70417 – Corporate Law Scaffold (Autumn 2020)

How to use this guide:

This guide is a scaffold for answering scenario-based questions in the assignments or exam. To use this scaffold, you simply need to go through the applicable breach of duties or topics. You then go through each element and fill in the blanks where indicated ([**xxx**]). By going through the scaffold and elements, you then derive a conclusion on whether or not a director has breached his/her duties and which remedies are applicable.

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Duty to Prevent Insolvent Trading (s 588G)

- [NAME] will have a positive statutory duty under s 588G to ensure that [COMPANY] does not trade while it is insolvent or is likely to become insolvent.
- S 588G only applies to directors (s 9) and not officers.
- Directors have a duty to be aware of the company's financial position at all times, and when a company is in financial difficulty, it must show awareness of creditor's interest (*Walker v Wimborne; Bell Group*).
- The facts seem to suggest that [NAME] continued to purchase [E.G. EQUIPMENT] when the company could not afford it.
- [NAME] must stop the company from incurring further liabilities or resign from the board (*Morley v Statewide Tobacco Services*).

(1) Elements manifesting a breach of s 588G (**DIRECTORS)**

(a) Person is a director when the company incurs a debt - s 588G(1)(a)

- To be liable for insolvent trading, [NAME] must be a director under s 9.
- A company will "incur debt" when a binding obligation to pay money in the future arises even where the debt is contingent (*Hawkins v Bank of China*).
- In *ASIC v Edwards*, Barret J said debt will be incurred by "any act, omission or other circumstance which causes the company to owe the debt".
- The present state of authorities appears to favour the view that a debt is incurred even where the debtor company has no choice but to incur the debt (e.g. sales tax) (*Powell v Fryer*).
- However, in *Standard Chartered Bank of Australia v Antico*, Hodgson J said that a penalty is not a debt as there is no positive act to bring it into existence – a choice is needed.
- In the facts, it can be assumed that [NAME] is a director at the time that the company incurs a debt.
- This is evidence by [APPLY FACTS].
- [APPLY WHERE RELEVANT]: s 588G(1A): For the purposes of this section, if a company takes action set out in column 2 of the following table, it incurs a debt at the time set out in column 3.

When debts are incurred		[operative table]
	Action of company	**When debt is incurred**
1	paying a **dividend**	**when the dividend is paid or**, if the company has a constitution that provides for the declaration of dividends, **when the dividend is declared**
2	making a **reduction of share capital** to which Division 1 of Part 2J.1 applies (other than a reduction that consists only of the cancellation of a share or shares for no consideration)	**when the reduction takes effect**
3	**buying back shares** (even if the consideration is not a sum certain in money)	**when the buy-back agreement is entered into**

When debts are incurred		[operative table]
	Action of company	**When debt is incurred**
4	**redeeming redeemable preference shares** that are redeemable at its option	**when the company exercises the option**
5	**issuing redeemable preference shares that are redeemable otherwise than at its option**	**when the shares are issued**
6	**financially assisting a person to acquire shares** (or units of shares) **in itself or a holding company**	**when the agreement** to provide the assistance **is entered into or**, if there is no agreement, when the **assistance is provided**
7	entering into an **uncommercial transaction** (within the meaning of section **588FB**, i.e. **a reasonable person would not have entered into the transaction** having regard to: the benefits and detriments to the company; benefits to any third parties; and any other matter) other than one that a court orders, or a prescribed agency directs, the company to enter into	**when the transaction is entered into**

(b) Company is insolvent at that time or becomes insolvent by incurring that debt or debts including that debt – s 588G(1)(b)

- Secondly, it is difficult to tell whether [COMPANY] is insolvent for the purposes of this section.
- The facts state that [COMPANY] is [LIQUIDITY PROBLEM/STRAIN ON FINANCES/MORTGAGE THE LAND, ETC.], which raises questions about solvency, and this is a question of fact to be ascertained from a consideration of the company's financial position as a whole (*Southern Cross Interiors v DCT*).
- Further, it is evident that the company is insolvent at that time or becomes insolvent by incurring that debt or debts including that debt.
- This is established on the facts as when [COMPANY] incurred [DEBT], they were not in the position to pay debts when they became due and payable (s 95A(1)), resulting in their insolvency.
- Thus, having regard to commercial realities (such as whether resources other than cash are realizable by sale or borrowing upon security), and when such realizations are achievable (*Rees v Bank of NSW*), it appears that:
    - The company is insolvent [and was insolvent prior to the liquidator being appointed] as it was unable to pay its debts when they fall due.
    - **NB.** A problematic concern is the extent to which directors can rely on non-enforcement of repayment by creditors (*Powell v Fryer*).
    - Scope to say not insolvent – Christmas period coming up and they usually have sales coming, therefore only temporary shortage of cash (*Toursprint v Bott*).

(c) Debt incurred after the commencement of Pt 5.7V – s 588G(1)(a)

- Debt must have been incurred after 23 June 1993.
- In the facts, the date of the debt is [DATE], thereby satisfying this element.

(d) At the time, there were reasonable grounds for suspecting that the company was insolvent, or would become insolvent – s 588G(1)(c)

- Similarly, it is evident that at the time, there were reasonable grounds for suspecting that the company was insolvent or would become insolvent.
- The court will use an objective test rather than the directors' actual subjective knowledge of the insolvency (*Metropolitan Fire Systems*) to determine whether there is a reasonable ground for suspecting insolvency under s 588G.
- A person is said to "suspect" insolvency where they have a "positive feeling of actual apprehension or mistrust" that is more than a mere idle wondering (*Queensland Bacon v Rees*).
- There are some specific indicators that will arouse a suspicion of insolvency, which were discussed in *ASIC v Plymin*, which suggests that [COMPANY] was experiencing [PICK ONE]:
    - Continuing losses
    - Liquidity ratios below 1
    - Overdue taxes
    - Poor relationship with bank
    - No access to alternative finance
    - Inability to raise further equity capital
    - Suppliers placing company on COD, or demanding payment before resuming supply
    - Creditors unpaid outside trading terms
    - Issuing of post-dated cheques
    - Dishonoured cheques
    - Special arrangements with selected creditors
    - Solicitors' letters, judgments or warrants issued against the company
    - Payments to creditors of rounded sums that are not reconcilable to specific invoices
    - The inability to produce timely and accurate financial information to display the company's trading performance and financial position and make reliable forecasts.
- From the facts, it appears that the trigger of liability is that [NAME] should have been suspicious that the company would become insolvent because the existence of several indicators of insolvency such as [PICK ONE FROM ABOVE] would constitute reasonable grounds to suspect insolvency.
- Thus, there appears to be scope to argue that s 588G has been engaged or is very close to being engaged.

(e) The director must be aware at the time that there are such grounds for suspecting insolvency, a reasonable person in a like position in a company in the company's circumstance would be so aware - s 588G(2)

- This element is satisfiable through either of two alternative tests:
    - **(1)** s 588G(2)(a) → (*ASIC v Plymin*).
        - The director must be aware at the time that there are such grounds for suspecting insolvency.

- This defence would require [DIRECTOR] to engage with management, unless they have valid reasons such as "illness" or "some other good reason".
- [APPLY WHERE APPLICABLE]:
    - Non-participation due to spousal directorship insufficient (*DVT v Clarke*)
        - Held that: the words 'some other good reason' must be read down so that they did not conflict with the obligation of directors generally to participate in the management of the company. A director's total reliance on their spousal director for management due to their love, faith and confidence would not entitle reliance on 'some other good reason' as it is in conflict with the basic expectation of all directors to ordinarily participate in management
- Thus, it is unlikely that [DIRECTOR] could rely on this defence, considering the commitment expected of directors and being absent from management without aa valid cause is inconsistent with the positive duty to take an active part in the affairs of the company (*Statewide Tobacco Services v Morley*).

Defence #4 – Reasonable steps to prevent the incurring of the debt – s 588H(5)

- This defence would require the [DIRECTOR] to have taken all reasonable steps to prevent the company incurring a debt.
- This may require [DIRECTOR] to resign as a director to express their opposition by resigning, or even put [COMPANY] into administration.
- In most cases, this defence can be established if the [DIRECTOR] have acted swiftly in their decision to appoint a voluntary administrator to take over management.
- To determine "reasonableness", the court is to consider the following non-exhaustive factors:
    - The size and complexity of the company concerned
    - The size of the debt which was incurred
    - The nature of the grounds which gave rise to the suspicion of insolvency
    - If the company stringently monitored its expenditure and income after it suspected liquidity problems
    - What powers and functions the director(s) seeking to rely on the defence possessed to either prevent the debt or bring it to the attention of the board or other appropriate officer; and whether the director(s) exercised those power and functions.
- In the facts, [DIRECTOR] [FACTS]. The [DIRECTOR] conduct is taken to [REASONABLE/NOT REASONABLE] as taking into account the factors listed above, [DIRECTOR] [FACTS],
- As a result, he is [ABLE/NOT ABLE] to rely on this defence.

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(1) Elements manifesting a breach of s 588G **(HOLDING COMPANIES)**

A holding company may be liable for a subsidiary that trades while insolvent if all of the elements below are satisfied (s 588V):

- (1) The company must be the holding company at the time when the subsidiary incurs a debt
- (2) The subsidiary must be insolvent at the time, or become insolvent by taking the debt
- (3) Reasonable grounds for suspecting that the company is insolvent, or will be
- (4) The holding company, or one or more of its directors are aware that there are reasonable grounds for suspecting insolvency OR having regard to the nature and extent of the holding company's control over the subsidiary's affairs, it is reasonable to expect either the holding company or one or more of its directors would be so aware.

NB. REFER TO EXPLANATION OF ELEMENTS UNDER DIRECTOR SCAFFOLD

(2) Defences for holding companies – s 588X

The defences that will allow a holding company to escape liability for the insolvent trading of its subsidiary in s 588X mirror the effect of those under s 588H. Thus, the defences are as follows:

1. The corporation and each relevant director (if any) had **reasonable grounds to expect and did expect** that **the company was solvent and would remain solvent** even if it incurred that debt – **s 588X(2)**;

2. The corporation and each relevant director (if any) **believed on reasonable grounds** that a **competent person** was monitoring the subsidiary company's solvency and keeping the company/director(s) informed and, as a consequence, the company was and would remain solvent even after it incurred the debt – **s 588X(3)**;

3. The fact that a relevant director of the holding company was aware that there were grounds for suspecting the insolvency of the subsidiary shall be disregarded where the director did not take part in the management of the holding company at the time when the subsidiary incurred the debt because of **illness or other good reason** - **s 588X(4)**; or

4. Where the corporation took **all reasonable steps** to prevent the company from incurring the debt – **s 588X(5)**.

Remedies for BOTH

Remedies for contravention of a civil penalty provision

S 588G is a civil penalty provision under s 1317E(1)(e), meaning the possible remedies against a director who has breached this section include a disqualification order under s 206C; pecuniary penalty order under s 1317G; or compensation order under s 1317H or s 588J (where the debt is wholly or partly unsecured and the creditor has suffered loss or damage).

Remedies may also be sought under Pt 5.7B Div 4 where the debt is wholly or partly unsecured and the company has suffered loss or damage as a result of the contravention

In addition to the civil recovery remedies under **Pt 9.4B**, recovery under **Pt 5.7B Div 4** may also be sought for **compensation for a creditor's loss** arising from contravention of the duty to prevent insolvent trading**, where the debt** incurred was **wholly or partly unsecured**.
Relevantly:

(1) *Liquidator*

- When the company is being wound up, the **liquidator may bring an action** against the director, as a debt due to the company, for recovery of an amount equal to the loss or damage sustained by the creditor(s) – **s 588M**.

(2) *Creditor*

- A **creditor** may bring an action against a director directly for a debt owed to them, **with the liquidator's consent**, under **s 588R**;

- If no action has been taken by the liquidator 6 months after the company began being wound up, a **creditor** may give the liquidator notice of their intention to commence proceedings under **s 588M** and request, within 3 months of the liquidator receiving that notice, either a written consent or a written statement outlining the reasons why the liquidator thinks proceedings should not be commenced: **s 588S**;

- After the expiry of the three months referred to above, the creditor may make an application to the court to seek leave to commence proceedings under **s 588M**, with or without a statement of reasons from the liquidator (depending upon whether such a statement has been received): **s 588T**;

- **A creditor may not bring proceedings** under **s 588M**, if, inter alia, the liquidator has already commenced proceedings under that section or has made an application for a civil penalty order: **s 588U**.

<u>Remedies for criminal liability (if dishonesty)</u>

Further, a director may face criminal liability if they **dishonestly** traded while insolvent: s 588G(3)(d), making them susceptible to a charge of $220,000 and/or 5 years imprisonment under **Sch 3**. In terms of compensation for a criminal act, if a director is found guilty under this provision, the debt is wholly or partly unsecured and the creditor has suffered loss or damage, a Court may order the director to pay compensation equal to the loss or damage to the company to satisfy the debt: **s 588K**.

<u>Remedies against holding company (where debt is wholly or partly secured)</u>

If the holding company is found liable for the subsidiary trading while insolvent under **s 588V** the subsidiary's liquidator may sue the holding company for compensation for loss suffered by unsecured creditors as a result of insolvent trading by the subsidiary: **s 588W(1)**. Proceedings must be commenced within six years after the beginning of the winding up: **s 588W(2)**.

Director's Duties: Duty to Act in Good Faith and For a Proper Purpose

Introduction

Directors owe a fiduciary duty to act in good faith in the best interests of the company and for a proper purpose (s 181(1)). These principles import the same standard under both the general law and statute (*Hospital Products;* s 181(1)). The duty is owed to the company as a whole (*Smith v Fawcett*). This is to be interpreted as the general body of shareholders (*Greenhalgh v Arderne Cinemas; Ngurli v McCann*), and not to be owed to individual shareholders (*Percival v Wright*), creditors (*Spies v R*) or employees (*Parke v Daily News*).

The general law duty of good faith is complemented by a specific statutory duty. A director or other officer must exercise their powers and discharge their duties (a) in good faith in the bests interests of the company and (b) for a proper purpose (s 181(1)).

It is important to note that a person who is involved in a contravention of s 181(1) contravenes s 181(2). Both subsections are civil penalty provisions.

First Limb: s 181(1)(a)

(1) Good Faith

To have been acting in good faith, [DIRECTOR] must have honestly believed that he was acting in the best interests of [COMPANY NAME] (*Bell Group; ASIC v Maxwell*). To satisfy the first limb of this fiduciary duty, the director(s) must honestly believe they are acting in the best interests of the company as they perceive them with consideration of all circumstances (*Bell Group; ASIC v Maxwell*). The court's inquiry is limited to each director's subjective intent, not an objective view of the company's best interests (*Re Smith and Fawcett Ltd; Harlowe's Nominees*). Thus, statements of intention are relevant but not conclusive (*Bell v Westpac*).

Besides this, the Charterbridge Test (objective) must be employed. The test considers "whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company" (*Charterbridge Corp v Lloyds Bank Ltd*).

In the facts, [APPLY FACTS].

CONTRAVENED:

- Therefore, it can be asserted that the director has contravened s 181(1)(a) as he has engaged deliberately in a conduct which is not in the best interests of the company (*ASIC v Maxwell*).
- This was qualified in *ASIC v Sydney Investment House Equities Pty Ltd* which stated that "consciousness in this sense means knowledge of the facts that make the conduct not in the

best interests of the company; it is not necessary to establish knowledge that the conduct constitute a breach of the law or was improper"

- Thus, it is likely that [DIRECTOR] as the director of [COMPANY NAME] will be found to have breached his statutory duty of good faith as he did not act honestly and in the best interests of the company when [INSERT FACT]. As it is likely that this duty has been breached, it is also likely that the equitable duty of good faith based on the director's fiduciary duty will succeed.

(2) Best interests of the company

To have been acting for the best interest of the company, the general rule at common law is that the best interest of the company will be that of the shareholders as a whole (*Greenhalgh*). This includes present and future members of company (*Ngurli v McCann*).

[APPLY WHERE RELEVANT]

1. **There is no duty to individual shareholders (*Percival v Wright*)**
    - Exception 1: Where directors hold themselves out as acting in their individual interests (*Allen v Hyatt)*
        i. The standard of conduct required from directors depends upon the nature of the responsibility that the directors have assumed toward the shareholders (*Coleman v Myers*).
            1. Relevant considerations include: if the director approached the shareholders to sell; relationship of trust and confidence; shareholder dependence on director's advice.
        ii. In *Allen v Hyatt*, directors did owe a duty to individual shareholders as they held themselves out as acting in their individual interests and by proactively approaching the shareholders.
        iii. In the facts, the director has held themselves out as acting in their individual interests, proven by [FACTS]. As a result, [DIRECTOR] owed a duty to individual shareholders as they held themselves out as acting in their individual interests and proactively approached them. Therefore, this exception applies and there is a duty to individual shareholders.
    - Exception 2: Duty owed as a result of quasi-partnership relationship (*Brunninghausen*)
        i. Where a transaction does not concern the company but only another shareholder, a director may owe a fiduciary duty to that shareholder.
    - Exception 3: Directors are brought into close contact with shareholders (*Peskin v Anderson*)
        i. Through dealings, negotiations, communications, and other contact directly between the directors and shareholders.
    - Exception 4: The relationship is capable of generating fiduciary obligations (*Peskin v Anderson*)
        i. Such as an obligation to use confidential information acquired by the directors in that office, for the benefit of the shareholders.

2. **Company's internal rules may affect scope of duty**
    - The company's constitution may permit directors to take account of a stakeholder's interests ahead of others (*Berlei Hestia (NZ) Ltd v Fernyhough*).
    - Adequately worded provision in company's constitution may allow directors to refuse to register shares (*Re Smith and Fawcett Ltd*).
    - In the facts, the company's constitution permitted the director to take into account stakeholder's interest above the company's. This is proven in [FACTS].

3. **Interests of employees and community (if congruent with company's interest)**
    - Insofar as the interests of employees and the community can be regarded as affecting the interests of the company, they can be taken into account (*Teck Corp v Millar*). This exists despite the limitation in *Parke v Daily News* where it was stated that interests of employees should not be considered by the directors ahead of the interest of the company as a whole.

4. **Employees**
    - Directors do not have a duty to employees.
    - But in some circumstances, providing benefits to employees will serve the proper purpose of benefiting the company as a whole (*Hutton v West Cork Railway*).

5. **Creditors**
    - Generally, directors do not owe an independent duty to creditors (*Spies v R*). However, creditors' interests must be considered when insolvency is imminent (*Kinsela v Russel Kinsela Pty Ltd*). This fiduciary duty to consider creditors' interests during insolvency cannot be relaxed or removed by the shareholders.
    - In *Bell,* upon insolvency, there is a duty to "protect" the creditor interests, since it is a duty to act in the interests of the company.

6. **Nominee directors**
    - NSWSC decisions in *Bennets v Board of Fire Commissioners* and *Harkness v Commonwealth Bank of Australia* prefer the interests of the company over the nominator in the event of a conflict, unless the interests are congruent (*Re Broadcasting Station 2GB*) or the company's constitution authorizes the action concerned (*Levin v Clark*).
    - In *Bennetts v Board of Fire Commissioners,* a director must favour the interests of the company to which they are appointed.
    - However, in *Re Broadcasting Station 2GB,* directors will not breach their duty if they honestly believed the interests of their nominator were congruent with those of the company upon which they sat as director.
    - In *Harkness*, rejected this approach and held that the duty of confidentiality towards the company overrides the duty owed to the nominator.
    - However, in *Fitzimmons v R,* it was held that the duty to act in good faith and in the best interests of a company overrode the duty of confidentiality towards another.

i. It may be said that this case can be confined in its application to directors who are actively involved in making decisions which they know are disadvantageous to the company upon whose board they are appointed.

7. **Corporate Groups**
    - In the facts, given [PARENT COMPANY] controls [SUBSIDIARY] pursuant to s 50AA(1). This is because [FACTS – e.g. parent company has the ability to determine the outcome of the subsidiary's financial and operating policies].

[SELECT WHERE APPLICABLE]:

- Under s 187, if a subsidiary's constitution authorizes the director to act in the best interests of the holding company (s 187(a)), no breach will occur if the director does so and:
    i. The director acts in good faith in the best interests of holding company (s 187(b)); and
    ii. The subsidiary is not insolvent at the time the director acts or becomes insolvent because of the director's act (s 187(c)).

- If there is no contrary provision in the subsidiary's constitution, the rule is that directors of non-wholly owned subsidiaries must uphold the interest of the subsidiary even if they have to go against the holding company (*Equiticorp v Bank of New Zealand*).

- General rule is that directors cannot put the interests of other companies above the interests of their own (*Walker v Wimborne*).
- Where the director assumed that the group would benefit as a whole and did not specifically consider the individual company (objective test)
    i. "Whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company" (Charterbridge Corporation Ltd v Lloyds Bank Ltd)
- The interests of the group may be congruent with the company's best interests (*Equiticorp Finance Ltd v Bank of New Zealand*).
- Therefore, if companies are not in a group (e.g. just a subsidiary and holding company), then need to prove benefit to the company specifically. However, where they are in a group, companies can also prove a benefit to the group collectively, as long as they can prove that group stability renders some derivative benefit to them personally.

Second Limb: s 181(1)(b)

<u>For a proper purpose</u>

Directors owe a fiduciary duty to exercise their powers under ss 198A & 198B for a proper purpose (s 181(1)(b)). It is asserted that [DIRECTOR] has breached his statutory duty of proper purpose pursuant to s 181(1)(b). In doing so, he has [FACTS]. This could be argued to be for an improper

(4) Improper use of position (s 182)

(a) *Introduction*

The plaintiff may seek to argue that the director has acted for an improper purpose by exercising his/her power to make or secure some private advantage for the director (*Mills v Mills*). Thus, it could be stated that the [DIRECTOR/SECRETARY/OTHER OFFICER] have improperly used their position to gain an advantage for themselves or someone else; or cause detriment to the corporation (s 182(1)(a)-(b)). Subsequently, a person who is involved in the contravention of subsection (1) contravenes s 182(2)) and is liable for a civil penalty.

This is shown in the facts as [FACTS AS TO HOW THE DIRECTOR BREACHED S 182].

(b) *The test*

The test is whether the [DIRECTOR] have improperly used their position to (a) gain an advantage for themselves or someone else; or (b) cause detriment to the corporation.

Improperly

"Improperly" or "impropriety" is to be assessed by an objective test of "the standards of conduct that would be expected of a person in his position by reasonable persons with knowledge of the duties, powers, and authority" (*Doyle v ASIC*). In *R v Byrnes*, "impropriety in the use of a position may consist in an abuse of the power or authority which the position confers". Therefore, there does not need to be dishonest or fraudulent conduct, but may be something the director does that is not authorized by the board (e.g. contract without authority). This is evident in the facts as the director [FACTS]. Further, the facts evidence that the director has gained or attempted to gain an advantage for himself by way of [FACTS].

Gaining an advantage

It is not necessary that the accrual of an advantage or suffering of a detriment actually occur, only that the accused "believed that the intended result would be an advantage for himself or herself or for some other person or a detriment to the corporation" (*Chew v R*). It is also important to note that the duty continues after leaving the company (s 183).

Examples of improper use of position:

- Selling assets to defeat a creditor – *Jeffree v NCSC*

- Loan to related entity without approval – *R v Byrnes*
- Transfer of money to personal account – *R v Cook*
- Adler controlled two companies; one company purchased the tech companies from the other company at an inflated price – *ASIC v Adler*

This action by [ACTION] has caused detriment to the company (s 182(1)(b)) as [FACTS].

(c) *Defences*

1. Reliance on information or advice provided by others (s 189)
    - This defence applies to all of Part 2D.1 (ss 179-198F) or the general law equivalents (s 189(c)).
    - The defendant may seek to argue that in making their decision, he reasonably relied on information provided by others who he thought were competent and reliable individuals.
    - Thus, as the facts highlight [DIRECTOR] employed [OFFICER] which provided [FACTS].
    - The reliance was made in good faith and the director had relied on the information after making an independent assessment of the information in the context of the director's position and the company's operational complexity (*Daniel v Anderson*).
    - Thus, [DIRECTOR] brought an active and inquisitive mind to the assessment of the information and did not blindly rely on the information provided.

2. Delegation of authority (s 190)
    - The defence is available as *ASIC v Adler* says that there is no substantive between the general law position and s 190. Therefore, it applies.
    - For
        - Under the replaceable rule in s 198D, directors have the authority to delegate their functions to other people, subject to contrary provisions of the company's constitution.
        - The defendant may seek to argue that in making their decision, he is not liable as he has delegated the task to another individual pursuant to s 190 CA.
        - The [DIRECTOR] is not responsible as he believed on reasonable grounds that at all times, the delegate would exercise the power in conformity with the duties imposed on directors of the company (s 190(2)(a)).
        - The [DIRECTOR] believed that the [OFFICER] would conform on reasonable grounds (s 190(2)(b)(i)) and in good faith (s 190(2)(b)(ii)) after making proper inquiry if the circumstances indicated the need for inquiry (s 190(2)(b)(iii)).
        - In the facts, a reasonable person in the position of a director would have held that the delegate was reliable and competent in relation to the power delegated.

Reliance on information or advice provided by others – s 189

Applies to:

1. Duty to act with reasonable care and diligence – s 180(1)
2. Duty to prevent insolvent trading – s 588G
3. Duty to act in good faith and for a proper purpose – s 181(1)
4. Managing conflict of interests
    a. Fiduciary duty to avoid conflict of interest with company (general law)
    b. Improper use of position – s 182
    c. Improper use of information – s 183

Scaffold:

The defendant may seek to argue that in making their decision, he reasonably relied on information provided by others who he thought were competent and reliable individuals. In the facts, the director relied on information provided by [PICK ONE]:

1. An employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned – s 189(a)(i)
2. A professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence – s 189(a)(ii)
3. Another director or officer in relation to matters within the director's or officer's authority – s 189(a)(iii)
4. A committee of directors on which the director did not serve in relation to matters within the committee's authority – s 189(a)(iv)

Furthermore, the reliance was made in good faith (s 189(b)(i)) and the director had relied on the information after making an independent assessment of the information in the context of the director's position and the company's operational complexity (s 189(b)(ii)) (*Daniels v Anderson*). In the facts, [FACTS WHICH SHOWS S 189(B)].

Thus, [DIRECTOR] brought an active and inquisitive mind to the assessment of the information and did not blindly rely on the information provided.

Delegation of authority – s 190

Applies to:

1. Duty to act with reasonable care and diligence – s 180(1)
2. Duty to act in good faith and for a proper purpose – s 181(1)
3. Managing conflict of interests
    a. Fiduciary duty to avoid conflict of interest with company (general law)
    b. Related party transactions – CH 2E
    c. Improper use of position – s 182
    d. Improper use of information – s 183

Scaffold:

FOR

Under the replaceable rule in s 198D, directors have the authority to delegate their functions to other people, subject to contrary provisions of the company's constitution. The defendant may seek to argue that in making their decision, he is not liable as he has delegated the task to another individual pursuant to s 190 CA. The [DIRECTOR] is not responsible as he believed on reasonable grounds that at all times, the delegate would exercise the power in conformity with the duties imposed on directors of the company (s 190(2)(a)). The [DIRECTOR] believed that the [OFFICER] would conform on reasonable grounds (s 190(2)(b)(i)) and in good faith (s 190(2)(b)(ii)) after making proper inquiry if the circumstances indicated the need for inquiry (s 190(2)(b)(iii)). In the facts, a reasonable person in the position of a director would have held that the delegate was reliable and competent in relation to the power delegated.

[APPLY IF APPLICABLE]:

- In *ASIC v Adler*, factors that should be taken into account in deciding whether a director's decision to rely on a delegate was reasonable includes:
    - (1) Whether the function that was delegated was such that it could properly be left to such officers
    - (2) The extent to which the director is put on inquiry, or should have been put on inquiry (*Re Property Force Consultant P/L*)
    - (3) The relationship between the director and delegate; director must honestly hold the belief that the delegate is trustworthy, competent, and someone on who reliance can be placed (*Biala P/L Malling Holdings*)
    - (4) The risk involved in the transaction and the nature of the transaction
    - (5) The extent to which the director advised the delegate of the trust and confidence reposed in them
- In *Daniels v Anderson; Adler v ASIC*, if the directors and officers reasonably believe the person delegated is competent of the task, then the officers and directors will not be liable for the delegate's mistake.

Against

However, it is unlikely that [OFFICER] will be deemed to be reasonably capable of doing the delegated task (*Daniels v Anderson*). This is because [FACTS]. Further, it is noted that there are certain duties that directors cannot delegate because it is something the directors must personally state, preventing him from relying on s 190 to escape liability (e.g. signing off on company's annual financial statements – *ASIC v Healey*). Moreover, directors cannot delegate responsibility for decisions they have been specifically requested by management to make. Defendant may argue that he had no grounds to suspect that the delegate was acting improperly. Thus, the delegate should be considered reasonably capable of completing the task (*Re City Equitable Fire Insurance Co*).

Business judgment rule – s 180(2)

Applies to:

1. Duty to act with reasonable care and diligence – s 180(1)

Scaffold:

The defendant may seek to argue the business judgment rule found under s 180(2), preventing the court's interference (*Harlowe*). S 180(2) states that a director who makes a business judgment is taken to have exercise due care and diligence if they (a) made a judgment in good faith and for a proper purpose, and (b) did not have material personal interest in the subject matter, and (c) informed themselves about the subject matter to the extent they reasonably believe to be appropriate, and (d) rationally believed that the judgment is in the best interests of the corporation. Pursuant to subsection (3), business judgment means any decision to take or not act in respect of a matter relevant to the business operations of the corporation. In the facts, [DEFENDANT] would assert that he was under no conflict of interest, acted in good faith and for a proper purpose, made rational decisions in the best interest of the corporation, and made some kind of enquiries in a way that a reasonable person in his position believes is appropriate to make sure it is a good business judgment that should be protected by the rule in s 180(2). However, it is important to note that this defence is hard to argue and rarely succeeds. In the facts, [DIRECTOR] is likely to have breached this duty and this will not apply.

[APPLY CASE LAW IF APPLICABLE]:

- *ASIC v Adler* → Onus on the director/officer to prove the defence
- *Gold Ribbon Accountants v Sheers* → It is not a business judgment to decide to take no interest in the affairs of the board

Ratification

Applies to:

1. Managing conflict of interests
    a. Fiduciary duty to avoid conflict of interest with company (general law)

Scaffold:

Acted honestly and ought to be excused – s 1318

Applies to:

1. Duty to act with reasonable care and diligence – s 180(1)
2. Duty to act in good faith and for a proper purpose – s 181(1)
3. Managing conflict of interests
    a. Fiduciary duty to avoid conflict of interest with company (general law)
    b. Related party transactions – CH 2E
    c. Improper use of position – s 182
    d. Improper use of information – s 183

Scaffold:

The defendant may seek to argue that there was an honest error in the contravention (s 1317S). This will require the director/officer to establish that they acted honestly and in all of the circumstances ought to be reasonable to be excused from liability. Honestly means without moral turpitude (*Commonwealth Bank of Australia v Friedrich*). Further in *Hall v Poolman,* Palmer J defined honesty in the following way: "[H]as [the person] acted without deceit or conscious impropriety, without intent to gain improper benefit or advantage for himself, herself or for another, and without carelessness or imprudence to such a degree as to demonstrate that no genuine attempt at all has been to carry out the duties and obligations of his or her office imposed by the Corporations Act or the general law[?]".

In the facts, taking into account his degree of care and diligence (*CBA v Friedrich*), [DEFENDANT] has acted honestly as [FACTS]. This defence is only available to minor issues that have not resulted in losses for shareholders and other individuals. In the facts, there was an honest mistake by [DIRECTOR], justifying his ability to rely on this defence.

IS [PERSON] A DIRECTOR/OFFICER?

Statutory Definitions

Director (s 9)

a) A person who:
   (i) Is appointed to the position of director; or
   (ii) Is appointed to the position of an alternate director and is acting in that capacity

   regardless of the name that is given to their position; and

b) Unless the contrary intention appears, a person who is not validly appointed as a director if:
   (i) They act in the position of a director (de-facto director); or
   (ii) The directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Officer (s 9)

a) A director or secretary of the corporation; or
b) A person:
   (i) Who makes, or participate sin 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 the board is 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
c) A receiver, or receiver and manager, of the property of the corporation; or
d) An administrator of the corporation; or
e) An administrator of a deed of company arrangement executed by the corporation; or
f) A liquidator of the corporation; or
g) A trustee or other person administering a compromise or arrangement made between the corporation and someone else.

If the question does not expressly say that [PERSON] is a director

(a) *Introduction*

ASIC/claimant has the onus to prove that [PERSON[is a director or an officer under s 9 of the Corporations Act. To determine this, the common law works in addition to the statute to find the test to determine whether an individual could be considered a director/officer. Of particular relevance, are the established tests relating to shadow directors and de-facto directors.

(b) *Generally*

If the individual makes decisions "affecting the whole or substantial part of the business of the subsidiary and also has the capacity to affect significantly the subsidiary's financial standing", they will be considered an officer (s 9; *ASIC v Adler*).

(c) *Shadow directors*

A shadow director is a person who exercises a controlling influence over the BOD but is not appointed himself or herself as a director. A company may act in such a way as to render itself a shadow director (*Standard Chartered Bank of Australia v Antico*). Since [PERSON] is taken to be a "puppet master controlling the actions of the board" (*Re Unisoft Group Ltd (No 3)*), he is taken to be a shadow director. He does not need to be involved in every, or even most, transactions undergone by the company. Strategic control (control when desired) is enough to prove a director under s 9 (*ASIC v As Nominees*).

(d) *De-facto directors*

A de-facto director is someone who works in the position of a director without being officially appointed as one (*Corporate Affairs Commission v Drysdale*) but is in control of the practical direction of the company and its driving force (*Harris v S*). To assess whether [PERSON] is a de-facto director, [PERSON] must have held himself out to be a director of the company by undertaking important tasks that directors would commonly do. Therefore, a person who attends board meetings and participates in collective decision-making as a director may thereby become de-facto director (*Drysdale*). It is the participation in the decision-making process as part of the governing structure of the company that makes the person a de-facto director (*Holland v Revenue and Customs Commrs*). Thus, since [PERSON] attended all board meetings and whose opinion is factored into decision-making, he is a de-facto director (*Austin v Spencer*).