

## LAWS1091 – FINAL EXAM DETAILED NOTES PREVIEW

### OFFICERS AND DIRECTORS DUTIES

Step	Notes
<b>Overview of liabilities</b>	<p><u>General information</u></p> <ul style="list-style-type: none"> <li>● Directors are fiduciaries with equitable obligations of disinterested conduct</li> <li>● Not all duties imposed on directors are fiduciaries e.g. duty to exercise care, diligence and skill is imposed both in equity and at CL but may not be fiduciary</li> <li>● Justifications               <ul style="list-style-type: none"> <li>○ Directors are in a powerful position which they can abuse - e.g through shrinking or self dealing</li> <li>○ Legal strategy to protect the company</li> <li>○ Separation of ownership and management - the company, not the directors, own company property</li> <li>○ Protects public as well as private interests - e.g. ASIC hold directors and companies liable for breaches of duty</li> </ul> </li> </ul>
<b>Statutory v general law duties</b>	<p><u>Standing</u></p> <ul style="list-style-type: none"> <li>● The company has standing to sue for breach of duty               <ul style="list-style-type: none"> <li>○ <a href="#">S 1317H</a>: the company also has standing to seek compensation orders for breach of the civil penalty provisions relating to the stat duties set out in: <a href="#">ss 180-183</a></li> </ul> </li> </ul> <p><u>Scope</u></p> <ul style="list-style-type: none"> <li>● Difference between stat and general law duties affects the scope and remedial relief;               <ul style="list-style-type: none"> <li>○ <a href="#">Ss 182 and 183</a> enliven the civil penalty regime but then apply to a wider range of people (employees) than the general law counterpart</li> </ul> </li> </ul> <p><u>Enforcement:</u> ASIC</p> <ul style="list-style-type: none"> <li>● Directors and officers who breach stat duty either recklessly or intentionally commit an offence: <a href="#">s 184</a></li> <li>● Directors who facilitate their company's insolvent trading may similarly be committing an offence where the failure to prevent the incurring of debt is dishonest: <a href="#">s 588G(3)</a></li> <li>● ASIC's enforcement as a public regulator are supplement by private enforcement</li> </ul> <p><i>ASIC v Adler (2002) 42 ACSR 72</i></p> <p><u>Facts</u></p> <ul style="list-style-type: none"> <li>● Adler was a director of HIH, a listed insurance company</li> <li>● HIHC, a wholly owned subsidiary of HIH, loaned \$10 million to PEE, a company controlled by Adler</li> </ul>

- The loan
  - Broke internal investment guidelines
  - Was not disclosed or approved by the board
  - Was used to
    - Purchase HIH shares (to support its falling price)
    - Acquire unlisted stocks Adler personally held (without independent valuation)
    - Provide unsecured loans to Adler-related entities
- Other parties involved:
  - Williams (CEO) and Fodera (CFO) were aware but failed to intervene
  - ASIC commenced civil proceedings under [Part 9.4B](#) of the Corporations Act, alleging multiple breaches of statutory directors' duties

#### Issues

- Did Adler (and others) breach directors duties under [ss 180-183](#) of the Corps Act
- Were the transactions improper related party benefits under [s 208](#)
- Did the transactions constitute unlawful financial assistance under [s 260A](#)
- Were the defendants liable as accessories under [s 79](#)

#### Held

- All three (Adler, Williams, Fodera) breached their statutory duties under [ss 180-183](#)
- The transactions contravened [s 208](#) (related party benefits) and [s 260A](#) (financial assistance)
- Accessory liability was found under [s 79](#) for involvement in the contraventions

#### Legal reasoning

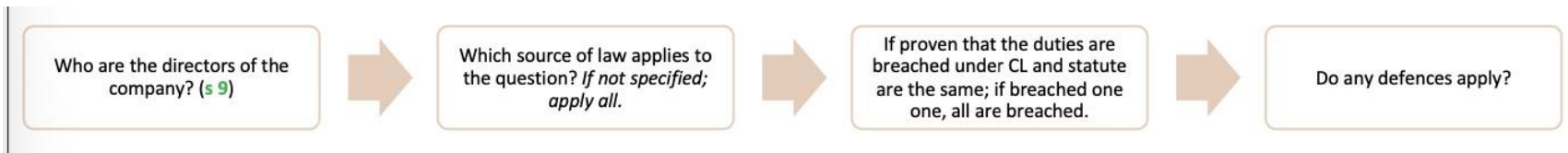
- [S 180\(1\)](#): Adler failed to exercise care and diligence. A reasonable director would not have approved the transaction given the risk, lack of valuation, and conflict of interest
- [S 181](#): Adler acted for an improper purpose - to promote his own financial interests, not in the best interests of HIH or HIHC
- [S 182](#): Adler used his position to obtain personal advantage by directing company funds for self-benefit
- [S 183](#): he misused confidential information by concealing the purpose and source of share purchases from the market
- [S 208](#): shareholder approval was required for the non-arm's length transaction with PEE but was not obtained
- [S 260A](#): HIHC funds were used to purchase HIH shares, which could materially prejudice the company - this was unauthorised financial assistance
- [S 79](#): accessory liability was established - Adler Corp, Adler and others were "knowingly involved in contraventions"

#### Legal significance

- Key authority on the application of statutory directors' duties, particularly:
  - [S 180](#) (care and diligence);
  - [S 181](#) (good faith and proper purpose);
  - [S 181-183](#) (misuse of position/information)
- Demonstrates how multiple breaches can arise from a single course of conduct

	<ul style="list-style-type: none"> <li>● Reinforces that self-dealing, lack of disclosure, and bypassing corporate procedures amount to serious statutory breaches</li> <li>● Sets precedent for civil penalties, banning orders and compensation under <a href="#">Part 9.4B</a></li> </ul> <p>Illustrates how accessorial liability under can capture other companies and officers involved in decision making</p>
<b>Scope of directors' personal liabilities</b>	<p>General rule: directors are generally not liable for acts or omissions of their company merely because of the office they hold, including acts or omissions of the board or performed by individual directors on the company's behalf</p> <p><u>Exceptions</u></p> <ul style="list-style-type: none"> <li>● Directors are personally liable to compensate creditors for losses suffered when the co incurs debts while insolvent and when there were reasonable grounds for suspecting that insolvency: <a href="#">ss 588G, 588R</a></li> </ul> <p><u>To whom are the duties owed?</u></p> <ul style="list-style-type: none"> <li>● To the company</li> </ul> <p><i>Percival v Wright [1902] 2 Ch 421</i></p> <p><u>Facts</u></p> <ul style="list-style-type: none"> <li>● Directors of Nixon's Navigation Company Ltd were in negotiations to sell the company's undertaking</li> <li>● At the same time, they purchased shares from minority shareholders (the plaintiffs) without disclosing these ongoing negotiations</li> <li>● The sale of the company ultimately did not go through</li> <li>● The shareholders later sought to set aside the share sales, alleging that the directors had a fiduciary duty to disclose the negotiations</li> </ul> <p><u>Issue</u></p> <ul style="list-style-type: none"> <li>● Did the directors owe a fiduciary duty to individual shareholders (the sellers of the shares) to disclose material information about ongoing company negotiations</li> </ul> <p><u>Held</u></p> <ul style="list-style-type: none"> <li>● No. The directors did not owe fiduciary duties to individual shareholders when buying shares from them</li> <li>● Duties are owed to the company as a whole, not to the individual members, absent special circumstances</li> </ul> <p><u>Legal reasoning</u></p> <p>The general fiduciary duties of directors (e.g. to act in good faith and for proper purpose) are owed to the company, not to individual shareholders</p> <ul style="list-style-type: none"> <li>● There was no evidence of fraud, misrepresentation or unfair dealing, not were the shares sold at undervalue</li> <li>● As the sale negotiations were part of ordinary business management, the directors were not required to disclose them, to shareholders in private transactions</li> <li>● The court refused to extend fiduciary obligations to shareholders in the absence of special relationships (e.g. advice, influence or representation)</li> </ul> <p><u>Legal significance</u></p> <ul style="list-style-type: none"> <li>● Established the general rule that directors owe their duties to the company, not to individual shareholders</li> <li>● Remain authoritative unless special circumstances exist (e.g. <a href="#">Coleman v Myers</a> (NZ case)), where there was a close personal relationship</li> </ul> <p>Reinforces the principle that corporate governance is centered around duties to the company as a separate legal entity, aligning with <a href="#">Salomon v Salomon</a></p>

## DUTY OF CARE



### USUALLY APPLIED WHEN A DIRECTOR/OFFICER FAILS TO DO SOMETHING

Step	Notes
<b>STEP 1: IDENTIFY DUTY HOLDER</b>	
<b>STEP 2: LEGAL FRAMEWORK</b>	<ul style="list-style-type: none"> <li>• S 180(1) is the statutory duty of care and diligence</li> <li>• It codifies the general law duty (common law + equity)</li> <li>• Different to the general law - doesn't involve "skill"               <ul style="list-style-type: none"> <li>◦ Courts have interpreted the provision to include "skill" as forming part of the care and diligence: <i>Daniels v Anderson (1995)</i></li> </ul> </li> <li>• Non-executive directors are not subject to the same standard of care as executive directors in view of their distinct roles, and to affirm that the standard of care, while varying along the two axes of the corporation's circumstances and officer position and responsibilities, is objective; <i>ASIC v Rich</i></li> <li>• The duty is owed to the company: <i>Cassimatis v ASIC [2020]</i></li> <li>• Standard of care is essentially the same as under the general law; <i>Vines v ASIC (2007)</i> Directors are expected to attend all meetings unless exceptional circumstances, such as illness or absence from the State prevent them from doing so; <i>Vrisakis</i></li> </ul> <p><i>AWA v Daniels (1992)</i></p> <p><u>Facts</u></p> <ul style="list-style-type: none"> <li>• AWA ltd, a listed electronics company, used a "managed hedging" strategy to protect profits from foreign currency fluctuations</li> <li>• The strategy was managed by a young and inexperienced FX manager (Koval) whose activities were not properly supervised by senior staff</li> <li>• The general manager and finance manager, also inexperienced, failed to establish proper oversight and allowed inadequate recordkeeping, which concealed serious speculative losses</li> <li>• The auditors discovered the deficiencies but only reported them to senior management, not the board - even though they were aware that no</li> </ul>

remedial action was taken

- AWA sued the auditors for negligence. The auditors then filed crossclaims seeking contribution from the CEO and three non-executive directors on the basis they were joint tortfeasors

#### Issue

- Whether non-executive directors could be found contributorily negligent for failing to detect and act upon significant risks within the company

#### Held

- Rogers CJ held that the non-executive directors had no reason to suspect that the board's FX policy was not being adhered to and that they were entitled to rely upon it, and assume proper oversight by senior management

#### *ASIC v Healey*

- Breach of s 180(1); failure to properly read and understand financial statements - even by non-executive director

#### Facts

- Directors of the **Centro Group** approached FY2007 Financial reports which
  - Misclassified \$2.6 billion in current liabilities as non-current
  - Failed to disclose \$1.75 billion in short-term guarantees as post-balance date event
- Directors relied on management and PwC, but did not turn their minds to these critical misstatements before approving the accounts
- ASIC sued under s 180(1) and 344 of the Corps Act for breach of care and diligence obligations

#### Issue

- Did the directors breach s 180(1) by failing to detect the misstatements in the financial reports before approving them?

#### Outcome

- Yes - the directors breached s 180(1)

The Court held that **care and diligence** requires directors to personally engage with financial statements and understand their content

- They **could not blindly rely** on others - the magnitude and obviousness of the errors meant red flags should have been raised

#### Legal reasoning

- Even intelligent and conscientious directors are required to take **reasonable steps** to understand financial statements - including key classifications like current v non-current liabilities
- Reliance on management and external advisors (PwC) was not sufficient especially given the directors' own duties under:
  - S 180(1) - to exercise care and diligence
  - S 344 - requires taking "all reasonable steps" to ensure compliance with the financial reporting obligations of the Act
- Directors must turn their minds to material disclosures, read and understand statement, and ask appropriate questions if things appear

wrong or unclear

#### Legal significance

- Establishes that directors (including non-executives) have a minimum standard of financial literacy
- Confirms that blind reliance on advisors or audit committees will not protect directors where the content of the reports shows clear and material errors
- Reinforce the idea (from *Daniels v Anderson and Cassimatis*) that directors **must, monitor, understand and question** key information - they are NOT passive overseers

#### Problem question application

- Using *ASIC v Healey* as a strong factual analogy when:
  - A director approves financial statements or other major reports without reading, understanding or questioning them
  - There's a clear, material information (debts, liabilities, risk) that is misstated or missing and the director failed to notice
  - The director relied on management or advisors without personal engagement
- You're applying the idea that a reasonable director would have taken further steps to inquire, understand or correct

#### *DSHE Holdings Ltd (in liq) v Potts [2022]*

- Reinforces that directors (especially CEOs/CFOs) have a heightened duty of care in relation to financial decision and company solvency

#### Facts

- DSHE Holdings Ltd was in significant financial distress
- Despite known cash flow issues, the board approved both an interim and final dividend payment
- ASIC brought proceedings alleging breach of s 180(1) by the CEO and CFO for failing to act with care and diligence in supporting these dividend declarations

#### Issue

- Did the CEO and CFO breach their s 180(1) duties by approving dividend payments in circumstances where the company was under financial pressure and risk of prejudice to creditors?

#### Outcome

- Yes - both the CEO and CFO breached s 180(1)

#### Legal reasoning

- The particular role and responsibilities of the officer or director are crucial when assessing what is required under s 180(1) (reaffirming *Cassimatis and Healey*)
- As CEO, Potts had an elevated obligation to ensure the company's financial position was properly understood
- His failure to:
  - Request more detailed cash forecasts from the CFO
  - Recognise the impact of poor liquidity on creditor interests
  - Refrain from supporting a dividend during financial instability

- Was found to fall below the standard expected of someone in his role
- Similarly the CFO, was expected to be proactive in advising the board on the risks and providing adequate financial data - he also failed to do so

#### Legal significance

- This case emphasises that senior executive roles (especially CEO/CFO) carry a higher duty of care under s 180(1) due to their access to financial knowledge and oversight responsibilities
- It highlights that failure to interrogate financial forecasts or to prevent risky decisions, like paying dividends while insolvent or near-insolvent, can amount to a breach
- Applies the objective standard of what a reasonable CEO/CFO would have done, considering
  - The company's financial distress
  - The magnitude of the decision
  - The risks to creditors

#### Problem question application

- Use this case when:
  - The CEO or CFO fails to ensure the company's financial position is sound before voting on a major financial decision (e.g. dividend, large expense, acquisition)
  - The company **is under financial stress**, and there are concerns about solvency and creditor interests
  - A senior officer or director fails to request more detailed information, even when risks are obvious