Director’s Duties:

DUTY OF CARE, SKILL & DILIGENCE:

Who Owes the Duty? Section 180 applies to both directors and officers:

s.9: officer 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 …

Section 180(1) Care and diligence:

- (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 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.

What Standard of Care Expected:

  o Must acquire basic understanding of business
  o Must keep informed about company’s activities
  o Don’t need detailed inspection of day-to-day activities, but must monitor company’s business
     o Should regularly attend board meetings
  o Must be familiar with financial status of company by regular review of financial statements
  o Directors are allowed to make business judgments and take commercial risks but they
    cannot safely proceed on the basis of ignorance and a failure to inquire are protection
    against liability for negligence
  o Directors cannot shut their eyes to corporate misconduct and then claim that they did not
    see the misconduct and did not have a duty to look

- All directors must make inquiries about their company’s financial position and to have skills to
  understand a balance sheet and profit and loss statement- Statewide Tobacco Services Ltd v
  Morely [1993]

- Reasonable care is objective test- Whether “discharge their duties in good faith and with
  that degree of diligence, care and skill which ordinary prudent men would exercise under similar
  circumstances in like positions” AWA Ltd v Daniels (1992).
Factors impacting standard of care, skill and diligence:

- The company’s circumstances- s180(1)(a)
  - Type of company
  - Size
  - Nature of its enterprise
  - Constitution
  - Board composition
  - Distribution of work between board and officers

- The position and responsibilities of the director or officer- s180(1)(b) and
  - ‘Responsibilities’ refers to the factual arrangements within the company that affect the director in question, not limited to legal duties
  - Executive?
    - Full time employees and have greater knowledge of daily operations
    - Subject to more stringent standards of care
  - Non-executive?
    - Not involved in daily management therefore rely on others for information
    - Standard of care recognises duties are of an intermittent nature
    - Chair
    - Special skill

To determine whether a director has complied with or breached their duty of care, it is necessary to compare the director's actual conduct against the standard of conduct expected of the director by the director's duty of care.

**Daniels v AWA Ltd (1995)**

Held:
- CEO and Snr Executives had 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

Standard of Care of Executive Directors:

Cases where executive directors (e.g. CEO or MD) have breached their standard of care:

- For failing to conduct due diligence
  - **South Australia v Clark (1996)**
    - Acquired subsidiary for considerably more than its true value-even thought this was a unusually large transaction, MANAGING DIRECTOR did not ensure company carried out usual due diligence inquiries and did not obtain independent valuation of the subsidiary

- For failing to monitor management effectively
  - **Daniels v Anderson (1995)**
    - CEO failed to make inquiries of company’s senior executives that would have led to a better appreciation of the risks and dangers of the foreign exchange dealings
    - As CEO, he was under a continuing obligation to supervise management and seek satisfactory explanations regarding the deficiencies of the foreign exchange trading system and procedures
• For failure of a CFO to exercise the level of skill of a reasonably competent CFO
  
  o *Vines v ASIC [2007]*
    - CFO breached standard of care when signed off on GIO’s profit forecast without taking positive steps to advise the board’s due diligence committee on the basis of the assumptions underlying the forecast
    - His supervisory and operational responsibilities required him to be proactive and to take steps to ensure that the monitoring process were continuing and up to date
    - Warning signals that would have led a reasonable person in Vines’ position to take steps to verify Fox’s advice that the reinsurance division’s profit forecast was accurate

Chair:

• Chair of listed companies has special responsibilities and is subject to a different standard of care than non-executive directors
• *ASIC v Rich [2003]:*
  - Court rejected argument and held that factual responsibilities of chairman of a listed company were more than ‘ceremonial or procedural matters’ relating to chairing board meetings or shareholder meetings
  - Chairman has primary responsibility of
    - Selecting matters and documents to be brought to the board’s attention,
    - In formulating the policy of the board and
    - In promoting the position of the company
  - Position of ‘chair’ came within the meaning of ‘responsibilities’ in s.180(1)(b)

When Appointed Because of a Particular Skill:

• What is the standard of skill expected of a person appointed because they have a particular skill?
  - The degree of skill that a reasonable person with that skill would exercise

*Shafron v ASIC [2012]:*

- Shafron was the general legal counsel for James Hardie
- JH made misleading statements regarding the adequacy of the company’s fund to cover asbestos related claims against the company
- Shafron had been delegated the task of providing the board with cash flow modelling regarding the fund and claims
- **Shafron breached s.180(1) because:**
  - Didn’t advise board that the ASX announcement regarding the adequacy of the compensation fund was based on inappropriate cash flow modelling assumptions
  - Failed to draw board’s attention to deficiencies in actuarial reports

Breach of Duty of Care Where...

• Completely unaware of company’s financial position
  - *Sheahan v Vero [2001]*
• Failing to ensure that financial statements were consistent with director’s knowledge of the company’s affairs
  - *ASIC v Healey [2011]*
• Causing the company to enter into transactions that expose it to risks without the prospect of producing any benefit
  - *ASIC v Adler [2002]*
• Permitting the company to contravene the law
  - *ASIC v Sydney Investment House Equities Pty Ltd [2008]*
Defence:

Business Judgment Rule:
• Defence to both General Law and Statutory (s.180) duty of care

Principle:
• Directors should not be held liable for business decisions that turn out badly
• Reflects attitude that it is not appropriate for courts to review merits of business judgments in a risk-taking environment with the benefit of hindsight as to how particular decisions turned out

Section 180 (2):

(2) Director or other officer who makes a business judgment is not liable for breach of duty of care if:
(a) Judgment made in good faith and for proper purpose and
(b) No material personal interest in subject of the judgment and
(c) Informed themselves about the subject of the judgment to extent they reasonably believe to be appropriate and
(d) Rationally believed judgement to be in the best interests of the company

The director or officer’s belief that the judgement is in the best interest of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold

Section 180 (3): Business judgment means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation

Delegation & Reliance:

Section 198D- Delegation:

(1) Unless the company’s constitution provides otherwise, the directors of a company may delegate any of their powers to:
   a) A committee of directors;
   b) A director;
   c) An employee; or
   d) Any other person

   ➢ Section 190(1) Director who delegate under s.198D is responsible for the exercise of the power by the delegate as if the power had been exercised by the director themselves

Boards commonly delegate to committees such as:

• Audit committee
• Remuneration committee

Boards also often delegate certain functions to a CEO
Defence:

Section 190(2)

(2) Director not responsible if:

- (a) Believe on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company and company constitution and

- (b) Director believed
  - (i) On reasonable grounds;
  - (ii) In good faith; and
  - (iii) 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

Reliance on Others:

When is it reasonable for a director to rely on information or advice of others?

Section 189:

(a) Can rely on info/advice from:

- (i) Employees if believe on reasonable ground to be reliable and competent in relation to matter;
- (ii) Professional advisers or experts or reasonable ground to believe within their professional or expert competence;
- (iii) Another director in relation to matters within their authority; or
- (iv) Committee of directors

(b) If reliance was made:

- (i) In good faith; and
- (ii) After making independent assessment of the info/advice