

Acting in Good Faith and in the Best Interest of Company in PNG

Written by Paul Toua, Vanessa Kihanges and Damian Kelly

Key Points

- Directors are obliged to act in good faith and in the best interests of the company in Papua New Guinea (**PNG**) when exercising or performing his or her duties.
- It is imperative for prospective and existing directors to understand how good faith is defined to ensure directors avoid penalties and fully comply with the law.
- Directors of company groups must be aware of these variations and balance their duties to their various companies appropriately.

Introduction

When a person is appointed as a director, he or she automatically become subject to certain duties. These 'duties' arise because directors are placed in a position of trust or fiduciary relationship. These duties are governed by both statute law and established common law principles. Directors must understand the nature of those duties and act accordingly or the consequences can be severe. In PNG, for example, a breach of certain duties may lead to a directors being held liable and possible exposure of fines of up to K200,000 or imprisonment for up to 5 years or both!¹ Acting as a director is not to be taken lightly.

There are several duties that a director owes to his or her Company. This article is focused on just one of those duties governed by PNG statute law and that is, a director's duty to act in good faith and in the best interests of the company as set out under Section 112 of the *Companies Act 1997* (PNG) (**the PNG Act**).

It is important to understand what these duties are and what is expected of the director under that provision.

The **PNG Act** states that a director of a company must act in good faith and in what the director believes to be in the best interests of the company when exercising or performing their duties.² PNG's *Companies Act* is based on the New Zealand's *Companies Act 1993* (NZ) (**the NZ Act**). The NZ experience, therefore, is of great interest to PNG directors because how directors are treated under the NZ Act is a useful guide in determining what PNG directors can or cannot do. Under the NZ Act the good faith requirements are substantively identical.³

¹ Companies Act 1997 (PNG) s112 (5)

² Companies Act 1997 (PNG) s 112(1).

³ Companies Act 1993 (NZ) s131(1).

Defining ‘in good faith’

In PNG, the duty of acting in good faith requires directors to exercise their discretion in the interest of the company and not for any collateral purpose.⁴ The following section will explore how the requirement is interpreted in PNG.

Good faith in PNG

The duty to act in good faith is essentially a duty of loyalty to the best interests of the company. This means that a director must put the company’s interests above the interests of individual parties within the company and ensure the company complies with its legal requirements.

Currently, it is clear that in order to act in good faith in PNG:

- Directors must turn their minds to the interests of the company by attending necessary meetings and considering company documents.⁵ Ignorance is no defence, meaning that directors must act competently in fulfilling their obligations;
- Directors must not actively use their office to obtain undue benefit, or to give their individual interest priority over that of the business.⁶ A substantial conflict of interest may make it impossible for the director to act in good faith.⁷

The test to determine if a director has been acting in good faith involves:

- examining objectively what society expects from a director; and
- Subjectively what the director honestly believed to be in good faith.⁸

However, in applying the test in New Zealand, it was held that a director’s mistaken belief will only act as a defence where it was not ‘a wholly inappropriate appreciation of the interests of the company.’⁹ For example, mistaken belief is no excuse where a director takes the view that shareholder interests always have priority regardless of the interests of creditors.¹⁰

The PNG Act makes reference to clear examples of where a director would be taken to have not acted in good faith and may be disqualified, in circumstances where a director:

- persistently failed to comply with the Act;
- is found guilty of fraud in relation to the company; or
- Acted in a reckless or incompetent manner.¹¹

What this means is that non-compliance with other duties of directors, fraud and acting recklessly or with incompetence may apply to a determination by a court that the director has not acted in good faith or in the best interests of the company.

⁴ *Re Smith & Fawcett Ltd* [1942] Ch 304.

⁵ *In re Mosbi Glass and Aluminium* [2012] PGNC 238 and *Guia v Arua* [2016] PGNC 17.

⁶ *PNG Balsa Company Ltd v New Britain Balsa Company Ltd* [2004] PGNC 247 and *Spirit Haus Ltd v Marshall* [2004] PGNC 166.

⁷ *Mainland Holdings Ltd v Stobbs* [2003] PGNC 10.

⁸ *Sojourner v Robb* [2006] 3 NZLR 808 at [102].

⁹ *Sojourner v Robb* [2006] 3 NZLR 808 at [105].

¹⁰ *Mizeen Painters Ltd (In Liq) v Tapusoa* [2016] NZAR 423 at [34].

¹¹ *Companies Act 1997* (PNG) s 426(1)(c).

Balancing duties in company groups

There are other important considerations when acting as a director. If you operate a PNG company, how can you make sure you continue to act in good faith when you are not a resident director? When you are a director a multi-national company group, which company interest do you put first?

So, how does a director of multiple organisations in various jurisdictions balance the interests of each company as individual entities? PNG addresses this by providing for legal exclusions to the good faith duty, enabling directors to prioritise some companies over others. In addition, directors may avail themselves of the 'business judgment rule' defence: See [Business Judgment Rule article here](#).

By way of contrast, in Australia, directors of wholly-owned subsidiaries may still fulfil their duty of good faith in the best interest of the subsidiary if:

- the subsidiary is wholly owned by the holding company;
- the constitution of the subsidiary authorises the prioritisation of the holding company's interests;
- the director acts in good faith in the best interests of the holding company; and
- the subsidiary is not insolvent and the director does not cause insolvency.¹²

This means that directors of multiple companies in the same company group can put the interests of the holding company before the interests of the subsidiaries if authorised by the company constitution and the subsidiary did not become insolvent due to the decision of the director to give the holding company's interests priority.

In PNG, not only do directors have the added discretion to prioritise holding companies of wholly owned subsidiaries, they are able to prioritise holding companies of partially owned subsidiaries and the shareholders of joint venture companies. In the case of wholly owned subsidiaries, when the constitution of the subsidiary expressly allows the prioritisation of the holding company's interests a director may ignore what is in the interests of the subsidiary.¹³ For partially owned subsidiaries, a director may prioritise one of the shareholder companies' interests if the constitution expressly permits and there is prior agreement of the shareholders.¹⁴

Further, the PNG Act lessens good faith requirements in cases of subsidiaries and joint ventures. This principle applies where the company constitution or agreement allows for the interests of a holding company, another company in a company group or the shareholders to take priority over another company.¹⁵

¹² *Corporations Act 2001 (Aust)* s 187.

¹³ *Companies Act 1997 (PNG)* ss 112(2).

¹⁴ *Companies Act 1997 (PNG)* ss 112(3).

¹⁵ *Companies Act 1997 (PNG)* ss 112(2)-(4).

Contact

For more information please contact:

Paul Toua

Special Counsel

T +61 409 769 785

E p.toua@pln.com.au

Vanessa Kihanges

Associate

T +675 321 4470

E vkihanges@fairfax.com.pg

Damian Kelly

Paralegal

T +61 424 067 184

E d.kelly@pln.com.au



This work is licensed under the Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License.