
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountants

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DIRECTORS' DUTIES

Introduction

In February 2015 the Court of Appeal of the Supreme Court of Victoria handed down its judgment in *Australasian Annuities Pty Ltd (In Liquidation) ("Australasian") v Rowley Super Fund Pty Ltd ("RSF")*. The case is an important reminder of the problems that arise when the interests of directors, shareholders and beneficiaries of a trust are not identical.

Background

Mr Steven Rowley ("SR") was the sole director of Australasian. He was a 50% shareholder, together with his wife. Australasian was the trustee of the Rowley Family Trust ("the Family Trust"), a discretionary trust. SR, his wife and two sons were beneficiaries of the Family Trust, but not the only beneficiaries. Australasian and London Partners Pty Ltd ("London Partners") carried on a financial planning business. Australasian was a service entity, whilst London Partners held the relevant financial services licence and received revenue from clients. All staff were employed by Australasian including SR, his wife and their sons.

During the year ended 30 June 2007 the Commonwealth Government

allowed a one-off opportunity for individuals to invest up to \$1M into superannuation on a non-concessional basis. In May 2007 Australasian, London Partners and other related entities borrowed \$2.5M from Macquarie Bank Limited ("Macquarie"). The purpose of the loan was to fund tax effective superannuation contributions and eligible termination payments ("ETPs"). Australasian, as trustee of the Family Trust, was able to claim an income tax deduction for the employer superannuation contributions and ETPs. The loans from Macquarie were secured by fixed and floating charges over the whole of the assets and business undertakings of London Partners and Australasian.

During the financial years ended 30 June 2007 and 2008 Australasian, as trustee of the Family Trust, recorded profits of approximately \$419,000 and \$1.1M, respectively.

In February 2008 RSF was incorporated. Following its incorporation, RSF became the trustee of the Rowley Super Fund ("Super Fund"). The directors of RSF were SR, his wife and their two sons. Prior to the incorporation of RSF, they were the trustees of the Super Fund.

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From time to time SR borrowed monies from Australasian and by 30 June 2008 he owed Australasian approximately \$3.3M. The loans from Australasian to SR were unsecured and did not accrue interest. Following the Global Financial Crisis the business of London Partners deteriorated markedly. In June 2009 Macquarie appointed Receivers and Managers to Australasian and London Partners. Subsequently, Australasian went into liquidation. The Receivers and Managers of Australasian commenced legal proceedings against SR and RSF to recover \$1.7M allegedly diverted from Australasian to the Super Fund, in breach of SR's fiduciary duties.

There was no need to prove insolvency, as required if the claim was to recover antecedent transactions under Part 5.7B of the *Corporations Act*. Further, the claim, was not one that could be brought exclusively by a Liquidator and therefore was subject to Macquarie's fixed and floating charge.

Following the commencement of legal proceedings, SR became bankrupt and the claim only proceeded against RSF, as trustee of the Super Fund.

Decision at first instance

At first instance Justice Almond, of the Supreme Court of Victoria, noted that where a company acts as a trustee of a trust, the best interests of the company are to act properly in accordance with the trust deed and in the interests of the trust. The trustee must exercise its powers honestly and in the best interest of the beneficiaries of the trust. Justice Almond noted that SR failed to pay proper regard to Australasian's separate interests and embarked on a deliberate strategy to cause Australasian to incur obligations, so that it was in a position to provide

substantial personal benefits to SR and certain members of his family. Further, SR did not give even token consideration to the interests of Australasian or any consideration at all as to what was in the interests of the beneficiaries of the Family Trust.

His Honour held that SR exercised his powers as director of Australasian for the collateral and improper purpose of obtaining substantial direct personal benefits, by causing Australasian to pay:

- (a) substantial employee contributions for himself and his wife;
- (b) substantial interest free loans to SR, which were then paid into the Super Fund for the benefit of himself, his wife and children; and,
- (c) ETPs to SR and his wife totalling \$839,000. There was no contemporaneous evidence that SR or his wife had ever resigned.

His Honour noted that the directors and shareholders of Australasian were not identical. Australasian was the trustee of the Family Trust and the beneficiaries of the Family Trust were not identical to Australasian's shareholders. In considering whether there was a possibility of conflict of interest, his Honour noted that Australasian owed a fiduciary duty to the beneficiaries. In this case there were the personal interests of the director, the interests of the shareholders of Australasian and the interests of numerous beneficiaries of the Family Trust. There was a 'significant' or 'real or substantial' possibility of conflict between those interests. His Honour held that SR had breached the fiduciary duties owed to Australasian in his capacity as director.

Because SR's wife was not fully informed as to the transactions, his

Honour held the shareholders of Australasian did not prospectively assent to the transactions and nor did the shareholders ratify the transactions. Further, because Australasian was insolvent, it was not possible for SR's wife to now absolve him of breaches of directors' duties.

Australasian submitted that RSF, as trustee of the Super Fund, was liable for knowing receipt of trust property under the first limb of *Barnes v Addy*. Australasian was required to establish that the Super Fund received the trust property and knew the relevant property was trust property being misapplied or transferred, pursuant to a breach of fiduciary duty or trust. Australasian's case was complicated by the fact that most of the transactions occurred prior to February 2008 when the trustees of the Super Fund were the four Rowley family members. His Honour found that on the evidence, SR made all decisions without seeking instructions or obtaining consent from his wife and two children, before the decisions were made or implemented. There was no evidence that the other trustees knew that the transactions would be effected, until after the event. Further, there was no evidence that there was any implied assent from the other trustees that SR should act on their behalf.

There was minimal evidence of the management of RSF or the Super Fund after February 2008. His Honour held that it was impossible to say how the directors of RSF managed the Super Fund. Therefore, there was no sound basis upon which to conclude that SR was the directing mind and will of RSF or the Super Fund.

Even though Australasian had successfully made out its case that SR had breached his fiduciary duties,

Australasian was unsuccessful in obtaining relief against RSF. A Pyrrhic victory.

Court of Appeal

Australasian then appealed the judgment. All three judges of the Court of Appeal had no difficulty in concluding that SR breached fiduciary duties owed to Australasian in his capacity as director. Further, the Court of Appeal confirmed that the shareholders of Australasian did not prospectively assent to the transactions and nor did the shareholders ratify the transactions. However, the Court was divided on whether there was knowing receipt of trust property by RSF as trustee of the Super Fund.

Justice Garde noted that the loans from Australasian to SR were undocumented, unsecured and interest free. In the context where Australasian had borrowed \$2.5M from Macquarie, at commercial interest rates and when the principal was repayable by 31 January 2011, then the best interests of Australasian were not served by such improvident arrangements.

Justices Garde and Neave held that the trial judge erred and that SR was the directing mind and will of RSF and the Super Fund. Therefore, SR's knowledge of his breaches of fiduciary duties was imputed to RSF. The effect of this was to impute SR's knowledge to RSF, both in respect of transactions which preceded the incorporation of RSF, and those transactions which followed. Hence, RSF took all of the funds which originated from Australasian with the imputed knowledge of SR's breaches of fiduciary duties to Australasian. Because SR's wife and children had no knowledge of the transactions taken by SR, they were

not liable for constructive knowledge under the first limb of *Barnes v Addy*. Chief Justice Warren provided a dissenting judgement on this point.

The Court of Appeal rejected submissions that Macquarie facilitated the transactions it subsequently complained about.

The Court Ordered that \$1.675M be repaid to Australasian by RSF as trustee of the Super Fund, plus interest calculated at 6% per annum.

Conclusions

The cases show the importance of directors:

- (a) exercising their powers in the best interest of the company to which they are appointed;
- (b) exercising powers for a proper purpose; and,
- (c) avoiding conflicts of interest.

Further, if the company is a trustee of a trust, directors should carefully consider the interests of all relevant stakeholders, when there is not an identity of interests between the directors, shareholders and beneficiaries of the trust.

The cases show that a claim for breaches of directors' duties can be a viable alternative to a Liquidator pursuing antecedent transactions. Further, claims for breaches of directors' duties have the benefits of not requiring the insolvency practitioner to be a party to the legal proceedings or to prove insolvency at the time of the transactions.

The cases again reinforce the importance for directors of companies that are trustees of trusts to carefully consider the interests of beneficiaries, before giving effect to transactions. Further, payments to a superannuation fund will not be sufficient to prevent transactions being attacked, should the company later become subject to an insolvency administration. However, if the funds were paid to an independent superannuation fund, then the result in this case may well have been different.

Nearly six years after the funds were advanced and after the incurring of no doubt substantial legal costs, Macquarie has obtained judgment in its favour for some, but not all, of the funds it originally advanced to Australasian in May 2007.

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