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Question 1

72/100

Intro

Kirsten’s (K) complaints identify several potential breaches of Director’s duties by Gav and Waz (G & W), and by Jason (J). If breach can be established, an action may be brought on behalf of the company under S236 of the Corporations Act if leave is granted by the court under s 237 [√].

Potential Breaches

1. Duty to avoid Conflict of Interest.

There is a statutory duty to disclose the nature and extent of any material personal interest in a matter that relates to the affairs of the company (s191) [√]. This is supplemented by a common law duty not to enter into any agreements to procure a personal interest (s191{3}); Transvaal Lands and to disclose any interest to the general meeting (Furs v Tomkies) and to the board of directors (s191). G & W were also under an obligation to account for any gain or benefit obtained (Chan v Zacharia), even though Block suffered no detriment (Regal Hastings). G & W, under the deal with Fees, received a 5% Commission which is clearly a material personal interest. This was no disclosed to the board nor to the general meeting. This appears to be a clear breach of duty, but their failure to disclose does not invalidate the agreement with Fees (191{4}) but may give rise to criminal liability (ss191 {1A}, 1311, Schedule 3) [√] – action would be brought by DPP or the Crown.

2. Duty to exercise care, diligence and skill

Jason is Chairman of the board who may be a director if he was appointed as one under s201G or if he is more than a mere figurehead (ASIC v Rich, s248B). If J were found to be a director, he is likely to be a non-executive director, as he does not take part in the day to day running of the company (Daniels v Anderson). He is therefore open to liability for breach of duties, and has the same standard imposed on him as on executive directors (Cth Bank v Friedrich) [√].

A director must act with the degree of care and diligence that a reasonable person in that position would exercise (s180{1}; ASC v Gallagher) [√]. Jason is expected therefore to exercise care in agreeing to enter contracts, and he appears to have breached this by his incredibly flippant attitude towards the crisis board meeting proposal. Entering into a $50K agreement would
perhaps require a reasonable person to make enquiries, rather than merely rely on G & W as delegation or reliance on others is no defence (Statewide Tobacco) [√].

J may raise the business judgment rule as a defence (s180(2)). But this is likely to fail, as his judgment was not made with good faith and an understanding of the circumstances (requirements of 180(2)) [√]. Therefore J appears likely to have breached s180(1) the duty to exercise care, diligence and skill.

3. Duty to prevent insolvent trading [√].

Where a director incurs a debt when the company is insolvent or likely to become so, from that debt, and there were reasonable grounds for suspecting insolvency the director may be liable for breach of the duty to prevent insolvent trading (s588G) [√].

Block was in crisis mode, and struggling to pay running costs. G & W incurred a $50,000 debt in the agreement with Alfonso which they are now ignoring, presumably unable to pay. Being unable to pay debts as and when they become payable is insolvency (s95A) so it is possible Block went insolvent from incurring the debt.

Were there reasonable grounds?

An objective test with a low threshold is used (Metro Fire) to determine whether a person would have had reasonable grounds to suspect insolvency (Cth Bank v Friedrich) [√]. This takes into account actual knowledge of G & W (Metal Manufacturers Ltd). Now, Block was already struggling and although mere financial difficulty does not alone constitute grounds (Int. Business Strategies v Lucas) the financial situation of Block did look critical. They did have some realizable assets (the apartments) but a reasonable person may not have rushed into such an expensive debt.

If breach is established 588G is a civil penalty provision (1317) so ASIC may apply for pecuniary orders or dismissal.

Statutory Derivative Action

An action may be brought under s236 on behalf of the company by a member [√]. Member is defined in s231 to include shareholders, so K is able to seek leave under s237 to bring proceedings against G & W and Jason.

Under s237 the court may grant leave if it is satisfied of 5 procedural matters [√]:

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1. K must have given notice to the company at least 14 days earlier, giving notice of her intention to seek leave. (237 {e}).

2. The court must believe it is probable the company will not bring proceedings on its own behalf (237{a}). Here that is likely, as the directors are unlikely to approve proceedings against themselves.

3. K must be acting in good faith and for a proper purpose – not a personal interest (Chapman). Here K appears to be acting in Good Faith, and is keen to rescue Block.

4. The Litigation must be in the best interests of the Company (s237{c}). There is a rebuttable presumption that proceedings will not be in the best interests (s237{3}) but, as the directors are potentially liable for multiple breaches of duties to the company, the court may be satisfied of this.

5. There must be a serious question to be tried (237{d}). The claim must not be frivolous or vexatious, and is assessed on a balance of convenience. Multiple breaches are potentially very serious, and that may be enough to satisfy the balance of convenience test.

IF the court is satisfied with all these requirements, which it appears may happen, K may receive leave under s237 and be able to bring an action under s236 on behalf of Block for breaches of duty by G & W, and Jason.