- (3) If these apply + is a public company, then requires member approval under s 208
- (4) Exceptions where member approval not needed listed in s 210-216
    - E.g. s 210 – arm's length terms: member approval not needed to give financial benefit on terms that would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length
        - *Re Boart Longyear*: 'The concept of "arm's length" terms in this section involves "the relationship which exists between parties who are strangers to each other, and who bear no special duty, obligation, or relation to each other" or "the standard under which unrelated parties, each acting in his or her own best interest, would carry out a particular transaction"'
        - *ASIC v Australian Investors Forum*: 'in applying the test [for "arm's length" terms] the Court is required to assess the terms of the subject transaction against objective standards: what the parties themselves thought about the reasonableness of the terms is relevant as an explanation of the transaction but is not decisive as to whether the terms were reasonable for the purposes of the section.
        - *ASIC v Australian Investors Forum*: in applying the test the Court assumes that the transaction is being entered by a public company which is:
            - unrelated to the other party to the transaction in any way, financially or through ties of family, affection or dependence;
            - free from any undue influence or pressure;
            - through its relevant decision-makers, sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgment as to what is in its interests;
            - concerned only to achieve the best available commercial result for itself in all of the circumstances.

(8) Duty 7: the Duty of Care

(a) Sources of the Duty of Care

- Duty of care is not a fiduciary duty – is trying to set a standard of 'reasonable behaviour' – what did you do, what would a reasonable person have done in those circumstances? – will depend on context as reasonableness is subjective
- Duty of care, skill and diligence arises under:
    - (i) Common law (tort)
        - Duty is about the defective decision-making process – a bad decision *may* reflect a negligent decision-making process, but not always – e.g.

        - flipping a coin to make a big business decision, even if it is successful, is negligent
        - Need to explain what the reasonable standard is – e.g. reasonable director would have read the document, asked questions, etc.
    - (ii) Equity
        - Equitable duty attaches to the position you hold – i.e. expected to perform at a reasonable standard of care and diligence if taking on a role (*PBS v Wheeler*)
    - (iii) Statute
        - s 180 (1) – does not require proof of actual harm to the company
        - ASIC may seek CPP order that is not based on harm suffered by the company
        - Although statutory duty does not mention skill, it is implied that if a director takes on a position, they will be held to the standard of that position, even if not qualified (*Daniels v Anderson*) – e.g. wives being 'sleeping directors'
- The duty applies to what the person does – not simply to a hypothetical skillset of a reasonable officer
    - *Shafron v ASIC*: S was general counsel and co-company secretary of James Hardie group; provided info to Board which was confusing at best, misleading at worse; set up fund to pay off tort claimants to last forever, only enough money to last 2 years; argued S should have known the info being provided to the Board was incomplete and unclear; S argued he was general counsel, not CFO, thus it was not his job to give this info; adduced evidence that this was not what general counsel usually does; HELD: breach of duty of care
        - The way S did his job over many years was him taking ownership of liabilities; knew the info and did not tell the Board anything – thus, the duty will follow what the person actually does (both what is in the job description and the additional thing taken on over time), then asks what a reasonable person would have done in the same position
- Duty is not owed to the public in general, but to the company (*ASIC v Maxwell*)
    - *But note: the harm likely to be caused by the company to its clients is relevant when assessing the scope of the duty (*Cassimatis* – duty of care does have a public interest element, even though the public cannot enforce it)

ASIC v Maxwell [2006]	
Facts	○ ASIC argued illegal fundraising would not have been engaged in by a reasonable director ○ N (another director) believed he should not be liable for breach of duty of care – why should he be responsible for financial/legal matters he had no knowledge of?
Decision/ Reasoning	HELD: N not liable re breach of duty of care – just being on the Board is not enough, as the duty is to the company, not the general public.

- Relevant powers and duties – powers conferred on the person by:
    - (i) their position description
    - (ii) the constitution
    - (iii) delegated authority
    - (iv) the *Corporations Act*
    - (v) voluntary assumption of responsibility
- Relevant duties will arise both from the role undertaken **and** the role they are responsible for

Cassimatis v ASIC [2020]	
Facts	○ Mr and Mrs C were directors of SF Co (pre-GFC); SF gave inappropriate financial advice to clients who were vulnerable, self-funded retirees ○ Clients borrowed money on their homes and obtained loans to invest in index funds ○ SF did not properly consider client circumstances – advisers had no discretion to give alternative advice; had to recommend investing in the index fund (illegal under Ch 7) ○ Mr and Mrs C controlled every aspect of SF: no payments made without their approval, no access to information without their approval, gave templates for advice, etc. ○ SF had side deal with SBA to make it easier for the clients to get mortgages/loans ○ SF goes into liquidation with GFC; ASIC takes action against Mr C and Mrs C
Decision/ Reasoning	HELD: a reasonable person would not have allowed this behaviour for years – they failed to recognised there was an issue and failed to do anything about it. [72]: 'A reasonable director, with the responsibilities of the appellants, and in Storm's circumstances, would not have provided advice to the 11 vulnerable investors that was not appropriate to them having regard to the consideration and investigation of the subject matter of the advice that ought to have been undertaken.' [78]: 'In failing to guard against that foreseeable harm flowing from contraventions by Storm, the directors failed to discharge the degree of care and diligence required of them by s 180 (1).'

(b) Who is the 'reasonable person'?

- Standard of conduct is to be assessed objectively – subjective knowledge, intentions and beliefs will help shape the scope of the duty as the test is for a reasonable person in the position and with the responsibilities of the person
- Test of **negligence** – *ASIC v Gallagher*: '[T]he test is basically an objective one in the sense that the question is what an ordinary person, with the knowledge and experience

of the defendant, might be expected to have done in the circumstances if he was acting on his own behalf'

- Test of **reasonableness** – *Vrisakis v ASC* per Ipp J: 'the duty of a director to exercise a reasonable degree of care and diligence cannot be defined without reference to the nature and extent of the foreseeable risk of harm to the company that would otherwise arise.'
  - 'Further, the mere fact that a director participates in conduct that carries with it a foreseeable risk of harm to the interests of the company will not necessarily mean that he has failed to exercise a reasonable degree of care and diligence in the discharge of his duties. The management and direction of companies involve taking decisions and embarking upon actions which may promise much, on the one hand, but which are, at the same time, fraught with risk on the other. That is inherent in the life of industry and commerce. The legislature undoubtedly did not intend by [s180(1)] to dampen business enterprise and penalise legitimate but unsuccessful entrepreneurial activity.'
- Negligence is **not a mere mistake** (*ASIC v Rich*)
- *Note that there may be a defence for directors who do not participate in management (e.g. wives), but this will still be dependent on the company (e.g. director of Telstra vs director of small family company)
  - *DCT v Clark*: 'What constitutes breach of the standards of care and of diligence, in a particular case, will depend on a wide variety of circumstances including the precise nature of the business conducted by the company and the composition of its board. However, the case law indicates that there is a core, irreducible requirement of involvement in the management of the company.'

- Corporation's circumstances – relevant to figuring out whether a reasonable person in the same position would have done the same thing:
  - (i) The type of company (public or private, listed or not, large or small)
  - (ii) The size and nature of the business
  - (iii) Whether the business is a subsidiary or not
  - (iv) The company's constitution
  - (v) Composition of the board
  - (vi) Distribution of the work within the company
  - *(vii) Circumstances are assessed at time of conduct (i.e. without hindsight)

(c) Office and Responsibilities

- Based on what the person actually does and what they are supposed to be responsible for, having regard to their position, delegations, etc.
- *Cassimatis*: the more a person takes on, the more they will be responsible for
  - *It is not true that the less a person does, the fewer obligations there will be – duties attach to the office (*Healy*) and there is a core irreducible duty to actively monitor (*Daniels v Anderson; DCT v Clark*)

- Certain positions may carry higher responsibilities, e.g. Chair, CEO (*PBS v Wheeler*)
- Person may act so as to create a positive duty to protect the company's interest – e.g. knowledge of harm to company caused by acting on a conflict of interest (*Adler*)
- **Directors in position of <u>conflicts of interest</u> may need to exercise <u>special or particular diligence</u> (*PBS v Wheeler*)
- *Healey* re monitoring:
    - Director should acquire at least a rudimentary understanding of the business and become family with fundamentals
    - Director should keep informed about the activities of the corporation
    - Not required to have detailed awareness of day-to-day activities, but directors should monitor corporate affairs and policies
    - Director should maintain familiarity with company's financial status by regularly reviewing and understanding financial statements

Permanent Building Society v Wheeler (1994)	
Facts	o PBS bought land from TC Co; PBS directors wanted TC to acquire another business from JCLD (both PBS and JCLD were owned by another company – CH) o W was chair of PBS, CH and JCLD o H was CEO and MD of PBS and MD of JCLD o PBS had no experience re land development; was heavy duty on W and H to scrutinise the proposed transaction with caution o H tried to avoid his duties due to conflict of interest o PBS sued former directors for improper use of position and breach of duty of care
Decision/ Reasoning	HELD: H could not avoid his duties by asserting a conflict of interest – as CEO/MD there was responsibility on him to ensure other directors appreciated the potential harm of the transaction. H also should have satisfied himself that adequate security was provided to PBS + should have taken further steps to verify it was a good deal.

<u>Specific Expertise</u>

- *Healey*: 'A director is not relieved of the duty to pay attention to the company's affairs which might reasonably be expected to attract inquiry, even outside the area of the director's expertise'
- *Daniels v Anderson*: 'There is no doubt reason for establishing a board which enjoys the varied wisdom of persons drawn from different commercial backgrounds. Even so a director, whatever his or her background, has a duty greater than that of simply representing a particular field of experience. That duty involves becoming familiar with the business of the company and how it is run and ensuring that the board has available means to audit the management of the company so that it can satisfy itself that the company is being properly run.'

<table>
<tr><th colspan="2">ASIC v Healey [2011]</th></tr>
<tr><td>Facts</td><td>
o Centro (C) was 2nd largest shopping mall operator in Aus
o H was Chair; S was CEO/MD; rest of Board were all-stars
o Co had complex financial structure; S was architect
o Nature of business: C would identify sites, buy them, build shopping mall, lock in 20-30 year management contract, put malls into trust then sell securities in trust arrangement to investors
o To finance, borrowed from investment banks and paid it off within a few months (was initially very successful)
o GFC stalled short-term finance market; C mischaracterised over $2 bil in short term debt – <u>failed to inform the market</u>, saying they had $0 in short term debts
o Board packs usually 450 pages or more; this one in particular was over 1,100 pages; Chair (H) claimed he was not aware of debt profile and did not read the financial statements unless CFO specifically told him to
o Hundreds of companies in the group; had 1 Board meeting for all the companies; said it was impossible to read all of this
</td></tr>
<tr><td>Decision/ Reasoning</td><td>
HELD: <u>breached their duty of care and diligence</u> by not reading Board papers – complexity of C's structure or documentation was no defence.

Reliance on management, CFOs, or auditors did not relieve directors of their personal responsibility to understand and approve accurate financial statements. Directors knew the company had significant short-term debt and that some facilities were due for repayment or rollover, but they failed to connect this to the financial classification in the balance sheet.

<u>Healey</u>: Admitted he didn't fully read financial statements before signing; relied on management and others; failed to connect the known short-term debt with the absence of current liabilities in the accounts.

<u>Scott</u>: Didn't understand current vs non-current debt classification; didn't read statements line by line; focused on investor relations rather than accounting detail.
</td></tr>
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<u>Reliance and Delegation</u>

- Directors may delegate duties (s 198D) and rely on others (s 189), <u>but</u> musts still make their <u>own independent assessment of information</u>
  - *Healey*: directors failed to assess financial info and relied blindly on management/auditors – was a breach of duty
  - *Overend v Gibb*: directors may trust competent managers, but cannot abdicate oversight responsibility
- Duties will be assessed according to: (i) size and complexity of company, (ii) internal allocation of responsibility and authority, (iii) actual responsibilities taken on
- Statutory framework:
  - s 198D: Board may delegate powers
  - s 190: Directors remain responsible for delegate's actions unless reliance was reasonable and based on belief in delegate's competence.

  - s 189: allow reliance on info from others if reliance in good faith + reasonable
  - ss 1317S, 1318 - Reliance may be relevant for relief from liability.
- Limits on delegation: (i) not all functions can be delegated (*ASIC v Macdonald*; *Healey*); (ii) delegation must be recorded in company minutes; (iii) constitution may limit delegation powers

(d) Statutory duty of care provisions

Corporations Act Provisions	
s 180 (1): Care and diligence--directors and other officers	(1) 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: (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. Note: This ss is a civil penalty provision (see s 1317E).
s 189: Reliance on information or advice provided by others	If: (a) a director relies on information, or professional or expert advice, given or prepared by: (i) an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or (ii) 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; or (iii) another director or officer in relation to matters within the director's or officer's authority; or (iv) a committee of directors on which the director did not serve in relation to matters within the committee's authority; and (b) the reliance was made: (i) in good faith; and (ii) after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation; and (c) the reasonableness of the director's reliance on the information or advice arises in proceedings brought to determine whether a director has performed a duty under this Part or an equivalent general law duty; the director's reliance on the information or advice is taken to be reasonable unless the contrary is proved.

(e) DEFENCE: The Business Judgment Rule

Corporations Act Provisions	
s 180 (2): Business judgment rule	(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of ss (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

	(a) make the judgment in good faith for a proper purpose; and (b) do not have a material personal interest in the subject matter of the judgment; and (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and (d) rationally believe that the judgment is in the best interests of the corporation.

- Statutory defence which operates on all 3 levels of duty (common law, equity, statute)
- Decision about how much information is needed to decide on a transaction may be protected by BJR (Pacific Current Group Ltd v Fitzpatrick), even if decision about what should be included in Board papers generally is not necessarily a 'business decision' (*ASIC v Mitchell*)

ASIC v Rich [2009]	
Facts	o Telcom Co (O) had computer problem (could not figure out whether people paid their bills); O eventually went bankrupt due to this failure as it was never fixed o ASIC brings proceedings against 2 CEOS, CFO and 1 non-exec director, arguing company was insolvent throughout various points in various years
Decision/ Reasoning	HELD: [evidence ended up being inadmissible as ASIC did not get the millions of documents proving insolvency reviewed] but, confirmed that deliberate decisions that result in significant losses can still fall under the Business Judgment Rule. Re s 180 (2)(c), confirmed the following factors are relevant to proving (approved in *ASIC v Mitchell*): importance of the business judgment to be made, time available for obtaining information, costs related to obtaining information, director's confidence in those exploring the matter, state of the company's business at that time and nature of competing demands on board's attention, whether material information is reasonably available to director, and confirmed this ss may be satisfied even if director not aware of information where steps were taken to be satisfied about the information available.

- Compliance decisions (i.e. how to comply with the law) are not decisions that are relevant to the operation of the business – thus, compliance decisions are not covered by the business judgment rule
- *ASIC v Fortescue Metals*: '… the decision not to disclose the true effect of the agreements cannot be described as "business judgment" at all. A decision not to make accurate disclosure of the terms of a major contract is not a decision related to the "business operations" of the corporation. Rather it is a decision related to compliance with the requirements of the Act.'