

# Director's Duties- Topic 13

## Categories of Duties

### Care, Skill & Diligence

- **General Law**
  - Act with reasonable care & diligence
    - Statutory Duties:
      - Act with reasonable care & diligence (s180)
      - Prevent insolvent trading (s588G)

### Loyalty & Good Faith

- **General Law**
  - Retain discretion
  - Avoid conflicts of interest
    - **Statutory Duties:**
      - Disclose certain information; s191-196
      - Related party transactions; Ch 2E
      - Duty not to misuse information or position; s182,183
  - Act in good faith in the interests of the company
    - **Statutory Duty:**
      - Act in good faith in best interests of the company and for proper purpose; s181
  - Use powers for proper purpose;
    - **Statutory duty: s181**

	Owed by	Owed to	Enforcer	Remedies
General Law Duties	Directors & Senior Executives	Company	Company & Liquidator	Compensation or damages
Statutory Duties	Directors, Officers & Employees*	Company	ASIC	Civil or Criminal Penalty

## Who owes the Duties?

### General Law Duties

- **Fiduciary:**
  - Person expected to act in the interests of another person because of their special relationship

- **Directors**
  - Director is fiduciary
- **Senior executive officers**
  - May also be fiduciaries; s9

### Statutory Duties

- **Directors**, including:
  - De facto directors
  - Shadow directors
- **Some also apply to:**
  - Officers
    - s9; definition
    - s180; care & diligence
    - s181; good faith
    - s183; improper use
- **Employees**
  - ss182 & 183 improper use

### Duty to individual shareholder?

- In rare circumstances where relationship between particular director and particular shareholder is fiduciary in nature, that director may owe duty to that shareholder.
  - *Bunningham v Glavanics* (1999) [13.2.35]

### Who Enforces the Duties?

#### General Law Duties

- **Enforced by Company**
  - Board of directors decide whether or not to sue for breach
- **Liquidator of Company** being wound up may act on behalf of company to sue for breach

#### Statutory Duties

- **Enforced by ASIC**

### Consequences of Breaching a Duty

#### General Law Duties

- Compensation paid to company
- Damages paid to company

#### Statutory Duties

- **Breach of Civil Penalty provision:**
  - Disqualification;
  - \$200,000 penalty; and/or

- Compensation order
- **Criminal penalty for serious breaches**
  - \$220,000 fine; and/or
  - 5 years prison

## Duty of Care; [Chapter 13.4]

### Sources of Duty of Care:

- s180
- General Law
  - Note: The standard of care under s180 and General Law is the same
- Contract

### Common Law (General law)

- **Directors and other officers who breach their duties of care and diligence** will be **liable** to pay damages to the company if:
  - Breached their standard of care and diligence (REASONABLE PERSON) and
  - Their carelessness caused the company's loss or damage; and
  - The kind or type of loss suffered by the company was reasonably foreseeable.

### S180; Care and Diligence (Statutory)

(1) A **director or other officer** (s9: scope of persons who owe this duty go beyond directors) 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 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.

**TEST= Compare amount of care and diligence exercised by the director with care and diligence that a reasonable person would exercise if they were a director of a similar company and had the same responsibilities? (REASONABLE PERSON STANDARD APPLIES)**

### S9- Officer of a corporation 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)

## What Standard of Care is expected?

### *Daniels v Anderson (1995)*

- AWA sued auditors for breach of contract and negligence
- **AWA Senior Executives did not:** adequately supervise, monitor inter procedure or maintain adequate records
- **Auditor failed to:** detect unauthorised borrowings, but did warn Snr Execs internal monitoring was inadequate, didn't warn board though to remedy problem.

Held:

- Auditor was negligent and liable.
- AWA was also negligent, CEO and Snr Execs breached 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

### Minimum Standard Expected of all Directors; *Daniels v Anderson*

- **Must** acquire basic understanding of business
- **Must** keep informed about company's activities
- **Don't need** detailed inspection of day-to-day activities, **but must** monitor company's business
  - Should regularly attend board meetings
- **Must** be familiar with financial status of company by regular review of financial statements
- **Director's cannot** shut their eyes to corporate misconduct and then claim that they did not see the misconduct

### TEST: (objective)

- **Directors must** "discharge their duties in good faith and with that degree of diligence, care and skill which ordinary prudent men would exercise under similar circumstances?

### Factors that impact on degree of care

- S180(1)(a): **Company's circumstances**; *CBA v Friedrich*
  - Type of company, Size, Nature of its enterprise, Constitution, Board composition and Distribution of work between board and officers.
- S180(1)(b): **Office held and responsibilities**; *ASIC v Rich [2003]*
  - 'Responsibilities' refers to the factual arrangements within the company that affect the director in question, not limited to legal duties; e.g. delegation of tasks;

### Standard of Care: Directors; *AWA Ltd v Daniel (1992) 10 ACLC 993*

- **Executive**
  - Full time employee and knowledge of daily operations
  - Subject to more stringent standard of care than non-executive directors
- **Cases where executive directors** (e.g. CEO or MD) **breached their standard of care:**
  - Failing to ensure company appropriate management systems in place and that systems are functioning properly; *South Australia v Clark (1996)*

- Failing to monitor management effectively; *Daniels v Anderson* (1995)
- Failure of a CFO to exercise the level of skill of a reasonably competent CFO; *Vines v ASIC* [2007]
- **Non-Executive**
  - **Not involved in daily management** therefore **rely on others information**
  - Standard of care recognises **duties are of an intermittent nature** (less stringent)
  - Expect to be informed of anything untoward or appropriate for consideration.

### Standard of Care: 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]

- Position of 'chair' came within the meaning of 'responsibilities' in s180(1)(b)
- **Role of non-exec Chair** not merely ceremonial or procedural duties
- Has **primary responsibility for**:
  - Selecting matters for discussion by board
  - Bringing documents to board
  - Formulating board policy

### Standard of Care: When Appointed because of a Particular Skill

- Standard of care is higher:
  - **The degree of skill that a reasonable person with that skill would exercise**

### *Shafron v ASIC* [2012]

- S was the general legal counsel for H. H made misleading statements about trust fund.
- S was delegated task of providing the board cash flow modelling regarding fund/claims

HELD:

- S breached s180(1) because: Not exercise skill of reasonable legal counsel.
  - **Didn't advise board** that the ASX announcement about adequacy of the compensation fund was based on inappropriate cash flow modelling assumptions
  - **Failed to draw board's attention to deficiencies** in actuarial reports

**Other Cases:**

- 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*

## Business Judgment Rule (BJR)

- The BJR is a **defence against actions for breach of Duty of Care**
  - Defence to both General Law and Statutory (s180) Duty of Care
- **BUT** it is **not a defence to breach of other duties**

## 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.
- Onus on directors to prove defence.

## S180 (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;
  - (b) **No material personal interest** in subject of the judgment;
  - (c) Informed themselves about the subject of the judgment; and
  - (d) Judgment was rationally believed to be in the best interests of the company
    - Rational if based on reasoning, not rational if no arguable reasoning to support
      - *ASIC v Rich*
- **S180(3): A 'Business judgment' means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation**
  - Such judgments are in the best interests of the company and rational unless the belief is one that no reasonable person in their position would hold

## Delegation & Reliance

### Can Director's Delegate? S198D

- 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
- Boards commonly delegate to committees such as:
  - Audit committee
  - Remuneration committee
- Boards also often delegate certain functions to a CEO
- Delegation must be recorded in companies minute book; s251A

### Director Responsible

- **Director who delegates** under s198D: is **responsible for the exercise of the power by the delegate** as if the **power had been exercised by the director themselves** (s190(1))
- Directors have a positive obligation to be informed and satisfy themselves that the person they are relying upon is competent and reliable.

## Defence; S190 (2)

- However, director not responsible if:
  - a. Believe on reasonable grounds delegate would act in conformity with directors duties; and
  - b. Belief
    - i. On reasonable grounds;
    - ii. In good faith; and
    - iii. After proper enquiry
  - c. That delegate reliable and competent in relation to power delegated (s190(2))

## Reasonable for a director to rely on information or advice of others? S189

1. Can rely on info/advice from:
  - a. Employees (who director believes competent on subject concerned);
  - b. Professional advisers or experts (believes on reasonable grounds in expert area);
  - c. Another director (within the directors authority); **or**
  - d. Committee of directors (committee of directors of which director did not serve)
2. If reliance was made:
  - a. In good faith; and
  - b. After making independent assessment of the info/advice
3. Reliance is taken to be reasonable unless the contrary is proved
  - a. Onus of proof on person seeking to prove directors reliance not reasonable

## ASIC v Adler [2002]

- Adler used an outside buyer to purchase shares, so his shares would raise in value.
- Outside buyer suffered a loss as a result of unsecured and not documented loan.

HELD: Adler liability

- Adler breached s180(1)- A reasonable director would not have made a loan off books and by means different to company procedure.
  - The use of funds to purchase HIH shares materially prejudiced interests of HIH & HIHC and was not disclosed to directors (other than W and F)
  - Also breached s181 and 182
- BJR not available; his contravention of s181 disclosed a lack of good faith; 180(2)(a)
- Adler had a conflict of interest regarding the loan and could not rely on s180(2)(b).

HELD: Directors W & F liability

- BJR not available; the loan was not a business judgment
  - No evidence that his judgment was made in good faith and for a proper purpose
- Major shareholder in HIH and thus material person interest, could not rely on s180(2)(b)
- Breached s180(1): failed to put in place proper safeguards including independent valuation of 'investment' and investment not approved by committee or board
- Breached s182 because improperly used his position to gain an advantage for Adler and caused detriment to HIH and HIHC
- Fodera Breached s180 because took no steps to have investment submitted for approval by committee or board