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BEST INTERESTS: MULTIFACETED BUT NOT UNBOUNDED

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ABSTRACT. *The best interests rule – the central fiduciary duty of company directors in a number of common law jurisdictions – encapsulates loyalty between director and company. Its multifaceted nature means that it is employed to impose a number of requirements, as demonstrated in the multi-jurisdictional analysis in this article. Contemporary commentary and cases (such as* Moulin Global Eyecare Holdings Ltd. v Mei *(2014) 17 HKCFAR 466, recently analysed in this Journal) have, however, doubted the fiduciary classification of the rule. This article defends the rule's fiduciary classification. After examining key facets of the rule, it demonstrates that, although flexible, the rule cannot be stretched to protect stakeholder interests independently of corporate benefit.*

Keywords: *directors' duties, company law, fiduciary duties, best interests, good faith, corporate social responsibility, loyalty.*

I. Introduction to the Duty

There has been much recent attention given to the fiduciary concept across a number of jurisdictions. What is sometimes ignored in this debate, but continues to operate steadily, but sometimes inconspicuously, in the background, is the duty to act in good faith in the interests of the company (the "*best interests rule*") – the central fiduciary duty of company directors.[1] The rule is the lynchpin of directors' fiduciary loyalty, which in turn forms the basis for regulation of directors, whether by way of general law duties, statutory duties or corporate governance codes.[2] As well as constituting the foundation of directors' accountability, the best interests rule also incorporates requirements of other duties. This article first demonstrates the

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[1] See e.g. *Madoff Securities International Ltd. (in liq.) v Raven* [2013] EWHC 3147 (Comm.), at [188]; *British Midland Tool Ltd. v Midland International Tooling Ltd.* [2003] EWHC 466 (Ch.); [2003] 2 B.C.L.C. 523, at [81]; *Item Software (UK) Ltd. v Fassihi* [2004] EWCA Civ 1244; [2005] 2 B.C.L.C. 91, at [41].

[2] See e.g. J. Birds, "The Reform of Directors' Duties" in J. de Lacy (ed.), *The Reform of United Kingdom Company Law* (London 2003), 151. For analysis of the connection between loyalty and fiduciary duties, which is at times contested, see A.S. Gold and P.B. Miller (eds.), *Philosophical Foundations of Fiduciary Law* (Oxford 2014), chs 5–8.

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centrality of the best interests rule in ensuring loyalty in the director–company relationship. It then outlines the extensive role played by the best interests rule in focusing directors on the company's interests. In a comparative survey of three key jurisdictions, this function of the rule is drawn out. This function also causes apparent problems as concerns the fiduciary classification of the rule, which is explored in the fourth section of the article.

As a result of this extensiveness, there may be a temptation to see the best interests rule as an accordion term and, as such, able to extend to the protection of stakeholder interests (independently of demonstrable corporate benefit). However, such extension should be resisted because it threatens the fiduciary basis of the director–company relationship. This is not to deny the importance of stakeholder interests or the need for directors to consider, and at times protect, such interests in the exercise of their functions. The role of directors' duties in this regard is outlined. A key feature of this discussion, and indeed of wider debate on directors' duties and corporate social responsibility, is the contours of the company's interests. This is also critically analysed in the final section of the article. It is concluded that, although the best interests rule can play a significant role as concerns stakeholder interests, it should not be stretched to the point where the foundation of fiduciary loyalty in the director–company relationship is endangered. Too much is at stake in so doing.

This comparative examination of the rule across the UK, Hong Kong and Australia aids in the interpretation and development of the rule in each of the jurisdictions, particularly as concerns contested and uncertain aspects. Highlighting the true nature of the best interests rule in its application to the exercise of discretionary power, and its central role in the sphere of directors' duties, paves the way for the critical examination of its appropriateness as a stakeholder protection tool.

II. Sources of the Duty

Before exploring the extent and reach of the best interests rule, it is important to outline the source of the rule. The rule is sourced in general law and in statute, depending on the jurisdiction in question. The contours of the rule in each jurisdiction are outlined at the outset to set the scene for subsequent critical examination.

A. Fiduciary Duty

The best interests rule has existed for many years as a key fiduciary duty of directors in each jurisdiction.[3] It plays a crucial role in focusing directors on

[3] For detail, see G. Thomas, *Thomas on Powers*, 2nd ed. (London 2012), 582, at [10.174]; A. Keay, *Directors' Duties*, 2nd ed. (Bristol 2014), 117–18, at [6.2]; R.T. Langford, *Directors' Duties: Principles and Application* (Sydney 2014), 74–75, at [4.4].

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the interests of the company, ensuring that, when directors exercise discretionary power, they focus on the company's interests. It is thus as essential to fiduciary loyalty in the corporate context as the conflicts and profits rules, which ensure that directors are not swayed from acting in the company's interests. As stated by Spiegelman N.P.J. in the very recent case of *Cheng Wai Tao v Poon Ka Man Jason*: "The duty of a director to act in the best interests of the company is a statement of the positive duty of loyalty which is broader than, but encompasses, the conflict rule."[4]

The best interests rule regulates the exercise of discretion by directors, with courts stating that directors "must exercise their discretion bona fide in what they consider – not what a court may consider – to be the interests of the company".[5] The rule consists of two indivisible elements that together require directors to act in good faith in the best interests of the company. It is not merely a duty to act in good faith. It is also not an absolute duty to act in the interests of the company. It comprises both elements, requiring directors to act in good faith in what they believe to be the best interests of the company.

Thus the rule does not centre on the success or otherwise of a transaction or other course of action, but rather on consideration and protection of the company's interests. Indeed, the rule plays a vital role in focusing directors on the company's interests. Its key role in regulating the exercise of fiduciary discretion fits with the second strand of fiduciary regulation, as further outlined in Section IV below.

1. *Objective/subjective nature*

There has been significant debate as to whether the best interests rule is subjective or objective in nature, or involves a combination of both. This is particularly noticeable concerning the Australian statutory duty in relation to which two quite divergent approaches have emerged.[6] Although largely subjective, the application of the best interests rule does involve the interplay of objective factors, particularly as concerns credibility but also arguably in allowing challenge of decisions that no reasonable director would consider to be in the interests of the company.[7] This reflects the well-known point made by Bowen J. in *Hutton v West Cork Railway Co.* that "[b]ona fides cannot be the sole test, otherwise you might have a lunatic conducting

[4] *Cheng Wai Tao v Poon Ka Man Jason* [2016] HKFCA 23, at [72].

[5] See *Re Smith and Fawcett Ltd.* [1942] Ch. 304, 306. Note, however, *Item Software (UK) Ltd.* [2004] EWCA Civ 1244; [2005] 2 B.C.L.C. 91 and associated cases, discussed below.

[6] See e.g. *Duncan v Independent Commission Against Corruption* [2016] NSWCA 143, at [426]–[429]. As concerns s. 172, see e.g. P.L. Davies and S. Worthington, *Gower and Davies' Principles of Modern Company Law*, 9th ed. (London 2012), 543, at [16–68], 545–46, at [16–72]–[16–73].

[7] For detail, see R.T. Langford and I.M. Ramsay, "Directors' Duty to Act in the Interests of the Company – Subjective or Objective?" [2015] J.B.L. 173; S.H.C. Lo and C.Z. Qu, *Law of Companies in Hong Kong*, 2nd ed. (Hong Kong 2015), 282–83, at [8.043]–[8.044].

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the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational".[8]

This issue arises partly due to the application in some cases of the "Charterbridge test". This test, originally applied in a case involving ultra vires, provides that, in the absence of actual consideration of a company's interests, the proper test must be whether "an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company".[9] This approach is favoured in the UK but has had a mixed reception in Australia and Hong Kong.[10] The appropriateness of this test is, however, arguably to be questioned in certain contexts due to the importance of adequate consideration by directors of the company's interests. It is to be queried how a director can be found to have acted in good faith in what they consider to be the company's interests if they cannot show that they have considered those interests.

B. Statutory Duties

The UK and Australia also impose statutory duties to act in good faith in the interests of the company. In Australia, this dates back to 1958 when a duty of honesty and reasonable diligence was introduced in the Companies Act 1958 (Vic.), then taken up in the Uniform Companies Acts of 1961. The current statutory equivalent of the general law best interests rule in Australia is s. 181(1) of the Corporations Act 2001 (Cth.), which states: "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."

The Australian statutory best interests rule in s. 181(1)(a) is expressed to apply in addition to general law duties[11] and cases have applied the duties interchangeably.[12] There is, however, a difference in the remedies available upon proof of breach of s. 181 as compared to those available upon breach of the general law duty. Section 181 is classified as a "civil penalty provision" meaning that the potential consequences of breach are a declaration of contravention, disqualification, pecuniary penalty and/or compensation.[13] Criminal liability may also be imposed for breach of s. 181 with requisite

[8] *Hutton v West Cork Railway Co.* (1883) L.R. 23 Ch. D 654, 671.

[9] See *Charterbridge Corp. Ltd. v Lloyds Bank Ltd.* [1970] Ch. 62, 74.

[10] See e.g. *Hellard v Carvalho* [2013] EWHC 2876 (Ch.); [2014] B.C.C. 337, at [91]–[92]; *Madoff Securities* [2013] EWHC 3147 (Comm.), at [194]; R.P. Austin and I.M. Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, LexisNexis (online), at [8.140]; *Akai Holdings Ltd. v Thanakharn Kasikorn Thai Chamkat (Mahachon)* [2008] HKEC 874, at [325]–[326]; *Akai Holdings Ltd. (in liq.) v Kasikorn Bank PCL* [2010] 3 HKC 153, at [64].

[11] See Corporations Act 2001 (Cth.), s. 185.

[12] See e.g. *Bell Group Ltd. (in liq.) v Westpac Banking Corp. (No.9)* [2008] WASC 239; (2008) 39 W.A.R. 1, at [4383]; *Hodgson v Amcor Ltd.* [2012] VSC 94; (2012) 264 F.L.R. 1, at [1338]–[1340].

[13] See generally Corporations Act 2001 (Cth.), ss. 1317E, 1317G, 1317H, 1317J, 206C.

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criminal intent under s. 184 and an injunction may be sought under s. 1324, although the availability of such injunctions in relation to breach of the statutory directors' duties is uncertain. Moreover, the Australian Securities and Investments Commission is responsible for enforcing the Corporations Act 2001 (Cth.) and has actively pursued cases involving breach of duty. This public enforcement regime constitutes a key difference between Australia and the UK.[14]

The statutory duty in s. 181 has the potential to operate differently to the general law duty in three other key ways. First, there is more uncertainty concerning the objective/subjective nature of s. 181 than there is concerning its general law equivalent, as discussed above. Secondly, there is an issue as to whether the duties will diverge due to the public interest aspect of the Corporations Act 2001 (Cth.),[15] particularly as concerns stakeholder interests. This issue is explored more fully in Section V below. Thirdly, there is the potential for s. 181 to operate in a more positive or mandatory sense than the general law equivalent due to the shift in fiduciary theory discussed in Section IV below. This is not so far evident given that cases imposing the general law duty have imposed positive elements.[16] In Australia, there is therefore currently no manifest significant divergence between the application of the statutory and general law best interests rules, although the potential for such divergence exists.

The UK introduced statutory directors' duties in the Companies Act 2006 (UK) after extensive review and consultation. These duties in fact replace the equivalent general law fiduciary duties of directors. The reasons for this codification were to restate the law on directors' duties in order to clarify it and make it more accessible.[17] The general law best interests rule has been replaced by s. 172 of the Companies Act 2006 (UK), which provides:

> A director of a company must act in the way he considers, in good faith, would be the most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,

[14] See also Lo and Qu, *Law of Companies in Hong Kong*, p. 269, at [8.006].
[15] See e.g. M. Welsh, "Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia" (2014) 42 F.L.Rev. 217; J. Harris, A. Hargovan and J. Austin, "Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?" (2008) 26 C&SLJ 355.
[16] See e.g. *Westpac Banking Corp. v Bell Group* [2012] WASCA 157; (2012) 44 W.A.R. 1.
[17] See *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (Law Commission Consultation Paper 261; Scottish Law Commission Paper No. 173 (September 1999)), at [4.40]–[4.41]; Keay, *Directors' Duties*, p. 60, at [44].

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(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

Although very differently expressed, the statutory duty is in fact being interpreted in line with its predecessor general law duty. This is legitimated by s. 170(4), which provides that "[t]he general law duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties".

Cases applying the duty in s. 172 have so far applied it consistently with the preceding fiduciary duty to act in good faith in the interests of the company.[18] Moreover, breaches of directors' duties are enforceable by the company (or by shareholders via a statutory derivative action) rather than by a public regulator.[19] The consequences of breach are specified in s. 178 to be "the same as would apply if the corresponding common law rule or equitable principle applied".

Interaction between statutory and general law duties is a key issue in the UK and Australia.[20] In Australia, general law and statutory duties exist alongside each other. In contrast, directors' duties in England are fully codified, while retaining the relevance of general law principles. Directors' duties in Hong Kong are largely imposed via general law, with the exception of the duty of care (and statutory duties concerning disclosure). After detailed consideration by the Standing Committee on Company Law Reform (S.C.C.L.R.), it was decided not to introduce a statutory duty similar to s. 172 of the Companies Act 2006 (UK).[21]

III. Multifaceted Nature of the Best Interests Rule

Having outlined the contours of the best interests rule, this section draws attention to particularly notable or unsettled aspects of the rule, especially in light of the cross-fertilisation of cases between the jurisdictions. The first key feature of the best interests rule is its multifaceted nature. There is a large degree of overlap between the best interests rule and the duty to act for proper purposes, which requires directors to act for the purposes for

[18] See *Re West Coast Capital (LIOS) Ltd.* [2008] CSOH 72, at [21]; *Odyssey Entertainment Ltd. v Kamp* [2012] EWHC 2316 (Ch.), at [207]; see also *Madoff Securities* [2013] EWHC 3147 (Comm.), at [189].
[19] For a discussion, see Keay, *Directors' Duties*, pp. 76–78, at [4.54]–[4.57].
[20] For discussion, see R.T. Langford, "General Law and Statutory Directors' Duties: 'Unmixed Oil and Water' or 'Integrated Parts of the Whole Law?'" (2015) 131 L.Q.R. 635.
[21] For detail, see J.K.S. Ho, "Director's Duty to Promote the Success of the Company: Should Hong Kong Implement a Similar Provision?" (2010) 10 J.C.L.S. 17.

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which powers were expressly or impliedly conferred.[22] In fact, in many situations, the proper purposes rule could be subsumed by the best interests rule but it does have a small independent sphere of operation in situations where a director believes action is in the best interests of the company but the purpose is nevertheless found to be improper.[23] The separateness of the rules was very recently confirmed in *Eclairs Group Limited v JKX Oil & Gas plc*.[24]

The best interests rule has also been used in each jurisdiction to require disclosure,[25] the most notable case being *Item Software (UK) Ltd. v Fassihi*, as recently upheld in *GHLM Trading Ltd. v Maroo* as concerns s. 172.[26] Debate continues in each jurisdiction as to the appropriateness of this requirement, particularly as concerns disclosure of wrongdoing.[27] In this respect, it arguably makes sense that a director who is acting in good faith in the best interests of the company would make adequate disclosure. On this view, disclosure can be seen as a subset of the best interests rule. Corkery states:

> The duty to act honestly or bona fide means, for example, that directors must make sufficient and accurate disclosures to shareholders when seeking the general meeting's support, opinion or decision. If a director sees a course of action as being harmful to the corporation, he must in honesty advise the shareholders of this and, if he has the appropriate skills, advise them of a proper course of conduct.[28]

It has also been shown elsewhere that the best interests rule could subsume the duty to retain discretions,[29] which encompasses requirements to give adequate or active consideration to the exercise of power, to exercise an independent mind, to keep discretions unfettered and not to delegate without authority.[30] The best interests rule also overlaps with the duty of care,

[22] See e.g. *Mills v Mills* (1938) 60 C.L.R. 150, 175; *Harlowe's Nominees Pty. Ltd. v Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 493–94.

[23] See e.g. *Hogg v Cramphorn Ltd.* [1967] Ch. 254, 267–69; *Whitehouse v Carlton Hotel Pty. Ltd.* (1987) 162 C.L.R. 285, 292–93; *Tsang Wai Lun Wayland v Chu King Fai* [2009] 5 HKLRD 105, 118–20 at [62]–[69].

[24] *Eclairs Group Limited v JKX Oil & Gas plc.* [2015] UKSC 71.

[25] See *Shepherds Investments Ltd. v Walters* [2006] EWHC 836 (Ch.); [2007] 2 B.C.L.C. 202, at [132]; *British Midland Tool Ltd.* [2003] EWHC 466 (Ch.); [2003] 2 B.C.L.C. 523, at [89]–[90], [92]; *Southern Real Estate Pty. Ltd. v Dellow* [2003] SASC 318; (2003) 87 S.A.S.R. 318, at [29]; *Motor Trades Association of Australia Superannuation Fund Pty. Ltd. v Rickus (No.3)* [2008] FCA 1986; (2008) 69 A.C.S.R. 264, at [71]–[72]; *Groeneveld Australia Pty. Ltd. v Nolten (No.3)* [2010] VSC 533; (2010) 80 A.C.S.R 562, at [57]–[61].

[26] *GHLM Trading Ltd. v Maroo* [2012] EWHC 61 (Ch.), at [192]–[193]; see also *Odyssey Entertainment Ltd.* [2012] EWHC 2316 (Ch.), at [273]; *IT Human Resources plc. v Land* [2014] EWHC 3812 (Ch.), at [121].

[27] See e.g. *P&V Industries Pty. Ltd. v Porto* [2006] VSC 131; (2006) 14 V.R. 1, at [24]–[25].

[28] J.F. Corkery, *Directors' Powers & Duties* (Melbourne 1987), 61 (citations omitted).

[29] See Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, at [8.300]; Langford, *Directors' Duties*, pp. 133–35, at [8.2.3]; A. Dignam and J. Lowry, *Company Law*, 8th ed. (Oxford 2014), 356, at [14.42].

[30] See generally Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, at [8.101]; Dignam and Lowry, *Company Law*, pp. 356–59, at [14.42]–[14.44]. Note that this is a separate duty in the UK – see Companies Act 2006 (UK), s. 173.

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although the latter duty is now generally characterised as non-fiduciary in nature in modern equitable jurisprudence.[31]

A. Conflicts and Profits

A comparative survey of the three jurisdictions demonstrates that a striking facet of the best interests rule is its key role in situations in which directors face a conflict of interest or conflict of duties. Valuable insights can be drawn from a comparative analysis of the duty in this respect. A number of cases demonstrate the fact that the best interests rule penalises directors who pursue, or who are affected by, conflicts and profits in the exercise of their powers, thus overlapping to a considerable extent with the duties to avoid conflicts and profits. This can be seen in a number of cases in both the UK and Australia.[32] For example, in *Shepherds Investments Ltd. v Walters*, Etherton J. said:

> In my judgment it is plain that the necessary starting point of the analysis is that it is the fiduciary duty of a director to act in good faith in the best interests of the company … that is to say "to do his best to promote its interests and to act with complete good faith towards it", and not to place himself in a position in which his own interests conflict with those of the company.[33]

In fact, when the first statutory duty of honesty (a predecessor to the best interests rule) was introduced in Victoria in 1958, Sir Douglas Menzies (a member of the High Court) propounded the view that the statutory duty required the avoidance of unauthorised conflicts and profits.[34] This facet of the best interests rule is particularly observable in relation to the Australian statutory duty in s. 181(1)(a), which has been employed in many cases involving situations of conflict. For example, in *Parker Re Purcom No. 34 Pty. Ltd. (in liq.)*, Gordon J. went so far as to say that "[s]ection 181 of the Act is concerned with self-dealing".[35] A prevalent interpretation of s. 181 is that it incorporates elements of not misusing or abusing powers, avoiding conflict between personal interest and the interests of the company, not taking advantage of position to make secret profits and not misappropriating the company's assets for oneself.[36]

[31] See e.g. *Permanent Building Society (in liq.) v Wheeler* (1994) 11 W.A.R. 187, 237–38; *Bristol & West Building Society v Mothew* [1998] Ch. 1, 16. For discussion, see R.T. Langford, "Book Review Essay – *Philosophical Foundations of Fiduciary Law*" (2016) 10 J.Eq. 51.

[32] See e.g. *Savoy Corporation Ltd. v Development Underwriting Ltd.* [1963] N.S.W.R. 138; *Paul A. Davies (Australia) Pty. Ltd. v Davies* (1982) 1 A.C.L.C. 66; *Southern Real Estate Pty. Ltd.* [2003] SASC 318; (2003) 87 S.A.S.R. 1; *JJ Harrison (Properties) Ltd. v Harrison* [2001] 1 B.C.L.C. 158; *CMS Dolphin Ltd. v Simonet* [2001] 2 B.C.L.C. 704.

[33] *Shepherds Investments Ltd.* [2006] EWHC 836 (Ch.); [2007] 2 B.C.L.C. 202, at [106].

[34] Sir D. Menzies, "Company Directors" (1959) 33 A.L.J. 156.

[35] *Parker Re Purcom No. 34 Pty. Ltd. (in liq.)* [2010] FCA 263; (2010) 77 A.C.S.R. 525, at [72].

[36] See e.g. *Chew v The Queen* (1991) 5 A.C.S.R. 473; *Duncan* [2016] NSWCA 143, at [424]–[426].

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A couple of important points arise as concerns the application of the best interests rule in the context of conflicts and profits. The first concerns benefits to third parties, which are more clearly covered by the best interests rule than the conflicts or profits rules.[37] The second point relates to authorisation. Authorisation of breach of the best interests rule is more problematic than authorisation of breach of the conflicts and profits rules.[38] Indeed, it has been thought that a breach of the best interests rule cannot be ratified.[39] Directors should therefore be careful of the requirements of the best interests rule in situations of conflict. In particular, directors should be aware that, even if they have obtained the company's consent to a conflict of interest, they still need to comply with the best interests rule. In other words, despite authorisation of a conflict or profit, directors must make sure they act in good faith in the interests of the relevant company.

Furthermore, the best interests rule may require additional action of directors in situations of conflict, in the form of extended disclosure of facts relevant to the particular decision (rather than, for example, just disclosure of the nature and extent of the conflict, as required under the duty to avoid conflicts) or even action to prevent a transaction from proceeding. For example, directors may be required to disclose information known to them which is material to issues being decided, particularly in situations in which the relevant transaction is potentially detrimental to the company.[40] In the very recent case of *Duncan v Independent Commission Against Corruption*, directors faced criminal penalties (based on the criminal version of the statutory best interests rule) in a situation in which they disclosed that they had a conflict of interest and stepped aside but did not disclose further information about the transaction to an independent board committee that was investigating the wisdom of proceeding with the transaction.[41]

The best interests rule therefore imposes requirements on directors who face a conflict of interest, meaning that it may not be sufficient for such directors to disclose the relevant conflict and absent themselves from voting or involvement in transactions. A number of Australian cases have imposed similar requirements on directors and these appear to be relevant in Hong Kong but not to the same extent in the UK.[42]

[37] See e.g. *Bell Group Ltd. (in liq.)* [2008] WASC 239; (2008) 39 W.A.R. 1, at [4520].
[38] See e.g. *Forge v Australian Securities and Investments Commission* [2004] NSWCA 448; (2004) 213 A.L.R. 574, at [238]; *Madoff Securities International Ltd. v Raven* [2013] EWHC 3102 (Comm.), at [123]; *Armitage v Nurse* [1997] Ch 241.
[39] See e.g. P. Redmond, *Corporations and Financial Markets Law*, 6th ed. (Sydney 2013), 614–16, at [8.25]; L.C.B. Gower, *The Principles of Modern Company Law*, 2nd ed. (London 1957), 511–12; Keay, *Directors' Duties*, p. 283, at [9.47].
[40] See e.g. *Fitzsimmons v The Queen* (1997) 23 A.C.S.R. 355, 363–64.
[41] *Duncan* [2016] NSWCA 143, at [442], [622]–[641].
[42] For discussion, see *Duncan* [2016] NSWCA 143, at [431]–[442], [624]–[634]; Lo and Qu, *Law of Companies in Hong Kong*, p. 277, at [8.029].

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In such situations, directors may even be required by the best interests rule to take positive action beyond disclosure such as action to prevent a transaction going ahead.[43] Although this requirement does not seem evident in English cases, some such cases have imposed an obligation on directors to take action to prevent other directors breaching their duties.[44] It is important for directors and their advisers to be aware of this potential operation of the best interests rule given that it means that in situations of conflict disclosure of the conflict and consent may not always be sufficient to avoid a breach of duty.

B. Consideration

In each jurisdiction, directors may breach the best interests rule if they cannot show they have considered, and in some cases investigated, the company's interests.[45] Thus, Thomas states:

> Under the general law, directors are required to exercise their powers in good faith in the best interests of their company. They have a duty to use company assets and resources only for the benefit of the company. Honesty is not enough. Directors (like trustees) may breach their duty even if they act in what they genuinely believe is in the best interests of the company if, in fact, they failed to give proper consideration to the interests of the company.[46]

The application of the best interests rule to require consideration is particularly evident in situations involving group companies and creditors' interests. For example, in group company situations, the best interests rule requires that directors consider and act in the interests of the specific company when they are making decisions for that company, rather than giving priority to the interests of the group or to the wishes of a dominant director of shareholder.[47] This facet of the best interests rule is important in ensuring that directors act loyally in focusing on the interests of each company – this is not always encompassed in the duty to avoid a conflict of duties given that directors will not necessarily owe duties to all of the companies involved. What is currently contested is the appropriateness of the best interests rule to effect creditor and stakeholder protection, as is now critically analysed.

[43] See e.g. *Adler v Australian Securities and Investments Commission* [2003] NSWCA 131; (2003) 179 F. L.R. 1, at [539]; *Permanent Building Society (in liq.) v McGee* (1993) 11 A.C.S.R. 260, 290; *Bell Group Ltd. (in liq.)* [2008] WASC 239; (2008) 39 W.A.R. 1, at [4526].

[44] See Keay, *Directors' Duties*, p. 167, at [6.155].

[45] See e.g. *Maronis Holdings Ltd. v Nippon Credit Australia Pty. Ltd.* [2001] NSWSC 448; (2001) 38 A. C.S.R. 404, at [301], [373]; *Akai Holdings Ltd.* [2008] HKEC 874, at [329], [342]; *Akai Holdings Ltd. (in liq.)* [2010] 3 HKC 153, at [64], [72], [179], [197].

[46] See Thomas, *Thomas on Powers*, p. 584, at [10.178].

[47] See e.g. *Walker v Wimborne* (1976) 137 C.L.R. 1; *Equiticorp Finance Ltd. (in liq.) v Bank of New Zealand* (1993) 32 N.S.W.L.R. 50; *Extrasure Travel Insurances Ltd. v Scattergood* [2003] 1 B.C.L.C. 598.

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As part of the best interests rule, directors are currently required to consider the interests of creditors. This is generally said to date back to the judgment of Mason J. in *Walker v Wimborne* in which his Honour said 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".[48] Thus, in Hong Kong, in *Moulin Global Eyecare Holdings Ltd. v Mei*, after reviewing relevant cases, Gummow N.P.J. thought that it was reasonably arguable that, in an insolvency context, the best interests rule requires directors to take into account the interests of creditors.[49] His Honour agreed that the rule may extend to not prejudicing the interests of creditors and preserving the assets of the company so that those assets may be dealt with in accordance with principles of insolvency law, including the *pari passu* rule.[50]

The scope of this requirement is much debated. Particular issues include the point of financial instability at which the duty arises, the content of the requirement where the interests of different creditors conflict and the extent of the requirement in terms of positive action.[51] In recent times, it has been thought that the duty may even require actual protection of creditors' interests as opposed to diligent consideration of their interests. This can be seen in recent cases that have required directors to treat creditors' interests as paramount in certain circumstances.[52] In Australia, suggestions by two judges in the Western Australian Supreme Court of Appeal in the Bell group litigation that the duty extends to protection of creditors have been met with opposition.[53]

At the same time, it is acknowledged that the duty is not owed to creditors and therefore cannot generally be enforced by them.[54] This paradox highlights the problematic nature of this requirement in terms of its fit within the best interests rule. Indeed, creditors are not included as one of the groups whom directors must consider under s. 172 of the Companies Act 2006 (UK) – instead, s. 172(3) provides that s. 172(1) has effect subject

[48] See *Walker* (1976) 137 C.L.R. 1, 7; see also *Bell Group Ltd. (in liq.)* [2008] WASC 239; (2008) 39 W.A.R. 1, at [6064], [6088]–[6089]; *Geneva Finance Ltd. v Resource & Industry Ltd.* [2002] WASC 121; (2002) 169 F.L.R. 152, at [28]; *Colin Gwyer & Associates Ltd. v London Wharf (Limehouse) Ltd.* [2002] EWHC 2748 (Ch.); [2003] 2 B.C.L.C. 153, at [74]; *Hellard* [2013] EWHC 2876 (Ch.); [2014] B.C.C. 337, at [91]–[92].

[49] See *Moulin Global Eyecare Holdings Ltd. v Mei* (2014) 17 HKCFAR 467, at [57]–[58].

[50] Ibid. See also *Tradepower (Holdings) Ltd. v Tradepower (HongKong) Ltd*. (2009) 12 HKCFAR 417, at [135]–[137].

[51] See e.g. A. Keay, "Directors' Duties and Creditors' Interests" (2014) 130 L.Q.R. 443; Davies and Worthington, *Gower and Davies*, pp. 519–23, at [16–35]–[16–35].

[52] See e.g. *Hellard* [2013] EWHC 2876 (Ch); [2014] B.C.C. 337, at [92]; *Re Pantone 485 Ltd.; Miller v Bain* [2002] 1 B.C.L.C. 225, at [68]–[69].

[53] See *Westpac Banking Corp.* [2012] WASCA 157; (2012) 44 W.A.R. 1, at [920], [993], [1011], [1969], [2031]; A. Hargovan and J. Harris, "For Whom the Bell Tolls: Directors' Duties to Creditors after *Bell*" (2013) 35 Syd.L.R. 433; R. Maslen-Stannage, "Directors' Duties to Creditors: *Walker v Wimborne* Revisited" (2013) 31 C&SLJ 71.

[54] See e.g. *Spies v The Queen* [2000] HCA 43; (2000) 201 C.L.R. 603, at [95]. Note, however, Companies Ordinance (Cap. 622), ss. 728–729; Companies Ordinance (Cap. 32), s. 350B; s. 276.

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to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company. This reflects the difficulty of the interaction between the best interests rule and the protection of creditors.

The Hon. K.M. Hayne has in fact recently questioned the appropriateness of this requirement, despite its apparently well-entrenched status.[55] His Honour's reasons include the fact that statements such as those in *Walker v Wimborne* and other cases have been taken out of context, that the notion that creditors have an interest in the company's assets is wrong and involves a manipulation of the concept of interests of the company in an effort to protect the interests of outside parties, that the nature of directors' fiduciary duties is proscriptive and that there is no need for the requirement.

The point in relation to the proscriptive nature of fiduciary duties is taken up in Section IV below. Hayne's point about the suitability of the requirement to consider creditors is, however, apt. Although it is well recognised that at some point of financial instability the company's interests coincide with those of creditors, the use of the best interests rule to require protection of creditors' interests unaligned to the company's interests arguably manipulates the rule and therefore weakens loyalty. The requirement to consider creditors' interests should therefore be linked to the company's interests rather than seen as an independent mechanism for creditor protection. This point will be taken up in more detail in Section V below, where the concept of the company's interests is also examined.

IV. Classification

The multifaceted nature of the best interests rule, as highlighted above, has led to the questioning of its fiduciary characterisation in some jurisdictions, particularly due to the fact that some facets appear to impose positive requirements (such as consideration, investigation and taking positive action in the face of conflict). As a result of a recent push towards proscriptive fiduciary model in all three jurisdictions,[56] the fiduciary classification of the best interests rule has been contested. Many proponents of this model argue that the fiduciary concept is in fact limited to the duties to avoid conflicts and profits.[57]

[55] See Hon. K.M. Hayne, "Directors' Duties and a Company's Creditors" (2014) 38 M.U.L.R. 795.

[56] See e.g. *Breen v Williams* (1996) 186 C.L.R. 71, 113; *Pilmer v Duke Group Ltd. (in liq.)* [2001] HCA 31; (2001) 207 C.L.R. 165, at [74]; *Friend v Brooker* [2009] HCA 21; (2009) 239 C.L.R. 129, at [84]–[86]; *Howard v Federal Commissioner of Taxation* (2014) 253 C.L.R. 83, at [56]; M. Conaglen, *Fiduciary Loyalty – Protecting the Due Performance of Non-Fiduciary Duties* (Portland 2010), 201–03; M. Conaglen, "Fiduciaries", in J. McGhee (ed.), *Snell's Equity*, 33rd ed. (London 2015), 144–46, at [7-008]; *Attorney General v Blake* [1998] Ch. 439, 455.

[57] See e.g. Conaglen, *Fiduciary Loyalty*, pp. 39, 270; G. Dempsey and A. Greinke, "Proscriptive Fiduciary Duties in Australia" (2004) 25 Aust. Bar Rev. 1; *P&V Industries Pty. Ltd.* [2006] VSC 131; (2006) 14 V.R. 1, at [23]; cf. R. Nolan and M. Conaglen, "Good Faith: What Does It Mean for Fiduciaries and

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In practical terms, the importance of characterising a duty as fiduciary in nature lies in the remedies available upon proof of breach (the most significant of these being the imposition of third-party liability based on the rule in *Barnes v Addy*[58]) and on the standards set in fiduciary relationships – breach of fiduciary duty is seen as a serious matter.[59] The potentially significant consequences following a finding of breach of fiduciary duty serve to deter such breaches and to reinforce the high standard required of fiduciaries. Determining which duties should be classified as fiduciary is important in setting appropriate standards in fiduciary contexts, particularly given the widespread association between fiduciary duties and loyalty and important scholarship on the educative and normative role of fiduciary duties. Fiduciary duties play a significant role in shaping the norms attached to various offices and in helping fiduciaries to grasp what is required if they are to be true to their commitments.[60] In addition, there has been recent critical examination of the contours of fiduciary loyalty at a more general level[61] and an analysis of the appropriate scope of fiduciary loyalty, viewed through the lens of directors' duties, is therefore important in its own right.

In this respect, the UK approach to fiduciary theory has much to commend it. The classic statement of the fiduciary principle in England is that of Millett L.J. in *Bristol & West Building Society v Mothew*.[62] After defining the term "fiduciary duty" as being "properly confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon breach of other duties"[63] and rejecting the view that the duty of care of fiduciaries is fiduciary in nature, his Honour stated:

> The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or for the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of the fiduciary obligations.[64]

What Does It Tell Us about Them?" in E. Bant and M. Harding (eds.), *Exploring Private Law* (Cambridge 2010), 320.

58 *Barnes v Addy* (1874) L.R. 9 Ch. App. 244.

59 See e.g. *Bell Group Ltd. (in liq.)* [2008] WASC 239; (2008) 39 W.A.R. 1, at [6034]; *Westpac Banking Corp.* [2012] WASCA 157; (2012) 44 W.A.R. 1, at [2916]; *Maguire v Makaronis* (1997) 188 C.L.R. 449, 466; *Giradet v Crease & Co.* (1987) 11 B.C.L.R. (2d) 361, 362.

60 See e.g. M. Harding, "Disgorgement of Profit and Fiduciary Loyalty" in S. Degeling and J. Varuhas (eds.), *Equitable Compensation and Disgorgement of Profits* (Oxford, forthcoming).

61 See generally Gold and Miller, *Philosophical Foundations*, chs 5–8.

62 *Bristol & West Building Society* [1998] 1 Ch. 1; see further Conaglen, "Fiduciaries", p. 145, at [7-008].

63 *Bristol & West Building Society* [1998] 1 Ch 1, 16.

64 Ibid., at p. 18.

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Millett L.J.'s statement therefore contemplates fiduciary duties to act in good faith, to avoid making unauthorised profits from the fiduciary position, to avoid conflicts of interest and to avoid acting for one's own benefit or for the benefit of a third person without informed consent. The duty of good faith appears to be a positive duty – later in the judgment, Millett L.J. explains that the duty of good faith requires the fiduciary to act in good faith in the interests of each principal.[65] This duty, sometimes referred to as the "inhibition principle", may require positive action.[66] In line with *Mothew*, the best interests rule is clearly recognised in case law and statute as a fiduciary duty in the UK.[67]

The fiduciary classification of the best interests rule has, however, come under fire in Australia and Hong Kong and to a certain extent in the UK as well, despite having been recognised as fiduciary in nature for many years.[68] For example, in *Moulin Global Eyecare Holdings Ltd. v Mei*, Gummow N.P.J. referred to Millett L.J.'s judgment in *Mothew* and said that the term "fiduciary" in the endorsement in *Moulin* was not used in its strict sense, but more broadly to encompass the established or asserted equitable duties of a director to act bona fide in the interests of the company as a whole, to act fairly between different shareholders and to consider the interests of creditors if the company be insolvent or of doubtful insolvency.[69] He continued:

> The obligations enforced by the fiduciary duties identified by Millett LJ in *Bristol and West Building Society v Mothew* are proscriptive, and concern avoidance of conflict between duty and personal interest and liability to account for improperly derived gains …. Where what is at stake is liability for failure by a director to discharge a non-proscriptive duty, such as that to act *bona fide* in the interests of the company, a court of equity may be reluctant to intervene in the absence of sharp practice by the director.[70]

In contrast, other Hong Kong cases have held the best interests rule to be fiduciary in nature.[71] The decision has been called into question.[72]

A number of points can be made in these respects. First, the best interests rule is fundamental to fiduciary loyalty, which underpins directorial accountability in a number of jurisdictions. Fiduciary duties are commonly,

[65] Ibid., at p. 19.
[66] See Conaglen, "Fiduciaries", p. 171, at [7-039].
[67] See note 1 above; Companies Act 2006 (UK), s. 178.
[68] See e.g. *Re Coalport China Company* [1895] 2 Ch. 404, 410; *Re Smith & Fawcett Ltd.* [1942] Ch. 304, 308; *Ngurli Ltd. v McCann* (1953) 90 C.L.R. 425, 439–40; Gower, *The Principles of Modern Company Law*, p. 474.
[69] *Moulin Global Eyecare Holdings Ltd. v Mei* (2014) 17 HKCFAR 466, at [35].
[70] Ibid., at para. [36].
[71] See e.g. *Grand Field Group Holdings Ltd. v Chu King Fai* [2014] HKEC 1025, at [166]; *Passport Special Opportunities Master Fund L.P. v Esun Holdings Ltd.* [2011] 4 HKC 62, at [50]; *Artan Investments Ltd. v Bank of East Asia Ltd.* [2015] HKEC 1055, at [23].
[72] T.K.C. Ng, "Directors' Duty Not to Prefer One Creditor to Another" [2015] C.L.J. 20.

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although not universally, connected with loyalty.[73] In this sense, the best interests rule plays a key role in ensuring that directors are loyal in that it requires consideration by directors of the company's interests and also avoidance of benefits to third parties. As stated by Popplewell J. in the recent case of *Madoff Securities International Ltd. (in liq.) v Raven*: "It is trite law that a director owes a duty to the company to act in what he honestly considers to be the interests of the company. This may be regarded as the core fiduciary duty of a director. It is a fiduciary duty because it is a duty of loyalty."[74]

Disloyalty in the form of non-consideration of the company's interests or in the conferral of benefits to third parties is not sanctioned by the duties to avoid conflicts and profits but instead by the best interests rule. Can a director really be said to be loyal if he or she is scrupulous in avoiding conflicts of interest but pays no thought to the company's interests in making decisions or confers benefits on third parties (such as a major shareholder or creditor)? When faced with a conflict of interest or conflict of duties, are directors really loyal if they step aside and make no further disclosure despite the fact that they know that the transaction in respect of which they have a conflict will be disastrous for the company? Given that the best interests rule has traditionally been classified as fiduciary, strong justification for the downgrading of its classification needs to be provided.[75]

Secondly, serious questions have been raised about the viability of the prescriptive/proscriptive distinction. For example, Hon. J.D. Heydon has pointed to factors such as that the existence of like distinctions in other areas of the law is waning, that negative duties sometimes require positive action, that older cases had no difficulties in applying positive duties to fiduciaries and that the distinction leads to artificiality of analysis.[76] Thomas states:

> What else is the function of an active trustee if not to act in the best interests of his beneficiaries? Such a duty could therefore be said to embrace and underpin all the powers of trustees discussed in this book. It conveys the core principle of trusteeship – although one that is often denied – namely that the fiduciary duties of an active trustee are first and foremost *positive* in nature .... Despite the fact that it is often claimed that fiduciary obligations are entirely negative in nature, this is not so.[77]

[73] See e.g. Conaglen, "Fiduciaries", p. 144, at [7-008]; Conaglen, *Fiduciary Loyalty*, p. 1; *Bristol & West Building Society* [1998] Ch. 1, 18; *Breen* (1996) 186 C.L.R. 71, 93, 108.

[74] *Madoff Securities* [2013] EWHC 3147 (Comm.), at [188].

[75] See e.g. *Westpac Banking Corp.* [2012] WASCA 157; (2012) 44 W.A.R. 1, 346, at [1962] (Drummond A.J.A.).

[76] J.D. Heydon, M.J. Leeming and P.G. Turner, *Meagher, Gummow & Lehane's Equity Doctrines & Remedies*, 5th ed. (Chatswood 2015), 211–15, at [5.385]; see also G. Virgo, *The Principles of Equity & Trusts* (Oxford 2012), 487, at [15.3.3].

[77] See Thomas, *Thomas on Powers*, p. 573, at [10.159] (citations omitted).

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To this could be added the difficulties of applying this distinction in the context of principles applying to the exercise of discretionary power.[78]

Thirdly, as concerns Australia, the High Court has never said that the only properly recognised fiduciary duties are the conflicts and profits rules. Nor has it ever ruled that the best interests rule is not fiduciary. Finally, as outlined above, the fiduciary characterisation of the best interests rule is consistent with English fiduciary theory.

The best way to reconcile these conundrums is arguably to recognise the key role played by the fiduciary concept in the regulation of the exercise of discretionary power, as emphasised by a number of commentators.[79] As mentioned by the Full Court of the Federal Court in *Grimaldi v Chameleon Mining N.L. (No.2)*, such principles form the second strand of the fiduciary concept and are often overlooked in discussion of the fiduciary principle.[80] The Full Court said:

> There are two discrete parts to modern Australian fiduciary law. The better known and understood part is connected with the setting of standards of conduct for persons in fiduciary positions. Its burden, put shortly, is with exacting disinterested and undivided loyalty from a fiduciary – hence, for example, its focus on conflicts …. The other part serves a different function and is often overlooked in discussion of fiduciary law. Its essential concern is with judicial review of the exercise of powers, duties and discretions given to a fiduciary to be exercised in the interests of another ("the beneficiary") where the beneficiary does not have the right to dictate or veto how the power, discretion, etc is exercised by the fiduciary. Here the law channels and directs how "fiduciary discretions" are exercised.[81]

There is scope for debate as to whether these fiduciary principles regulating the exercise of fiduciary power can properly be described as duties or whether they are more properly seen as "required mode[s] of exercise of fiduciary power"[82] or "required manner[s] of exercising judgment"[83] or "prescriptive conditions on the exercise of fiduciary power".[84] Seeing the best interests rule in these ways may impact on the available remedies. What is clear is that such concepts form an integral part of the fiduciary concept and complete the contours of fiduciary loyalty. It is also submitted

[78] See further Langford, *Directors' Duties*, pp. 46–49, at [3.3.1.5], pp. 50–52, at [3.3.2.2]; P.D. Finn, "The Fiduciary Principle" in T.G. Youdan (ed.), *Equity, Fiduciaries and Trusts* (Ontario 1989), 1, 28; P.B. Miller, "The Fiduciary Relationship" in Gold and Miller, *Philosophical Foundations*.

[79] See e.g. L. Smith, "Can We Be Obliged to Be Selfless?", in Gold and Miller, *Philosophical Foundations*; Miller, "The Fiduciary Relationship"; C. Harpum, "Fiduciary Obligations and Fiduciary Powers: Where Are We Going?" in P. Birks (ed.), *Privacy and Loyalty* (Oxford 1997), 145, 160.

[80] *Grimaldi v Chameleon Mining N.L. (No.2)* [2012] FCAFC 6; (2012) 200 F.C.R. 296, at [174].

[81] Ibid.

[82] See Smith, "Can We Be Obliged to Be Selfless?".

[83] See L. Smith, "Fiduciary Relationships: Ensuring the Loyal Exercise of Judgment on behalf of Another'" (2014) 130 L.Q.R. 608.

[84] See *Netglory Pty. Ltd. v Caratti* [2013] WASC 364, at [349].

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that failure to exercise a fiduciary power in accordance with principles such as the best interests rule should give rise to third-party liability based on the rule in *Barnes v Addy* given that such failure would constitute a breach of trust.[85]

Ignoring the regulation of discretionary power overlooks the key role of fiduciaries in exercising discretionary power and the important role of the fiduciary concept in regulating such exercise. As stated by Mason J. in *Hospital Products Ltd. v United States Surgical Corporation*:

> It is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that *the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed.*[86]

In summary, the best interests rule should retain its fiduciary classification and be recognised as a key requirement in the exercise of discretionary power by directors.

V. Stakeholder Protection

Given its fundamental role in the exaction of fiduciary loyalty in the director–company relationship, the appropriateness of the best interests rule as a stakeholder protection model warrants thorough analysis. This issue also follows on from Hayne's questioning of the appropriateness of the best interests rule as a creditor protection mechanism. This is a key issue that arises in each of the three jurisdictions. Cross-fertilisation and comparative analysis are therefore invaluable in this respect. Stakeholders in this sense include groups other than shareholders or the company as a commercial entity. Examples include employees, the environment, customers, suppliers, distributors and the community. Although it will generally be in the interests of a company and its shareholders for directors to carefully *consider* the interests of stakeholders in making decisions, the best interests rule is arguably an unsuitable mechanism for the imposition of an independent requirement or duty to actually *promote* or *protect* stakeholder interests. This is reflected in the fact that the best interests rule is not owed to stakeholders and cannot be enforced by them.

The interaction between stakeholder interests and the best interests rule is complex, so much so that Australia has seen the advent of a third major inquiry into this issue.[87] The first two – by the Corporations and Markets Advisory Committee and the Parliamentary Joint Committee on

[85] See Thomas, *Thomas on Powers*, pp. 572–73, at [10.158].

[86] *Hospital Products Ltd. v United States Surgical Corporation* (1984) 156 C.L.R. 41, 97, emphasis added.

[87] See Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (December 2006); Parliamentary Joint Committee on Corporations and Financial Services, *Corporate*

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Corporations and Financial Services – concluded that there was no need to change the formulation of the best interests rule as directors have enough leeway to consider stakeholder interests within the current formulation. These first two inquiries differed though in terms of what the company's interests were. In 2014, the Governance Institute launched a new inquiry in light of recent focus on the concept of companies' social licence to operate. This concept embodies stakeholder perceptions of the legitimacy of a company, which incorporates matters such as environmental performance, ethical business conduct, workers' rights and safety and community relationships.

The Australian best interests rule is framed in terms of acting in good faith in the interests of the company. As mentioned, it will generally be in a company's interests for directors to consider the interests of stakeholders in that, for example, a company's reputation may suffer due to failure to do so and due to the benefits of positive stakeholder relationships. A key factor in the debate is the fact that the financial interests of companies and their shareholders are gradually changing to include stakeholder interests so that it is arguably in the interests of the company and shareholders to consider and even promote stakeholder concerns.[88] What was impermissible in the days of *Hutton v West Cork Railway* would more likely now be seen as linked to corporate benefit.[89] For example, investment in renewable energy or promoting diversity on boards are less likely now to be seen as independent stakeholder issues but rather as linked to corporate benefit in light of investor demand.[90]

In this sense, as pointed out above, shareholder and stakeholder models are not always polarised. Ultimately, promoting long-term value of the company is in shareholder interest so that the models are in fact in many ways complimentary. The point is, however, that protection or promotion of stakeholder interests in their own right, unaligned to corporate benefit, are arguably inappropriate functions of the best interests rule and destructive of the fiduciary paradigm on which directors' duties are built, as further discussed below. Such protection and promotion require more significant change to the regulatory framework. In this respect, recent focus is being placed on the purpose of companies.[91]

Responsibility: Managing Risk and Creating Value (Commonwealth of Australia, June 2006); Governance Institute of Australia, *Shareholder Primacy: Is There a Need for Change?* (2014).

[88] See further Ho, "Director's Duty"; S. Barker et al., "Climate Change and the Fiduciary Duties of Pension Fund Trustees – Lessons from the Australian Law" (2016) 6 Journal of Sustainable Finance & Investment 211.

[89] See *Hutton* (1883) 23 Ch. D 654, 673, involving gratuitous benefits to employees.

[90] See e.g. CalPERS, *Towards Sustainable Investment and Operations* (2014), 4–5; Australian Council of Superannuation Investors, "ACSI Turns up the Heat on 'Zero Women Boards'" (Media Release, 10 July 2015); *Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia* [2016] FCAFC 80.

[91] See e.g. B. Sjåfjell, "The Future of Company Law and Sustainability" in B. Sjåfjell and B. J. Richardson (eds.), *Company Law and Sustainability* (Cambridge 2015); L.Q. Johnson, "Relating Fiduciary Duties

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Further issues arise in this respect in Australia due to the interaction of provisions of the Corporations Act 2001 (Cth.). For example, shareholder ratification is not effective in relation to directors' statutory duties.[92] Thus, if shareholders approve a course of action favouring one stakeholder (e.g. the adoption of an expensive environmental policy) at the expense of company profitability, this may protect directors from an action for breach of their general law duties but would not necessarily protect them in relation to breach of s. 181, particularly as that section has been held to include a requirement to consider creditors' interests. Moreover, statutory provisions in Australia and Hong Kong allow certain persons whose interests are affected by breach of the relevant statutory provision (or breach of directors' duty) to seek an injunction or damages (although the scope of the Australian section is at present constrained).[93]

The resultant uncertainty is undesirable, particularly against a background of concerns raised by the Australian Institute of Company Directors that over-regulation and uncertainty in the law as applied to directors are resulting in an undue focus on compliance and discouraging people from taking up directorships.[94] There is also the related issue of enforceability.[95] In fact, in Hong Kong, this issue was influential in the Steering Committee's decision not to implement a statutory provision in line with that adopted in the UK or to recommend a stakeholder model. As mentioned above, after detailed consideration, the Committee decided against codification of the best interests rule, leaving the rule to case law.

The fact that the best interests rule is arguably an unsuitable mechanism for the protection of stakeholder interests per se does not mean that such interests do not deserve protection. It also does not mean that core directors' duties are not relevant. In Australia, for example, the duty of care and/or the best interests rule may be breached by directors who do not cause the company to comply with stakeholder protection legislation. This is sometimes referred to as the "stepping stones approach"[96] and its introduction has been envisaged in other jurisdictions.[97] This model allows for breach of the duty

to Corporate Personhood and Corporate Purpose" in D.G. Smith and A. Gold (eds.), *Research Handbook on Fiduciary Law* (forthcoming 2016); see also P.B. Miller and A.S. Gold, "Fiduciary Governance" (2015) 57 Wm.& Mary L.Rev. 513.

[92] See *Forge* [2004] NSWCA 448; (2004) 213 A.L.R. 574, at [381]; *Angas Law Services Pty. Ltd. (in liq.) v Carabellas* [2005] HCA 23; (2005) 226 C.L.R. 507, at [32].

[93] See Corporations Act 2001 (Cth), s. 1324; Companies Ordinance (Cap. 622), ss. 728–729.

[94] Australian Institute of Company Directors, *The Honest and Reasonable Director Defence* (2014).

[95] See Ho, "Director's Duty", p. 17; S.C.C.L.R., *Report of the S.C.C.L.R. on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance* (2000), 92–93; Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (December 2006); cf. Greenfield, "The Third Way" (2015) 7 Seattle U.L.Rev. 749.

[96] See *Australian Securities and Investments Commission v Mariner Corp.* [2015] FCA 589; (2015) 106 A.C.S.R. 343; A. Herzberg and H. Anderson, "Stepping Stones – From Corporate Fault to Directors' Civil Liability" (2012) 40 F.L.Rev. 181.

[97] See e.g. W.Y. Wan, "The Illegality Defence in Corporate Law Claims Against Directors and Officers" (2016) 46 H.K.L.J. 1.

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of care or the best interests rule to be made out where a director causes the company to breach the law or some other duty (or fails to prevent such breach) and the elements of the best interests rule or the duty of care are established.

The use of direct legislation to protect stakeholder interests, with potential derivative liability via the duty of care and the best interests rule, is arguably more appropriate than pushing the limits of the best interests rule to effect stakeholder protection. Moreover, as brought out above, directors may in fact breach the best interests rule if they do not consider the interests of stakeholders and this has an adverse impact on the company's commercial interests. Indeed, it is likely to be a good answer to allegations of breach of the best interests rule that, in considering the company's interests, directors considered stakeholder interests.

This issue has also been the subject of considered review and debate in the UK. As part of the Company Law Review process, the Steering Committee examined this issue in detail and favoured an "enlightened shareholder value" model in preference to a pluralist model. As outlined above, s. 172 requires directors to act in what they consider would most likely promote the success of the company for the benefit of the members as a whole and in so doing have regard to a number of stakeholder and shareholder interests. Although it has been queried whether this rewording actually effects any real change to the predecessor duty, it does arguably encompass a long-term view of shareholder interest.

One point to be noted concerning the duty in s. 172 is that there is a clear baseline reference point in the UK, namely the success of the company for the benefit of the members as a whole. This means that directors have firm guidance as to how to resolve any conflict between the interests of the various stakeholders, namely to focus on the success of the company for the benefit of the members as a whole. In other words, the UK duty does not envisage the pluralist balancing of a number of interests with equal priority, but rather consideration and balancing of interests subject to the overarching requirement to promote the success of the company for the benefit of the members as a whole as the final determining issue.

It is submitted that the existence of such a bottom line or reference point is essential in terms of retaining directors' fiduciary loyalty, which underpins directors' accountability. Effecting a pluralist model via the best interests rule would disrupt the fiduciary model on which directors' duties are based and affect the operation of other fiduciary duties, even if the best interests rule were not classified as fiduciary. If the ultimate beneficiary of directors' fiduciary duties is no longer the company, then wholesale revision of corporate law in each of the three jurisdictions will be necessary.

However, there is an issue as to what exactly that bottom line should be. Traditionally, directors have owed duties to the company and the company's interests have been aligned with those of members. This is the

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position ultimately taken in s. 172, although the law in all three jurisdictions has moved away from a model based on shareholder profit maximisation (particularly short term profit maximisation) at all costs. There is also increasing recognition of the diversity of shareholder interests, of the changes in the way in which shareholders should be perceived and of the fact that shareholders are increasingly demanding socially responsible investments. It is therefore arguably no longer appropriate to equate shareholder interests solely with profit maximisation.

In this respect, Professor Andrew Keay propounds an "entity maximization and sustainability" model.[98] This model involves directors endeavouring to increase the overall long-term market value of the company as a whole, combined with aiming to ensure the survival of the entity and taking into account the investment made by various people and groups. This is an attractive model because it recognises the need to consider stakeholder interests but also has a reference point. Under Keay's model, directors' necessary discretion in balancing the various interests is guided by the standard of seeking to maximise entity wealth and entity survival.[99] The model also arguably allows for the fact that shareholder interests may differ and encompasses the need to consider the interests of future shareholders.

In the context of this debate, it is also vital in this respect to distinguish between the responsibilities of directors and corporate responsibilities – this is the issue of to whom companies (rather than directors) have responsibilities. Rather than extending the contours of the best interests rule to protect stakeholders, a closer examination of the responsibilities of companies (as opposed to directors) may be opportune. In broadening the duties and interests of companies in relation to stakeholders, directors' duties are necessarily affected. As argued above, directors may face liability in connection with such duties as accessories or via the stepping stones model. This is another aspect in relation to which Keay's entity sustainability and maximisation model works in well.

Moreover, increasing focus is being placed on disclosure and corporate social responsibility (or Environmental Social and Governance) reporting.[100] There are a number of current requirements in relation to such reporting. There is also investor demand for such reporting, as well as for socially responsible investing. Professor Jean du Plessis has recently

[98] A. Keay, *The Corporate Objective* (Cheltenham 2011).
[99] Ibid., at pp. 295–96, 301.
[100] See e.g. Companies Act 2006 (UK), ss. 414A–C; Corporations Act 2001 (Cth.), ss. 1013D(1)(l), 299(1)(f), 299A; A.S.X. Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 3rd ed. (2014), principles 3 and 7.4; see also H.K.Ex., *Main Board Listing Rules* (2015), Appendix 27. For a discussion of potential liability, see R. Baxt, "The Importance of a Culture of Compliance" (2013) 41 A.B.L.R. 106; J. du Plessis and A. Rühmkorf, "New Trends Regarding Sustainability and Integrated Reporting for Companies – What Protection do Directors Have?" (2015) 36 Co.Law. 51; Davies and Worthington, *Gower and Davies*, pp. 781–83, at [21–28]–[21–29].

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predicted the advent of mandatory integrated reporting (which encompasses sustainability reporting). This is currently voluntary but has recently been mandated in certain respects in the EU.[101] In du Plessis's view, such reporting will make companies more responsible and result in positive changes in corporate behaviour. In December 2015, the Stock Exchange of Hong Kong Limited strengthened the Environmental, Social and Governance Reporting Guide in its Listing Rules to upgrade such disclosure obligations.[102]

Such proposals have a number of advantages. First, they arguably create a level playing field, allowing investors to choose between companies in light of such disclosure. Secondly, directors' core duties would attach to these requirements in that a breach of the duty of care or the best interests rule could be made out on misleading or inadequate disclosure.

Where there is doubt or a clear mandate or desire on the part of shareholders to pursue corporate social responsibility rather than profit maximisation, "community interest company (CIC)" or "benefit corporation (B Corp)" format could be used. Such entities espouse a stakeholder model of corporate governance, carrying on activities for the benefit of the broader community.[103] This model is possible in the UK and is currently being proposed in Australia. Hong Kong does not appear to have moved in this direction so far, but no doubt these developments in Australia and the UK will raise this issue. In fact, the availability of such corporate form in the UK and the proposed availability of such form in Australia could take the burden off current corporate law doctrines in terms of stakeholder protection and help solve some of the issues and uncertainties with which corporate law in each of the jurisdictions is grappling.

In summary, effecting actual protection and promotion of stakeholder interests (independently of a reference point such as the interests of the company or entity maximisation and sustainability) via the best interests rule arguably renders the current model of directors' duties unworkable and undermines the fiduciary paradigm. Ultimately, deeper revision of company law is necessary to effect such protection and promotion. Although a key quality of the best interests rule is its multifaceted nature, extension of this rule to effect protection of stakeholders unassociated with clear corporate benefit is inappropriate. There is no need to distort the fiduciary model of directors' duties to effect corporate social

[101] See J.J. du Plessis, "Disclosure of Non-Financial Information: A Powerful Corporate Governance Tool" (2016) 34 C&SLJ 69; see also B. Choudhury, "Social Disclosure" (2016) Berkeley Business Law Journal (forthcoming); J.J. du Plessis, "Shareholder Primacy and Other Stakeholder Interests" (2016) 34 C&SLJ 238.

[102] See Hong Kong Exchanges and Clearing Limited, "Exchange to Strengthen ESG Guide in Its Listing Rules" (News Release, 21 December 2015).

[103] See Department for Business, Innovation and Skills (UK), *Community Interest Companies: Information and Guidance Notes* (November 2015); BLab, *Developing Model Legislation for Australian B Corps*, available at <http://bcorporation.com.au/benefitcorp_au>.

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responsibility. The damage done to the expressive impact of fiduciary duties and to their role in focusing directors on the fiduciary mandate should be avoided. There is no doubt, however, that, in considering the interests of the company and its shareholders, directors should consider the interests of stakeholders. Increasing the focus on the legal and social obligations of companies avoids the overburdening and inappropriate stretching of directors' duties such as the best interests rule, whilst at the same time recognising the need for companies to behave in a socially responsible way. In light of current uncertainty, directors should consider a range of interests in making decisions, but also be able to point to corporate benefit as concerns those decisions.

VI. Conclusion

Detailed comparative analysis of the contours and practical application of the best interests rule in the three key jurisdictions of the UK, Australia and Hong Kong demonstrates a multifaceted duty that incorporates a number of requirements. These give rise to the need for vigilance in situations of conflict and for careful consideration of the company's interests. In light of corporate social responsibility challenges, it has been shown that the best interests rule is arguably not a suitable mechanism for effecting actual promotion of stakeholder interests but that such interests should be considered as part of determining the interests of the company. The multifaceted nature of the best interests rule demonstrates the central role played by the rule, which underlies and unifies directors' fiduciary duties, and is integral to fiduciary loyalty in the corporate context.

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