

BEING A COMPANY DIRECTOR

So, you are a company director, or thinking of becoming one? Know your responsibilities.

What is a company?

A Company is an association of many people with a common object. It is owned by Shareholders and managed by Directors. Once created it is an entity and has a legal personality to do what a natural person can do. Therefore, a Company can sue and be sued.

What is a Director?

A Director is a person employed as an officer of a company and has a duty to perform the duties of management of the business of the company. The duties set out in this document stem from a director's fiduciary duty to the company. That is that a director owes a duty first and foremost to the company and its shareholders above all else. The specific duties come back to this proposition and ensure that Directors are applying this basic principle in all aspects of their role.

What are a Director's Duties?

Directors' duties derive from three potential sources:

- ✓ Those imposed by **Statute**, primary the Corporations Law;
- ✓ Those developed by the **Courts**, particularly those duties arising from a director's fiduciary position; and
- ✓ Those that may be expanded upon or shaped by the circumstances of a company, primarily by a **Company's Constitution or Replaceable Rules** and other contracts such as **Shareholders' Agreements**.

Statutory Duties – Please note: these statutory duties can extend to beyond those with the official title of 'Director.' Statutory duties under the *Corporations Act 2001* impose responsibilities on company secretaries as well. The following duties apply to your role as a Director always and in relation to all aspects of your business.

Failure to comply with these duties can result in fines of up to \$200,000 for a serious breach as well as potentially being personally liable for the loss suffered to the company.

Section 180(1) – Care and Diligence: *"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."*

The basic premise of this duty is that you are to act as a reasonable person with your knowledge of the company and at the very least a basic understanding of business could have acted in the same or similar circumstances.

Section 181(1) – Duty to Act in Good Faith: *"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."*

To fulfill your duties under this section the reasoning behind your business decisions must be motivated by the best interests of the company and that you are doing what you believe to be in the best interests of the company

Section 182(1) – Use of position: *“A director, secretary or other officer or employee of a corporation must not improperly use their position to: - gain an advantage for themselves or someone else; or cause a detriment to the corporation.”*

Section 183(1) – Use of Information: *“A person who obtains information because they are, or have been, a director or other officer or employee of a corporation must not improperly use the information to – gain an advantage for themselves or someone else; or cause detriment to the corporation.”*

Under these duties, you are not able to use information obtained in your role as director of your company for personal gain for yourself or someone else.

Section 191(1) – Disclosure of Interest: *“A Director who has a material personal interest in a matter that relates to the affairs of the company must give notice of the interest.”*

In most cases to avoid liability under this case you are required to disclose any conflict or potential conflict of interest by application to ASIC.

There are various exceptions to this rule.

Common Law – Fiduciary Duties

Duty to Act in Good Faith: The duty of good faith is owed by each director and is owed to the company itself. Directors are required to act in what they honestly believe to be the interests of the company. In considering what is in the interests of the company, a director must have regard to the interests of the shareholders of the company and the interests of the company as a commercial entity.

Duty to Avoid a Conflict of Interest: A director has a duty to avoid conflicting his or her own interests with the interests of the Company. A director is liable to account to the Company for any profit derived or to indemnify the Company from any loss arising from the director’s action. Directors are also unable to use their positions or corporate information to make a personal profit. Additionally, the Company can choose to void any conflict that the director entered because of the conflict.

Duty to Exercise Power for a Proper Purpose: A director must exercise his or her powers conferred on them under the Company’s Constitution or the Act for a proper purpose. Powers must not be exercised for an ulterior purpose or for manipulating voting power.

Duty to act honestly: Directors must act honestly in the best interests of their company. While this gives directors a wide discretion, the courts have said that they must act in such a way that an intelligent and honest man in the position of the director would, in the same circumstances, reasonably believe that the directors actions were in the best interests of the company.

Duty Retain Discretion: A director cannot agree that they will not exercise powers given to them in their Constitution or the Corporations Act in a way. The director must act independently and in the best interests of the company. Generally, a director cannot contract as to how they will vote at a future board meeting. A director can however, having entered into a contract on behalf of the Company in the bona fide exercise of his or her duties, agree to take certain action at a board meeting that is necessary to carry out the contract.

Duty to individual shareholders: Directors owe no fiduciary duties to individual shareholders and they also do not have to take into consideration the interests of the company’s creditors. Instead, directors owe a duty to the body of shareholders, both existing and future ones. This is reversed when a company becomes insolvent at which point the director’s duties to repay creditors fairly will come before their duty to the shareholders.

Insolvent Trading: Directors are now under a positive duty to ensure that the Company does not incur a debt while insolvent.

It will be the liquidator, rather than individual creditors, who will have the primary right to sue directors for insolvent trading with the money recovered by the liquidator being available for all unsecured creditors on a pro rata basis.

Directors can also be criminally liable under the insolvent trading provisions of the Corporations Law. Section 588G (3) of the Law provides that a person commits an offence if:

- the person is a director of the Company when it incurs a debt;
- the Company is insolvent at that time, or becomes insolvent by incurring that debt, or incurring at the time debts including that debt;
- the person suspected at the time when the Company incurred the debt that the Company was insolvent or would become insolvent because of incurring that debt or other debts (as paragraph (1)(b)); and
- the person's failure to prevent the Company incurring the debt was dishonest.

Trading whilst insolvent is regulated strongly and there are serious consequences. For more information on trading whilst insolvent please navigate to the website below for a thorough understanding on exactly what insolvent trading looks like and how to avoid doing so yourself.

<http://download.asic.gov.au/media/1241384/rg217-29july2010.pdf>

Recovery by the Australian Tax Office (ATO) - The ATO has made Director Penalty Notices ("DPN") issued pursuant to section 222AOE of the *Income Assessment Act* 1936, part of their enforcement activities. Directors of a Company which fails to pay its tax as it becomes due and payable, are liable to pay to the Commissioner of Taxation a penalty equivalent to the unremitted amounts. The Director Penalty Regime applies to PAYG Tax and to the Super Guarantee Charge. Directors who may not have even been employed at the time that the tax was not paid. It is vital that you ensure that your tax records are up to date to avoid any personal penalties. The purpose of the regime is to ensure that all Directors are responsible for ensuring that they are up to date and compliant with their tax.

Prior to recovery of that penalty from the directors, the Commissioner of Taxation must issue a written notice requiring the directors of the Company to cause the company to do one of the following things within fourteen (14) days, namely: -

- remit the group tax or prescribed payments;
- enter into and comply with a payment agreement in relation to the company's liability with the ATO (upon default of which, the current directors are personally liable for the Company's obligations under the agreement);
- appoint an administrator to the Company under Part 5.3A of the Corporations Law; or
- begin to be wound up under the Corporations Law.

Directors of the Company will become personally liable even if they were not appointed at the time the liability was incurred.

For further information, please see <https://www.ato.gov.au/business/starting-your-own-business/in-detail/getting-started/director-penalty-regime/>

Creditor's Rights

Creditors have rights that cannot be ignored as a Director. Creditors that have provided you with goods and/or services that remain unpaid gives rise to these rights.

In the event of insolvency creditor's rights tend to come up as everyone seeks to recover their money.

It is important to note the below provisions to ensure you are not criminally liable. Directors' criminal liability for corporate actions leading to the defrauding of creditors under the under the *Crimes Act* 1958 (Vic): -

- S 81 – obtaining property by deception
- S 82 – obtaining financial advantage by deception
- S 83 – engaging in false accounting
- S 84 – Where an offence committed by a Company under section 81, 82 or 83 is proved to have been committed with the consent or connivance of any Company director, manager, secretary or similar officer, or any person purporting to act in any such capacity, he as well as the Company shall be guilty of that offence and punished accordingly
- S 85 – directors intend to deceive creditors by false or misleading statements and/or publication

Breaches of these provisions are taken seriously and can result in large fines and in extreme situations involving major fraud penalties may include imprisonment.

Occupational Health and Safety

Employers and Directors have an overarching obligation to provide a safe working environment for not only their employees but also for visitors.

Competition and Consumer Act (2010)

This act imposes many obligations on small businesses in the interests of creating a fair market for both business and customers. The act is enforced by the Australian Competition and Consumer commission and impacts in some of the following areas:

- ✓ Protecting businesses
- ✓ Protecting Customers
- ✓ Unfair Contracts

Under the act there are provisions that can result in significant penalties for directors if they fail to act in accordance with the Competition and Consumer Act. For more information on the act and the ACCC please see the following website <https://www.accc.gov.au/business> in your life. So, it is important to know where you stand legally.

DISCLAIMER: This White Paper is provided as a broad overview and should not be relied upon as a substitute for legal advice.

If you require further advice in relation to the above or business generally, please contact us.

More Information?

E: legal@mcplegal.com.au

P: (03) 9620 2001

W: www.mcplegal.com.au