IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No M174 of 2013

BETWEEN:

STEPHEN JAMES HOWARD
Appellant

and

COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA
Respondent

APPELLANT'S SUBMISSIONS IN REPLY

1. It is common ground that the essential issue in the appeal is whether the Appellant was obliged to account to Disctronics for the benefit he obtained in connection with the golf course project, or was entitled to retain it for himself.

2. It is also common ground that for so long as Disctronics pursued as a possibility the acquisition of the golf course, the Appellant had a duty to Disctronics to further its interests in relation to such an acquisition, and that the derivation by him for his own benefit of any gain from the golf course project would be in conflict with that duty; so that any gain so derived would be one for which he was obliged to account to the company.

3. Pared to its core, the Respondent's case is that before the Appellant took steps to recover the project, or its value, from the defendants, Disctronics had ceased to be interested in pursuing the opportunity to invest in the project, so relieving the Appellant from any duty to the company in relation to it. The propositions on which the case rests are that (i) Disctronics was not interested in pursuing the opportunity to invest in the golf course unless the defendants assented to its doing so, and assented to its acquisition at a price which would limit its outlay of funds (net of borrowings) to $1.5m;[1] (ii) the defendants did not so assent;[2] and (iii) in consequence the Appellant was relieved of any fiduciary duties to the company in respect of the golf course venture, and could

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1 Respondent's submissions ("RS") at [32]
2 RS at [54]

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for his own benefit (exclusive of the company) both pursue the venture and retain any benefit obtained in connection with it.

4. The major premise in the Respondent's argument is wrong.[3] There could be no clearer indication of the company's continuing intent to pursue the project than its institution of the proceedings in the Supreme Court to recover the golf course from the defendants.[4] The Appellant could not claim for himself any interest in the course, or in any benefit arising from the course, without preferring his own interests to those of the company, and that he could not do.

5. The Respondent's argument rests on the proposition that "where there is a governing agreement ... the [fiduciary] relationship must accommodate itself to its terms so it is consistent with and conforms to them."[5] This proposition, and the authorities on which it rests,[6] is appropriate to the case of fiduciary obligations arising from contractual relationships, but it is inapposite to the relationship between a company and its directors. There was here no "governing agreement" between Disctronics and its directors: there was a decision by the directors, as such and for the benefit of the company, to pursue an investment opportunity. Attaching the label[7] "London Agreement"[8] to the directors' decision of 14 July 1999 does not convert the decision into a contract nor attract the analysis of the fiduciary obligations arising between contracting parties.

6. The company at all relevant times claimed an interest in the golf course project, and any benefit which came to the Appellant personally could only reduce or replace the interest claimed by the company.

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3 See also paragraphs [13] to [15] below.

4 The principal relief sought was a declaration that the golf course or the proceeds of its sale were held on constructive trust for Disctronics: *Disctronics Ltd v Edmonds* [2002] VSC 454 at [103]. The company had also lodged a caveat protecting its claimed interest; the Court of Appeal held that it had reasonable cause to do so, as "the company which would have taken title to the golf course had the joint venture proceeded as planned", *Edmonds v Donovan* (2005) 12 VR 513, 550 [96]

5 RS at [15], invoked in application to the present facts at RS [32], [51] (the Appellant's "fiduciary relationship with Disctronics came to have operation on relation to the KLGC venture *only* because of, and consistent with the terms of, the London Agreement")

6 The authorities cited at RS [15] footnotes 17 and 18. Notably, the cases cited all concerned relationships which were solely contractual (distributorship, *Hospital Products*; audit, *Pilmer*; partnership, *Birtchnell* and *Chan v Zacharia*; joint venture partnership, *United Dominions*; contracts for dealings in land, *John Alexander*) and involved parties negotiating at arm's length.

7 As to labels, see *Radaich v Smith* (1959) 101 CLR 209, 214; *Samuel v Salmon & Gluckstein Ltd* [1946] Ch 8, 13

8 Respondent's chronology [17], RS [15] and throughout the argument in the Respondent's submissions. Agreement among the directors as an organ of the company upon adoption of a course of conduct by the company does not amount to a contract ("agreement") between the company and the directors.

7. It is not to the point that the company itself had not yet acquired enforceable rights against the defendants or in the land. It had sought to obtain such rights and it was the Appellant's duty not to put his own interests in conflict with those of the company. What is at issue in the present appeal is the relationship between the company and the Appellant, not that between the company and the defendants.

8. Nor is it to the point whether the Appellant had a "prescriptive" fiduciary duty to pursue the claim against the defendants for the benefit of the company. In the event he did so, and he recovered a sum of equitable compensation for the defendants' wrongdoing. That sum was as much a profit arising from the project as would have been any sum received if the project had proceeded as sought by the Appellant.[9]

9. The Appellant's fiduciary duties to the company in relation to the project bound him to account to the company for any benefit actually obtained. He derived the benefit not beneficially but as constructive trustee. It did not form part of his assessable income.

Matters arising from the Respondent's submissions

"Core principles"

10. The Respondent advances no submission in support of the Full Court's reliance on breach of duty as an essential element of the Appellant's fiduciary obligation to account, relying rather (and erroneously) on an absence of any fiduciary duty in relation to the golf course project after the asserted failure of "contingencies."[10]

11. Whether the fiduciary obligations of a director to his company extend to a "general or positive legal duty to act in the interests of the beneficiary"[11] does not arise in the present appeal; the Appellant did in fact act, in the interests of Disctronics, and did make a gain. What arises is whether he was bound to account to the company for the gain made.

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9 It was an award to place the plaintiff directors "in the position they would have been save for the breaches of fiduciary duty by Edmonds and Cahill," *Disctronics Ltd v Edmonds* [2002] VSC 454 at [216].

10 RS [54-5], [67-68]

11 RS [10]. *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1 suggests that the absence of such a duty on the part of a director is not "well established."

12. That "equity will only *intervene* to give a remedy where there is a breach"[12] is not in point. The Appellant accounted to Disctronics, which needed no remedy. What is in point is whether he had an obligation to account. In equity he did.

Factual matters

13. The Respondent's foundation contention that any interest on the part of Disctronics in making an investment was contingent on the defendants' assent to a sale to it at a price requiring "equity" of no more than $1.5m, and ceased to exist (so extinguishing the directors' fiduciary obligations in relation to the project) when the defendants demanded more, is unfounded on the evidence. Disctronics did not abandon the project, but rather sought to negotiate a lower price. As part of those negotiations Disctronics on 6 August put forward a proposal involving an equity of $750,000 and fees of $300,000 to the defendants.[13]

14. The submission that by 10 August "on the latest figures involving an independent third party participant, the equity contribution was in excess of $2.5m"[14] is ill founded. There was no such participant; the "figures" were part of a proposal by Edmonds on 3 August that the joint venturers themselves supply the equity, estimated at $760,000. The proposal included alternative hypothetical calculations contrasting what might be obtained if the golf course were to be sold for $10.4m.[15] That proposal elicited Disctronics' counter-proposal of 6 August.

15. Disctronics continued to pursue the possible investment in the golf course throughout August[16] and maintained its entitlement to acquire the course by lodgment of a caveat and by institution of the Supreme Court proceedings. The Appellant as a director remained bound to further its claim and to abdicate in its favour any personal right in relation to the project.

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12 RS [23]

13 Jessup J at [43]

14 RS [44]

15 Ex SJH-2 pp 6 and 7 of 10 (similar scenarios, one involving Disctronics contributing equity of $1.48m, had been prepared by Edmonds in early July, Jessup J at [18], and in mid July, Ex SHJ2 to Howard, 27 April 2011). The likelihood that a third party equity provider would "squeeze" the venturers to achieve a contribution lower than $2.5m had previously been suggested by Quinert (see Jessup J at [25]), and was again suggested by him after receiving the 3 August 1999 proposal: Ex SJH-3 to Howard, 27 May 2010.

16 Jessup J at [38-50]

The litigation agreement

16. The Respondent's arguments concerning the litigation agreement viewed as a confirmation of the constructive trust rest wholly on the premise that the Appellant ceased to have any obligation to Disctronics immediately upon the "contingency," that the defendants assented to its investment at a price requiring equity of no more than $1.5m, being "not satisfied." That premise is false, for the reasons given.

17. The parties are at issue as to the subject matter of the assignment. The contention that the litigation agreement "did not transfer control of the conduct of the Supreme Court proceedings to Disctronics" is wrong.[17]

Costs

18. The award to the Appellant was not income as a yield on investment, like rent or interest, nor a reward for services. It was income, if at all, as the profit of a profit-making venture. In reckoning such a profit, all costs must be taken into account.[18] If the Appellant had been beneficially entitled to retain the award, he would have been obliged to recoup Disctronics for the costs incurred by it for his benefit (that is, his proportionate share of the costs). His profit, even if the facts were to be construed such that he derived the profit before being obliged to remit it to the company, was no more than the excess of his gross receipts over the amount incurred to secure it.

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17 RS [86]. The agreement (set out by Jessup J at [52]) provided by clause 5 that the "directors will do all such things required by [Disctronics], or its solicitors, to diligently prosecute the proceedings and to provide all reasonable assistance to [Disctronics]".

18 *Bernard Elsey Pty Ltd v FC of T* (1969) 121 CLR 119