Question 1

Crook Restaurants Ltd satisfies the definition of a company outlined in *s9* of the *Corporations Act 2001*[1]. While the company's degree of limitation is not specifically defined within the questions body, its relevance is unimportant in the analysis of the company's director's duties. CR Ltd director's structure typifies the common formation outlined in corporate society today. Sue, who is the managing director in assumed accordance with *s201J*, has been elected to run the managerial constituent of the company on the board's behalf. This specifically implies that she has powers equal to that of any of the remaining board members as detailed in *s198C* of the act. James, Ian and Henry are executive directors whose roles are to assist Sue, as the managing director, and supervise the day-to-day operations of the company[2]. Lee is a non-executive director, whose position as financial adviser is to provide independent views which are believed to be subjective to the nature of Crook Restaurants business.

In the analysis of the director structure of this company, the possibility for conflict is clearly evident. *s198A(1)* gives directors the power to manage the business of a company in accordance with their role, however this role is open to abuse when a clear separation between ownership and management does not distinctively exist. The lack of segregation by CR Ltd creates a fracture in the transparency of its director's actions and allows for obvious exploitation to occur. While it is a statutory requirement for directors to act in good faith and the best interests of a company, as stated in *s181*, the capacity for this to be upheld in CR Ltd is now restricted to the ethical and professionalism of each board member. Henry in his capacity as a director, owed his first obligation to the company and the subsequent employment of his criminal son creates not only an improper[3] use of his position, as per *s182* and *s184*, but also contravenes the fiduciary relationship owed in *s181*. Equivalently, not only does James disregard his responsibilities[4] as a director by rarely attending board meetings[5], his inability to uphold his fiduciary duty towards the company by not actioning the suspicions of Henrys son, highlights both the inadequacies of the current CR Ltd company structure and the lack of professionalism in both these directors.

In *AWA Ltd v Daniels*[6] it was established that while the standard of care owed by non-executive directors was intermittent in nature, a fiduciary relationship still exists at

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[1] CCH (2005), Australian Corporations & Securities Legislation 2005, CCH Australia Limited, Sydney

[2] Although the question clearly states that James is not involved in this activity whatsoever, as discussed later

[3] In R v Byrnes (1995) 13 ACLC 1488, the court defined the word improper as *"Impropriety does not depend on the alleged offender's consciousness of impropriety. Impropriety consists in a breach of the standards of conduct that would be expected of a person in the position of the alleged offender by reasonable persons with the knowledge of the duties, powers and authority of the position and the circumstances of the case. When impropriety is said to consists in an abuse of power, the state of mind of the alleged offender is important: the alleged offender's knowledge, or means of knowledge of the circumstances in which the power is exercised and their purpose or intention in exercising the power are important factors in determining the question whether the power has been abused. But impropriety is not restricted to abuse of power. It may consists in the doing of an act which a director or officer knows or ought to know that they have no authority to do"*

[4] In ASIC v Rich [2003] NSWSC 85 Austin J stated *"The word "responsibilities" was intended to direct attention to the factual arrangements operating within the company and affecting the director in question – as opposed to the legal duty of care, implying specific legal duties in particular circumstances. The content of those specific duties would be affected by the factual matters specified in the section, relating to the corporations circumstances, the nature of the director's office, and the director's responsibilities. The director's responsibilities would include arrangements flowing from the experience and skills that the director brought to his or her office, and also any arrangements within the board or between the director and the executive management affecting the work that the director would be expected to carry out. The precise duty of care flowing from these arrangements would be subject, of course, to a minimum standard of care and diligence set by the statute in reflection of the common law position"*

[5] In *Vrisakis v ASC (1993) 11 ACLC 763*, Malcolm CJ stated that directors were expected to attend all meetings unless exceptional circumstances arose pertaining to non attendance. While this was an extreme view of the duties owed by a director, a further decision in Daniels v Anderson (1996) ACLC 13 614 derived a more equitable solution. The New South Wales Court of Appeal in this case, thought that directors should meet as often as is required in order to adequately ensure management functions are suitable.

[6] AWA v Daniels (1992) 10 ACLC 933

both common law and statutory levels. Furthermore, in their capacity as directors they have a duty to inquire about, and request more information regarding the reasoning behind management decisions. Evidently Lee, who represents the only impartial view on the board and holds the position of financial controller, should have recommended further investigation into the specific nature of the declining profits at the Sydney restaurants. This requirement of non-executive directors was affirmed in *Sheahan v Verco*[7] whereby it was decided that non-executive directors would be held accountable if they did not enquire about how the company was run or its business conducted. The court ruled that a non-executive director must demonstrate a reasonable interest into company operations, as this is the inherent function of a director. The inability to perform this duty would lead to a direct conflict in the formation of an independent opinion, which is the very purpose of a non-executive director, in judging the suitability of a company's administration. In respect of this judgement, this is undoubtedly the position Lee has placed himself in.

At common law, if a potential conflict of interests arises, directors can avoid a breach of their fiduciary relationship by making a full disclosure to the company. This was established in *Furs Ltd v Tomkies*[8], where the court held that a conflict of interest existed because the defendant failed to put the company ahead of his own personal agenda. *s191* derives a similar conclusion to this case, whereby it requires a director who has material personal interests in a matter that relates to the affairs of the company, to give notice to all other directors of such an interest[9]. The subsequent discovery of criminal activities by Henry, should have in his position as a director, led to an immediate fulfilment of this section. His inability to report his son's criminal activities, and the consequential misappropriation of company funds as a means of protecting him, signifies the most obvious breach of Henrys duties in this case. *s229*, in connection with *s208*[10], establishes the definition of giving a financial benefit to another entity and also encompasses granting a financial benefit without a monetary attachment. Thus, the preceding sections are breached by Henrys actions threefold:

1. Firstly, because he misappropriated funds without the authorised consent from all other company members in compliance with Corporation Acts *s217* to *s227*
2. Secondly, by allowing his son to continue to work while extradition arrangements were made to avoid further criminal charges for his son, he fully endorsed the continuation of his sons employment at the restaurant effectively providing his son with a non-monetary financial advantage in this sense; and
3. Thirdly, he continued to expressively permit his son to embezzle another large sum of money before leaving the country (satisfying point 1 again).

Henry's actions in this case, are paralleled to those displayed in *ASIC v Alder*[11] where the statutory duties of a director were abused for the personal benefit of the same director. This Court of Appeal established in this case, that any financial benefit entered into by an authorised contracting party of a company, which had the wilful

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[7] Sheahan v Verco [2001] SASC 91

[8] Furs Ltd v Tomkies (1936) 54 CLR 83

[9] Daniels v Anderson (1995) 13 ACLC 614 equally established that a director must take reasonable steps to ensure they are in position that casts a supervisory eye over the management decisions of the company.

[10] s208 is the main provision outlined in Chapter 2E of the Corporations Act 2001, whose purpose is to specify the need for member approval before allowing a financial benefit to be authorised. s208(1) states:

> *(1) For a public company or entity, that the public company controls, to give a financial benefit to a related party of the public company:*
>
> *a. The public company or entity must:*
>
> *i. Obtain approval of the public company's members in the way set out in sections s217 to 277;*

A related party is defined within defined in s228 and specifically includes in this case:

S228(1) – Controlling Entities

S228(3) – Relatives of directors and spouses

[11] ASIC v Alder [2002] NSWSC 171

knowledge that a reasonable arms length[12] relationship did not exist, was in direct contravention of *s208* in their capacity to authorise such a transaction. The Explanatory Memorandum accompanying the 1992 Corporation Law amendments[13] further highlights[14] Henrys breach of *s208* in his capacity as a director of CR Ltd.

The subsequent presentation of Henrys findings to all board members (except James), and lackadaisical attitude shown in response to them, highlights the most concerning feature of this case. Each director, from Sue in her position as managing director to Lee as a non-executive director, had a fiduciary duty to at least question the integrity of Henrys findings as established in *s181* of the Corporations Act. At the most fundamental level this is the minimum requirement a director must adhere to, and despite the obvious improper use of Henrys position, the inadequacies of the other directors provided the underlying reasoning as to why the misappropriation of company funds was allowed to occur. A clear breach by all directors, pertaining to *s180* and *s181* at the very minimum, is obviously evident regarding the lack of analysis into Henry's findings.

The discovery of the scam and the consequential losses resulting directly from the criminal activities of a director's son were inevitable. To suggest that either one of the directors in this case did not have an opportunity to discover the actions that eventuated, is to discount the statutory rights given to a person who assumes the role of director. The inadequate segregation of ownership and management coupled with a clear lack of professionalism and moral obligation by each of the directors is why the company sustained such large losses. The remedies available to the company may therefore be limited; if the court rules that the remaining directors of CR Ltd were equally liable for Henrys actions, due to their own negligence of the events that surpassed, CR Ltd may not be able to recover any of the stolen funds. This is unlikely however, because of the seriousness of Henrys actions, as demonstrated in the *ASIC v Alder* case, the court will most likely rule specifically against him.

Since this case has involved many breaches on Henrys behalf, both civil and possibly criminal charges may apply. *s1317E(1)* outlines the civil penalties that exist for breaches of *s180* through *s183*, which will most definitely be applicable to Henry, if not all the remaining directors[15]. He may also be legally responsible to pay compensation to the CR Ltd because the company has suffered such significant losses as a result of his actions, in accordance with *s1317H*. Henrys son may also be liable for civil, if not criminal penalties for connection with his fathers misappropriation and *s79* which defines the degree to which a person is considered to have been involved[16] in a contravention. Since Henry also breached *s184(1)*, then he may also be further

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[12] s210 states that any financial benefit can be authorised without member approval if done at an arms length level. Arms length is not defined specifically within the Corporations Act 2001, and its meaning is effectively the formation of relationship who is not a related entity, but an independent third party.

[13] Lipton and Herzberg, Understanding Company Law, 12th Edition Thomson Lawbook Co, Sydney, 2004 pg 317

[14] *"The Part is intended to protect shareholders of public companies against the possibility that the value of their investment will be eroded by a related party arranging for the company to enter into a transaction which gives a benefit to the related party. The Part will not prevent a public company from entering into full value, commercial transactions with related parties. The proposed changes (now Chapter 2E) will prevent only "uncommercial" transactions, as these are the kinds of transaction which have a potential to adversely affect shareholder' interests. And even in the case, [Ch 2E] will allow any transaction that has been agreed to by a majority of the public company's disinterested shareholders, provided they have been fully informed about the transaction and its likely impact on the company"*

[15] *s1317* penalties that are awarded for breaches of this section range from $200,000, to 5 years imprisonment or both according to Sch 3 Penalties listings.

[16] *s79* states *that a person is involved in a contravention if, and only if, the person:*

- *(a) has aided, abetted, counselled or procured the contravention; or*
- *(b) has induced, whether by threats or promises or otherwise, the contravention; or*
- *(c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or*
- *(d) has conspired with others to effect the contravention*.

liable for criminal offences in accordance with *s1311(1)*, and any other penalties as determined by the court.

The position of director is one of high authority and professional integrity and to abuse the power that attaches itself to the role, simply ruptures the underpinnings of corporate integrity and economic structure. The actions of the entire group of directors in this case, indicate both a lack of fiduciary duty and professionalism. It does highlight however, the ease at which unacceptable segregation between ownership and management can be exploited by dishonest directors to effectively misuse their positions within a company. Ultimately, it is the director's responsibilities as a collective group, to ensure that risk is diversified and company transparency is maintained. Had this been evident in this case, Henrys son may never have been allowed to become an employee of CR Ltd, and none of Henrys actions would ever have taken place[17].

Word Count: 1,563

[17] The *Bibliography* for this question is at end of the 2nd paper

QUESTION 2

Should a company that is a member of a corporate group be liable for the debts of other companies in the group? In your answer consider whether it should make a difference if the creditors concerned are contract or tort creditors.

In this context, should directors consider the interests of stakeholders such as tort victims ahead of, or as well as, shareholder interests?

Society demands that the governing law of a modern corporate group is established so the interests of the socioeconomic environment it operations in are impartially balanced, and equally protected. Modern corporations endeavour to achieve an equilibrium between optimal economic profitably in combination with appropriate levels of fiduciary and ethical standards. This paper seeks to identify the relationship that is established between a corporate group, its controlling body, and the extent to which it and its subsidiaries assume the responsibility for each others actions. It will also consider if company directors are required to consider contractual tort relationships in comparison to shareholder interests, and the degree to which this may influence corporate group direction. The impact of legislative requirements and common law statute regarding these decisions will also be explored.

The legislative body governing Company Law in Australia is the *Corporations Act 2001*, which collectively, with abundant common law cases, has established a precedent for rulings over corporate groups. Arguably, the most significant ruling concerning company law universally was the decision from the *Salomon v Salomon*[1] case which established the concept of *limited liability* for shareholders, and allowed companies to become separate and distinct entities from their members. In this case, Lord Macnaghten stated *"The company is at law a different person altogether from subscribers to the memorandum….the company is not in law the agent of the subscribers or trustee for them"*[2]. The separate legal entity principle, does not itself 'impose' limited liability[3], but rather enables a company to become a separate entity from that of the members[4].

In its most simplistic form, *"Limited Liability refers to the legal default rules that limit the personal liability of a firm's stakeholders and participants from the firm's obligations"*[5] – which has been reproduced in Australian legislation pursuant to *s 112*[6], with its most common derivative being limitation by shares[7]. It facilitates numerous advantages for companies limited in this manner, such as stemming market imperfections by reducing the overall costs of investment and facilitating specialisation for a corporation choosing to adopt it. Equally, it promotes market

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[1] Salomon v Salomon & Co Ltd [1897] AC 22

[2] Ibid 1

[3] Annexure T - Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation, "The Concept of Limited Liability – Existing Law and Rationale" http://www.cabinet.nsw.gov.au/hardie/T.pdf, September 2004

[4] Since the members are considered separate legal entities from the company and vice-versa, this enables members to effectively 'acquire' limited liability; the limitation restricts a member's financial obligation to the company by their initial capital investment.

[5] Glynn, Timothy P. "Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers", Vanderbilt Law Review, 2004 (Volume 57 No. 2), http://law.shu.edu/faculty/fulltime_faculty/glynntim/publications/Glynn_vanderbilt_article.pdf

[6] CCH (2005), Australian Corporations & Securities Legislation 2005, CCH Australia Limited, Sydney

[7] *s 516 - If the company is limited by shares, a member need not contribute more than the amount (if any) unpaid on the shares in respect of which the member is liable as present or past member.*

efficiency[8] by reducing systematic and unsystematic risk factors for investors, which assists in market diversification by allowing investors to engage in either active or passive share trading, without being entirely restricted to their personal wealth level. In effect, it creates a 'corporate veil' over members shielding them from company liabilities, and limiting them to their initial capital investment.

While the importance of both the limited liability and separate legal entity concepts cannot be emphasized enough in respect of the underpinnings in listed company structure, its attractiveness reduces considerably when applied to the corporate group organization. Parent, or holding companies, are indirectly defined through *s9* and *s46* of the Corporations Act[9], and they seek to define when a company is a 'subsidiary' of another body corporate[10]. The legal relationship fashioned from this connection arises in conjunction with *s50AA*, which ascertains the principle of control[11]. The degree to which a parent company has effective or complete control over its subsidiary can be explored in either a single or separate entity sense[12], with limited liability being measured respectively between either the entire group, or each individual company of it. However, the inability for either viewpoint to effectively produce an appropriate conclusion in determining the amount of control a holding company should exert over its subsidiaries, and whether it is rational for liability to exist in such a sense, signifies the organisational complexities which still exist in formulating appropriate legislative law.

In *Briggs v James Hardie & Co Pty Ltd*[13], Rogers AJA established that a holding company has complete autonomy in respect of its subsidiaries[14], which was later affirmed in *Adams v Cape Industries*[15] where the UK court of appeal criticised the this principle, but equally acknowledged its importance in general law[16]. These common

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[8] Companies and Securities Advisory Committee, "Corporate Groups Final Report" (May 2000) http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2000/$file/Corporate_Groups,_May_2000.pdf Page 32

[9] Lipton and Herzberg, Understanding Company Law, 12th Edition Thomson Lawbook Co, Sydney, 2004 pg 76

[10] *s46 A body corporate is a subsidiary of another body corporate if, and only if:*

(a) the other body:

(i) controls the composition of the first body's board; or

(ii) is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast a general meeting of the first body; or

(iii) holds more than one-half of issued share capital of the company (excluding any part of that issued capital that carries no right to participate beyond a specified amount in a distribution of a subsidiary of either profits or capital); or

(b) the first body is a subsidiary of the a subsidiary of the other body.

s 50 Where a body corporate is:

(a) a holding company of another body corporate;

(b) a subsidiary of another corporate; or

(c) a subsidiary of a holding company of another body corporate

the first mentioned body and the other body are related to each other

[11] This definition is further extended by *s259E(1)* for companies limited by shares. It establishes that a company is regarded as being in 'control' of another entity, if the entity holds shares in the company, and the company has the capacity to determine to the outcome of decisions related to the entities financial and operating policies.

[12] Ibid 8, Page 28

[13] Briggs v James Hardie & Co Pty Ltd (1989) 7 ACLC 841

[14] *"….a company has a separate legal personality from its corporators….. the existence of the large numbers of fully-owned subsidiaries of companies and their complete domination by their holding company…..There was continued adherence to the principle recognised by Salomon v Salomon & Co Ltd [1897] AC 22 (whereby) the legislation recognises the existence of a group of companies as a single entity"*

[15] Adams v Cape Industries plc [1991] 1 All ER

[16] *"Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense are the creatures of their parent companies, will nevertheless under the general law, fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities"*

law cases highlight the exacerbation of incorporation techniques used by corporate groups as a means of achieving limited liability. Furthermore, the court's general reluctance to pierce the corporate veil of protection[17] except when an existing legal duty is owed[18], demonstrates the willingness of incorporated groups to externalize the costs of its risks to their subsidiaries entities. While in cases such as *Gilford Motor Co Ltd v Horne*[19] and *Re Darby*[20] the corporate veil is quite willing to be pierced and appropriate application of legislative and general law applied[21], cases exhibiting diverse circumstances such as *CSR Ltd v Wren*[22] are subjective, with the decision relying on the judicial interpretation of the law.

Due to this fact, the relative amount of control a parent company has over its subsidiaries, and the duty owed between one subsidiary and another, should be measured from the original *Donoghue v Stevenson*[23] case recognising the duty of care principle. Ethically, it would seem apparent that a parent company is duty bound to ensure that reasonable care is taken to avoid exploitation of the separate legal entity principle within its group, as a relationship of proximity exists[24] between both it, and each subsequent group company. Yet arguably, a parent company does not owe this duty of care to its subsidiaries and nor does one individual subsidiary owe this duty to another, unless it can be established that one has exercised an undue amount of control over another's activities. It is only through this type of misappropriation that the courts are willing to lift the veil of incorporation to establish any wrong doing on any entity within the group[25].

In *Dairy Containers Ltd v NIZ Bank Ltd (1995)*[26], Thomas J of the New Zealand High Court challenged the view that a duty of care was owed between any holding company and its subsidiaries, ascertaining that even if total control by a parent company occurred, it should not be still not be liable for its subsidiaries debts[27]. While this view is clearly an objective, if not irrational interpretation of the law that has seldom applied in Australian courts, it simply reinforces the courts unwillingness to allow either parent or subsidiary companies to be liable for each others actions unless

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[17] Disregarding the specialization of corporate structure between a holding body and its subsidiary, and removing the application ruled in *Salomon v Salomon & Co Ltd [1897] AC 22* to unveil the true reason behind a corporation's action.

[18] Rankin, G. & Popkin, M, Parent, Director and Related Company Exposures - "The Erosion of Limited Liability – Extending the Reach of Liquidators", Allens Arthur Robinson, 2004 Pg 12

[19] Gilford Motor Co Ltd v Horne [1933] Ch 935

[20] Re Darby [1911] 1 KB 95

[21] *Gilford Motor Co Ltd v Horne* and *Re Darby* were both cases where intention and synthetic misappropriate were clearly displayed for the purposes of avoiding contractual and legal obligations. Consequently, the veil of incorporation was lifted.

[22] CSR Ltd v Wren [1998] Aust Tort Reports

[23] Donoghue v Stevenson [1932] AC 562

[24] This has long been established through cases such as *Hackshaw v Shaw (1984)* and *Byrant v Fawdon Pty Ltd (1993)* whereby if one entity knows or should know that their acts or omissions may cause the loss or impairment of legal rights of another entity, and that the other entity is not in a position to protect its own interests, there is a relationship of proximity formed, and therefore a duty of care owed.

[25] The court will consistently rule that a parent company is liable for the debts of a subsidiary, if there were reasonable grounds that the subsidiary was, or could have become insolvent as a result of a particular transaction. In accordance with s588V of the Corporations Act, either the holding company or its directors must, or should have been aware that the subsidiary was, or is, insolvent.

[26] Dairy Containers Ltd v NZI Bank 13 ACLC

[27] *"….the general or usual control exerted by a parent company over its subsidiary [cannot of itself] be the basis for a duty of care to the subsidiary relating to the way in which the company conducts its business. To my mind, not even total control [by the parent company] over its subsidiary could give rise to that duty. The parent may hold its subsidiary accountable if it does not perform as required, but it is going too far to suggest that it must undertake the monitoring functions reposed in the directors of [the subsidiary] which it has appointed to look after its interests."*

unwarranted control or extensive malpractice occurs. This notion was correspondingly applied in *Adams v Cape Industry*[28] where the court rejected any argument regarding the liability of one entity being forced onto that of another simply because it was the member of a corporate group structure[29].

This consistent protection and willingness to defend corporate group structure by the courts, has sheltered the foundation of economic development in our society. The suggestion that the single group liability structure is most appropriate in our corporate regulation is unfounded, simply because the separate legal entity doctrine is not only an elementary legal principle, but a commercial expectation within the embodiment of our corporate culture[30]. Similarly, to permit the separate legal entity principle to exist entirely unrestricted, would ensure the absolute exploitation of it by the same community. This further illustrates the need to regulate the separate legal entity doctrine directly, which is perhaps the central reasoning behind the courts pragmatic defence as recognized by Lord Wilberforce in *Ford & Carter Ltd v Midland Bank Ltd*[31] whereby he stated that *"When creditors become involved…..the separate legal existence of the constituent companies of the group has to be respected".*

If the single or separate notion of corporate group liability was entirely implemented into our commercial society, it would force a disappropriation of contract creditor entitlement's to exist. By exposing the assets of the corporate group as a whole to the contract creditors of a subsidiary, the corporate group would inadvertently suffer. The creditors of the subsidiary would benefit from a greater exposure to corporate groups assets, while the creditors of the corporate group would have to bear a decrease in their equity allocation[32]. Conversely, corporate groups could lawfully abuse the separate legal entity principle by moving funds between subsidiary entities for the purpose of ensuring unsecured creditors do not have a claim on company assets. This was highlighted in *Walker v Wimborne*[33] where funds were transferred intra-alia for the purposes of paying debts and ultimately resulted in the liquidation of the entire corporate group[34]. While this case establishes a direct connection to the actions of directors within a corporate structure[35], it highlights the need to offer protection for unsecured and tort creditors who have limited rights to assets once a parent company allocates them to affiliate subsidiaries.

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[28] Ibid 15

[29] It was not accepted that *"as a matter of law the court is entitled to lift the corporate veil as against a defendant company which is a member of a corporate group, merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company…..Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law"*

[30] Murphy D, Holding Company Liability for debts of its subsidiaries: Corporate Governance Implications, Bond University, 1998 Pg 1

[31] Ford & Carter Ltd v Midland Bank Ltd (1979) 129 NLJ

[32] Ibid 30, Pg 14

[33] Walker v Wimborne (1976) 137 CLR 1

[34] *"…In this respect it should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company, whether it be a member of a 'group' of companies in the acceptance sense of that term or not, must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent"*

[35] The reason the group was held responsible was justice Mason Js rejection of the argument that directors can disregard their duties to individual companies by ensuring they are undertaking actions for the benefit of the entire group.

This presents further difficulties inadvertently placed on unsecured and tort creditors. While contractual and secured creditors are guaranteed at least some principal returned to them in the event of liquidation, almost no protection is offered to unsecured or tort creditors[36] by single entity principle law[37]. Even *s588V*, which offers at least some protection for unsecured creditors in the event of insolvency[38], does not extend to liabilities such as damages for breach of contracts or victims of torts. In *Briggs v James Hardie & Co Pty Ltd*[39] Rogers AJA commented on the lack of protection offered to a tort claimant[40] and the inability for a claimant to achieve adequate protection under the current legislation. A comparison of differences between the *CSR Ltd v Young* and *Briggs* case's yielded only a differing interpretation of the amount of control exercised between each respective holding company which was the crucial factor influencing the final outcome of each case.

From these two cases, it seems distinctly apparent that directors must be held significantly more accountable, both ethically and professionally, for the actions of the companies in which they control. To knowingly seek shelter under the veil of corporate protection, for actions that are ethically questionable yet lawfully viable, casts doubt over nature of a duty of care relationship and equally questions the integrity of the very justice system that seeks to uphold these values. Conversely, taking such a sympathetic approach may adversely affect the duty that a director owes both firstly to their company, and secondary to their shareholders. In *Daniels v Anderson*[41] the NSW Court of Appeal found that both a common law and fiduciary duty of care was expected to reside in company directors, but was only limited to their capacity as a director of a company. Clarke and Scheller JJA stated *"We are of the opinion that a director owes to the company a duty to take reasonable care in the performance of the office"*. Realistically, if corporate law was to impose on company directors a fiduciary duty and subsequent duty of care to tort victims, individual members, employees or equivalent derivatives, it would place directors in a position of inherent conflict and potential disagreement which would adversely affect the position of a company as a whole[42]. This was affirmed by Gummow J in *Re New World Alliance Pty Ltd*[43], who concluded that directors owe a duty to shareholders

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[36] Ibid 8, Page 29

[37] Except for rights under liquidation, shares or security holding provisions of the respective companies

[38] *s588V establishes through s588W where:*

(a) the creditor to whom the debt is owed suffers loss or damaged in relation to the debt because of the subsidiaries insolvency,

(b) the debt is wholly or partly unsecured when the loss or damage was suffered; and

(c) the subsidiary is being wound up

the liquidator of the subsidiary may recover from the holding company as a debt due an amount equal to the amount of loss and damage.

[39] Ibid 13

[40] This can equally be applied to an unsecured creditor. Roger AJA stated *""Generally speaking, a person suffering injury as a result of the tortious act of a corporation has no choice in the selection of the tortfeasor. The victim of the negligent act has no choice as to the corporation which will do him harm. In contrast, a contracting party may readily choose not to enter into a contract with a subsidiary of a wealthy parent. The contracting entity may enquire as to the amount of paid-up capital and, generally speaking, as to the capacity of the other party to pay the proposed contract debt and may guard against the possibility that the subsidiary may be unable to pay. … [Where the injured party is an employee,] whilst the employee may be able to choose whether or not to be employed by the particular employer, generally speaking, he has no real input in determining how the business will be conducted and whether reasonable care will be taken for his safety."*

[41] Daniels v Anderson (1995) 13 ACLC 614

[42] Bostock T, Directors Duties: Recent Developments and their implications for Directors and Advisers, Australia Institute for Company Directors, 2000 Pg 4

[43] New World Alliance Pty Ltd (1994) 51 FCR 425 at 444 - 445

first and foremost, with any obligation to creditors being a restriction on shareholder rights[44].

Law grows through subjective interpretation and prejudice, rather than through knowledge and familiarity, and the fabric of corporate law has grown from this comparison to its understanding today. While the concept of limited liability, established in *Salomon v Salomon*[45] has inevitably evolved, the underlying principle of separate corporate entities still exists. It is through this notion that corporate groups have developed and conflicts have arisen, with the most optimistic outcome being an beneficial situation for all. Inevitably, the nature of law will not allow such a scenario to exist, and hopefully the most ethical and truthful derivation of its application is always achieved. In saying this, the decision handed down by Roger AJA in the *Briggs v James Hardie & Co Pty Ltd*[46] case was, in the author's opinion, an appropriate application of the law. The assumption that the degree of control transferred between a holding company and its subsidiary increases the risk of injury to tort claimants cannot be substantiated and is subsequently flawed. Unless unequivocal evidence establishing a relationship of proximity and therefore a duty of care is provided, an appropriate measure of control over a subsidiary entity cannot be established. Had the decision in Hardies case been different, it would have forced directors in a situation of enormous complexity and inherent conflict, torn between the duty owed to their company and shareholders, and the potential unlimited duty owed to third party relationships. The foundation of corporate law allows companies to exist legally as separate entities, even if arranged in a corporate structure, and any notion to alter this structure should be fundamentally ignored. While it is accepted that some corporate law still exists with a degree of uncertainty, such as that of tort victims and unsecured creditors, it is anticipated that an adequate solution will be forthcoming that achieves an equitable solution for all. This will ensure that corporate law remains predominantly unchanged into the future and protection of both the corporate group and director's responsibilities is continued.

Word Count: 2,156

[44] *"It is clear that the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company. The restriction is similar to that found in cases involving fraud on the minority. Where a company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the shareholders. This restriction does not, in the absence of any conferral of such right by statute, confer upon creditors any general law right against former directors of the company to recover losses suffered by those creditors … the result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator."*

[45] Ibid 1

[46] Ibid 13

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