

# Topic eight: corporate governance and director's duties

## Duty of care, skill and diligence (s 180(1) OR CL)

### Step one: legal basis

- [Directors / officers] must exercise the degree of care, skill and diligence that a reasonable person would exercise if they were in that corporation's circumstances and held the same position and responsibilities (s 180(1)).
- NB: Same duties are owed in equity, CL and K (*Vines*)
- In CL, the duty is of care, SKILL and diligence. In *Vines*, the court said that the concept of 'skill' is imported into s 180(1) by virtue of its reference to the office and responsibilities of [directors / officers].
- There is no meaningful difference between the general law and statutory duties, so will consider them both together

### Step two: standard of care

- While a subjective standard of duty of care used to be used (*Marquise of Bute's Case; Re City Equitable Fire Insurance*), the courts now use an objective standard (s 180(1)). That is, directors cannot 'simply surrender their duties...by washing their hands' with management duties (*Kirby in Metal Manufacturers*).
- That is, court must consider if an objective reasonable person would [insert facts] in light of the 'context' (s 180(1))

### 'Reasonable person' - objective test (*Vines*)

Consider:

- The magnitude of risk of harm and probability of harm occurring
- Seriousness of loss and consequences if harm occurs
- Expense, difficulty and inconvenience of taking alleviating action

### 'Corporations circumstances' (s 180(1)(a)) – do once for all directors

Consider:

- Type of company (**higher standard for public companies**)
- Size and nature of its business (higher standard for larger)
- State of company finances/urgency (more urgent requires urgent response (*Rich*))
  - In *Rich*, court said that if there is a rapidly deteriorating financial situation, this may require directors give more urgent direction to the decision they are making. I.e. if business is declining, the level of care and diligence should INCREASE
- Industry the company is in
- Financial situation of the company
- Consider specific amount spent, is this likely to be a relatively large amount for the company to spend? Or does it often spend this amount?
- If company is deviating from its current business model, perhaps a greater standard should be adopted

### Office occupied / responsibilities held by the director (s 180(1)(b)) – apply to each individual director

Responsibilities held:

- *AWA* establishes financial competence and knowledge of the business as a base line in terms of skill for directors
  - *Gamble v Hoffman* confirms – essentially objective test
- All directors must meet a minimum set of responsibilities (*Anderson*)
- Be familiar with the company's business when they join the board (*AWA*)
- Guide and monitor management to satisfy themselves the co. is being properly run (*AWA*)

- Make inquiries and keep informed about all aspects of the co.'s business (*AWA*)
- Attend all board meetings (*Vrisakis*)
- Participate in board meetings (*AWA*)

Office occupied:

- Special skills:
  - A RP in D's position would exercise a degree of care that encompasses the [skills / qualifications / expertise] that D brings to his position (*AWA; Gold Ribbon*)
- Non-executive chair:
  - Higher standard than non-executive Ds (*AWA*) – chair has responsibility of running board meetings and selecting matters to be brought before the board.
- Executive directors:
  - Higher standard than non-executive directors (*AWA*) – greater knowledge of company's daily operations
- If D has more than one role, must meet responsibilities attaching to both
- CFO: higher standard, required to take proactive steps (*Hardie; Vines*)

*Daniels v Anderson* (1995) ACSR (*AWA*)

- *AWA* incurred losses through foreign exchange trading. Company sued its auditors, who alleged contributory negligence on the part of the company, and non-executive directors and the managing director.
- Rogers CJ at first instance, upheld by Clark and Sheller JJA majority judgement:
- Auditors and executive directors liable in negligence. Auditors had breached their duty, failed to inform *AWA*'s board of the company's lack of internal controls, deficiencies in books and records. MD was contributory negligence.
- Rogers CJ held that non-executive directors hadn't breached. Majority at appeal less clear in this distinction between executive directors and non-executive directors. Have to judge each situation case by case.

*ASIC v Rich* – investigated the distribution of responsibilities

- 'Responsibilities' isn't just what is in the constitution or through resolutions allocated to an individual, but a wider concept – includes responsibilities acquired through the way aowkr is distributed throughout the corp and the expectations placed by those arrangements on individual directors
- NOTE that Austin J was (and again in *ASIC v Vines*) happy to admit non-legal practice material

*ASIC v Vines*

- Admitted expert evidence of the usual responsibilities of a CFO

Diligence

- Austin J summarised the meaning of diligence in *ASIC v Rich*
  - 1. To become familiar with the fundamentals of the business of the company
  - 2. To keep informed about the company's activities
  - 3. To monitor, generally, the company's affairs
  - 4. To maintain familiarity with the financial status of the company by appropriate means (including review of statements, and further inquiries if necessary)
  - 5. Director (and some officers) – to have a reasonably informed opinion of the company's financial capacity

**Step three: has there been a breach of duty?**

- By [act], when [D] knew or ought to have known [facts] (*Centro*), there is a prima facie breach given [director/officer] did not exercise the degree of care of a reasonable director / officer

**Step four: defences – apply to individual directors**

Reliance on information provided by others (s 189)

D may argue that he relied on the advice of a competent [employee, professional, another director or officer, or a committee of directors] in good faith, after making an independent assessment of the information or advice (s 189)

- Must take all reasonable steps (*Centro*)
- Cannot be a 'blind trust' (*AWA*)
- Must look at information with a critical eye (*AWA*)
- Person alleging unreasonable reliance has burden of proof (i.e. ASIC)
  - I.e. there is a reputable presumption
- Consider: if the [director] that they are purporting to rely on has authority in [relevant area]. If so, may be more reasonable for [other director] to rely on [him / her]

#### Delegation of power (ss 198D + 190)

- Constitutions generally allow the Board to delegate to a MD (s198C RR)
- [Director] may argue that [he / she] delegated his power to another person (s 198D).
- Directors are prima facie responsible for the delegate's exercise of power (s 190(1)).
- However, [director] will not be responsible for the delegate's exercise of power if (s 190(2)):
  - D reasonably believed that the delegate would exercise the power per statutory duties/constitution; AND
  - D reasonably believed, in good faith, after making proper enquiry, that the delegate was reliable and competent to do what he was delegated.
- Reasonableness of the delegation may be considered (*ASIC v Adler*, per Santow J) For example:
  - The extent to which D is put on inquiry (*Property Force*)
  - Knowledge that the delegate is dishonest (*Biala*)
  - The risk involved in the transaction and nature of the transaction (*Wheeler*)
  - The extent of steps taken by D (e.g. inquiries made)
- Certain responsibilities cannot be reasonably delegated
  - Making decisions that Ds must make under the Act (*Centro* – signing off that accounts give a true and fair indication of the co.'s financial position is a statutory obligation of directors)
- Making decisions that the Board has been asked by management to make (*Hardie*)

#### *ASIC v Healey* [2011] FCA 717 (the *Centro* case)

- Mistakes in financial reporting eventuated from reliance on the management and external auditors.
- Justice Middleton: directors have a non-delegable responsibility for the financial report and the directors report. Although directors can rely on management, this reliance cannot be a substitute for their own non-delegable responsibilities

#### *ASIC v Hellicar & Ors* [2012] HCA 17 (the *Hardie* case)

- Boards cannot delegate their responsibility to make decisions that management asked them to make

#### Business judgment rule (s 180(3))

##### 1. Has a business judgment been made?

- If D has made a positive / conscious decision in a matter relevant to the company's business, it can be argued that a business judgment has been made (s 180(3))
  - This defence applies to the statutory duty and its general law equivalent, so will consider them together
- D has the onus of proof to show that a business judgement has been made (*Fortescue Metals*)
- Matters relevant to the company's business include:
  - Planning, budgeting and forecasting (*Rich*)
  - Apportionment of responsibilities between board and management (*Rich*)
  - Setting of policy goals (*Rich*)
  - Litigating, or settling litigation (*Rich*)
- Matters NOT relevant to the company's business include:
  - Decisions related to compliance/non-compliance with *Corporations Act*
  - The general monitoring of the co.'s affairs and monitoring its solvency (*Rich*)

2. Satisfy section 180(2) requirements (must meet ALL requirements, but only briefly mention the ones that are obviously satisfied)

- a) D must make the judgment in good faith and for a proper purpose; and
- b) D must not have a material personal interest in the subject matter of the judgment; and
- c) D must inform himself about the subject matter of the judgment to the extent that he reasonably believes it to be appropriate; and
  - This overlaps with the reliance defence, can refer above if have gone through this
- d) D must rationally believe the judgment is in the best interests of the corporation
  - The belief is a rational one unless the belief is one that no reasonable person in their position would hold (s 180(2))