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Pharmacy Insights

Directors' Duties

Do you own a pharmacy through a corporate entity such as a proprietary company? Are there shareholders who hold a minority interest? As a majority shareholder and director, you need to be aware of your duties to the company in the conduct of your business.

Pharmacy businesses are often owned by individuals and partnerships, but increasingly we see clients utilising a corporate and/or trust structure as the owner of the business. It is important for pharmacists who hold interests in companies or trusts to be aware of their common law and statutory duties as directors, and the regulatory requirements regarding pharmacy ownership in the State or Territory where the pharmacy is located. Owning a pharmacy business through a company has some advantages: for example, it can enable more efficient succession planning as long-term pharmacy owners look to sell down their interest in the company over time to others. In many cases the incoming shareholder is a pharmacist or an employee pharmacist who has worked in the pharmacy and wants to take the next step of pharmacy ownership.

The *Corporations Act 2001*, the common law and the company's constitution impose a range of duties on directors of a company.

The key duties of directors that you should be aware of are:

- 2 to exercise their powers and discharge their duties in good faith in the best interests of the company;
- 3 to exercise their powers and discharge their duties in accordance with the purposes for which they were conferred;
- 4 to act with reasonable care and diligence;
- 5 to avoid conflicts of interest; and
- 6 not to improperly use company information for the director's own personal benefit or to the detriment of the company.

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Set out below are three scenarios that demonstrate the practical application of these director duties.

Scenario 1

Trinity owns a majority interest in a company (**PharmCo A**). PharmCo A owns a pharmacy (**pharmacy A**). A few years ago, Trinity sold 30% of the shares in PharmCo A to an employee pharmacist, Neo, as part of Trinity's succession plan. As a result, Trinity holds 70%, and Neo holds 30% of the shares in PharmCo A.

A pharmacy along the same street goes up for sale (**pharmacy B**) and Trinity, having reconsidered her succession plan, decides to purchase pharmacy B, but in her own name. Trinity does not mention this to Neo, and Neo, although aware of the fact that pharmacy B is for sale, does not think to approach Trinity about it – he has his hands full managing pharmacy A.

The opportunity presented by the sale of pharmacy B is, given its location, an opportunity that should have been made available to PharmCo A and both of its shareholders. Pharmacy B competes with pharmacy A and its acquisition by Trinity is likely to give rise to conflicts between her duties to PharmCo A and her personal interests. By acquiring pharmacy B without giving PharmCo A the opportunity to do so, Trinity has almost certainly breached her duties to PharmCo A.

Scenario 2

Having agreed to purchase pharmacy B, Trinity finds that PharmCo A is required to give a guarantee to the bank as support for the loan she needs for the purchase. This surprised her and meant that she had to open up to Neo about her purchase of pharmacy B. Neo is upset, but Trinity promises that over time she will consider offering Neo equity in pharmacy B as well. Trinity asks Neo to sign bank paperwork which involves him consenting to the guarantee by PharmCo A of Trinity's new loan. She tells Neo not to worry as she intends to put more of her own money into pharmacy B, at which time the bank will release PharmCo A from the guarantee (at the time Trinity has no idea of where the extra capital might come from).

There is no benefit to PharmCo A in giving a guarantee for Trinity's loan. Trinity's actions to procure a guarantee from PharmCo A are taken for her own benefit and are not in PharmCo A's interests. Trinity has breached her duties to act in PharmCo A's best interests. While Neo signed the bank paperwork, he was not fully informed about the risks to PharmCo A and was arguably misled.

Scenario 3

Trinity is excited about building her pharmacy empire. At the time of purchasing pharmacy B she sets up a new management company (**Management Co**) to provide management services to pharmacies A and B. Trinity is the sole owner of Management Co. Trinity persuades Neo that Management Co is well placed to secure great deals for PharmCo A, because it is providing management services to pharmacy B, and to other pharmacies owned by Trinity's parents. This will reduce Neo's administrative burden in running pharmacy A and allow him to focus on professional services. PharmCo A enters into a services agreement with Management Co.

Neo leaves these services arrangements to Trinity and doesn't really focus on the details. Many months later Neo sees some Management Co invoices directed to Trinity's parents and to Trinity for the management

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services provided to their pharmacies. He compares their invoices with PharmCo A's invoices from Management Co and is shocked to see that PharmCo A is being charged \$6,000 per month, three times the amount charged to the other pharmacies.

Neo confronts Trinity who says that Management Co is discounting its usual fee for her and her parents, and that the fee charged to PharmCo A is the market rate. Neo makes enquiries and discovers that Management Co's fees are more than double the market rate for comparable services.

Trinity has again preferred her own interests over those of PharmCo A. She has placed herself in a position where her duties to Management Co conflict with her duties to PharmCo A. She has failed to act in good faith in PharmCo A's best interests and is in breach of her duties to PharmCo A.

If you would like advice regarding mergers, acquisitions and business structures, whether you control a large corporate group, or are buying a pharmacy interest for the first time, or you are concerned about inappropriate corporate behaviour, please contact a member of Meridian's pharmacy team for advice.

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