

Slide Set 3

Recent Trends in Directors' Duties in Australia



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Overview

- > Duties of Directors and other Officers:-
 - Evolution of Corporate Law and Corporate Governance
 - Summary of the duties
 - Who owes the duties?
 - To whom are the duties owed?
 - Who enforces the duties?
 - Consequences of breaching a duty
 - The duty of care





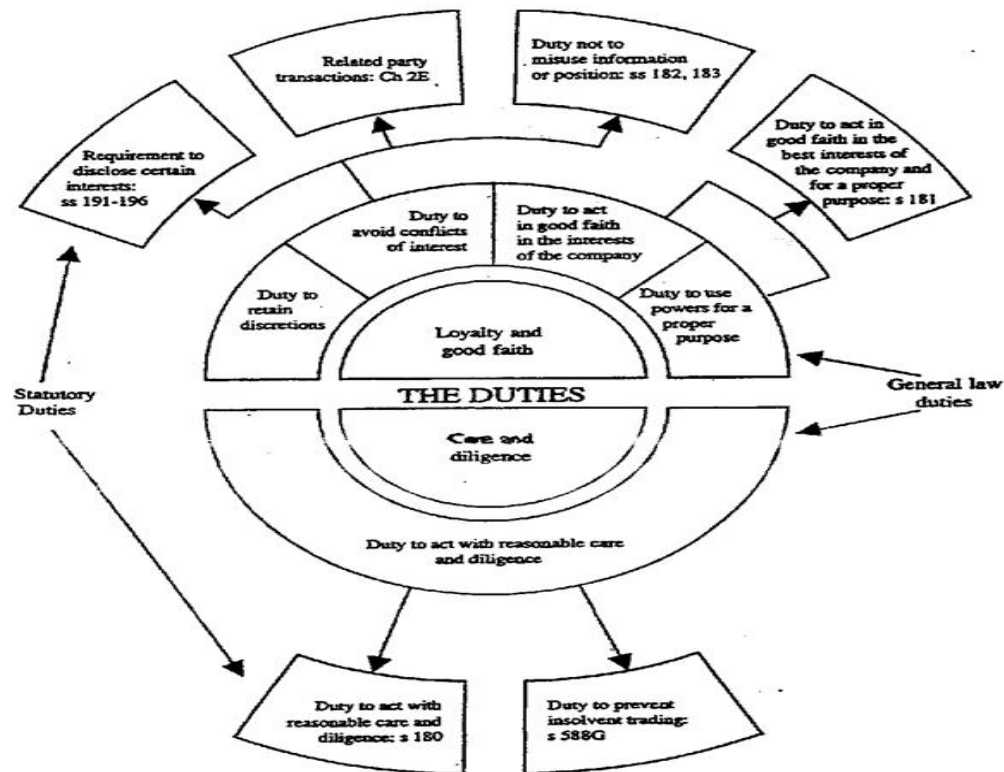
Evolution of Corporate Law and Corporate Governance

- > Reception of U.K. *Companies Act* 1862
- > Historic Path Dependency to the U.K.
 - Australia
 - New Zealand
 - Hong Kong
 - Malaysia; and
 - Singapore.





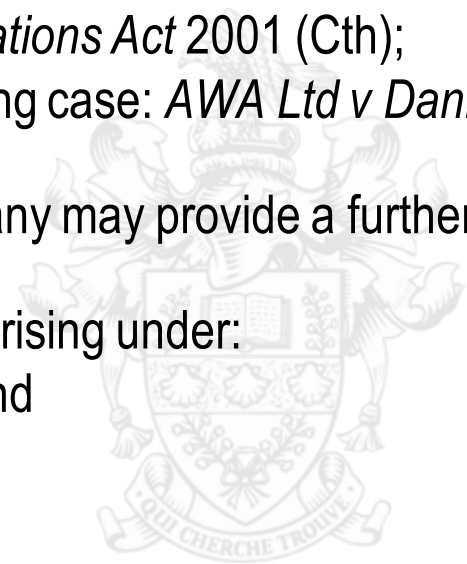
Summary of Directors' Duties





Two Categories of Duties

- > Two categories of duties which are conceptually and functionally distinct:
 - (i) duty of care, skill and diligence arising under:
 - (a) statute - s 180(1) of the *Australian Corporations Act* 2001 (Cth);
 - (b) general law (common law & equity)– leading case: *AWA Ltd v Daniels* (1995); and
 - (c) a contract between director and the company may provide a further source of the duty of care.
 - (ii) fiduciary duties: duties of loyalty and good faith arising under:
 - (a) statute: s 181, s 182 s 183 and s 184; and
 - (b) general law.





Who Owes the Duties?

- > Common law duties
 - Directors
 - Senior executive officers
 - Why? because they are “fiduciaries”
- > Statutory duties
 - all statutory duties apply to directors
 - this includes “de facto” and “shadow” directors
 - the relationship between the statutory and common law duties





To Whom are the Duties Owed?

- Answer = the company.
- Some statutory duties to shareholders.
- In exceptional circumstances, a duty will be owed to an individual shareholder at common law.





Who Enforces the Duties?

- > Australia
 - Australian Securities and Investment Commission (ASIC)
- > New Zealand
 - the new Financial Markets Authority (FMA)

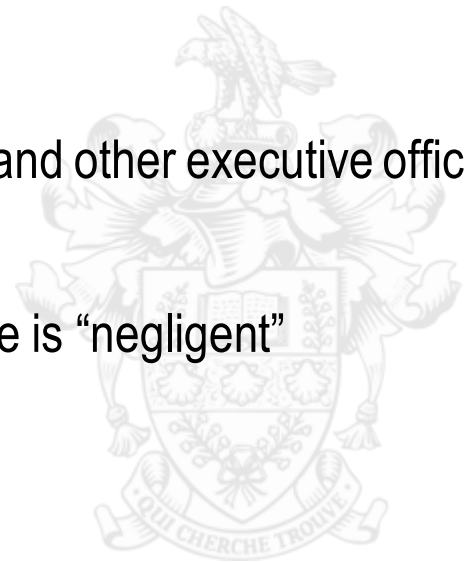




Duty of Care, Skill and Diligence

- > Sources of the duty :
 - s 180(1), *Corporations Act* 2001 (Cth)
 - common law
 - contract of employment — for executive directors and other executive officers

- > A director or other officer breaches this duty if he or she is “negligent”





Duty of Care (cont)

- > A director must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, taking into account:
 - the nature of the company
 - the nature of the decision
 - the position of the director and the nature of the responsibilities undertaken





Duty of Care (cont)

- > What is the standard of care?
 - s 180(1), *Corporations Act* 2001 (Cth)
 - objective standard
 - the “reasonable” director
 - the nature of the company
 - the nature of the decision
 - the director’s position in the company



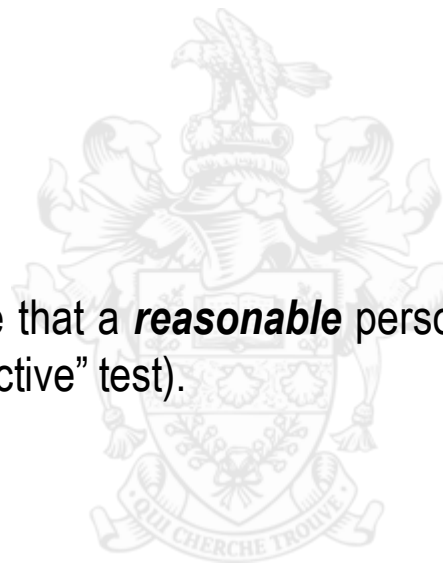


Duty of Care (cont)

What is the standard of care? (cont)

– In *Daniels v AWA Ltd* (Australian case):

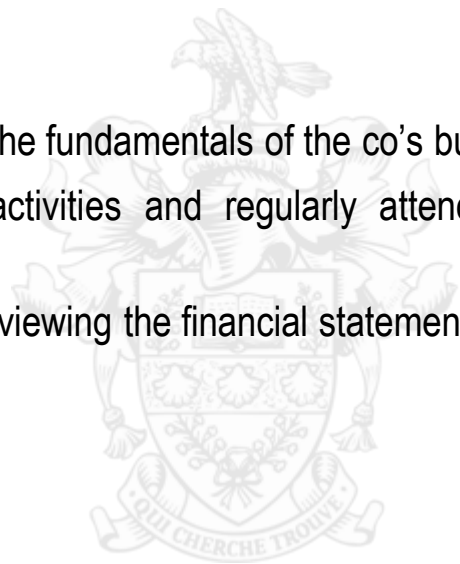
- there is no “uniform” standard for all directors
- it is no longer a largely subjective test, however
- the standard of care required of director X is the care that a **reasonable** person doing X’s job in X’s company would exercise (a largely “objective” test).





Duty of Care (cont.)

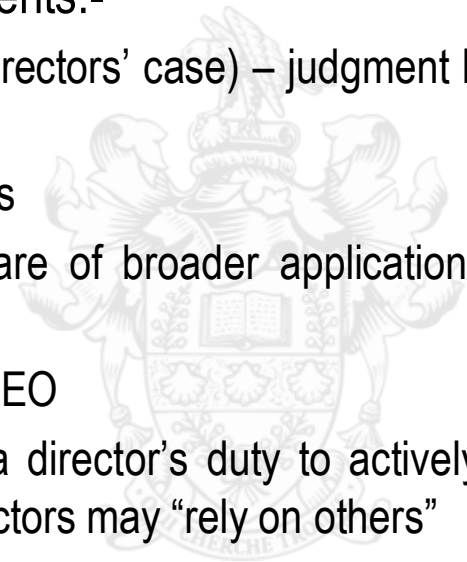
- Under the modern standard, is there any minimum requirement for all directors?
 - yes (*Daniels v AWA Ltd*) — every director must:
 - obtain a basic understanding of the co's business and the fundamentals of the co's business;
 - keep informed about and monitor the company's activities and regularly attend board meetings, and
 - monitor the company's financial position by regularly reviewing the financial statements.





Duty of Care (cont) and *Centro*

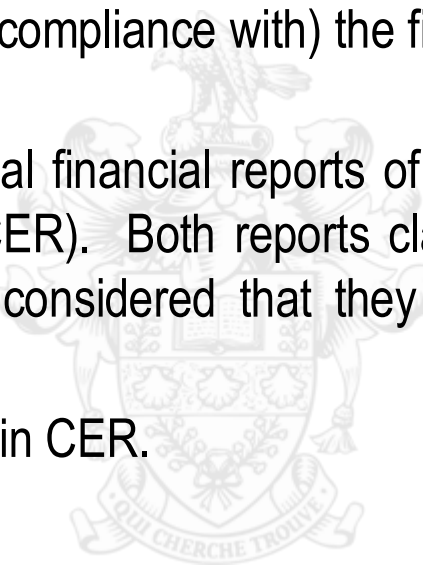
- > Familiarity with & understanding of the co's financial affairs: *Sheahan v Verco* [2001] SASC 91
- > Ability to read & understand the co's financial statements:-
 - *ASIC v Healey & Ors* [2011] FCA 717 (the “*Centro*” directors’ case) – judgment handed down on 27 June 2011:-
 - case involved misstatements in financial accounts
 - however principles laid down by Middleton J are of broader application in the context of directors’ duties generally
 - the focus is on non-executive directors and the CEO
 - the judgment deals with, among other things, a director’s duty to actively make further enquiries and the extent to which the directors may “rely on others”





Duty of Care (cont) and *Centro*

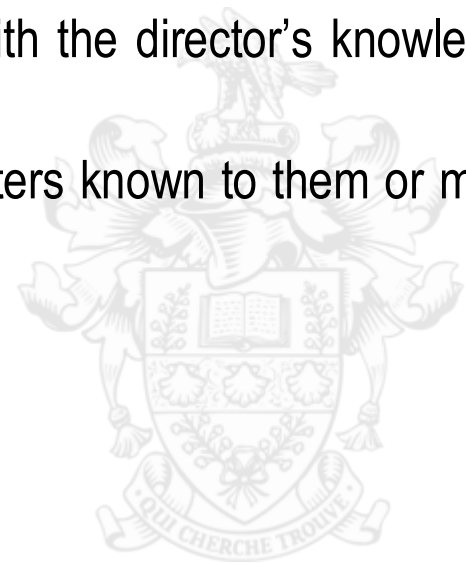
- The directors and the officer involved in the proceedings were found to have breached, *inter alia*, duties of care and diligence under s 180 CA and to have failed to take all reasonable steps to comply with (or secure compliance with) the financial reporting obligations of s 344 CA.
- The breaches related to disclosure in the 2007 annual financial reports of Centro Properties Group (CNP) and Centro Retail Group (CER). Both reports classified liabilities as “non-current”, when the Federal Court considered that they should have been classified as current liabilities.
- The amounts involved were \$1.5b in CNP and \$500m in CER.





Duty of Care and *Centro* (cont)

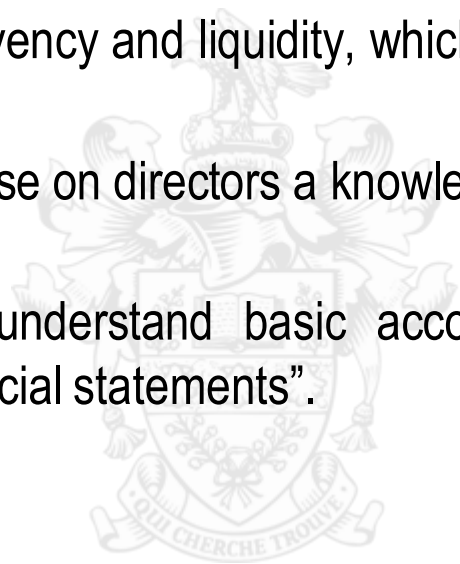
- > Core issue was whether (and to what extent) the directors were required to carry out a careful review of the annual financial report to determine:
 - (i) if the information it contained was consistent with the director's knowledge of the Centro group's financial affairs; and
 - (ii) that the annual report did not omit material matters known to them or material matters that should have been known to them.





Duty of Care and *Centro* (cont)

- Held: the duty of care and skill is an objective duty of competence that requires directors to have the ability to read and understand financial statements.
- These skills are necessary for an assessment of solvency and liquidity, which is an obligation imposed by the CA on directors.
- However, the judgment does not go so far as to impose on directors a knowledge of accounting practice and accounting standards.
- All that is required is the financial literacy to “understand basic accounting conventions and proper diligence in reading the financial statements”.

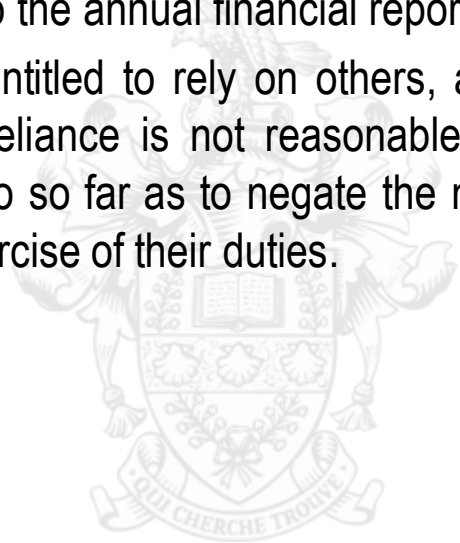




The *Centro* Judgment and ‘Reliance’

> *ASIC v Healey* [2011] FCA 717

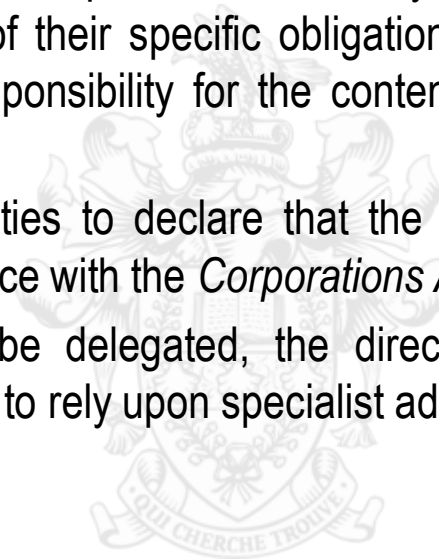
- One of the issues for determination was the extent to which the directors could rely on others to satisfy their statutory obligations in relation to the annual financial report.
- Justice Middleton acknowledged that directors are entitled to rely on others, at least except where they know (or ought to know) that reliance is not reasonable in the circumstances. However that entitlement does not go so far as to negate the need to bring an independent and questioning mind to the exercise of their duties.





The *Centro* Judgment and 'Reliance' (cont)

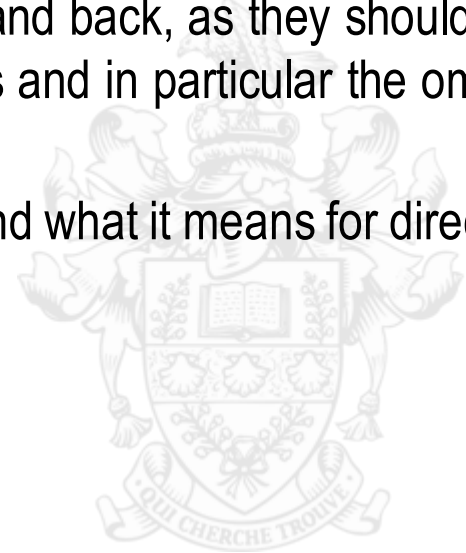
- > Importance of annual reporting obligations: the decision suggests that directors' duties have *special* application in the context of financial reporting obligations.
- > Although the obligation to prepare the annual financial report is placed on the entity (and not the directors), the directors cannot place the discharge of their specific obligations in the hands of others. They have an important individual responsibility for the content of the report.
- > Thus directors cannot delegate their specific responsibilities to declare that the financial statements and notes are, among other things, in compliance with the *Corporations Act*.
- > Nevertheless while the obligations themselves cannot be delegated, the directors are entitled to delegate various tasks to others and are entitled to rely upon specialist advice.





The *Centro* Judgment and 'Reliance' (cont)

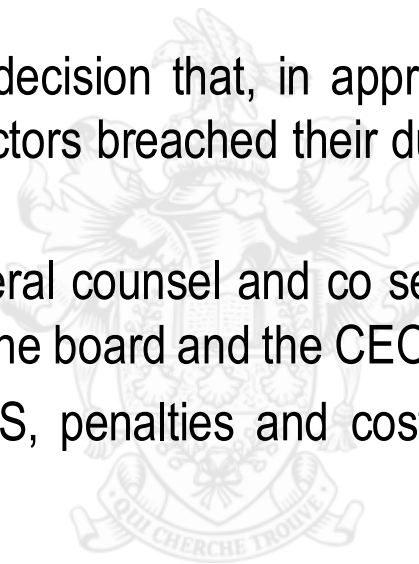
- > On the facts, while there was no suggestion that reliance by the directors was unwarranted or misplaced, they were not entitled to rely *solely* on management and others to be properly informed. They did not stand back, as they should have, and consider for themselves the financial statements and in particular the omission of matters that were readily apparent.
- > Consider the broader implications of this judgment and what it means for directors!





Duty of Care and *James Hardie*

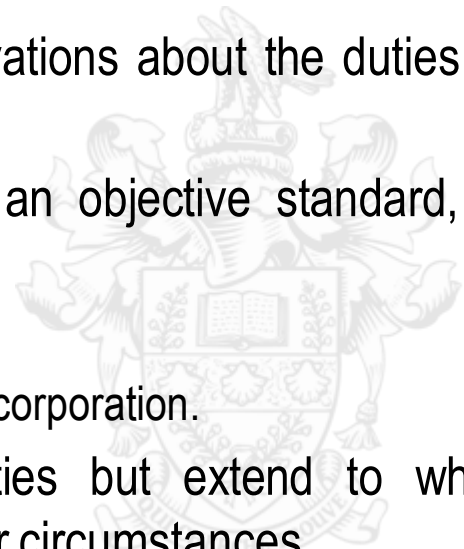
- > On 3 May 2012, the HC released its decision in the two *James Hardie* appeals: *ASIC v Hellicar & Ors* (ASIC appeal) and *Shafron v ASIC* (co secretary and general counsel appeal ie. the GC appeal).
- > The HC confirmed the Federal Court first instance decision that, in approving a misleading ASX announcement, seven non-exec directors breached their duties as directors.
- > The HC also upheld the finding of liability of the general counsel and co secretary (Peter Shafron) for failing to provide proper advice to the board and the CEO.
- > Certain matters on relief from liability under s 1317S, penalties and costs have been remitted back to the NSWCA for determination.





Duty of Care and *James Hardie* (cont)

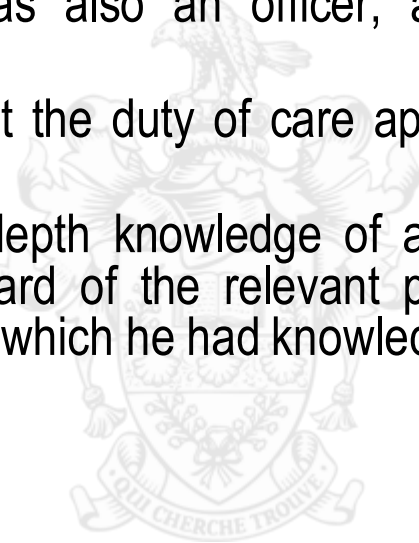
- > The decisions were largely driven by the specific facts.
- > No new principles were established - the HC did not expand the nature or scope of directors' duties of care, skill and diligence.
- > However the HC did make some interesting observations about the duties of the company secretary.
- > It confirmed that the degree of care and skill is an objective standard, to be determined by reference to two elements:-
 - the corporations' circumstances; and
 - the responsibilities that the officer has within the corporation.
- > These are not confined to statutory responsibilities but extend to whatever responsibilities the officer actually has in the particular circumstances.





Duty of Care and *James Hardie* (cont)

- > Accordingly, even if Shafron's capacities as co sec and GC could be distinguished, the duty of care would apply to *whatever* responsibilities he exercised in his role at James Hardie, regardless of the capacity in which he came to have them.
- > In other words, once he was a secretary, he was also an officer, and his responsibilities, all of them, attracted the duty of care.
- > The decision of the HC therefore makes it clear that the duty of care applies to *everything* the co sec and the GC do.
- > Although Shafron was not required to have an in-depth knowledge of actuarial matters, s 180(1) mandated that he advise the board of the relevant potential issues, relating to compliance and exposure to risk, of which he had knowledge.





Duty of Care and *James Hardie* (cont)

- > The HC also noted *obiter* that Shafron had been so deeply involved in the preparation of the restructure proposal that he would have been found to be an “officer” even if he was not the co sec.
- > This is because the statutory definition of “officer” recognises that a person can be an officer by virtue of participating in decision-making, without making the actual decision. Under the CA, an officer is, amongst other things, a person who:
 - is a director or secretary of the company; or
 - makes, or participates in making, decisions that affect the whole, or a substantial part of, the business of the co: s 9.

