

Directors duty to exercise care and diligence

I. Breach of duty to exercise care and diligence

1. Fiduciary duties

Fiduciary duties are only applied to directors under common law. XXX is/is not the director of the corporation. So fiduciary duties can/cannot be applied.

In order to determine whether the fiduciary duty is breached, a test should be performed:

(a) Director owns duty to exercise reasonable care

XXX owns duty to XXX...

(b) Duty is breached

On the facts, how the duty is breached...

(c) The breach caused loss or damage to the corporation;

The loss or damage indicated in the facts...

(d) Loss or damage is not too remote for recovery.

(but for test) if there is no such a breach, the XXX would not have happened...

Apparently, XXX breaches fiduciary duty to exercise care under common law.

2. Statutory duties: s 180(1)

Under s 180(1), a director (or other officer) of a corporation must exercise their powers and discharge their duties with the degree of **care and diligence** that a reasonable person would exercise if they:

(a) Were a director or officer of a corporation in the corporation's circumstances; and

(b) Occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

On the facts, it appears that an issue of breach by XXX of the duty to exercise care and diligence under s 180(1) arises due to:

- XXX were a director or officer of the corporation
- XXX occupied the office and had the responsibilities as the director or officer
- XXX had the duties to XXX but failed to exercise it, which a reasonable person would have exercised if he were in the same position as XXX.

2.1 Elements of duties

Directors' duty to exercise care and diligence is assessed through both subjective and objective elements. [Bell Group Ltd v Westpac (No 9)] In terms of subjective elements, company's circumstance, person's office, person's responsibility and state of mind of the director are taken into account. In terms of objective elements, the duty is tested on whether a reasonable person with the knowledge and experience of the defendant would have exercised the business judgment in the

best interests of the company in the same way as XXX did. *[ASIC v Adler]* By considering all the facts relevant to the issue, it could be concluded that **XXX had the duty to XXX** on the facts including: (listing facts that in favour of the duties)

- The company is XXX company. it has the duty to XXX [*Commonwealth Bank of Australia v Friedrich*]
- XXX was the director and had the responsibilities and office as a director.
- XXX believed that by doing XXX, it would increase the value of the company and was in the best interests of the company.
- Any reasonable persons with the same knowledge and experience would not have done so as a director.

It could also be reflected in cases regarding people in the same position. (refer to minimum duty, example of breach in different positions to find similar cases)

In conclusion, as XXX, the director, failed to XXX, he is in breach of the duty to exercise care and diligence.

2.2 Business judgment: s 180(2)

Defence under business judgment is only applied to decisions relevant to ordinary business operations. *[s 180(3)]* XXX's decision is about XXX, which is within/without the scope of ordinary business operations.

Such breach may be defended by business judgment under *s 180(2)* if

- (a) He made the judgment in good faith for proper purposes

On the facts, XXX

- (b) He did not have a material personal interest involved [*ASIC v Adler*]

On the facts, XXX

- (c) He informed themselves about the subject matter properly

On the facts, XXX

- (d) He rationally believes that the judgment is in the best interests of the corporation.

On the facts, XXX

Apparently, based on the facts indicated in the scenario, he could defend himself with business judgment under s 180(2).

2.3 Reliance on information or advice: s 189 – director only

S 189 reduces the liability of directors in relation to failure to exercise directors' duties when they reasonably relied on the information or advice prepared by others, if:

- (a) The information relied on was prepared by (i) a reliable and competent employee; (ii) a professional advisor or expert; (iii) another director or office within his authority; or (iv) a committee of director within the committee's authority.

On the facts, the information XXX relied on is prepared by XXX.

(b) The reliance is in good faith.

On the facts, XXX's reliance on the information could be assumed to be in good faith as XXX;

(c) The information or advice is assessed independently afterwards

On the facts, XXX reassessed the information by XXX.

(d) The reliance is reasonable.

On the facts, XXX is the director and XXX is the XXX. It is reasonable to rely on XXX's information as it is within the normal course of business operations and industrial practices.

In addition, XXX had sufficient monitoring systems in place to be aware of possible internal irregularities [Daniels v Anderson]

To sum up, it could be concluded that the reliance on information by XXX is reasonable.

2.4 Relief from liability for breach of s 588G(2): s 1317S

Relief from liability arising from the contravention of civil penalty provision may be granted if:

(a) The person has acted honestly

Acting honestly is defined in [Hall v Poolman]... on the facts, XXX has acted honestly....

(b) He ought to be excused fairly for the contravention

II. Consequences and remedies

1. Fiduciary remedies

under general law, only the company can seek remedies against directors [*Tavistock Holdings Pty Ltd v Saulsman*] and persons who knowingly participate in the breach [*Green v Bestobell Industries Pty Ltd*].

Remedies:

(a) **Damage for compensation** [*Daniels v Anderson*]

(b) Account of profit [*Regal (Hastings) Ltd v Gulliver*]

(c) Rescission of contract [*Transvaal Lands Co v New Belgium*]

(d) Injunction [*Parke v Daily News Ltd*]

(e) Return of property through a trust [*Cook v Deeks*]

2. Statutory consequences

Civil penalty provisions are available for ASIC against the directors who breached the duty.

As s 180(1) is civil penalty provision under s 1317E, the court will make a declaration of contravention under s 1317E(1) and the followings may be applied:

(a) **A pecuniary penalty order up to \$200,000 under s 1317G**

(b) **Disqualification from management under s 206C**

For a period that the court considers appropriate.

(c) **A compensation order under s 1317H**

A compensation order could be applied by ASIC or the company or the liquidator. Including the loss suffered and the profit that would have earned (s 1317H(2))

III. SDA: s 236(1)

SDA applies to company which is still solvent [*Smart Company Pty Ltd (liq) v Clipsal Australi Pty Ltd*]

Under s 236(1), a person may bring proceedings on behalf of a company, or intervene in any proceedings to which the company is a party for the purpose of taking responsibility on behalf of the company for those proceedings, or for a particular step in those proceedings, if:

- (a) The person is:
 - (i) A member, former member, or person entitled to be registered as a member; or
 - (ii) An officer or former officer of the company; and
- (b) The person is acting with leave granted under s 237.

Member

On the facts, XXX is the member of the company.

1. Leave under s 237

Under s 237(2), the court must grant the application if it is satisfied that

- (a) It is probable that the company will not itself bring the proceedings, or properly take responsible for them, or for the steps in them; and

On the facts,e.g. director's breach of duty [*Swansson v R A Pratt Properties Pty Ltd*]

- (b) The applicant is acting in good faith; and

on the facts,.....

- The applicant has a good cause of action (e.g. to reduce the loss of the company) [*Swansson v R A Pratt Properties Pty Ltd*]
- The applicant has a reasonable prospect of success
- There is no abuse of the process [*Swansson v R A Pratt Properties Pty Ltd*]

- (c) It is in the best interests of the company that the applicant be granted leave;

On the facts, ...

- Avoid s 237(3)

- (d) If the applicant is applying for leave to bring proceedings, there is a serious question to be tried; and

On the facts, the question brought to the proceedings is XXX...

- (e) At least 14 days written notice to the company unless otherwise appropriate

Apparently, the facts satisfy the requirements for the leave under s 237 and can get leave from the court to bring proceedings on behalf of the company.

2. Ratifications

Under s 239, ratifications do not prevent SDA and have effect on court’s decision. It may be considered for reference with regard to how well-informed members are when approving and whether members are for proper purposes.

3. Cost

Under s 242, an order regarding the cost of the parties to the proceedings may be made.

4. Remedies

The company may grant compensation under the circumstance

5. Results: s 241(1)

- (a) Interim order
- (b) Directions about the conduct of the proceedings
- (c) An order directing the company to do or not to do
- (d) An order appointing an independent person to investigate and report to the court on
 - Financial affairs
 - The cause of the action
 - Cost incurred in the proceedings

Duty of care and diligence

General law duty	<ul style="list-style-type: none"> - Scope: only directors - Test: <ul style="list-style-type: none"> a) Director owns duty to exercise reasonable care; b) Duty is breached; c) Breach causes loss or damage to the company; d) Loss or damage is not too remote for recovery (but-for test) - Conclusion: Tort of negligence
Statutory law duty s 180(1)	<ul style="list-style-type: none"> - Scope: directors + officers - Elements of duties [case] Bell Group Ltd v Westpac (No 9) <ul style="list-style-type: none"> a) Subjective elements <ul style="list-style-type: none"> ✓ Company’s circumstance: Indicators: [case] Commonwealth Bank of Australia v Friedrich (1991) ✓ Person’s office ✓ Person’s responsibility ✓ State of mind of the director b) Objective elements: Is a reasonable person with the knowledge and experience of the defendant would have exercised the business judgment in the best interest of the company? [case] ASIC v Adler (2002)

- Minimum duty:
 - a) Be familiar with company's business [case] Daniels v Anderson
 - b) Make inquiry and keep informed about all aspects of business operations [case] Daniels v Anderson
 - c) Be familiar with company's financial position [case] Daniels v Anderson
Be able to read, understand and avoid material omission [case] ASIC v Healey (2011)
Verify the accuracy of the financial position. [case] Sheahan v Verco
 - d) Duty to safeguard company's interest
Will not enter into transactions that produced no benefits to the company. [case] ASIC v Adler
Will not allow a customer to exceed the credit limits from normal practice [case] Circle Petroleum (Qld) Pty Ltd v Greenslade (1998)
Make inquiry into unusual transactions that were capable of causing harm to the company. [case] Permanent Building Society v Wheeler (1994)
 - e) Have opinion of company's solvency [case] ASIC v Adler
 - f) Attend board meetings unless exceptional circumstances [case] Vrisakis v ASC (1993)

- Examples of breach

[case] ASIC v Citrofresh (MD)

-making false and misleading statements to the ASX

Chair of board

- a) Primary responsibility of selecting matter and documents to be brought to the board [case] AWA Ltd v Daniels (1992)
- b) Performance of the board: organize board meeting [case] ASIC v Rich (2009)
- c) Flow financial information to the board and inform the board about the risk of solvency [case] ASIC v Rich (2009)
- d) Establishment and maintenance of systems for information flow to the board [case] ASIC v Rich (2009)

Executive directors

- a) More stringent standards [case] Daniels v Anderson
- b) MD/CEO: Ensure appropriate management systems in place and they are functioning properly [case] SA v Clark (1998)
- c) MD: ensure the carrying out of usual due diligence inquiries [case] SA v Clark (1998)
- d) MD: ensure the obtaining of an independent valuation regarding a purchase [case] SA v Clark (1998)
- e) MD: monitor management effectively, e.g. making inquiries if necessary [case] Daniels v Anderson

<p>Non-executive directors</p>	<p>a) Less stringent standards [case] Daniels v Anderson b) Be familiar with company's business [case] Daniels v Anderson c) Making inquiry and keep informed about all aspects of business operations [case] Daniels v Anderson d) Be familiar with company's financial position [case] Daniels v Anderson e) Will not ignore the commercial risks and shut eyes to misconduct [case] Daniels v Anderson f) Directors with special backgrounds must give the benefit of background [case] Gold Ribbon (Accountants) Pty Ltd v Sheers and pay attention to other aspects [case] Daniels v Anderson</p>
<p>CFO</p>	<p>a) Prepare financial statements and profit forecasts [case] Vines v ASIC b) Be proactive in supervisory and operational roles [case] Vines v ASIC c) Verify advice for profit forecasts [case] Vines v ASIC</p>
<p>Secretary</p>	<p>a) Statutory responsibility under s 188(1) e.g. lodging continuous disclosure announcement with the ASX for a listed company [case] Morley v ASIC (2009) e.g. ensuring the accuracy of announcements for a listed company [case] Morley v ASIC (2009) b) Additional responsibility</p>
<p>Officers</p>	<p>Officers below board level who are appointed for backgrounds are responsible to exercise that degree of skill that a reasonable person would exercise [case] Shafron v ASIC (2912)</p>
<p>People with 1 more positions</p>	<p>Regarding people with more than one positions, the responsibilities include <u>whatever responsibilities he had</u> within the company, regardless of how or why those responsibilities came to be imposed on him. [case] Shafron v ASIC (2012)</p>
<p>Business judgment S 180(2)</p>	<ul style="list-style-type: none"> - Scope: apply to the breach of s 180(1) and the equivalent common law - Business judgment: defined in s 180(3) <p>Including: decision about ordinary business operation e.g. undertake business activities; matters relevant to business operation e.g. planning, budgeting, forecasting [case] ASIC v Rich (2009)</p> <p>Excluding: decisions other than about the ordinary business operation e.g. compliance with regulation or not; where a director or officer neglects to make a business judgment; [case] ASIC v Adler (2002) where he makes judgment not in good faith for property purpose [case] ASIC v Adler (2002); where he fails to monitor the company affairs and maintain familiarity with financial positions; where the decision takes no interest from [case] Gold Ribbon (Accountants) Pty Ltd v Sheers</p> <ul style="list-style-type: none"> - Test of s 180(2):

	<p>make the judgment in good faith for property purposes</p> <p>do not have a material personal interest [case] ASIC v Adler (2002)</p> <p>inform themselves about the subject matter</p> <p>rationally believe that the judgment is in the best interests of the corporation</p>
<p>Reliance on information / advice</p> <p>S 189</p>	<p>Test of s 189:</p> <ul style="list-style-type: none"> ● The information is prepared by 4 categories of people <ol style="list-style-type: none"> (i) a reliable and competent employee in relation to the matter; or (ii) a professional advisor or expert in relation to the matter within the person's professional or expert competence; or (iii) another director or officer in relation to matters within his authority; or (iv) a committee of directors in relation to matters within the committee's authority ● the reliance is in good faith ● the information or advice is assessed independently afterwards ● the reliance is reasonable <p>Reliance would be reasonable only where the officer had sufficient monitoring systems in place to be aware of possible internal irregularities. [case] Daniels v Anderson</p>
<p>Delegates</p> <p>S 190(1)</p>	<ul style="list-style-type: none"> - A director is responsible for the exercise of the power by the delegates. S 190(1) - Defense on delegation s 190(2) <p>Test of s 190(2):</p> <ul style="list-style-type: none"> ● the director believed on reasonable grounds that the delegate would exercise the duties all the time; ● the director believed on reasonable grounds in good faith ● the director made inquiry if necessary ● the delegate was reliable and competent in relation to matters <p>[case] Sheahan v Verco (2001)</p> <p>It is never accepted to blindly delegate responsibility</p>
<p>Consequence</p>	<p>common law: damage</p> <p>s 180(1): civil penalty provision under s 1317E – a pecuniary penalty order up to \$200,000 under s 1317G, compensation to the corporation for damage under s 1317H, be disqualified from management under s 206C</p> <p>s 180(1): not a criminal offence.</p>