*:" (February 2003). This is available on the FSA's website: www.fsa.gov.uk .

promotional material on the basis of the tort of deceit or statutory causes of action.[26] A major disadvantage of not being owed fiduciary duties by directors is that consequently it is not open to the shareholders (as distinct from the company itself) to sue "deep pocket" accessories (e.g. accountants, banks, lawyers and valuers) on the basis of dishonestly assisting the directors in a breach of a relevant fiduciary duty.[27] This may be a factor in explaining the paucity of class actions by investors against accessories.

26. Independence issues have attracted increasing attention in the UK, especially in relation to non-executive directors and auditors. Independence is frequently invoked in asserting a putative fiduciary duty.[28] Nevertheless the quality of independence is distinct from the quality of loyalty. Indeed it circumscribes loyalty - or rather what would be a misplaced sense of loyalty. Thus a failure to qualify an audit report may be the product of a misplaced sense of loyalty supplanting independence. While we await a UK decision on the issue, it is suggested that independence is better perceived as a quality rather than a duty or, if a duty, at best an ethical duty. It is hard to perceive independence as a substantive duty owed to a client, for which liability may be incurred. Lack of independence may, nevertheless, be an aspect or explanation of breach of some other substantive duty to the client, e.g. the duty of care or a fiduciary duty.

D. Australian experience

27. There has been significant capital raisings in Australia in the last couple of years. There were 47 floats in calendar 2003, compared with 42 in 2002. There were 23 small capital floats last year, compared with 22 in 2002. The total raised in floats last year was $6.6 billion, more than double the $3.2 billion raised in 2002. The proportion of underwritten floats declined to 36 per cent last year, compared with 43 per cent in 2002 and 50 per cent in 2001. So all in all directors in

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[26] e.g. FSMA 2000, s. 90. Further the directors' misconduct may entitle the regulator (the Financial Services Authority) to seek injunctions, remedial and restitution orders against them under ss. 380 and 382 of the same statute.

[27] Shareholders may be able to establish a claim against such accessories on the basis of conspiracy to injure by unlawful means. Also regulators may seek remedies against directors under statutory participatory liability provisions: see below.

[28] As in. *Pilmer v. Duke Group Ltd. (in liq.)* (2001) 180 ALR 249; [2001] 2 BCLC 773. (unsuccessfully).

Australian public companies will continue to turn their minds to raising large amounts of funds from the public and in doing so what are their duties at law?

Fiduciary Duties of Australian Directors

28. There are many statutory provisions which impose liability on directors which due to time constraints will not be canvassed here.[29] However, the basic duties of directors are now more or less enshrined in sections 180 to 184 of the *Corporations Act*. They include:

- the duty to act with due care and diligence;
- the duty to act in good faith in the best interests of the company and for a proper purpose;
- the duty not to improperly use their position or information obtained during the course of their directorship; and
- the duty not to act recklessly or dishonestly.

29. Broadly these duties reflect the common law duties of directors. According to Glover, only the duty owed by directors to the company may be said to be fiduciary.[30] Similarly Gower notes that fiduciary duties are declared to be "owed to the company and to the company alone".[31] Accordingly the company 'as a whole' is the focal point in respect to fiduciary obligations.[32] Furthermore, directors must be loyal to the company and their powers must be exercised in the company's interests and in good faith.[33]

30. While as a general principle directors owe their duties to the company 'as a whole' and not to individual shareholders[34], there are some exceptions. For example, it has been decided that fiduciary obligations exist in the case of a small

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[29] See eg. ss. 52,75B, 80, 82, 86C of the *Trade Practices Act* 1974 (Cth); ss 12DA, 12GF *Australian Securities & Investment Commission Act ;* ss.1041H, 1041I, 1323, 1324, 1324B, 1325 of the *Corporations Act* 2001 (Cth)

[30] Glover, *Equity, Restitution and Fraud*, Butterworths, 2004 at 228.

[31] Gower, *Gower's Principles of Modern Company Law*, 5th ed, Sweet & Maxwell, London, 1992, p 551 citing *Percival v Wright* [1902] 2 Ch 421; see also *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.

[32] *Re Horsley & Weight Ltd* [1982] 1 Ch 442 at 453-54 per Buckley LJ.

[33] Glover, op cit 20 at 233.

[34] *Johnson v Gore Wood* [2001] 2 WLR 72, Lord Bingham at 94 (HL).

family company involving personal relationships of trust and confidence between directors and shareholders.[35]

Corporations Act - statutory liability of directors for debts – ss. 197 & 588J

31. There are two specific provisions of the *Corporations Act* which deserve specific attention because they potentially impose personal liability on directors for the debts of a company. The two sections are ss.197 and 588J of the *Corporations Act*. (Other commentators will deal with s.588J).

Section 197

32. I want to direct attention to s.197 of the *Corporations Act*, as this makes a director of a trustee company personally liable to discharge debts incurred by the company as trustee, if the trustee company cannot discharge the liability and the company is not entitled to be indemnified out of trust assets. However s.197 then goes on to provide, that "This is so even if the trust does not have enough assets to indemnify the trustee."

33. This is an often overlooked section of the Act and as a result has received little judicial attention.

34. More recently the Full Court of the Supreme Court of South Australia considered the section in *Hanel v O'Neill*[36]. The case considered whether the sole director of a trustee company was personally liable in accordance with s.197 for payment of a judgment debt for damages arising out of default in rental payments by the trustee company under a commercial lease. The trustee company had previously distributed all of the trust's assets to the trust's beneficiary and was therefore without assets. It was not in issue whether the trustee company had lost its usual right of indemnity.

35. The Court was divided 2-1 in its approach to the section. The wider view favoured by the majority was that the directors of an insolvent trustee company are personally liable to creditors in circumstances where the trustee company's entitlement to indemnification cannot be satisfied because of insufficiency of the

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[35] Parkinson, op cit 1 at 342-343.

trust's assets. This was despite the fact that the trustee had not lost its usual right of indemnity but rather the amount owing under the indemnity could not be satisfied because there were no assets out of which it could be satisfied.

36. The majority accepted that if there were no assets comprising the trust there was no entitlement for the trustee company to be indemnified with the result that under s.197, the director was personally liable to meet the debt. In doing so one of the majority stated that the rewording of the provision suggested an intention of the legislature to move away from the narrower view.

37. The dissenting judge considered that the s.197 was essentially a re-enactment of the former position, "albeit in different and obscure terms". He accepted that a director of the trustee company will not be personally liable where the trustee company is entitled to indemnification, even if the trust assets are insufficient to satisfy the indemnity.

38. As a result until the section is given further consideration at appellate level the current uncertainties in the interpretation of s.197 and the prevalent use of trustee companies, will very likely to be subject of considerable argument as to its true parameters.

Are there Duties owed to Creditors by Directors?

39. This question was once thought answered in another way. However, what is of significance to commercial lawyers is the decision of *Spies v. Queen*[37]. In particular the passage commencing at paragraph 93 recited the form of perceived wisdom, either apparent or real, considered by commercial lawyers since 1976, that directors owe a duty to the company to consider the interests of creditors and potential creditors for company.

40. In dealing with this wisdom the majority at paragraph 93 stated:

> "*It is true that there are statements in the authorities beginning with that of Mason J in Walker v. Wimborne (1976) 137 CLR 1 at 6-7, which would suggest that because of*

[36] [2003] SASC 409

the insolvency of (the company), the Appellant, as one of its directors, owed a duty to that company to consider the interests of the creditors and potential creditors of the company in entering into transactions on behalf of the company. Walker v. Wimborne was an appeal by a liquidator against the dismissal of his misfeasance brought against former directors under Section 367B of the Company Act 1961. Statements in this and other cases came within Professor Sealy's description of:

> *'Words of censure directed at conduct which any way comes within some well – established rule of law, such as law imposing liability for misfeasance, the expropriation of corporate assets or fraudulent preference.'*

Hence the view that it is 'extremely doubtful' whether Mason J intended to suggest the directors owe an independent duty directly to creditors." (Haydon "Directors' duties and the Company's Interests" in Finn (Ed), Equity and Commercial Relationships (1987) 120 at p.126).

41. The rationale seems to be that to give some unsecured creditors remedies in an insolvency which are denied to others undermines the basic principle of *pari passu* participation by creditors. I think this is correct.

42. In so far as remarks in *Grove v. Flavel*[38] suggests that directors owe an independent duty to, and enforceable by, creditors by reason of their position as directors, the High Court has now decided in *Spies* case that they are contrary to principle and later authority[39] and do not correctly state the law. When I canvassed this topic in a similar seminar in May this year, many experienced insolvency practitioners were quite adamant that *Spies c*ase did not authoritatively stand for the principle I have identified. I am not yet persuaded by the vehemence of their advocacy that this is so. However, it is an area which may admit of some development. In this regard I can direct those interested in a well written article in the Insolvency Law Journal[40] and I welcome further discussion on this point.

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[37] (2000) 201 CLR 403

[38] (1986) 43 SASR 410. See also remarks in *Nicholson v. Permakraft (NZ) Ltd* [1985] 1 NZLR 424.

[39] *Kuwait Asia Bank EC v. National Mutual Life Nominees Ltd* [1991] 1 AC 187; *Re New World Alliance Pty Ltd; Sycotex Pty Ltd v. Baseler* (1994) 51 FCR 425. See also *Farrar's Company Law,* 4th ed (1998), pp 382-385.

[40] Anil Hargovan, *Geneva Finance and the 'duty' of directors to creditors: Imperfect obligation and critique*, (2004) 12 Insolv LJ 134

Duties of Directors Prior to Departure from Office

43. I wish to turn to quite a discrete area not often commented upon. Are there any duties upon a director prior to leaving office? It is trite that a director, senior manager or mere employee has a right to leave their employer and set up in competition. To hold otherwise would be to restrain trade and deny competition. In *Stenhouse Australia Ltd v Phillips*[41] Lord Wilberforce said,

> *"The accepted proposition that an employee is not entitled to protection from mere competition by a former employee means that the employee is entitled to use to the full, any personal skill or experience, even if this has been acquired in the service of his employer: it is this freedom to use to the full a man's improving ability and talents which lies at the root of the policy of the law regarding this type of restraint. Leaving aside the case of misuse of trade secrets..., the employers claim for protection must be based upon the identification of some advantage or asset inherent in the business which can properly be regarded as, in a general sense, his own property, and which it would be unjust to allow the employee to appropriate for his purposes, even though he, the employee, may have contributed to its creation...These two obligations interlock during his employment; after its termination they diverge and mark the boundary between what the employee may take with him and what he may legitimately be asked to leave behind to his employers."*

44. However, in leaving the employ of a company directors must not breach their duty of fidelity to the employer. In brief these duties cover the following instances.

Canvassing customers

45. A director, prior to leaving, must not canvass customers for the new business[42]. It does not matter that the clients initiate the discussion[43]. Yet as soon as the obligation terminates, canvassing can begin but not a minute before.[44] However. ingratiating one's self by giving top service to cients in the knowledge that the

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[41] [1974] AC 391, 400

[42] *Robb v Green* [1895] 2 QB 1; *Wessex Dairies v Smith* (1935) 2 KB 80

[43] *Saunders v Perry* [1967] 1 WLR 753, 765

[44] *Thomas Marshall (Exports) Ltd v Guinle* [1978] 3 ALR 193

director is about to leave is not a breach[45] and just because customers flock to follow the ex-employed director is also not evidence of wrongdoing [46]

Preparation for New Business

46. Preparations taken by the about-to-depart director, such as setting up a company, leasing a building and the like out of hours is not likely a breach.[47] However, anything done in work hours whilst still employed, even if disclosed to the employer, puts the employee/director at risk[48]. Advising staff they should follow to the new business is a breach regardless of when the offer is taken up [49] but simply telling staff that the departing director is setting up a new business is not.[50] Deliberately concealing information useful to the employer for use in the new business is a breach[51]. The touchstone appears to require moral turpitude.

Dishonesty

47. Copying and removing customer lists, noting business opportunities, deliberately memorising lists or formulae, deliberately acquiring knowledge of processes which are not within the usual scope of the employment will be considered a breach[52].

48. The liability of former directors once they have left office will not be canvassed here.

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45 *Green & Clara v Bestobell* [1982] WAR 1

46 *Metrons v Courtney-Smith* (1983) 1 IPR 185

47 *State Vacuum v Phillips* (1954) 3 DLR 2 621; *Bristol Pharmaceuticals v Collins* (1995) 31 IPR 488, 495.

48 *US Surgical v Hospital Products* (1982) NSWLR 766; *Blithe Chemicals v Bushnell* (1933) 49 CLR 66

49 *AF Associates v Ralston* (1973) NR 229

50 *Cope Allman v Farrow* 1984) 3 IPR 567, 573.

51 *Cranleigh Precision Engineering v Bryant* [1965] 1 WLR 1293

52 *Faccenda Chicken v Fowler* [1986] 3 WLR 288; *Roger Bullivant v Ellis* (1987) FSR 172; *Ormond Roofing v Bitumenoids* (1930) 31 SR (NSW) 347.

Corporations and Markets Advisory Committee ('CAMAC') Referral

49. In conclusion[53], it would be remiss not to mention the formal referral by Senator Ian Campbell, Parliamentary Secretary to the Treasurer, of matters related to the personal liability of directors, to CAMAC for further consideration.

50. In his referral on 9 July 2002, Senator Campbell recommended that CAMAC consider:
    - whether the current situation resulted in disincentive for persons accepting or continuing to hold directorships and directors engaging in entrepreneurial but responsible risk taking;
    - the impact of director's liability on the availability of professional indemnity insurance; and
    - consequences of rising insurance premiums.

51. It is likely that a uniform provision will be introduced to replace the current myriad of provisions across all Australian jurisdictions. This would have the effect of clarifying the precise scope of directors' duties. The effect of creating a uniform provision may well be to increase scope for liability in some instances and to reduce it in others. However, creating uniformity and certainty is likely to be better for everyone, no matter what view you take on the adequacy of laws imposing liability on directors.

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[53] I wish to acknowledge the kind permission of John L Powell QC (London) to quote from his paper delivered at the 13th Commonwealth Law Conference in Melbourne in April 2003 and from notes used by Dr Robert Dean of Counsel at a meeting of CommBar on duties of resigning directors delivered in April 2004. In my discussion of the Sarbanes-Oxley Act I have been assisted by notes of Robert Webb, Attorney-at-Law. I acknowledge a discussion paper on the Corporations and Markets Advisory Committee by Bruce Cowley and Brett Thorneycroft of Minter Ellison. Finally I thank my son, Geoff Denton, who is completing his law degree at Victoria University Melbourne, who carried out some research for this paper. I accept responsibility for all errors and omissions.