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Sole-shareholder directors' duties and obligations

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One of the core obligations which exist in company law concerns the duties which directors have to their companies. These duties arise both out of the general law and legislation.

Section 180(1) of the **Corporations Act 2001** (Corporations Act) requires a director to act with reasonable care and diligence. There has for some time been legal conjecture as to the extent of this 'care and diligence' in the circumstance where the directors are the sole shareholders of the company.

The recent decision of the Full Federal Court in *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52 appears to be authority for the proposition that, even where the directors are the company's sole shareholders, the directors will still have obligations pursuant to section 180(1) of care and diligence towards the company.

This decision is significant, in that it suggests that the duties imposed upon directors by section 180(1) will not necessarily be diluted by the fact that the directors are the sole shareholders of the company. This will particularly be so where directors' actions cause the company to act illegally.

The facts of the case and the judgment are set out in the following sections of this paper. It will be seen that, given the clear dissent on

the issue from one of the three judges, Justice Rares, it is very possible that the issue is not completely resolved.

The issue may await further determination by the High Court.

Facts

The case arose out of the collapse in 2008 of Storm Financial. The Storm Financial "model" involved investors borrowing against their assets, and investing the borrowings in various financial derivatives, being principally Storm Financial indexed trusts.

Many of the investors following the Storm "model" were people over 50 years old, retired or approaching retirement, had little or limited income and few assets, and had little or no prospect of rebuilding their financial position in the event of suffering significant loss.

When the global financial crisis (GFC) occurred, the Storm Financial group collapsed and many investors, particularly those who were not financially sophisticated, sustained significant losses.

The Australian Securities and Investments Commission (ASIC) prosecuted Storm Financial pursuant to the provisions in the then section 945A of the Corporations Act, claiming that Storm Financial had failed to provide appropriate financial advice to its investors, in that it had failed to:

- determine the personal relevant circumstances of its clients
- investigate the information provided to it by the clients
- ensure that, in the light of such information provided to it, by its investors, it gave advice to the clients which was financially appropriate.

Storm Financial was duly convicted of breaching section 945A, and with the advent of the GFC subsequently went into liquidation. The trial judge found that a reasonable director in the position of Mr Emmanuel Cassimatis and Mrs Julie Cassimatis, would have realised that the application of the Storm Financial “model” to the circumstances of very unsophisticated investors was likely to involve inappropriate advice. They, as directors, should have taken some alleviating precautions to prevent the giving of that inappropriate advice.

In addition however to prosecuting the company, ASIC also prosecuted the two directors of Storm Financial, being Emmanuel Cassimatis and Julie Cassimatis, who were also its sole shareholders, for breach of their duties of care and diligence under section 180(1) of the Corporations Act.

In their defence, Mr and Mrs Cassimatis pleaded that they were the sole shareholders of Storm Financial, and that their personal interests therefore were virtually identical with those of the company. It followed by implication that any actions by them as directors could prejudice only their own interests in the company, and that therefore, even though their actions may have caused Storm Financial to be in breach of section 945A, this did not necessarily mean that they personally had breached their duties of care and diligence prescribed by section 180(1).

In the primary proceedings, Justice Edelman (as he then was) noted the complete control which Mr and Mrs Cassimatis had over every aspect of the operations of Storm Financial, including devising the Storm Financial “model” for client investment.

He further noted that the contraventions by the company of section 945A of the Corporations Act represented a criminal offence. He found that by their actions in controlling the way Storm Financial operated (particularly with regard to the way unsophisticated investors were left exposed to significant financial detriment), they had breached the required directors’ duty of care and diligence mandated by section 180(1).

Mr and Mrs Cassimatis appealed to the Full Federal Court.

Judgment

In a split decision of the Full Federal Court, the appeal was dismissed. The court found that by permitting Storm Financial to breach section 945A of the Corporations Act, Mr and Mrs Cassimatis had themselves breached section 180(1).

The plurality of the judges (Justices Greenwood and Thawley) found that section 180(1) operates in addition to, and not in derogation of, any similar rule in common law or equity; it imposes on directors specific duties in a multitude of instances.

Significantly, the majority judges found that the fact that the subject directors were the sole shareholders of the company did not preclude them from being guilty of breaching section 180(1).

Justice Thawley in particular emphasised that a company’s interests are not exclusively those of its shareholders. Even where there might be complete identity of interests between the directors and its shareholders, the interests of both are not necessarily identical. Fundamentally, he found that shareholders cannot release directors from statutory duties such as those imposed by section 180(1).

His Honour quoted and affirmed the remarks made by the primary judge, that a reasonable director in the position of Mr and Mrs Cassimatis would have known that the Storm investment “model” was being applied to vulnerable clients virtually on ‘a one size fits all’ basis, and that these clients were being given inappropriate financial advice. It would have been clear to any reasonable director that the consequences of that inappropriate advice would be “catastrophic” for Storm Financial, and for the investors in the event of a financial crisis like the GFC.

Directly or indirectly, the “model” and the consequent breach of section 945A of the Corporations Act caused Storm Financial to lose its Australian financial services (AFS) licence and to go into liquidation. The further consequence was that some vulnerable clients lost all their investments and were left with large debts.

Interestingly, in his minority judgment, Justice Rares found that the conduct of Mr and Mrs Cassimatis did not constitute a breach of section 180(1), even though they were responsible for Storm Financial’s contraventions of section 945A. He was not satisfied that a reasonable director, in their position and in all the circumstances, came under a duty pursuant to section 180(1) to prevent those contraventions.

It was not the case that such a reasonable director should have seen that the consequences of the financial advice given to vulnerable investors would be catastrophic for Storm Financial and for the investors. He did not believe that directors in that position should have perceived a risk that the company’s conduct would prompt ASIC to take action to suspend or cancel Storm’s AFS licence or to impose a banning order. **FS**



The quote

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