

## CORPORATE LAW

### FINAL EXAM NOTES

1. Directors' Duties
2. Enforcement of Directors' Duties
3. Minority Protection
4. Share and Capital Transactions
5. Public Issues
6. Debt Capital
7. Liquidation, Voluntary Administration, Receivership

## (1) Directors' Duties

*Finely balances cases don't get to court as often as ASIC only brings cases it thinks it can win, for resources reasons*

Directors controlling company assets means opportunity for fraud (lack of loyalty) or mismanagement (lack of care)  
Agency problem, separation of ownership and control

Duties – set of standards assessed ex post by courts, rather than set of exhaustive rules set ex ante

Balance of risk and return – still want directors to take risks  
Enforceability – separation of ownership and control. How do shareholders know when breach/enforce?

### TYPES OF DUTIES

1. Fiduciary duties (loyalty and good faith)
2. Duty of care, skill, and diligence
3. Statutory duties

- Parallel set of duties in ADDITION to CL duties (s185)
- Criminal liability, civil penalties

### Why parallel obligations exist?

- When statutory duties introduced, only criminal conduct cases
- Criminal standard of proof high
- Make duties more accessible, obvious, user friendly
- Restatement of duties
- **COURT tends to read down differences between them – can generally talk about them as the same**

## DIRECTORS

### Who is a 'director'

**s9 definition – director means:**

(a) [DE JURE] a person who:

- (i) is appointed to the position of a director; or
- (ii) is appointed to the position of an alternate director and is acting in that capacity; (eg. a defect in process of appointment so not technically a director)

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) [DE FACTO] they act in the position of a director; or
- (ii) [SHADOW] the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions

attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.

### 'DIRECTOR' CASES

*Standard Chartered Bank Aus v Antico (1995)* - Parent company Pioneer, subsidiary Giant. Senior executives of P sat on board of G. Giant folded. Was Pioneer shadow director, and liable for insolvent trading?

Held: mere fact Pioneer owned 42% of G and had 3 sitting on G's board insufficient for shadow director situation. However:

- complete absence of decision making by G – simply implemented decisions passed down from P
- P had effective control in context of size of shareholding
- Actual exercise of management and financial control
- G produced financial report in line with P's requirements
- In meetings, P didn't consider G interests separately
- **P was a shadow director company**
- **\*\*body corporate cannot be a director but can be shadow director**

*Buzzle v Apple (2011)*

Buzzle was major retailer of Apple products in Aus. Finance director of Apple got office in Buzzle's premises. Buzzle collapsed. Was Apple and/or finance director a shadow director of Buzzle? Held: Not a shadow directorship.

- Apple acted in own interests, was at arms-length
- No point Buzzle directors simply did what Apple said

### Executive vs Non-executive/Independent directors

*ASX Corporate Governance Principles* – majority of the board should be independent directors

### Independent directors

- Independent exec's have different ideas - executives internally focussed, all think same thing
  - Monitoring tool – reduce pursuit of self-interest
- BUT
- know nothing about company
  - less able to contribute to prosperity of company
  - Spend little time working for the board

## OFFICERS

**Statutory duties can apply to directors or officers**

**s9 definitions - "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); 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.

*Shafron v ASIC (2012)* HC Case – part of James Hardie litigation

- Shafron was general counsel and company secretary of James Hardie. Argued he was acting in general counsel role when advising Board on restructure and draft ASX statement (which was misleading)
- Held: job description was both secretary and general counsel, so all tasks were performed in joint role, not possible to divide his duties and responsibilities.
- Also s180(1) requires officer to discharge all duties with due care and diligence

### TO WHOM ARE DUTIES OWED

Directors' duties owed to company as a separate legal entity (*Percival v Wright*)

- DD's can only be enforced by company, not shareholders or creditors
  - Unless special relationship to shareholder etc.
- For duty to arise on facts [EXCEPTIONAL]:
- Shareholder dependency, relationship of trust and confidence (or position of advantage), significant transaction

*Bunninghausen v Glavanics (1999)* – 2 director/shareholders. G sold shares to B, without knowledge that B was in process of selling company at a higher price. B made huge profit. Held: B had fiduciary duty to G to inform him of sale of company. G had been locked out from activities of company and had no other means to know real value.

### 1. FIDUCIARY DUTIES of loyalty and good faith

(see below couple of pages)

**Arise because of fiduciary position** – directors have *sui generis* fiduciary relationship

- Directors in a position in which self-interest and interests of principal conflict

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- Constrains them
- Also senior executive officers and employees may owe (depends on nature of office and contract)
- Owed to the company

*Re Smith v Fawcett (1942)* - [Directors] must exercise their discretion bona fide in what they consider - not what a Court may consider - is in the interests of the company, and not for any collateral purpose.

Now largely embodied in statute. See a couple pages below for detail.

## 2. DUTY OF CARE, SKILL, DILIGENCE (common law)

Arises both in Common Law and Equity, and statute

### Care

- Take such care as a reasonable person would take on their own behalf (*Re City Equitable Fire Insurance Co (1925)*)

### Skill

- Attentiveness, keeping an eye on company affairs, monitoring
- If particular skills, should use for benefit of company (*Re Brazilian Rubber Plantations (1911)*)
- Now more objective standard of skill, although minimal, wrt financial affairs of company (*Commonwealth Bank v Friedrich (1991)*)

### Diligence

*Re City Equitable Fire Insurance Co (1925)*

Not bound to give continuous attention to affairs of company

Not bound to attend all such meetings

### Delegation and reliance

*Re City Equitable Fire Insurance Co (1925)*

- In the absence of grounds for suspicion
- Justified in trusting official to perform such duties delegated honestly

However stricter restatement of law in statute since *Daniels v Anderson*

### The Standard

Standards of care between CL and Corp Act essentially the same now

### OLD STANDARD – subjective (up until 1970s/80s)

*Marks and Bute Case* – Marks appointed to board at 4 years old. On board for 40 years, attended 3 meetings. Company folded. Held: had discharged duty of care.

- Need not have any more care/skill/diligence than someone with that persons knowledge/skill – purely subjective standard
- Not bound to give continuous attention to co. affairs
- Directors able to delegate almost anything, can be absolved of all legal responsibility

Why low standard?

- Courts not competent to make business decisions, reluctant to intervene
- Variety of company types/structures – hard to have objective test/standard for 'reasonable director'
- Part-time honorary director role – not fair to hold responsible

### NEW STANDARD – objective (post 1970s/80s)

Corporate scandals, reckless decisions, no accountability

Corporate creditors being unduly prejudiced by reckless directors

Shareholder and director liability limited

*AWA v Daniels; Daniels v Anderson (1995)*

AWA 25% profits from foreign currency trading. Officer in charge of this allowed to operate without effective supervision and hid losses through unauthorized loans. Accountant (Daniels) was contracted to audit company accounts and processes – didn't report the issue to AWA directors. AWA sued D for negligence. D sued directors for contributory negligence. Did non-executive and/or executive directors breach DOC? Held: executive directors breached, non-executive didn't.

- NED: reasonable to believe internal controls ok + have confidence in senior management
- ED: had reliable info re deficiencies - fail to put effective supervision to monitor proper audit and follow up info (rather than rely on info of sources to say it is all ok)

Resulting new standard for directors:

- Basic understanding of co. business, financial position
- Keep informed of activities of company – ongoing obligation
- Actively monitor activities, regularly attend board meetings
- Maintain familiarity with company financial status by regular review of financial statements

Led to statutory standard – objective reasonable person

## 3. STATUTORY DUTY - s180

### s180 - 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.

### [Business judgment rule]

(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (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.

(3) In this section: "business judgment" means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

### CASES INTERPRETING s180

'in the corporation's circumstances' – OBJECTIVE part  
*ASIC v Rich (2009)*

- Type of company – size, level of supervision needed
- Size/nature of business
- Constitution
- Composition of board – other able people on board?
- Distribution of work, responsibility
- Whether parent company controls

'had the same responsibilities within the corporation' – SUBJECTIVE part

*ASIC v Rich (2009)*

- Specific tasks delegated to director
- Way in which work distributed in company
- Particular director's experience and skills

### Standard of skill: Executive vs Non-executive director

- Standard of care depends whether exec or non-exec director
  - o Executive director greater involvement – expect greater knowledge and awareness
- Directors with special skills held to standard of a person professing to have those skills (*Gold Ribbon v Sheers (2006)*)

*ASIC v Rich* – said wording of s180(1)(b) 'occupied office held by, and same responsibilities within the corporation' intended that non-executive directors NOT subject to same standard as executive.

*Vines v ASIC (2007)* – V was CFO of GIO being taken over. As CFO responsible for financial statements. Hurricane (subsidiary of GIO) suffered huge losses. V approved of projected profits of subsidiary and included in financial statement. Alleged breach DOC failing to get up-to-date info before putting projected profit in statement. Held: V breached DOC.

- Reasonable CFO would verify subsidiary losses as they accrued
- Information was readily available if V requested it
- Reasonable CFO wouldn't rely on monthly updates from subordinates
- V had duty to be proactive – ensure accurate information

*Permanent Building Society v Wheeler (1994)*

PBS purchasing property from T to get T to purchase JCLD. 2 directors of PBS including Wheeler who indirectly benefited from T purchasing

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JCLD. 3 directors, including W, had improper purpose. 2 other directors, M and H (MD of both PBS and JCDL) knew but failed to stop transaction. H didn't vote because conflict of interest. Did H breach DOC by failing to express opposition? Held: Yes, breached DOC by not doing more than not voting.

- What ordinary person with knowledge and experience of H would have done in circumstances

- \*\*Note could not establish causation of the loss by H though

#### Standard for Non-executive Directors

- poorer position to find out what is going on than EDs

#### Case for HIGHER non-deligable standard owed by NEDs

*ASIC v McDonald* (2009) [case appealed but limits of permissible delegation by NEDs still good law] – ASIC sued EDs and NEDs of Hardies. Board approved press release for ASX saying company 'fully funded' when it wasn't. ASIC sued for approving carelessly. Directors alleged some of them were not there.

Diligence required by each type of director – limits of NEDs to rely on expertise of co-directors/management? Held: some duties cannot be delegated.

- Non-executive directors cannot abdicate responsibility for key statement to ASX concerning highly significant restructure of group
- NED's should have known misleading statement would entail liability for company
- NED's liable for failure to make adequate enquiries and provide adequate supervision for press statement, to ensure did not assert that it was fully funded when it was not
- Failure to request a copy of announcement dealing with such significant matter, failure to familiarize themselves with it, failure to abstain from voting otherwise – not what reasonable person in their position with their responsibilities would do

#### Case for LOWER standard owed by NEDs

*AWA v Daniels; Daniels v Anderson* (1995)

AWA 25% profits from foreign currency trading. Officer in charge hid losses through unauthorized loans. Accountant (Daniels) didn't report the issue to AWA directors. AWA sued D for negligence. D sued directors for contributory negligence. Did non-executive and/or executive directors breach DOC? Held: executive directors breached, non-executive didn't.

- Non-executive director doesn't have to turn themselves into auditor, managing director, chairman or other officer to find out whether management are deceiving them
- However what they 'ought to know' – must take some sort of proactive approach to put themselves in position to guide and monitor management of company

#### Special cases for Non-Executive Directors having higher responsibility

- *ASIC v Rich* (2004) – non-executive Chairman was also chair of the audit committee
- *Visakis v ASC* (1993) – experienced non-executive director
- *Gold Ribbon Accountants v Sheers* (2002) – non-executive was the only director with lending experience

#### Business Judgment Rule – s180(2) CA

- Specific **defence**
- Allow directors room to be entrepreneurial – responsible risk taking
- Protect authority of directors in exercise of duties

Directors should not be liable for decisions made in good faith and due care – otherwise may lead directors NOT to take advantage of opportunities involving responsible risk-taking

#### s180(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 subsection (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) rationaly believe that the judgment is in the best interests of the corporation.

(3) In this section: "*business judgment*" means **any decision** to take or not take action in respect of a matter relevant to the **business operations** of the corporation.

Court does not judge the merits of the decision

- s180(2) reflects principle that courts do not their substitute business judgment

About procedural correctness – no bias, well informed, reasonable/rational decision

*ASIC v Rich* (2009) – Rich was director, failed to bring to attention of board that company was probably insolvent. Could he use business judgment rule defence?

"business judgment" wide interpretation

- covers actual decision but also planning process leading up to decision
- must be a decision, not mere inaction

Properly inform themselves

- importance of decision – big transaction?
- Amount of time to make decision – had to make quickly?

- Overall state of company's business
- Rational does not mean Reasonable
- Rational is lower standard (but not much difference)

#### DILIGENCE

- Positive obligation to find out
- Varies according to director appointment
- All directors must be familiar with operations of company business and keep informed about financial status of company

#### DELEGATION

Delegation of tasks – expressly allowed by s198D

#### s198D – Delegation [power to delegate]

(1) Unless the company's constitution provides otherwise, the directors of a company may delegate any of their powers to:

- (a) a committee of directors; or
- (b) a director; or
- (c) an employee of the company; or
- (d) any other person.

(2) The delegate must exercise the powers delegated in accordance with any directions of the directors.

(3) The exercise of the power by the delegate is as effective as if the directors had exercised it.

#### s190 - Responsibility for actions of delegate

(1) If the directors delegate a power under section 198D, a director is responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves.

(2) A director is **not responsible** under subsection (1) if:

- (a) the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by this Act and the company's constitution (if any); and
- (b) the director believed:
  - (i) on reasonable grounds; and
  - (ii) in good faith; and
  - (iii) after making proper inquiry if the circumstances indicated the need for inquiry;that the delegate was reliable and competent in relation to the power delegated.

#### Limits of Permissible Delegation

*ASIC v McDonald* (2009) – see above. Limits of NEDs to delegate and rely on expertise of co-directors/management. Some duties cannot be delegated.