



Précis Paper

Directors' Duties

Richard Perry QC and Christopher Wood discuss the dangers that arise when directors fix their own remuneration.

Discussion Includes

- Where does the authority generally lie to approve directors' remuneration?
- The common exclusions in directors' and officers' insurance policies
- The inherent conflict of interest when directors decide their own remuneration
- The importance of directors considering whether an increase in their remuneration is of benefit to the company
- The importance of getting not just the consent of the full Board, but the informed consent of the full Board
- Statutory duties under sections 180, 181 and 182 of the *Corporations Act 2001* (Cth)
- How directors should proceed if they propose to increase their remuneration

Précis Paper

Directors' Duties

1. In this edition of BenchTV, Richard Perry QC (Barrister) and Christopher Wood (Barrister) present on the Queensland Supreme Court (de Jersey CJ) decision in *Invision Ltd v SGB Jones Pty Ltd & Ors* [2014] QSC 97 which involved considerations of fiduciary duties owed by company directors.
2. Mr Perry QC acted for the successful second respondent, Chartis Australia Insurance Ltd, in the Supreme Court and in the Court of Appeal (*Jones & Ors v Invision Ltd & Anor* [2015] QCA 100), which reaffirmed the earlier decision. Mr Wood is an experienced barrister in the areas of Corporations Law, Commercial Law and Equity. He is a co-author of Finnane E, Newton N & Wood C, *Equity Practice and Precedents* (Thomson, Sydney, 2008).

Material Facts

3. The plaintiff, Invision Ltd, sought compensation under s 1317H of the *Corporations Act 2001* (Cth) against three of the company's former directors (2 of whom were executives, and the third was the director of a company providing consulting services (SGB Jones Pty Ltd)). Invision alleged the directors had breached ss 180-182 (extracted below).
4. The breaches were said to arise from the three directors having amended Invision's contracts with themselves in their capacity as executives and with SGB Jones, without the board's approval. The amendment allowed the three directors to terminate their contract with Invision and receive a termination payment equivalent to 12 month's salary (or SGB Jones' 12 month retainer). The amendment of the contracts had followed an approved resolution of the board presented by the three directors to amend their contracts to allow 12 months termination payment following the relevant contracts being terminated by the company. The three directors did not vote on the board resolutions.
5. The three directors were involved in the preparation and execution of their amended employment contracts. Those amended contracts did not conform to the board resolutions, but included terms more favourable to the employees. These changes included making the 12 month termination payments payable to them if they terminated their own employment contracts. In contrast, the board had no knowledge of the change to remuneration if the directors terminated the contract themselves, nor were they informed at subsequent board meetings.
6. The executives did not disclose the fact that they had amended the contracts (creating a significant liability for the company) to the board in subsequent board meetings. The

executives and SGB Jones then terminated their contracts and received the relevant payments. After the re-constitution of the board, the company then instituted proceedings against the former directors.

7. A separate issue for the Courts was whether the three directors could claim indemnity cover under Invion's director's & officer's policy. The policy excluded cover for loss connected with "the committing of any deliberately dishonest or deliberately fraudulent act." Furthermore, the policy definition of "loss" excluded "employment related benefits".

Invion Ltd v SGB Jones Pty Ltd & Ors [2014] QSC

Breach of Duty

8. The question for the Supreme Court was whether the amendments to the contract constituted a breach of the directors' duties governed by ss 180-182 of the Act, which provide the following:

SECTION 180:

Care and diligence--directors and other officers

- (1) *A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:*
 - (a) *were a director or officer of a corporation in the corporation's circumstances; and*
 - (b) *occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.*

SECTION 181:

Good faith--directors and other officers

- (1) *A director or other officer of a corporation must exercise their powers and discharge their duties:*
 - (a) *in good faith in the best interests of the corporation; and*
 - (b) *for a proper purpose.*

SECTION 182:

Use of position--directors, other officers and employees

- (1) *A director, secretary, other officer or employee of a corporation must not improperly use their position to:*

- (a) *gain an advantage for themselves or someone else; or*
- (b) *cause detriment to the corporation.*

9. De Jersey CJ concluded that the directors had breached the relevant provisions and had no authority to amend the contracts as they had. The company was not bound by the payments made to those directors, and could recover them. He relied on the fact that the full board was not aware of what the directors had done, the directors had acted dishonestly in knowing the amendments should have been approved by the board, and there were clear breaches of the duties to avoid a conflict of interest with the company's interests and the duty not to make a profit from their position without fully informed consent.
10. In establishing the breaches, it was relevant to His Honour that the company was small and financially vulnerable, such that the variations to the contracts could potentially have major impacts on the continued solvency of Invion. Accordingly, the three directors should have appreciated the need to fully inform the whole board of the actions which they took.
11. Inferentially, the three directors bypassed the board not because they thought they did not need to inform it but because they surmised that the board would not agree with the amendments. In the opinion of His Honour, this failure to provide significant information to the board that related to their own remuneration amounted to a breach of duty of ss 180-181 of the Act. In amending their remuneration contracts in these circumstances they failed to avoid a conflict between their own self-interest and the company's interests (pursuant to s 181 of the Act) and used their positions to procure themselves a financial benefit (pursuant to s 182 of the Act). Thus, His Honour concluded that the three defendant directors had breached ss 180-182 of the Act and would be required to compensate Invion for the payments wrongly made to them (see s 1317H of the Act).
12. His Honour further found that the failure to fully inform the board constituted dishonesty, which was further exacerbated given that they had the opportunity to inform the board at subsequent board meetings prior to their resignation.

Third Party Insurance Claim

13. The Court held that there was no right to indemnity cover because the directors' conduct had been deliberately dishonest. Importantly, the established breach of s 182 necessarily triggered the operation of the exclusion clause because a willful breach of duty established by the contravention of s 182 also answered the description of willful breach in the relevant exclusion clause.

14. In the case of the executive directors, indemnity was also excluded because the policy definition of 'loss' excluded 'employment related benefits' and these termination payments appropriately fell into this category. The Court doubted that the claim made against the non-executive director concerned 'employment related benefits', as the termination payment was made to SGB, rather than the director personally.

Significance

15. Mr Perry QC asserts that the facts of this case are a "cautionary tale" for any director or officer of a relatively small company. It is particularly relevant for small companies because it is in those situations where the specific roles of board and executive officers is blurred and hence caution is particularly required.
16. Mr Perry QC lists the following steps that directors and officers of smaller companies can take to prevent findings against them for breaching relevant duties:

- a. *Provide full information to the board:*

The first caution Mr Perry notes is the importance of simple prudence in business decisions. On the facts in *Invion*, this step would have called for the provision of all information and advice to the board even if it was not necessary for them to consent to specific arrangements. 'All information' does not mean three quarters of the story. Mr Perry suggests that doing so may even be more reprehensible in that you present a partial view of what has happened, consciously and wilfully, and this can shine a real light on your motives. Mr Wood echoes the reasoning of de Jersey CJ in noting that where a director/officer does not provide full information because they are concerned they might receive an unfavourable response, it is likely a breach of duty.

- b. *Seek board approval:*

Furthermore, Mr Perry QC notes that presenting the full information after-the-fact to the board may not prevent the breach of a duty where board approval is required. In seeking board approval, the proposal should be presented in a way that fully considers the pros and cons of a relevant resolution. The directors/officers that have a conflict of interest in relation to a resolution should not participate at all in discussion of the proposal and cannot vote. In some cases where they have had some involvement in the debate, the mere expedient of leaving the room when the time for voting comes may be insufficient to overcome the no-conflict rule. Finally, it may prove necessary for directors/officers in the circumstances of the defendants in *Invion* to advise the other members of the board to retain third party business/legal advice to completely inoculate themselves from potentially breaching their duties.

BIOGRAPHY

Richard Perry QC

Mr Perry QC was called to the Bar in 1983 and appointed Queen's Counsel in 2004. His chambers are at 31 West Chambers, Brisbane.

Christopher Wood

Barrister. 13 Floor, Wentworth Chambers, Sydney

Chris was admitted as a solicitor in 1998 and admitted to the bar in 2001. He specialises in Bankruptcy & Insolvency, Commercial Law, Equity & Trusts and Intellectual Property. He has a bachelor's degree in science, and an Honours degree in law. Christopher is co-author of Finnane E, Newton N & Wood C, Equity Practice and Precedents (Thomson, Sydney, 2008) as well as several other publications. He is also a Member of the Society for Computers and the Law.

BIBLIOGRAPHY

Focus Cases

Invion Ltd v SGB Jones Pty Ltd & Ors [2014] QSC 97

Jones & Ors v Invion Ltd & Anor [2015] QCA 100

Benchmark Link

http://www.benchmarkinc.com.au/benchmark/composite/benchmark_06-06-2014_insurance_banking_construction_government.pdf

http://benchmarkinc.com.au/benchmark/composite/benchmark_17-06-2015_insurance_banking_construction_government.pdf

Judgment Link

<http://archive.sclqld.org.au/qjudgment/2014/QSC14-097.pdf>

<http://archive.sclqld.org.au/qjudgment/2015/QCA15-100.pdf>

Legislation

Corporations Act 2001 (Cth), s 180(1), s 181(1), s 182(1), s199B(1), s 1317H, s 1317S, s 1318