

## 6.1.1.1. S180 – Duty of care and diligence

- Can also be found in 'general law negligence cases' (company can take action) and 'contract of employment' for executive directors and other officers.

|   |   | Cases  |
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| Who owed duty?  | A <b>director</b> or <b>other officer</b> breaches this duty if they are "negligent"  |  |
| Modern standard of care                                     | <p><b>S180(1)</b> → <b>Reasonable person (objective) test</b> regarding the standard of care required of director/officer X.</p> <p>Director/officer X <b>breached</b> modern standard of care (reasonable person test) outlined in s180(1) because:</p> <ul style="list-style-type: none"> <li>+ a <b>reasonable</b> person</li> <li>+ <b>doing the job as ... (title)</b> e.g. CEO, CFO, executive directors, non-executive</li> <li>+ <b>in X's company</b> → circumstances e.g. financially struggling in bad situation</li> <li>+ <b>would exercise</b> (e.g. would have read FS carefully) <b>but X has not done so</b></li> </ul> <p><b>***Separately discuss for executive &amp; non-executive directors</b> since different positions and thus different levels of care required!!!</p>  |  |
| Minimum standards (even for directors in name & do nothing) | <p><b>All directors (executive &amp; non-executive)</b> must have basic understanding of the business of the company and be aware of its financial status.</p> <p>Director X (executive and non-executive...) breached minimum standards required of directors (<b>Daniels v AWA Ltd</b>) because X failed to:</p> <ul style="list-style-type: none"> <li>+ obtain a basic understanding of their company's business e.g. risks</li> <li>+ keep informed about and monitor the company's activities e.g. s198A[RR] – general power of management</li> <li>+ regularly attend board meetings - general monitoring of company affairs, no need for detailed inspection of day-to-day activities (diligence)</li> <li>+ monitor the co.'s financial position/ status - review financial statements</li> </ul>  | <p><b>Daniels v AWA Ltd</b> → middle managers not follow constitution and exceed authority (internal guidelines → who is allowed to do what) and use the co's cash to invest in highly risky securities → financial trouble → co. sued auditors for not discovering middle managers were not following guidelines BUT auditors sued directors for not monitoring middle managers properly.</p> |
| Are some people expected a higher level of care?            | <p>+ Directors with <b>special skills</b> are held to the standard of a person professing to have those skills e.g. CPA qualified → expected to be at CPA standard</p> <p>+ <b>The more you are involved</b>, the more is expected of you e.g. <u>executive</u> directors.</p> <p>However, the standard of care expected of each director may be different depending on their involvement in mgmt. and special skills (<b>ASIC v Vines</b>). This difference in expected standard of care will affect the extent of punishments each director is subject to.</p> <ul style="list-style-type: none"> <li>- Executive directors (including [director's name]) would be expected higher standard of care than non-executive directors.</li> <li>- As an <u>executive director and CEO</u>, Fred is held to a higher standard of care than other executive and non-executive since he is more involved in the co's daily running, subject him to higher level of punishment if this duty is held breached.</li> <li>- Meanwhile, given Frank is a CPA which enables him to have better understanding of the company's financial status, he will be held at higher level of care than other <u>non-executive directors</u>.</li> </ul>   | <p><b>ASIC v Vines</b> – CFO of company – expect must have identifiable specialised skills of that position → actions compared against what a reasonably competent CFO would have done</p>   |
| Are there defences available?                               | <p><b>Delegation: s190</b></p> <p>+ <b>s198D</b>: Directors may <u>delegate</u> any of their powers (s198A[RR] general mgmt.) to any person, <b>unless constitution restricts delegation</b>.</p> <p>+ If delegate is negligent, director will be liable <b>unless s190 satisfied</b>.</p> <ul style="list-style-type: none"> <li>• <b>s190(1)</b> If directors delegate power under s198D, a <u>director</u> is responsible for the exercise of the power by the delegate as if the power had been exercised by directors themselves → can be delegated by Board but <b>each director is liable</b></li> <li>• <b>s190(2) A director is not responsible under subsection (1) if:</b> <ul style="list-style-type: none"> <li>➢ <b>s190(2)(a)</b> the director believed on <b>reasonable grounds at all times</b> that the delegate would <b>exercise the power in conformity with the duties imposed on directors</b> by this Act and the company's constitution; <b>and</b></li> <li>➢ <b>s190(2)(b)</b> the director believed: <ul style="list-style-type: none"> <li>(i) on <b>reasonable grounds</b>; <b>and</b></li> <li>(ii) in <b>good faith</b>; <b>and</b></li> <li>(iii) after making <b>proper inquiry</b> if the circumstances indicated the need for inquiry;</li> </ul> </li> </ul> <p>that <b>the delegate was reliable and competent</b> in relation to power delegated.</p> </li></ul> | <p><b>***e.g.</b> the delegate is a properly appointed person but disappearing without explanation for a period of time, drinking heavily, fail the degree → the delegate is not reliable and competent.</p>   |
| Delegation: s190  |   |  |
| Reliance on info: s189                                      |   |  |
| Business Judgement rule: s180(2)                            |   |  |

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|   | <p><b>Directors may make a defence under s190 delegation.</b></p> <ul style="list-style-type: none"> <li>+ Because there is no constitution restriction, the director/ Board has delegated the power to [what matters ...] to [whom...] under s198D.</li> <li>+ If delegate is negligent, director will be liable (s190(1)) <b>unless s190(2)</b> satisfied.</li> <li>+ <b>s190(2)(a)</b> passed because there are reasonable grounds for the director to believe at all times the delegate will <i>exercise the power in conformity with the duties imposed on directors</i> by Act and constitution. The facts suggest the delegate is careful and has no evil motives.</li> <li>+ However, <b>s190(2)(b)</b> failed. <ul style="list-style-type: none"> <li>- While director believe in good faith <b>s190(2)(b) (ii) the delegate is reliable and competent</b> in relation to the power delegated, there are no reasonable grounds <b>s190(2)(b) (i)</b> because he/she ... (experience, expertise, attitude, knowledge)</li> <li>- The director also does not make proper inquiry <b>s190(2)(b) (iii)</b></li> </ul> </li> </ul>   |  |
|   | <p><b>Reliance on information: s189</b></p> <ul style="list-style-type: none"> <li>➤ <b>S189 (a)</b> When a director <b>relies on information</b> (e.g. reports) <b>provided by</b> <ul style="list-style-type: none"> <li>• (i) <b>employees</b> (the director believes on <i>reasonable grounds</i> to be <i>reliable and competent</i> in relation to the matters concerned)</li> <li>• (ii) <b>professional advisers or experts</b> (in relation to matters the director believes on <i>reasonable grounds</i> to be <i>within the person's professional or expert competence</i>)</li> <li>• (iii) <b>other director or officer</b> (e.g. CEO, CFO) in relation to <i>matters within the director's or officer's authority</i></li> <li>• (iv) <b>board committee</b> (committee of directors) on which <i>the director did not serve</i> in relation to matters within the committee's authority</li> </ul> </li> <li>➤ <b>S189 (b)</b> the reliance was made: <ul style="list-style-type: none"> <li>• (i) <b>in good faith</b> (i.e. honest, not evil) <b>and</b></li> <li>• (ii) after making an <b>independent assessment</b> of the info or advice, having regard to the director's knowledge of the firm (structure and operations)</li> </ul> </li> </ul> <p><b>Directors may make a defence under S189.</b></p> <ul style="list-style-type: none"> <li>+ The directors <i>rely on information provided by professional experts</i> (WPC). Since WPC is one of the largest accounting firms, <i>director can believe on reasonable grounds this matter (preparing financial report) is within WPC's professional or expert competence</i> (s189(a)(ii)).</li> <li>+ This reliance on information was made <b>in good faith (s189(b)(i))</b>, <i>How? because nothing on the facts suggest evil motive.</i></li> <li>+ But <b>s189(b)(ii)</b> failed because the directors have not made an independent assessment of the information. <i>How? They did not read and assess the financial statements closely to realize those significant errors and omissions. (ASIC v Healey)</i></li> </ul> | <p><b>ASIC v Healey</b> → <i>PWC report was wrong and director did not read and assess it properly or ask any questions (no need to get 3<sup>rd</sup> party opinion). Is the information reasonable to rely on? E.g. timely info (not 20 years ago), from whom (expert), source (internet or paper)</i></p>   |
|   | <p><b>Business Judgement rule: s180(2)</b></p> <ul style="list-style-type: none"> <li>+ <b>properly made decisions end badly</b> e.g. open new product line, open a new division overseas, expand the business, buy back shares, issue shares, issue debt, etc.</li> <li>+ <b>s180(2)</b>: Director/officer is taken to meet statutory (s180(1)) and general law duties of care <b>in connection with a business judgment</b> if: <ul style="list-style-type: none"> <li>• (a) <b>good faith and for a proper purpose</b> (i.e. good for the co.) <b>and</b></li> <li>• (b) <b>no material personal interest</b> in subject matter of judgment e.g. NOT expand the business and buy land from the director <b>and</b></li> <li>• (c) <b>inform themselves</b> about the subject matter of the judgment to the extent they <b>reasonably</b> believe to be appropriate i.e. market research, careful investigation, proposal <b>and</b></li> <li>• (d) <b>rationaly believe the judgment is in the best interests of the company</b> → 'rational' <i>unless</i> the belief is one that no reasonable person in their position would hold</li> </ul> </li> </ul> <p><b>Directors may make a defence under S180(2).</b></p> <ul style="list-style-type: none"> <li>+ A business judgment rule has been made to [...]</li> <li>+ Is this made in accordance with s180(2)? Discuss each point separately.</li> </ul>  | <p><b>ASIC v Rich</b></p> <p><b>Reasonableness of the belief</b> (c) should be assessed by reference to:</p> <ul style="list-style-type: none"> <li>+ the importance of the business judgement to be made</li> <li>+ time available for obtaining info</li> <li>+ costs related to obtaining info</li> <li>+ director's or officer's confidence in those exploring the matters</li> <li>+ state of the company's business at that time and the nature of competing demands on board's attention</li> <li>+ Whether or not material info is reasonably available to the director</li> </ul> |
| <p>Who can enforce the duty? What remedies are available?</p> | <p><b>The punishments imposed on each director will depend on the standard of care expected from them.</b> Directors who are held at higher standards (e.g. [name]) will be punished more heavily.</p> <p><b>1. Civil penalty actions</b></p> <ul style="list-style-type: none"> <li>• <b>ASIC</b> <ul style="list-style-type: none"> <li>➤ Make a <b>declaration of contravention</b>: s 1317E</li> <li>➤ Order a <b>pecuniary penalty</b> up to \$200,000: s 1317G</li> </ul> </li> </ul>  |  |

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|  | <ul style="list-style-type: none"><li>➤ Disqualify the directors for an appropriate period: s 206C</li><li>➤ Order compensation be paid to company: s 1317H.</li></ul> <ul style="list-style-type: none"><li>• <b>Company</b> (only compensation)</li></ul> <p>2. <b>General law duties</b></p> <ul style="list-style-type: none"><li>• <b>Company</b><ul style="list-style-type: none"><li>➤ Injunction</li><li>➤ Compensation/damages</li><li>➤ Account of profits</li><li>➤ Rescission of contract</li><li>➤ Constructive trust</li></ul></li></ul> <p>+ <b>Directors will make decision that the company will sue</b> a director for a breach of duty. But unlikely directors will sue themselves.</p> <p>+ <b>Member derivative action</b> to enforce a right belonging to the company. (Part 2F.1A) i.e. duties owed to company, NOT members.</p> |  |
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