

Act with **due care and diligence/skill** (CL tort of negligence, equitable duty of care and s 180(1)(a)-(b))

Test

- A director/officer must exercise their power and discharge their duties with the degree of care and diligence that *a reasonable person* would exercise if they (a) were a director/officer of a corporation in the corporation's circumstances (type, size, nature of business) and (b) held the same responsibilities (the person's actual role and functions: *ASIC v Rich*) (s 180(1))
- *Daniels v Anderson* makes clear that the law imposes minimum standards of care and diligence on directors. All directors, whether exec or non-exec, must take reasonable steps to place themselves in a position to guide and monitor the management of a company

This is an objective 'reasonable person' standard

- Duty is not limited by director's subjective knowledge, experience, ignorance or inaction: *Daniels v Anderson*

If there is a risk of harm, then tort law applies: *ASIC v Vines*

- The reasonable person and standard of care is determined by considering:
 - The magnitude of the risk of harm and possibility of it occurring
 - The seriousness of the loss that would result if the harm occurs; and
 - The expense, difficulty and inconvenience of taking alleviating action

BUT... Standard of care may raise for some directors: *ASIC v Rich*

- **Executive directors and officers (CFO: *Morley* and Managing Directors: *MacDonald*)**
 - Functions
 - Involved in the management of the company and day-to-day activities
 - **May delegate** but still responsible for overall control: *South Australia v Clark*
 - **Managing directors (CEO)**
 - Must ensure co has appropriate management systems in place and that they are functioning properly: *South Australia v Clark*
 - **CFOs**
 - Responsible for preparation of company's financial statements and forecasts. Must obtain and inquire about information if reasonable in the circumstances on questions relating to finances: *Vines v ASIC*
 - **Company secretary**
 - Comes under "officer" definition.
 - Duties are listed under s 188(1). Responsible for lodging company's disclosure announcements with the ASX and accuracy of those documents: *Morley v ASIC*
 - Board may also give secretary additional responsibilities i.e. complete positions as a chief legal officer, chief HR officer. These must not be separated from their duties as a secretary.

- Standard of care is higher than non-execs because they have a position on the board and are employees of the company: *ASIC v Rich*
- If appointed due to a particular **skill**, an objective higher standards/levels of skill applies and must exercise that skill: *Vines v ASIC; Gold Ribbon (Accountants)*
- Report to the board, the board will then review these reports
- Good faith duty in relation to decision-making **and** how those decisions are carried out

- **Non-executive directors**

- Duties are of an intermittent nature to be performed at periodic board meetings and at meetings or any committee of the board to which the director has been appointed: *AWA v Daniels*
 - Gets a lot of paperwork to review and report during the meeting
 - Good faith duty in relation to decision-making
 - Participates in meetings to oversee/inform activities of management
- Do not expect to be informed of the minute details of how the company is managed or daily management, but expected to be informed of anything untoward or anything appropriate for consideration by the board
- May take into consideration changing community attitudes and expectations
- No minimum qualifications but law imposes minimum standards of care and diligence, especially relating to listed companies (see “minimum standards” below)
- If appointed for a skill, then must exercise that skill: *Gold Ribbons v Sheers*

- **Chair**

- Standard of care
 - Chair, especially of a listed company, has special responsibilities and is subject to a higher standard of care and diligence than that applicable to non-executive directors.
- Functions (*ASIC v Rich*):
 - Generally not directly involved in company business
 - Appointed by directors to chair meetings.
 - *Colorado Constructions Pty Ltd v Platus 1966*
 - Two directors left a meeting after a brawl and the remaining directors purported to pass a resolution. This was challenged and the Court said that was invalid as no chair had been appointed.
 - In charge of governance of professional operation of board – higher duty for **functioning** of the board (*ASIC v Rich*) to ensure it is functioning properly which requires a lot of administration

- **Non-executive chair:** *ASIC v Rich*
 - Standard of care
 - Conduct of non-exec Chair is different level/standard to ordinary non-executive directors – goes beyond matters entrusted by constitution or board to Chair: *ASIC v Rich*
 - Functions
 - Not merely ceremonial or procedural duties. Has primary responsibility for:
 - Selecting matters for discussion by board
 - Bringing documents to board
 - Formulating board policy
- **Individual director**
 - Can only do as much allowed by the constitution and the company's internal rules
- **Initial director**
 - Those names which appear with their consent on the application for registration
- **Alternate director**
 - Stand in at board meetings for directors when directors are unavailable only
 - Not merely an agent of the director (acts independently) but has no powers when director is present

If there is a person who exercises multiple positions...

- Responsibilities referred to in s 180(1)9b) include all responsibilities a person has within the company. It is inappropriate to separate the person's responsibilities from their responsibilities in another capacity

Minimum standard expected of all directors: *Daniels v Anderson*

- Must **acquire basic understanding of business**
- Must **keep informed and kept up to date** about company's activities
 - Under a continuing obligation to make inquiries and keep themselves informed about all aspects of the company's business operations
- Don't need detailed inspection of day-to-day activities, but must **guide and monitor** company's business (especially exec directors)(i.e. by attending meetings)
- **Expected to attend all meetings** unless exceptional circumstances i.e. ill: *Vrisakis v ASC*
 - Attendance and participation is a prime responsibility: *Gold Ribbon Pty Ltd v Sheers*
 - Directors should meet as often as necessary to fulfil oversight function: *Daniels v Anderson*
 - No set number of meeting but s 300(10) requires disclosure of number of meetings (including sub-committee meetings) and each director's attendance
- Must be **familiar with and have an understanding of the company's financial status/affairs** through regular review of financial statements
 - Cannot mislead or present the company as being profitable: *Sheahan v Verco*
 - Must seek information to enable them to monitor management by asking for previous financial statements or seek financial information: *Sheahan v Verco*
 - Cannot omit statements that ought to be known to them
 - Can read and understand financial statements: *ASIC v Healey*
 - Implies ability to read and interpret statements: *ASIC v Healey*
 - Level of financial literacy required to identify errors not high: *ASIC v Healey*
 - Directors cannot escape liability for insolvent trading by claiming that they do not know how to read financial statements: *CBA v Friedrich*
 - Financial reports of a company must include a statement of directors' opinion that provides a true and fair view of financial position and performance: *Sheahan v Verco*
 - Must carefully and diligently review statement: *ASIC v Healey*
 - May delegate but must ensure content is consistent with knowledge of company: *Sheahan v Verco*; *ASIC v Healey*
- If appointed for **special skills or expertise**, then must apply them, but must also pay reasonable attention to all other matters
 - Non-exec directors cannot avoid liability by asserting that they relied on the company's exec directors/officers: *Gold Ribbon v Sheers*
- May make **business judgments** and take reasonable commercial risks, if informed
 - Cannot enter into transactions that exposes co to risk without prospect of producing any benefit for the co: *ASIC v Adler*
 - Includes contracting with creditors who cannot meet obligations: *Circle Petroleum*
- Have a **duty to be alert** – cannot shut their eyes to corporate misconduct
 - Cannot claim that they did not see the misconduct and did not have a duty to look

Additional duties for executives and officers

- **Duty to safeguard company's interests**
 - Cannot allow company to incur risk with no benefit
 - *ASIC v Adler*: Failure to safeguard interests of HIH and HIHC
 - *Circle Petroleum (Qld) Pty Ltd v Greenslade*: MD allowing difficult trade debtor to exceed credit limit, contrary to board resolution
 - *Permanent Building Society v Wheeler*: Failure to alert company to potential harm of unusual contract, even though he declared conflict of interest and refrained from voting
- **Cannot permit company to contravene the law**
 - Cannot expose company to penalties or civil claims
 - *ASIC v Sydney Investment House Equities Pty Ltd*: Permitting companies to conduct unregistered investment schemes and engage in deceptive conduct
 - *ASIC v Citrofresh*: Allowed co to issue a deceptive disclosure statement that it developed a cream that could prevent the spread of HIV, amongst others
- **Must advise board about issues**
 - *ASIC v MacDonald*:
 - Part of the James Hardie Group, who wrote a misleading claim regarding sufficiency of funding for corporate compensation fund that must pay victims of asbestos
 - MacDonald (MD) had responsibility for that statement
 - Failed to advise the board of limitations of assumptions underlying the statement
 - *ASIC v Shafron*:
 - Part of the James Hardie Group, company secretary and legal counsel was responsible for cash flow and financial modelling
 - Shafron held to have breached s 180 as he failed to advise board about inappropriate cash flow modelling assumptions and deficiencies in actuarial reports (did not discount inflation)
 - Failed to inform board that modelling assumptions did not discount inflation
 - Failed to ensure that company disclosed further relevant info
 - *ASIC v Morley*
 - Part of the James Hardie Group. Morley (CFO) was also responsible for financial modelling – failed to inform board that cash flow modelling and reviews were limited

- **Must inquire and obtain information, and then advise board about issues**
 - *Vines v ASIC*
 - Vines was the CFO of GIO (Insurance)
 - Two (junior) managers working for him prepared a rosy profit forecast that did not reflect the impact of a recent hurricane
 - Managers and Vines (CFO) held to have breached their duty of care
 - Vines failed to take positive steps to inform the relevant Board committee of the basis of the assumptions underlying the forecast
 - He had warning signs that would have led a reasonable person in his position to take steps to verify the managers' advice that forecast was accurate
 - NB. Managers no longer regarded as "officers" are under *Corporations Act*

Daniel v Anderson 1995

Facts

- AWA Ltd (large listed Co) incurred large losses from unsupervised foreign exchange transactions
- **AWA Senior Executives did not:**
 - Adequately supervise the transactions
 - Put adequate internal procedures in place to monitor the transactions
 - Maintain adequate records
- **Manager in charge of transactions:**
 - initially concealed losses from the Snr Execs when arranged unauthorised borrowings
- **Auditor**
 - Failed to detect unauthorised borrowings
 - But, warned Snr Execs the internal monitoring procedures were inadequate
 - Did not warn Board re inadequate procedures, even though he knew Snr Execs weren't acting to remedy inadequacies
 - Sometime later, Auditor wrote to Chairman and CEO suggesting improvements in audit procedures
 - But did not mention foreign exchange problems or full extent of unauthorised transactions and borrowings

Held

- Auditor and AWA: negligent
- CEO and Snr Executives: breached their duty of care
- Non-exec directors: did not breach their duty of care because they had made inquiries and requested information about foreign exchange dealings from Snr Execs and Auditor, but full details were concealed