

# 70417 Corporate Law Notes

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# **Appendix: Exam Scaffold**

## **Directors' Duties - Structure**

- 1. Is X a director?**
- 2. Has X breached or will X breach a duty?**
- 3. Does X have a defence?**

# Q1: Is X a Director?

The first question that must be decided with regard to any liability on the part of (**insert name**) is whether he could be considered as a director or officer of (**insert corporation's name**), which could imply a fiduciary or statutory duty upon him. Whether (**insert name**) is a director, will be determined by the statutory definitions (*s9 Corporations Act*).

**"director "** of a company or other body means:

(a) a person who:

(i) **is appointed to the position of a director; or**

**(ii) is appointed to the position of an alternate director and is acting in that capacity;**

regardless of the name that is given to their position; and

(b) unless the contrary intention appears, a person who is not validly appointed as a director if:

(i) they act in the position of a director; or

(ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.

**"officer "** of a corporation means:

(a) a director or secretary of the corporation; or

(b) a person:

(i) **who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or**

**(ii) who has the capacity to affect significantly the corporation's financial standing; or**

**(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation); or**

(c) a receiver, or receiver and manager, of the property of the corporation;

or

(d) an administrator of the corporation; or

(e) an administrator of a deed of company arrangement executed by the corporation; or

(f) a liquidator of the corporation; or

(g) a trustee or other person administering a compromise or arrangement made between the corporation and someone else.

**\*Note the ones highlighted are crucial when applying it to the facts\***

## Q2: Has X breached a duty?

Directors owe duties under:

- **Contract (actual and/or statutory contract): s 140** – a company’s constitution has effect as a contract between the company and each member, the company and each director/secretary & between members);
- **Equity: directors’ fiduciary duties** –
  - No conflict;
  - No profit;
  - To act in good faith in the interests of the company;
  - To use powers for a proper purpose;
  - Undivided loyalty
  - Duty of confidentiality
- **Common Law**
- **Statute:**
  - **s180 – duty of care and diligence;**
  - **s181 – good faith;**
  - **s182 – improper use of position;**
  - **s183 – use of inside information;**
  - **s184 – criminal offence** for breach of duties under ss 181-183

## Duties of Care, Skill and Diligence

### Duty to Act with Reasonable Care and Diligence [s180(1) CA] (Only applies to Directors and Officers)

It appears that **X** may have failed to act with care, skill and diligence by **(insert reason)** and may possibly be in breach of both the general law and statutory duty in **s 180(1)**. The general law duty is worded slightly different from the statute, however, the standards of care are equivalent and hence they will be considered together.

Directors are under a duty of care to exercise a reasonable degree of care and diligence, imposed by **s180(1)**, the common law and equity. “This means conduct ordinarily measured by reference to what the reasonable man of ordinary prudence would do in the circumstances”: **Daniels v Anderson**. Directors must comply with a ‘core, irreducible requirement of skill; involving objective tests of ‘ordinary competence’ or ‘reasonable ability’: **DCT v Clark**.

#### The Test and Elements

It must first be analysed whether or not **X** had breached a standard duty of care, as set out in **Daniels v Anderson**. Being of a high level of influence as the **(insert role in the company)**, **X** is under a significant burden to point out steps that could be taken to reduce the possibility of a conflict of interest (**Permanent Building Society**). In the present case, **(apply to facts and give reasons i.e. did he/she cause detriment to the company?)** As such, **X** has

## Q3: Can X establish a defence?

The defences discussed in class are:

1. Reliance on others: **s189**
2. Delegation of authority: **s190**
3. Business judgment rule: **s180(2)** & Common Law
4. Ratification
5. Acted honestly and ought to be excused **s1318**

I will show you how to structure each defence into a problem-style response for the exam

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### Reliance On Information Or Advice Provided By Others - S 189

**THIS DEFENCE IS USED WHEN:** directors relied upon reliable and competent person who provided faulty/incorrect info.

The directors may seek to raise the defence of reliance on information by others (**s189**) as they have relied on (**insert the facts**) to provide them with information which they didn't have the relevant expertise.

The advice was prepared by: (**s189**)

If:

- (a) a director relies on information, or professional or expert advice, given or prepared by:
- (i) an **employee** whom the **director believes on reasonable grounds** to be **reliable and competent** in relation to the matters concerned; or
  - (ii) a **professional adviser or expert** in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or
  - (iii) **another director or officer** in relation to matters **within the director's or officer's authority**; or
  - (iv) a **committee of directors** on which the director did not serve in relation to matters **within the committee's authority**; and

If the defence does not work you say....

However it was not relied to after making an independent assessment (189bii) of the advice. Therefore this defence falls here.

- If director relies on information, it **cannot be blind reliance**. If there is something that raises suspicions from this information, the director must make appropriate enquiries. (*Daniels v Anderson*)

### Delegation Of Authority – s190

Applies to the proper **statutory duties**.

Under the replaceable rule, **s198D**, directors have **the authority to delegate** their functions to other people (including a single director, committee of directors, employee or any other person), subject to contrary provisions in the company's constitution.

The directors may seek to raise the defence of delegation of authority (**s190**) as they believed on reasonable grounds that **(insert delegate's name)** would **exercise the power in conformity with the duties imposed on directors** of the company by this Act and the company's constitution (**s190(2)(a)**). The directors believed **on reasonable grounds, in good faith; and after making proper inquiry** if the circumstances indicated the need for inquiry; that the **delegate was reliable and competent in relation to the power delegated** (**s190(2)(b)**)

Accordingly, if the delegate acts fraudulently, negligently or outside the scope of the delegation, then the director is not liable.



# Topic 8 - Directors' and Officers' Duties: Duty of Care, Skill & Diligence, and Insolvent Trading

## 8.1 Overview

- Duties of good faith and to avoid conflicts of interest are directed at misuse of power and position.
- The duty of care is directed at a failure to work at a sufficient standard as expected by the community and judged by the standard of a reasonable person in the same position.
- A negligent officer often shirks responsibility in order to obtain private benefits: *Adler* case (*Re HIH Insurance Ltd (in liq)*; *ASIC v Adler* [2002] NSWSC 171; (2002) 41 ACSR 72)
- Directors and officers are NOT liable for mere mistakes: *ASIC v Rich* [2009] NSWSC 1229; (2009) 75 ACSR 1

## 8.2 Theoretical Perspectives

Economic perspectives view the duty of care as an important default rule that protects investors from 'shirking' behaviour by corporate managers.

- The need for the duty of care is based on the assumption that managers will seek to avoid work, perform at a sub-optimal standard and appropriate gains for themselves rather than work to benefit shareholders.
- Eco perspectives argue that a legal duty of care facilitates the use of a company as a nexus of bilateral contracting between capital providers and the managers of that capital
- Advocates the duty as being full contractible

The 'team production' model of corporate law (TPM), a variant on the contractarian economic perspective places importance on the duty of care in helping protect against shirking in a manner that may lead to capital providers withdrawing their capital from the company.

- Primarily concerned with how directors mediate disputes between capital providers and managers of that capital that arises regarding how the gains from the use of capital are to be distributed amongst participants including shareholders, creditors and employees.

Communitarian perspectives argue the duty of care should be used to promote the interests of stakeholders (not just shareholders).

- Focus is on the duty of care as being to cause directors to consider and balance the varying interests of stakeholders in the company
- They argue that eco perspectives are too narrow, and exclude important stakeholders through their focus on voluntary economic contracting
- Argue that non-shareholder interests should be equally valued

Feminist perspectives take a broader focus on the role and utility of the duty of care, by disputing the individual, rights-based concepts underpinning economic and communitarian discussions regarding the duty of care.

- Focusses more on family relationships impacting the corporation
- Duty of care is not relevant and is asking the wrong question

## 8.3 Sources of the Duty of Care

The duty of care can arise from several different sources:

- Common law
  - Based on the law of tort, and imposes a duty to act as a reasonable person would act in response to the foreseeable risks faced by the company
- Equity
  - Duty of care, skill and diligence - derived from the roles of directors and managers in the company
  - Equitable duty is not fiduciary in nature: *Permanent Building Society (in liq) v Wheeler*
- CA
  - Statutory duty of care arises under s180(1)

(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.

Note: This subsection is a civil penalty provision (see section 1317E).

## 8.4 The AWA Litigation

This concerned 2 major cases:

- *AWA v Daniels* (1992) 7 ACSR 759 (AWA trial decision)
- *Daniels v Anderson* (1995) 37 NSWLR

FACTS:

- These cases involved claims by AWA against its auditors for alleged negligence in failing to identify internal accounting deficiencies and trading irregularities by a foreign exchange trader (Koval), employed by AWA in order to hedge against currency fluctuations.
- AWA's managing director and CEO (Hooke) had relevant information which he did not pass on to the company's auditors or to the board
- Believed his subordinates were responsible for putting appropriate monitoring mechanisms in place to protect the company from reckless trading, despite the fact AWA's banks and foreign exchange trading partners raised concerns about its trading activities with Hooke
- The directors all agreed they knew little about the foreign exchange trading markets
- The auditors did not disclose relevant information to the board because he assumed Hooke and his subordinates would have already done so
- Deloitte claimed this was the responsibility of the company, while the AWA directors claimed the external auditor had a responsibility to alert the company to internal reporting weakness.

HELD:

- The court found that while AWA had primary responsibility for its own reporting and accounting procedures, Deloitte also had responsibility to warn the board if company management were known to maintain deficient internal accounting systems
- Rogers CJ:
  - The auditors and executive directors liable in negligence

- “It is of the essence of the responsibilities of directors that they take reasonable steps to place themselves in a position to guide and monitor the management of the company”
- Non-exec directors were NOT negligent, as they could properly rely on the advice given by the company’s internal auditors without breaching their duty
- Their Honours: “the responsibilities of directors require that they take reasonable steps to place themselves in a position to guide and monitor the management of the company”
- Directors can and should closely monitor the day-to-day running of the company
- “It would be unreasonable to expect every director to have equal knowledge and experience of every aspect of the company’s activities”

## 8.5 Establishing Liability

### The Test

The test used to assess whether the duty of care has been complied with is, what **a reasonable person would have done in similar circumstances**.

In *Vrisakis v ASC* (1993) 11 ACSR 162 at 212, Ipp J explained how the duty of care is assessed:

*The question whether a director has exercised a reasonable degree of care and diligence by **balancing the foreseeable risk of harm against the potential benefits that could only be reasonably have been expected to accrue to the company from the conduct in question.***

In the important decision in *ASIC v Rich* [2009] NSWSC 1229; (2009) 75 ACSR 1, Austin J held that the reference in s180(1)(a) to the company’s ‘circumstances’ require an assessment of:

- The type of company (inc whether or not it is listed on a licensed financial market)
- The size and nature of its business;
- The terms of its constitution;
- The composition of the board;
- The distribution of work and responsibility between executives and the board members;
- and
- Whether or not the company is controlled by a parent company

