

(12) DIRECTOR'S DUTIES (3) – DUTY OF CARE, SKILL AND DILLIGENCE

** In problem questions always start with this duty

1. Source of this duty:

- a. At CL in tort, directors owe a DOC founded in negligence.
- b. In contract, executive directors have a contractual DOC arising from service contracts: Daniel v Anderson.
- c. In equity, all directors owe a DOC in equity, although it is not to be equated with their fiduciary duties: PBS v Wheeler.
- d. In statute; s 180 which imposes a statutory DOC and diligence on directors and other officers

2. Standard of care for various officers

- a. Executive directors: applicable standard is what would be reasonably expected of a competent MD/ED
- b. Managing directors are held to a higher standard as they have special skills: ASIC v Rich
 - i. There is a heavy duty on managing directors to 'scrutinise the proposed transaction with caution and thoroughness': PBS v Wheeler
- c. Non-Executive directors: now a minimum expectation of diligence, care and skill expected of NEDs; Daniels
- d. CFO: the position of CFO is recognised in large public companies as a special position with special skills: Vines

3. Establishing Breach of this Duty

- a. Test: What would a reasonable person with the knowledge and experience of the director have done? ASIC v Adler; Daniels v Anderson – Clarke and Sheller JJ at [500]
 - i. While **the test is objective**, subjective considerations are relevant: consider the type and size of the company, the nature of the business, its constitution, board composition, distribution of work, any skills a director held himself out to possess in support of appointment: ASIC v Rich
- b. The standard of Skill and Diligence required:
 - i. Position to guide and monitor: directors must take reasonable steps to place themselves in a position to guide and monitor the management of the company: Daniels v Anderson – [503] – [504]
 1. Directors should be familiar with fundamentals of the company business;
 2. Directors are under a continuing obligation to make enquiries and keep informed about the company's business operations
 3. Directors are required to regularly attend board meetings
 4. Directors must maintain familiarity with company's financial status by a regular review of financial statements
 - ii. **Minimum financial literacy**: all directors expected to have a minimum standard of financial literacy with respect to financial statements & the financial affairs of his/her own company, irrespective of their own level of experience: ASIC v Adler; Daniels v Anderson
 - iii. **Implied term for particular appointments**: under an implied term in a contract of employment of an executive director, the director will be taken to have promise that he/she has the skills of a reasonably competent person in his or her category of appointment, and that these skills will be exercised with reasonable care, diligence and skill: PBS v Wheeler (e.g. finance director impliedly promises he has skills of a reasonably competent finance director)
 - iv. **Beyond scope**: directors appointed for particular skills and experience must still pay attention to areas beyond the scope of their particular experience: Daniels v Anderson.
 - v. **Heightened duty**: to the extent that conflicts of interest are present, the duty of care, skill and diligence is going to be heightened: ASIC v Adler

- vi. **CEO and MDs have a positive obligation to protect the interests of the company, which was not discharged by abstaining from the vote due to his perceived conflict; PBS**
 - 1. They have special skills essential to company
- vii. court asks whether directors were cognisant of circumstances of such a character that no man of ordinary prudence, acting on his own behalf, would enter into the transaction; PBS
- viii. **Directors are obliged to balance foreseeable risk of harm vs potential benefits reasonably expected to accrue to company from the conduct; PBS;**
- ix. Non-executive status will not prevent owing a DOC to the company if they have substantial responsibilities within the company/their conduct/possession of special skills; ASIC v Rich

4. Statutory Duty: S 180(1)

- a. 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:
 - i. (a) were a director or officer of a corporation in the corporation's circumstances; AND
 - ii. (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.
- b. This mirrors general law (ASIC v Adler; Daniels v Anderson) but a difference is the absence of any reference to skill → But case law regarding modern DOC based off objective minimum requirement of financial competence in insolvent trading cases & ability to have re to director's special skills in the context of distribution of responsibilities within the corp means **skill is a component of statutory duty**
- c. s180(1) requires a director or officer to balance the foreseeable risk of harm to the corporation (the magnitude of the risk and the likelihood of its occurrence) by a certain course of action or non-action, along with the burden (expense, difficulty and/or inconvenience) of taking alleviating action; ASIC v Cassimatis at [450] quoting Ipp K in Vrisakis
- d. Foreseeable risk of harm to corporation to be considered under **s 180(1)** is not confined to financial harm and includes harm to all interests of corporation including reputation and interests relating to compliance with law; ASIC v Cassimatis at [483] – Edelman J

5. Defences:

- a. **Delegation of Duty**
 - i. Delegation is allowed unless constitution forbids; **S 198D(1)**
 - 1. Directors may delegate any of their powers to:
 - a) a committee of directors; or
 - b) a director; or
 - c) an employee of the company; or
 - d) any other person.
 - 2. The delegate must exercise the powers delegated in accordance with any directions of the directors; **S 198D (2)**
 - 3. The exercise of the power by the delegate is as effective as if the directors had exercised it; **S 198D (3); ASIC v Macdonald; ASIC v FMG; ASIC v Healey**
 - ii. **General Rule: If directors delegate a power under s 198D, they are responsible for the exercise of that power by the delegate as though the power was exercised by directors themselves; s 190(1).**
 - 1. Exception: They are not responsible if; **s 190(2)** (similar to Rodger J's approach in AWA)
 - a) the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with duties imposed on directors of the company by this law and company's constitution (if any); and
 - b) the director believed: