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COMPANY DIRECTORS AND FAMILY LAW

Many families operate businesses through companies, whether this is by a husband and wife working together or by a parent and their adult children. Usually in a smaller company the people running the business are also the Directors of the company. What many people fail to realise is that Directors of companies owe serious obligations to the company and its shareholders. A failure by a Director to abide by these obligations could lead to criminal conviction and serious consequences for a property settlement if the company is an asset of a couple who have separated.

A company is its own legal entity. When making decisions about the running of a company, Directors must act with the care and diligence that a 'reasonable person' would use if they were the Director of the company. A Director will have acted with the appropriate level of care and diligence if they:

- Act in good faith and for a proper purpose.
- Do not have a material interest in the decision made.
- Have informed themselves about the subject of the decision to the extent they believe appropriate.
- Rationally believe the decision is in the best interests of the company.

A Director can still make decisions of an

entrepreneurial nature for the company, even if those decisions are risky and ultimately cause the company to lose money, without being guilty of a crime, if they meet the criteria set out above.

A breach of the 'Director Duties' will occur when the Director:

- Exercises their powers against the interests of the company.
- Misuses their position to gain advantage for themselves or someone else or causes detriment to the company.
- Improperly uses company information to gain an advantage for themselves or someone else or to cause damage or loss to the company.
- Has a conflict between their personal interests and those of the company (that they do not disclose to the members of the company).
- Takes advantage of their role in the company to make a secret profit.
- Misappropriates the assets of the company for themselves.

It will not matter whether the Director genuinely believes that the purpose of their activity was honest, if the activity was not in the interests of the company, they will be in breach of the



Corporations Law. This may lead to a Director being charged with a crime. If convicted the Director can be fined or can even go to jail. Where a breach is proved a Director may also have to compensate the company for the loss it has suffered.

When one or both of the parties to a marriage or de facto relationship is a Director of a company and that company is an asset of the relationship, they may find themselves in breach of their Directors Duties, whether they mean to or not, if they behave in a way that is contrary to the best interests of the company and their relationship breaks down.

For example:

Bill and June are the Directors of



Rankin Nathan Lawyers
1300 727 813

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'Fishtanks R Us Pty Ltd'. Bill and June are both Directors and Shareholders of the company which they have operated together in a very profitable way for many years. Unfortunately Bill and June's marriage breaks down and they decide to separate. Bill and June both keep working in the business, but eventually Bill and June start to feel a lot of animosity toward each other, especially after June begins a new relationship with Raoul.

Against Bill's wishes, June gives Raoul a highly paid job with the business and eventually June tells Raoul the secret fish food recipe that has made Fishtanks R Us so successful over the years. June also gives Raoul the names and addresses of Fishtanks R Us' clients.

June then takes half of the money out of the company bank account and gives \$50,000.00 to Raoul for his birthday. June thinks that this is her money and she can do what she likes with it. Raoul uses his birthday money to set up his own fishtank business and he starts making fish food using the secret Fishtanks R Us' recipe. Raoul sends a letter to all the Fishtanks R Us client's inviting them to an opening party. Fishtanks R Us starts to lose business. June does not think she has done anything wrong.

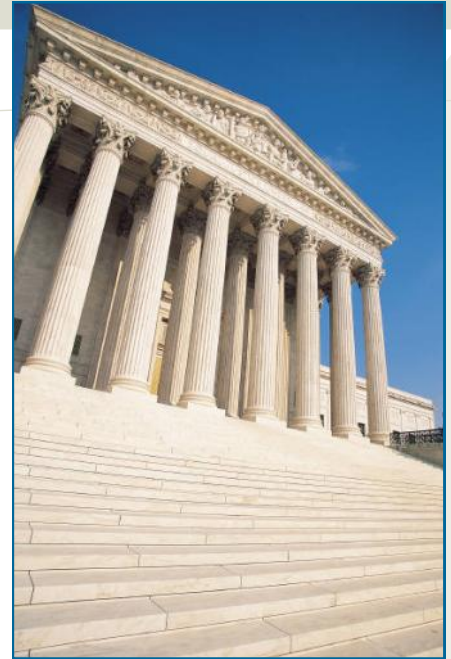
June is in breach of her director's duties as she has put her own interests and/or those of Raoul ahead of the interests of Fishtanks R Us. June has also misappropriated assets of the company and improperly used company information, both the fish food recipe and the client list, to gain

an advantage for herself and/or Raoul. Even though she thought she wasn't doing anything wrong, a reasonable person would probably not think that June was acting in good faith and for a proper purpose and in the best interests of Fishtanks R Us.

There may also be serious tax consequences for Fishtanks R Us because of the money taken by June from the company account. Many people use the assets and income of their company as though they were their personal assets. This can lead to serious, unintended and sometimes very large tax bills, particularly if the company is sold or wound up as part of a family law property settlement.

The Family Court has the power to make Orders under the Corporations Law, which governs breach of Directors Duties. The Family Court can also make Orders about Fishtanks R Us as an asset owned by Bill and June. If the Family Court had to decide how to divide Bill and June's asset, it is possible that the Court could (amongst other things):

- Report June to the relevant authorities because of the things she did against the interests of Fishtanks R Us.
- Accept that June had caused Fishtanks R Us to decrease in value and make June bear the brunt of that loss in her property settlement with Bill.
- Accept that June had been reckless and 'wasted' the assets of Fishtanks R Us.
- Make Orders joining Raoul and



the new fish tank business to Bill and June's Family Court case.

- Sell or make Orders about the assets of Raoul's business if it decided that this was necessary to provide fairness to Bill in his property settlement with June.
- Order that June bear the whole of the responsibility for any tax debt that arose because of the money June took out of the business.

It is clear therefore that even seemingly simple things done in a business can have very serious consequences. If you have any questions about your obligations to your company or how to operate your business after your separation, please contact us on 1300 727 813.