

# CORPORATE LAW NOTES

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## DUTY OF CARE, SKILL AND DILIGENCE

Objective/reasonable person test - breached the modern standard of a reasonable person test?

*Step 1 - what would a reasonable person in the company's position in that job do?*

**s 180(1)** – a director or officer must exercise power/discharge their duties that a reasonable person would in that position at that time

- (a) – ‘in the corporation’s circumstances’ → if the company is doing well, director more relaxed vs. if the company not doing so well, then the directors have duty to help improve the company’s situation
- (b) – ‘occupied the office held by’ → the higher the role, the greater responsibility

See - **Daniels v AWA Ltd** → ‘the extent of the duty and the standard that is required in discharging the duty differs, however there is a min standard that applies’ - establishes the minimum requirement

-obtain a basic understanding of the company’s business (care)

-keep informed about and monitor the company’s activities (skill)

\*e.g. a reasonably competent executive director would discover mistakes in FS/investigate further

-regularly attend board meetings (diligence)

-monitor the company’s financial position, at least understand/can question FS (delegation and reliance)

Look at this list as a minimum starting point THEN (if they pass), look at their individual role and see what MORE is expected of the person

*Step 2 – distinguish between executive vs non-executive directors*

- executive directors have greater involvement in the business of the company hence → greater expectation of knowledge, focus and awareness
- non-executive directors still liable but not as severe

See – **ASIC v Vines** → CEO/CFO’s held to higher standards

-CFO of Vines was also a CPA, hold these special skills hence MORE is expected of him

*Step 3 – defences*

### Delegation

**s 198D** – directors may delegate any of their powers to any person, unless constitution restrict delegation

Directors **together** are liable for the actions of their delegates

UNLESS, directors not responsible under **s 190** if:

- (a) - director believed on reasonable grounds that the delegate was reliable and competent
- (b) - (i) on reasonable grounds + (ii) in good faith + (iii) after making proper inquiry

### Reliance on Information

**s 189(a)** – director can rely on information or professional/expert advice given or prepare by an employee, a professional adviser or expert, another director or officer, committee of directors

**s 189(b)** – reliance must be made in:

- (i) good faith
- (ii) after making an independent assessment of the info, having regard to the director’s knowledge of the corporation and the complexity of the structure and operations of the corporation

AWA standard of care → states directors must have basic accounting knowledge so that they can read and understand the balance sheet to ask questions

see – *ASIC v Healey*

-PwC improperly prepares FS, board signs it off as true and fair

-under s 189B

\*yes reliance made in good faith

\*but does not fulfil 'making independent assessment of the information'

#### Business judgement rule – s180(2)

-can only be used as a defence if the directors have met the requirements for s(180)(1) ONLY + must be making an actual judgement (e.g. should/should not expand the company)

\*cannot be used as a defence for insolvent trading under s588G

-a director is taken to have met the statutory and general law duties in connection with a business judgement if:

(a) made the judgement out of good faith and proper purpose

(b) no material personal interest in the subject matter of the judgement

(c) have informed themselves (i.e. market research)

(d) rationally thought that the judgement is in the best interests of the company

MUST satisfy all 4 to escape liabilities

See – *ASIC v Rich*

Step 4 –  
consequences

-civil penalty provisions under Pt9.4B or

-criminal offence under s184 (if intentional and reckless)

## INSOLVENT TRADING

### What is the definition of insolvent?

- s 95A – insolvency worked out using a cash flow test (NOT a balance sheet test)
- ask the question:
  - is the company able to pay all its debt, when they become due and payable?
  - what cash does the company have? What access to finance does the company have?
- DOES NOT require absolute knowledge, just suspicion

Step 1 –  
establish have  
directors  
breached their  
duties?

s 588G – directors have a duty to prevent the company from incurring debts when the company is insolvent or would become insolvent

s 588G(1) – applies if:

(a) – person is a director when company incurred the debt

(b) – company insolvent at the time or becomes insolvent by incurring debt

(c) – **at the time**, reasonable grounds for suspecting that the company is insolvent or would so become insolvent

→ e.g. on Monday you trade and expect with certainty for the money to come in, then on Tuesday, you find out that is not the case → you are not liable b/c must have suspicions at the time you are incurring the debt

(d) That time is at or after the commencement of this Act

Step 2 – has a  
debt been  
incurred?

### What is the definition of debt?

- debt must be for a specific amount
- must be incurred voluntarily by the company
- a company incurs a debt when they:

- o buy something or gets services performed but does not pay for it yet

**s 588G(1A)** – some actions are deemed to be debts but are not ‘true debts’

- (1) paying a dividend
- (2) making a reduction in share capital
- (3) buying back shares
- (4) redeeming redeemable preference shares that are redeemable at its option
- (5) issuing redeemable preference shares that are redeemable otherwise than at its option
- (6) financially assisting a person to acquire shares in itself or a holding co.
- (7) entering into an uncommercial transaction (e.g. selling an asset for less than its true value)

*Step 3 – are there reasonable grounds to suspect insolvency?*

**s 588G(2)** – liability is imposed where:

- (a) – person is aware at the time that there are such grounds for suspecting
- (b) – a reasonable person in a like position in the company’s circumstances would be so aware

*Step 4 – defences*

**s 588H(2)** – director had reasonable ground to expect and did expect that the company was solvent and would remain solvent

see – **Metropolitan Fire Systems v Miller**

-established: harder to ‘expect’ than to ‘suspect’

-higher threshold of knowledge/awareness req. → need reasonable grounds that company can pay debts when they fall due

**s 588H(3)** – delegation and reliance on **competent and reliable person**

-e.g. person cannot be constantly absent/alcoholic etc.

**s 588H(4)** – absence from management due to illness or other good reason is acceptable

see – **Deputy Commissioner of Taxation v Clark**

-Mr & Mrs Clark, Mrs Clark was director but had no business experience

-she just signed docs, Mr Clark did not inform her

-NOT a good reason to be absent from mgmt.

**s 588H(5) + (6)** – director took all reasonable steps to prevent the company from incurring the debt

*Step 5 – consequences*

**Civil penalty provisions – pecuniary penalty, disqualification, compensation**

**s 588M** – liquidator can seek compensation

**s 588S, s 588T** – if director breaches s588G, unsecured creditor can seek compensation

**Criminal liability**

**s 588G(3)** – if director breaches s 588G & director’s failure to prevent company incurring debt is dishonest