

Lecture 7: Duty of Care & Diligence

Director's Duties – content

- The [Corporations Act 2001 \(Cth\)](#) contains a number of duties, known as “directors’ duties”, to be observed by certain persons when exercising their powers and discharging their duties for a company.
- Although called “directors’ duties”, they can, depending on the terms of the particular duty, apply to a:
 - Director ([s 9 – “director”](#))
 - Officer ([s 9 – “officer”](#))
 - Secretary ([s 204A–s 204F – “secretary of a company”](#))
 - Employee

Director's Duties – issues

- Accordingly, the following issues must be examined:
 - What are the sources of the duties?
 - Who owes the duties?
 - To whom are the duties owed?
 - What are the duties?
 - What are the consequences of breach?

Director's Duties – sources

General Law

- Fiduciary Duties ([s 185](#)), and
 - Those duties that are owed by a person when acting on another’s behalf. i.e. Fiduciary owes beneficiary duties.
- principles and rules (derived from case law) of ([s 9 – “general law”](#)):
 - Common Law, and
 - Equity

Statute

- restatement / modification of the General Law
- duties & obligations in addition to the General Law ([s 185](#))
- [s 179](#):
 - This [Part \(Part 2D.1\)](#) sets out some of the most significant duties of directors, secretaries, other officers and employees of corporations.
 - Other duties are imposed by other provisions of this Act and other laws (including the general law) e.g. [s588G](#) – duty to prevent insolvent trading.
- [s 185](#):
 - [ss 180 – 184](#) have effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation

Director's Duties – who owes them?

- General Law duties
 - Directors
- Statutory duties

- s 180 & s 181 – Directors / officers
- s 182 & s 183 – Directors / officers / employees
- s 588G – Directors
- s 9 – extended definitions:
 - Alternate director e.g. delegates
 - De facto director / officer i.e. not properly appointed
 - Shadow director / officer i.e. directors of the company are customarily taking into effect dictate of this particular person. Or could be shadow officer.

^officers includes directors, and employees (those who make substantial decisions etc in the company or financial decisions).

Director's Duties – categories

- Duties of care, skill and diligence
 - Exercise powers / discharge duties with reasonable care and diligence:
 - General Law
 - Statute: s 180(1)
 - Prevent insolvent trading
 - Statute: s 588G
- Duties of loyalty and good faith
 - Exercise powers / discharge duties in good faith in the best interests of the company
 - General Law
 - Statute: s 181(1)(a)
 - Exercise powers/discharge duties for a proper purpose
 - General Law
 - Statute: s 181(1)(b)
 - Avoid conflicts of interest (if they do must make beneficiary aware of this conflict) secret profits and misappropriation
 - General Law
 - Statute: s 182 & s 183
 - Statute: s 191 & s 208

Directors' Duties – care & diligence

General Law duty

- Tort of negligence and equitable duty of care – director in breach if:
 - director owes duty to exercise reasonable care
 - duty is breached
 - breach causes loss or damage to company, and
 - loss or damage not too remote for recovery (a question of causation)

Statute Law duty

- s 180(1) – director / officer must use care + diligence that a reasonable person would use if:
 - (a) Director / officer in corporation's circumstances, and
 - (b) occupied same office & same responsibilities
- Both forms of duty have the same substance: ASIC v Vines
- Generally, the duties are owed to the company and so cannot normally be enforced by:
 - creditors or employees: Spies v The Queen
 - holding company: Forty Two International Pty Ltd v Barnes
 - individual shareholders: Percival v Wright (absent any relationship between the directors and members that may give rise to fiduciary obligations to individual

members: [Brunninghausen v Glavanics](#) i.e. Director kept in the dark about the profitability of the company)

***Elements of the duty - [Bell Group Ltd v Westpac \(No 9\)](#)

- **Subjective element** – consider:
 - company’s circumstances
 - [Commonwealth Bank v Friedrich](#)
 - ✚ type of company
 - ✚ size and nature of enterprise
 - ✚ composition of board
 - ✚ distribution of responsibilities between board and other persons
 - person’s office
 - person’s position and responsibilities
 - chair: [ASIC v Rich](#)
 - ✚ Chair essentially tried to argue he was a figurehead and just organised BOD in meetings.
 - ✚ special responsibilities – general performance of the board and provision of information to the board
 - executive director / CEO / MD: [Daniels v Anderson](#)
 - ✚ full-time employees – more stringent standards of care and diligence than non-executive directors
 - non-executive director: [Daniels v Anderson \(AWA case\)](#)
 - ✚ part-time contractors – less stringent standards of care and diligence than executive directors
 - directors appointed because of special skill/experience:
 - ✚ must give company benefit of skills/experience: [Gold Ribbon \(Accountants\) Pty Ltd v Sheers](#)
 - They were specialists in loans and lending.
 - ✚ must pay attention to other aspects of business as well: [Daniels v Anderson](#)
 - state of mind of the directors as to whether they honestly considered the business judgment to be in the best interests of the company
- **Objective element** – consider:
 - Is the business judgment one that “reasonable directors” would have exercised in the best interests of the company?
 - if not, then the directors’ assertions about their subjective beliefs can be rejected

Minimum Standard – all directors must:

EXAMS – given that they are a director, what type of director are they? Why? This affects the standard of care.

- [Daniels v Anderson](#)
 - become familiar with company’s business
 - keep informed about business operations
 - be familiar with financial position
- [ASIC v Adler](#)
 - have opinion of company’s solvency e.g. when a large payment is to be made, will the payment put the company at risk of insolvency.
 - attend board meetings (unless exceptional circumstances)

Examples of breach of s 180 (1):

What's an example? Could be selling an asset at an unreasonable discount.

- Neglecting to observe management, discover the actual financial position of the company and failing to inform the board of developments that could adversely affect the company: [ASIC v Rich](#)
- Allowing the company to enter into transactions that produce no benefit to the company: [ASIC v Adler](#).
- Failing to supervise the accuracy of the financial accounts of the company: [Sheahan v Verco](#)
- Making unreasonable profit forecasts: [Vines v ASIC](#)
- Failing to be involved in the active supervision of the company's management: [Daniels v Anderson](#)
- Authorising and procuring the company to make false and misleading statements to the ASX: [ASIC v Citrofresh](#)
 - I.e. not just a breach of the Director's duties, also leads to a breach of the Corporations Act by the company.

Directors' Duties – care & diligence – defence

Why do we have these? We don't want BOD to be unduly inhibited in decision making out of fear of breaching [s180\(1\)](#).

EXAMS EXPLAIN ELEMENT BY ELEMENT (all of them i.e. even if the Court determines element 1 satisfied element 2 is applicable, etc.)!

- Business Judgment Rule – [s 180\(2\)](#)
 - Defence only to alleged breach of [s 180\(1\)](#) and equivalent General Law duties
 - Elements to be satisfied:
 - **Make judgment** in good faith for proper purpose
 - **No material personal interest**
 - **Informed about subject matter** to extent believe reasonably appropriate, and
 - Rationally believe judgment in **company's best interests**
- Business Judgment Rule – [s 180\(3\)](#):
 - In [s 180](#), "business judgment " means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation
 - "business judgment " includes:
 - decision making about the **ordinary business operations** of the company (e.g. undertake a particular kind of business activity promoted in a prospectus)
 - "business judgment " does not include:
 - decision making other than about the ordinary business operations of the company (e.g. compliance or non-compliance with prospectus regulations)
- Reliance on information / advice – [s 189](#):
 - director can be protected from [ss 180\(1\), 181, 182, 183](#) if:
 - relies on information / expert advice from
 - 🚧 reliable, competent employee
 - 🚧 professional adviser / expert on matter within expertise
 - 🚧 another director / officer on matter within their authority
 - 🚧 committee of directors on matter within its authority
 - provided that the reliance was:
 - 🚧 in good faith, and
 - 🚧 **after making independent assessment** (considering director's knowledge and complexity of matter)

- Responsibility for delegates – [s 190](#):
 - if directors delegate a power under [s 198D](#), then the directors are responsible for the exercise of power by the delegate as if the power had been exercised by the directors themselves: [s 190\(1\)](#)
 - a director avoids that responsibility if the director believed on reasonable grounds that the delegate would exercise the power in conformity with the duties imposed on directors by the Corporations Act 2001 (Cth) and the company's constitution (if any) in good faith, after making proper inquiry if necessary, and the delegate was reliable and competent in relation to the power delegated: [s 190\(2\)](#)