

1.1 DUTY OF CARE

<p>Intro</p>	<ul style="list-style-type: none"> – Directors and officers are subject to the duty of care under s 180(1)¹ – Here, the following may be breaches of the duty → list here specific conduct that may constitute a breach on the facts – Given that the business judgment rule in s 180 (2) provides a complete shield to negligence claims at both general law and statute, it will be dealt with first. <p><i>Remember here –</i></p> <ul style="list-style-type: none"> ⇒ All of the following requirements must be met before this can be used as a defence ⇒ The onus is on the defendant director to establish evidence to support each element of the business judgment rule defence [ASIC v Rich]²
<p>Main defence: Business judgement Rule³</p> <p>s 180 (2): a director or other officer who makes a business judgment is taken to meet the requirements of subsection (1) and their equivalent duties at common law and in equity, in respect of the judgment if they:</p> <ul style="list-style-type: none"> (a) make the judgment in good faith for a proper purpose; and (b) do not have material interest in the subject matter of the judgment; and (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and (d) rationally believe that the judgment is in the best interests of the corporation 	
<p>1. Business judgment</p> <p>Was there a decision made?</p>	<p>“Any decision to take or not take action in respect of a matter relevant to the business operations of the corporation”</p> <ul style="list-style-type: none"> – Requires a conscious decision → the director or officer must have turned their mind to the matter [Rich] <ul style="list-style-type: none"> ○ Therefore ‘oversight’ duties including duties to monitor the co’s affairs and policies and to maintain familiarity with the financial position of the company are NOT protected⁴ – Explanatory memo: ‘involves decision making about the ordinary business operations of the company’ → can be existing or new business – Examples [Rich]: <ul style="list-style-type: none"> ○ Entering into transactions for financial purposes ○ Planning ○ Budgeting ○ Forecasting – NOT a business judgment:

² In this sense → if there is not enough info – suggest on the facts that you require more information if the director is to establish a defence – given that the onus is on the defendant director

³ *the belief that the judgment is in the best interests of a corporation is a **rational one** – unless the belief is one that NO reasonable person in their position would hold

⁴ This becomes contentious for **non executive** directors → as part of their responsibilities will be oversight and monitoring

	<ul style="list-style-type: none"> ○ a decision relating to compliance with the requirements of the Corporations Act [ASIC v Fortescue Metal Group]
<p>2(a) Good faith and proper purpose</p> <p>Was the judgement made in good faith for a proper purpose?</p>	<ul style="list-style-type: none"> – Look if they breached s 181 – Have they acted for a proper purpose? – In relation to the good faith requirement (which is usually related to the best interests of the corporation) → you instead just consider whether the defendant acted honestly
<p>2b) Material interest in the subject matter</p>	<ul style="list-style-type: none"> – Adler: had a material personal interest → his connection with the company that the loan funds were used to purchase and in increasing HIH's share price – BUT → personal interest in achieving certain purposes may be different to the subject matter <ul style="list-style-type: none"> ○ In Rich → the defendants personal interests as shareholders and directors were not material personal interest in the <u>subject matter</u> of the business judgment – <i>which was decisions not to pay certain creditors in accordance with strict contractual terms and decisions to accumulate cash to cover the claims of these creditors</i>
<p>3. Informing themselves</p> <p>Did they inform themselves about the subject matter of the judgment – to the extent they reasonably believe to be appropriate?</p>	<ul style="list-style-type: none"> – Subjective test: did the director/officer take steps to the extent they reasonably believed to be appropriate? [Rich]⁵ – Relevant factors [Rich] <ul style="list-style-type: none"> ○ The importance of the business judgment to be made; ○ The time available for obtaining information; ○ The costs related to obtaining information; ○ The director's or officer's confidence in those exploring the matter; ○ The state of the company's business at the time and the nature of competing demands on the board's attention; and ○ Whether or not material information is reasonably available to the director – Adler: seems to be a suggestion that obtaining proper independent advice obtained on behalf of HIH (where the unsecured loan was obtained from) would be adequate to meet this criteria
<p>4. Company's best interests</p> <p>Did they rationally believe that the judgment was in the best interest of the corporation?</p>	<ul style="list-style-type: none"> – THIS IS DETERMINED SUBJECTIVELY [Rich]⁶ <ul style="list-style-type: none"> ○ The requirement is met if the defendant believed that his or her judgment was in the best interests of the corporation; and ○ The belief was supported by a reasoning process sufficient to warrant describing it as a rational belief; ○ Whether or not the reasoning process is objectively a convincing one

⁵ i.e. even if the director was not aware of available information material to the decision, if he **reasonably believed** that he had taken appropriate steps on the decision-making occasion to inform himself about the subject matter – the protection may be available

⁶ Remember the broader policy here -> the reluctance of courts to review business judgments of directors and to substitute their own judgment on the merits

Requirements met → defence is made out

Requirements not met → s 180(1) applies – go on to that analysis now

Duty of care (s180 (1))		
S180 (1)	s180 (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: <ul style="list-style-type: none"> (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 	
Objective test	<ul style="list-style-type: none"> • Ask what an ordinary person, with the knowledge and experience of the defendant might be expected to have done in the circumstances if he or she was acting on their behalf [Permanent Building Society – Adler] 	
Taking into account the company’s circumstances	<ul style="list-style-type: none"> • [Maxwell]: the circumstances of the company are relevant to determining breach: <ul style="list-style-type: none"> ○ <u>Type of company</u> <ul style="list-style-type: none"> ▪ Public or private? ○ <u>Company’s constitution?</u> ○ <u>Distribution of decision-making in the company</u> <ul style="list-style-type: none"> ▪ Management is by directors → unless replaced [198A – is a replaceable rule] ○ <u>Size and nature of the company’s business</u> <ul style="list-style-type: none"> ▪ Large enterprise – the directors role involves more oversight/monitoring rather than day to day management ▪ Smaller businesses – likely that the directors are directly running the business themselves ▪ [Daniels v Anderson]: exact nature of the obligation will vary according to size and complexity of the company; the larger and more complex the company is – the broader the level of monitoring ○ <u>Membership of the board</u> ○ <u>Director’s position and responsibilities [discussed below]</u> <ul style="list-style-type: none"> ▪ here ask – what were the responsibilities actually carried out by the director/officer? ▪ If it doesn’t really say on the facts – look at directors responsibilities in the act – remember it's a replaceable rule ○ <u>Director’s experience and skills [discussed below]</u> ○ <u>Terms on which the Director has been appointed</u> ○ <u>Any other circumstances of the specific case</u> <ul style="list-style-type: none"> ▪ Transaction outside the general course of the company’s business (and so the company has little expertise in the area) – can give rise to a heightened duty of care to scrutinize the transaction [Permanent Building Society] ○ <u>Can also look to the distribution of responsibilities: between directors and employees and the competence of management/advisors [Macdonald]</u> 	
Standard of care	<u>Starting point:</u>	⇒ Bare minimum standard for all directors → <ul style="list-style-type: none"> ○ Requires a director to have a general understanding of their company’s risks and company’s financial position

	<p><u>Daniels v Anderson</u></p> <p>[discussed in Adler]</p>	<ul style="list-style-type: none"> ○ Directors can not remain ignorant about affairs or take a passive interest in decisions made by the board ○ They can not be financially illiterate – they are expected at the least – to be able to read and understand key financial statements such as the profit loss account and balance sheet <p>⇒ ADLER:</p> <ul style="list-style-type: none"> ○ A director should become familiar with the fundamentals of the business in which the corporation is engaged; ○ A director is under a continuing obligation to keep informed about the activities of the corporation; <p>A director should maintain familiarity with the financial status of the corporation by a regular review of financial statements</p>
	<p><u>ASIC v Rich</u></p>	<p>⇒ Opened the door to a requirement of sophistication for executive directors</p> <p>⇒ Standard:</p> <p>You must understand the nature and extent of your company’s financial performance – regardless of how sophisticated you may be/your background/level of knowledge</p>
	<p><u>ASIC v Vines</u></p>	<p>⇒ A heightened requirement of duty based on the expertise of the particular directors → here vine was the CFO and the other two involved were chartered insurers with very high technical background</p> <p>May not be a universal standard applicable to all directors – but only to persons who are well qualified and well experienced</p>
	<p><u>ASIC v Macdonald</u></p>	<p>⇒ Heighted requirement for ALL directors</p> <p>It is no longer sufficient to say directors who have a general level of understanding is sufficient</p>
	<p><u>ASIC v Healy</u></p>	<p>⇒ If directors see any errors or issues with a financial statement – they must make further enquiries if matters revealed in these financial statements call for such enquiries → i.e. they must be both financially literate in a way to recognize issues or errors</p> <p>⇒ Involved non-executive director with extensive experience in corporate finance and accounting</p>
<p>Specific circumstances</p>	<ol style="list-style-type: none"> 1. Conflict of interest <ol style="list-style-type: none"> a. Where a contract has a conflict of interest between interest and duty – they must exercise special vigilance [Adler] 2. Expertise <ol style="list-style-type: none"> a. If appointed for a special skill – they cannot shut their eyes to the other areas of the business [Ford] b. Examples: <ol style="list-style-type: none"> i. [Adler]: director was highly experienced and was a senior partner of a leading accounting firm ii. [Healey]: non-executive directors who had extensive experience in corporate finance and accounting iii. [Rich]: was a chartered accountant and had experience in finance and the court held that he owed a higher duty relating to financial matters 	

<p>Breach</p>	<ul style="list-style-type: none"> • Risk v Benefit: <ul style="list-style-type: none"> ○ The courts will balance the foreseeable harm from the defendant’s actions against the potential benefits to the company [Vrisakis; Vines; Rich] • Breaches can involve: <ul style="list-style-type: none"> ○ Failure to do something [Macdonald] ○ Failure to seek out information [Macdonald] ○ Doing something you ought to have known was wrong [Macdonald] <hr/> <p>Examples:</p> <ul style="list-style-type: none"> • <u>Understanding and monitoring financial health</u> <ul style="list-style-type: none"> ○ [D v A]: held to be negligent in establishing an inadequate system of supervision of Koval’s activities ○ [Vrisakis]: not attending board meetings without good reason – prima facie evidence of negligence ○ [Adler]: reasonable person in this position as director of HIH would not have paid \$10m to PE • <u>Understanding and quantifying risks</u> <ul style="list-style-type: none"> ○ [Vines]: breached duty of care by providing information to shareholders on the basis of false information ○ [Macdonald]: non-executive directors failed to call for a copy of the draft announcement to familiarize themselves with its terms <ul style="list-style-type: none"> ▪ CEO knew or ought to have known the announcement was misleading but nevertheless voted to approve it ▪ CFO failed to advise the board that the cash flow model underpinning the funding of the Foundation did not consider key assumptions • <u>Challenge information they were given</u> <ul style="list-style-type: none"> ○ [Healey]: director relied on faulty reports which misclassified liabilities as noncurrent provided by PWC – but did not even read it⁷
<p>Secondary defenses:</p>	
<p>Delegation S190</p>	<p>Start here:</p> <ul style="list-style-type: none"> • If delegating to a managing director [s198C]: <ul style="list-style-type: none"> ○ They can delegate any of the powers they themselves can exercise ○ This is a replaceable rule* ○ This is revocable • If delegating to anyone else [s198D]: <ul style="list-style-type: none"> ○ Can be to → <ul style="list-style-type: none"> ▪ A committee of directors; ▪ A director; ▪ An employee of the company; ▪ Any other person ○ Can be delegated unless the company’s constitution provides otherwise ○ Delegation has to be recorded in the company’s minute book [s251A] ○ Requirements: <ul style="list-style-type: none"> ▪ Delegate must exercise the powers delegated in accordance with any directors of the directors ▪ The exercise of the power by the delegate is as effective as if the directors had exercised it

⁷ Remember that this probably extends the duty → they must be both financially literate in a way to recognize issues or errors

	<p>A director is not responsible if:</p> <ol style="list-style-type: none"> a. The director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by this Act and the co's constitution; and b. The director believed: <ol style="list-style-type: none"> i. On reasonable grounds; and 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 <p><u>Was reliance reasonable? [Adler]</u></p> <ul style="list-style-type: none"> • Was the power one able to be properly delegated? • Did the defendant know/should have known of facts that would deny reliance? • What was the relationship between the director and the delegate? • What was the nature of the subject matter and the risks involved? • What sort of inquiries did the defendant make?
<p>Reliance S 189</p>	<p>Director is not responsible if they rely on information, or professional or expert advice given or prepared by:</p> <ul style="list-style-type: none"> • <u>An employee</u> – whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned [189 (a)(i)] • <u>A professional adviser or expert</u> – whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned [189 (a)(ii)] • <u>Another director or officer</u> - in relation to matters within the director or officers authority [189 (a)(iii); or • <u>A committee of directors</u> – on which the director did not serve in relation to the matters within the committee's authority [189 (a) (iv)] <p><u>Requirements for delegation:</u></p> <ul style="list-style-type: none"> • The reliance must have been made [189 (b) (i-ii): <ol style="list-style-type: none"> ○ In good faith; and ○ After making an independent assessment of the information or advice – having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation • Then → the directors reliance on the information or advice is taken to be reasonable unless the contrary is proved
<p>Conclude:</p>	
<p>Sanctions</p>	
<p>Civil</p>	<p>Civil penalty provision – s 1317E</p> <ul style="list-style-type: none"> • D may be subject to a disqualification order (s206C); or • A pecuniary order up to \$200k (s1317G) for each breach upon a court's declaration of contravention
<p>Criminal</p>	<p>n/a</p>