COMPANY DIRECTORS AND OFFICERS

THE POWER OF MANAGEMENT

S 198A *RR:* The business of a company is to be managed by, or under the direction of, its directors, who may exercise all of the company's powers that the Corporations Act or the company's constitution requires the company to exercise in general meeting.
S 198A(1): Gives the directors the power to manage the business of the company
S 198A(2): Directors may exercise all the powers of the company except for the powers that the Corporations act or the company constitution requires the company to exercise in a general meeting.
S 198D: Directors may delegate any of their powers to a committee of directors, an employee, a director or any other person (unless the company constitution says otherwise).
S 1072F: Gives the power to register the transfer of shares. They may also refuse the transfer of shares if they are not fully paid for or the company has lien of the shares.
S 1072G: Enables the directors to register the transfer of share for any reason (Proprietary companies only).
S 1072F(4): Directors may also suspend registration of the transfer of shares for periods not exceeding 30 days.
S 254U: Gives directors the power to determine that a dividend is payable. They may also fix the amount, the time for the payment.
S 127: A company may execute a document without using common seal (official seal of a corporate body) if the document is signed by: 2 directors. A director and a company secretary or; sole director in the case of a proprietary company.
A 198B: Any two directors of a company that has two or more directors (or the director of a proprietary company) can sign, draw, endorse or otherwise execute negotiable instruments such as bills of exchange, cheques.

SHAREHOLDERS CANNOT OVERIDE MANAGEMENT DECISIONS

If the board has full management powers, shareholders cannot override the directors and involve themselves in the management of the company.

Automatic self-cleansing Filter Syndicate v Conninghame: Directors of a company were ordered by a general meeting to sell the company's property. The directors refused to do this, relying on a provision in the constitution similar to section 198A. The members argued that the constitution was subject to the overriding rule that the directors, as agents of the company, were obliged to follow the instructions of their principal; the company – the will of the company being a resolution of the general meeting. The court rejected this argument – held that the directions of the general meeting were a nullity that could be ignored by the directors. The constitution gave management powers to the board of directors, which included the power to sell the company's property. The members could not interfere with the directors in respect as they were contractually bound by the constitution.

John Shaw & Sons v Shaw: The court held that the board of directors was properly exercising the powers of management vested in it by the constitution and the general meeting could not usurp this power. Of the director's purport to exercise a power that should properly have been exercised by the general meeting and the improper exercise of power becomes valid.

(1) APPOINTMENT OF DIRECTORS

Company may appoint a director (201G) *RR:* A company may appoint a person as a director by resolution passed in a general meeting.
Director may appoint other director (201H) *RR:* (2) Proprietary companies must confirm appointment by resolution within 2 months. (3) Public companies confirm appointment at next AGM.
Appointment of Managing Director (201J) *RR:* Directors may appoint 1 or more of themselves to the office of the company for terms they see fit.
S201M & 204E: Deal with the effectiveness of acts done by invalidly appointed directors and secretaries. According to these provisions, an act done by a director or secretary is effective, even if their appointment is invalid because the company, the director or secretary did not comply with the company's constitution or a provision of the corporations act. The kinds of acts that are validated are those which are only legally effective as a director or secretary (ie the power to call a meeting etc.)

(2) REMUNERATION OF DIRECTORS

Directors have a fiduciary relationship with their company, which means they are not entitled to receive any remuneration from the company unless it is specifically permitted by the shareholders, the replaceable rules or the company constitution ***(Re George Newman & Co).*** It may be contrary to good corporate governance practice, but it Is not in breach of the law to provide that companies may fix their own salaries ***(Sali v SPC Ltd)***

S202A *RR:* (1) The directors of a company are to be paid the remuneration that the company determines by resolution. (2) The company may also pay the directors' travelling and other expenses that they properly incur (Attending meetings etc.).

<u>S 232 POTENTIAL FOR OPPRESSION:</u> The payment of excessive remuneration to directors may constitute oppressive or unfair conduct, especially where dividends are either not paid or reduced to a small amount.

Guinness v Saunders: Emphasises that remuneration to a director has to be in specific accordance with what is provided in the constitution (if this is where it is provided). The company was entitled to return of the payment because, under the constitution, only the board could authorise special remuneration to a director – not a committee of the board.

DISCLOSURE OF REMUNERATION

Generally, levels of pay should be linked to the profitability of the company.
S202B: Company must disclose director's remunerations if 5% votes or 100 members who are entitled to vote make a request. ***HOWEVER:***
S300A: The Annual Directors' Report must contain remuneration in a clearly identified section.

"SAY ON PAY" (S250Y-250Y)

<u>APPLIES TO LISTED COMPANIES ONLY (PUBLIC COMPANY 'LTD')</u>

[x] Is a listed company, therefore the 'say on pay' provisions detailed in s250Y-250U apply. The **First strike** occurs when a company's remuneration report (outlining directors' salaries) receives a 'no' vote of 25% or more by shareholders at the AGM. The **Second strike** occurs where the companies subsequent remuneration report receives a 'no' vote of 25% or more. Shareholders will vote at the same AGM for a 'spill motion'. This resolution will pass if it receives 50% or more of eligible votes cast. A 'spill meeting' will take place within 90 days. Here, individuals who were directors will be required to stand for re-elections. **[APPLICATION].**

(3) TYPES OF DIRECTORS

No lower standard of care for non-executive directors.

(i) Alternate Directors

S201K *RR:* Directors are permitted to appoint alternate directors under the constitution. The appointed director can exercise all their powers such as standing in board meetings and exercising their power to vote.
[VOTING ABILITY] Alternate directors are able to vote on behalf of the appointor at board meetings only if the appointor is not at the meeting himself ***(Anaray v Sydney Futures Exchange).***
[LIABILITY] A director who has not been called upon to act as such and never attended any board or management meetings will not be liable for insolvent trading (S588G) ***(Playcorp v Shaw).***
Markwell Bros v CPN Diesels: Alternate directors are within the definition of 'director' and subject to the fiduciary and statutory duties a director owes to their company.

(ii) Nominee Directors

A class of shareholders or a creditor can appoint a nominee director to the board. However, the nominee director cannot carry out instructions of the nominator. They must act in the best interests of the company and not as an agent for the nominator. However, *as long as there is no clash with the best interests of the company, he may "legitimately exercise his votes on the board in the interests of the person who appointed him". But he may not push his nominator's interests when this is contrary to the company's best interests or without regard for its interests. If the company's interests and those of the patron or nominator clash, the company's interests prevail* ***(Bennetts v Board of Fire Commissioners of NSW).***

(iii) Interlocking Directors

Laws allows for directors to sit on the boards of competing companies, however the director must give their best to each company to benefit its affairs. Hence, once company cannot sacrifice for the benefit of another company.
<u>TEST:</u> whether, on objective evidence, a director could have reasonably believed that the transactions were for the benefit of the company.
<u>HOWEVER:</u> Even where there is no question of a director using confidential information, there may well be cases in which director breaches his fiduciary duty to company merely by acting as a director of company B ***(Abbey Glen Property Corp v Stumborg).***

(iv) De facto Directors

S9: The title 'director' is also given to persons who act in the position of a director even though they have not been appointed to that position.
[LIABILITY] De facto directors will be liable as if they were properly appointed as a director.
DFC of T v Austin: Indications that a person may be a "director" despite the absence of formal appointment require a consideration of the duties performed by that person in the context of the operations and circumstances of the particular company concerned.
ARE THEY THE 'DRIVING FORCE BEHIND THE BUSINESS????
Corporate affairs Commission v Drysdale: Normally regarded if they are the **driving force behind the company business despite not having been appointed** to that position, or continues to participate in management of the company after the expiration of the term of their appointment as a director as if still a director.
A relevant issue may be the reasonable perception of the person who is claimed to have acted as a director by outsiders who dealt with the company ***(Natcomp).***
Natcomp Technology Australia v Graiche: *Distributed a business card carrying the logo of Amtech, which described him as the "CEO" of the Company; Claimed he made the decisions at Amtech; Paid for equipment; Contributed financially to the company.* Graiche's involvement with Amtech was apparently limited to an interest in the development and marketing of possible new products and this was insufficient to bring Graiche within the definition of "director". (APPLIED AUSTIN)
***NOTE* S128-130: (OUTLINED IN SHADOW DIRECTORS)**

(v) Shadow Directors

The directors of the company or body are accustomed to act in accordance with the person's instructions or wishes. Someone who influences directors to make decisions. Falls under the meaning of directors as per s 9 of the act, whether or not they were appropriately appointed. A shadow officer is someone who has the capacity to 'affect significantly' the corporation's financial standing in his or her management of the affairs of the corporation. That might, for example, be the finance manager who is not a director. However, it does not refer to a person who has the capacity as a third party to affect a corporation's financial standing, with no involvement in the management of the corporation's affairs ***(Buzzle v Apple)***
[LIABLITY] Will be liable even though not validly appointed
Standard Chartered Bank of Australia v Antico: A body corporate can be a shadow director, therefore a holding company can be a "shadow" director of a subsidiary company if the directors of the subsidiary are nominee directors who customarily follow the holding company's instructions and directions.
Ho v Akai: A person may be a shadow director without necessarily exerting influence or control over the whole field of the company's activities.
ASC v AC Nominees: The influence and control may be of a broad, strategic nature or instrumental in arranging fir the company to enter into significant transactions.
Buzzle operations v Apple Computer Australia: A creditor may be a shadow director of a company where the directors of a company are accustomed to act in accordance with the creditors instructions or wishes as to how they should act. However, a creditor will not be a shadow director merely because the directors of the company feel obliged to comply with the conditions imposed by that creditor in commercial dealings with the company. Buzzle Operations Pty Ltd was created in July 2000 as a merger of six retailers of Apple products. Buzzle held much of its stock on credit from Apple and granted it a charge over its assets. By November 2000, Buzzle was insolvent. It then incurred additional debts of $18 million to Apple and other creditors, and made $12 million in payments to Apple. After Apple appointed receivers in March 2001, the Buzzle liquidators brought proceedings against Apple. Argued that Apple was a shadow director of Buzzle because the directors were accustomed to act according to the instructions or wishes of Apple and its financial director.
S128-130: A person dealing with a company is entitled to make certain assumptions of regularity in relation to those dealings. These assumptions are binding on the company, which is not able to assert that the assumptions are incorrect. The right to make these assumptions is lost when the person knew or ought to have suspected that the assumptions were incorrect. The purpose of these assumptions is to enable outsiders who deal in good faith with persons who can reasonably be expected to have authority to act for the company.

(vi) Executive and non-executive directors

Executive directors: Executive directors are full time employees of the company. Their main role is to take part in the daily management of the company's business. In this respect, the compromise the senior management of the company under leadership of the CEO. In the case of large listed companies, the style and complexity of business means that the board of directors must delegate substantial control of the company's activities to its management.
Non-executive directors: Not directly involved in the daily management of the company's business. They have part-time involvement in the company an participate in board meetings or meetings of board committees. Non-executive directors have an important role to play in monitoring the activities of the management team headed by the CEO. They bring an independent view and judgment and often an outside or broad perspective to the boards deliberations. Their role is to consider the interests of the company as a whole and the general body of shareholders.

(4) RETIREMENT AND REMOVAL OF DIRECTORS

RIGHT TO REMOVE/LEAVE

- Directors can resign at any time (usually requires a notice in writing)
- Removal of a director is a genuine power of the shareholders
- S203C(a): Proprietary company may by resolution remove a director from office.
- S203D(1): Public companies may by resolution remove a director from office.
- S203E: Directors cannot themselves remove a fellow director (To avoid groupthink – provides genuine debate and independence of boards; ensures directors are independent of one another).

<u>PROPRIETARY COMPANY DIRECTORS:</u> Proprietary company shareholders can remove a director only if they are given that right in the replaceable rules or the constitution. The proprietary company replaceable rule in s 203C permits the shareholders to remove a director and appoint another person by resolution.

<u>PUBLIC COMPANY DIRECTORS:</u> Removal of a public company director can only be done by resolution of the public company's shareholders, even if there are contrary provisions in either the public company's constitution or a separate agreement between the director and the company (S203D). The office of director becomes vacant on the passing of the resolution. This is not the case if the director was appointed to represent the interests of a particular class of shareholders or debenture-holders. In such case, the resolution to remove the director does not take effect until a successor has been appointed (203D(1)). This ensures that the particular class of shareholders or debenture-holders are represented by a director at all times.

S203D: Gives shareholders of public companies control over the composition of the board of directors. It prevents a majority of public company directors from removing a director unless granted shareholder approval. A director of a public company cannot be removed by the other directors, not withstanding anything in the constitution or any agreement to that effect (203E).

It has been suggested that where a shareholder's meeting has been called to consider a resolution to remove a director, the board is placed into a caretaker role so that it is subject to restrictions on its powers to make fundamental or significant decisions, act outside of the company's OCOB or alter the balance of voting power. This principle may extend beyond situations where there is a controlling shareholder and the decision of the general meeting is not in doubt ***(Woonda Nominees v Chng)***

REQUIREMENTS/RIGHTS

Notice: Special notice required of sacking motion (2 months).
Right to be heard: Director has right to be heard at meeting and to circulate his views.
S 200B (1): retirement benefits to be approved by the general meeting
(ASX Listing rule 10.19) Retiring directors of LISTED Companies: cannot receive "termination benefits" exceeding 5% of the company's equity, unless there is shareholder approval.

DISMISSALS IN BREACH OF SERVICE CONTRACTS

Where a director is removed prior to the expiry of their term, the question arises whether the director can restrain the company from so acting to obtain damages for wrongful dismissal. A director cannot prevent the company from exercising its right of removal. The equitable remedies of injunction and specific-performance are not granted to enforce personal relations of unwilling parties ***(Atlas Steels).***

Dismissals in breach of service contracts occurs where a director is dismissed despite having a remaining contractual term of duties to fulfil. Although it may be lawful to remove a director, the company will still be liable for contractual damages if the term initially agreed upon has yet been fulfilled ***(Southern Foundries v Shirlaw).*** Hence, the obligation of companies under service contracts remains notwithstanding the fact that an individual has been lawfully dismissed ***(Carrier Australasia v Hunt).***

Southern foundries v Shirlaw: S was appointed managing director of SFL for 10 years under service contract. Control of SFL changed and the company altered its articles to give shareholders the power to remove any director. S was then removed and sought damages for breach of contract. HOL held that S was entitled to compensation as the company had broken its contract albeit lawfully removed S.
Shindler v Northern Raincoat Co: Plaintiff was removed as managing director by resolution at the general meeting despite being appointed for a set term. **HELD:** It was correct that the statute granted power to remove lawfully however, the company had entered into an arrangement and they **could not now take advantage of the contract to avoid this separate undertaking 'to put an end to a set of circumstances they had made'** otherwise it would be a futile contract, which is contrary to good practice.
Carrier Australasia v Hunt: H was appointed MD of CA under a 5 year service contract. H was removed as director and his position as managing director was therefore terminated. HELD: Although the company had the power to alter its articles it was liable for damages for breach of contract.

MITIGATION OF DAMAGES

[The director] will be unable to claim damages that would cover the cost of their earnings if they fail to take the opportunity to reduce losses, such as accepting an offer of employment ***(Brace v Cadler).*** However, the courts say to mitigate damages reasonably. Hence, the dismissed director should not decline reasonable offers of alternate employment and should even make reasonable efforts to find reasonable employment (CAN CONSIDER: pay, location, practicality, term of job).

(4) DISQUALIFICATION OF DIRECTORS

S 206B: Insolvents and fraudsters are automatically excluded from 'managing corporations' for 5 years.

COURT POWER OF DISQUALIFICATION

S206C: Contravention of a civil penalty provision
S206D: Insolvency and non-payments of debts
S206E: Repeated contraventions of the Corporations Act.
S206F: ASIC has the power of disqualification (up to 5 years managing, 7 insolvent)
Rich v ASIC: A disqualification order can be imposed to protect the company's shareholders.

APPEAL OF DISQUALIFICATION – S206G

S206G: A disqualified person can appeal the disqualification
S206G(1): A disqualified person can seek the courts permission to act in management. (2) Notice must be lodged within 21 days before applying for leave.

CONSIDERATIONS OF THE COURT WHEN DECIDING TO GRANT PERMISSION

- Nature of the offence (little chance if it entails 'dishonesty')
- Nature of the person's involvement in that offence (leader or jus associates)
- Character (up to the offence and also post offence behaviour)
- Size and structure of the company
- Hardship to employees and to others (shareholder, creditors – loan may be in jeopardy etc.)
- Public interest (this is the paramount concern)

PUBLIC PROTECTION CASE LAW

[DENIED]**Re Van Reeseema:** Manager and director of several companies was convicted of fraud and dishonesty, hence was automatically disqualified for 5 years (S206B). Whilst barred, he acted in management of a company and hence, re-offended. Argued: without him, the shareholders and employees would have suffered hardship. Judge REFUSED – Public needs protection and these offences were ones of dishonesty.

NATURE OF THE OFFENCE CASE LAW

[GRANTED] **Zuker:** Found in possession of a suitcase full of $20 bank notes and was convicted of conspiring to forge banknotes. He applied to the court for leave to act in a large company with a high turnover as they required is managerial expertise. Court GRANTED because (i) section is not to be regarded as 'punitive' (ii) good host of behaviour (iii) forgery on the bank notes is not related to dishonest management.

COMMON LAW CONSIDERATIONS FOR DISQULIFICATION PERIOD

ASIC v Adler: A breached s 180(1) (among other contraventions) as a reasonably careful and diligent director would not have procured a $10million payment to a company also owned by A. The court disqualified A under 206C and received 20year disqualification – OUTLINED CATEGORIES FOR CORRESPONDING PENALTIES:
>25 Years: Large financial losses of company; remorse; disregard for the law; previous contraventions for a similar activity.
7-12 years: Substantial loss; willing contraventions of the law; prospect that the individual will reform.
[GRANTED] **Re Shneider:** Chances of re-offending were minimal, high reputation considered; senior member of the rotary club. Court permitted S to act in management but not permission to act as a director.

DUTIES OF DIRECTORS

COMMON LAW DUTIES

(i) Duty to Act Bona fide in the interests of the company (s181 equivalent)

(a) Interests of the shareholders: The company as a whole means "the corporators as a general body" and that the "hypothetical individual member" could be seen as the personification of the company ***(Greenhalgh's Case).*** The interests of both "**present and future members**" are synonymous with the interests of the artificial legal **entity *(Gaiman v National Assn for Mental health).***
Percival v Wright (1902): The director's duty to act in good faith and for the best interests of the shareholders does not mean they owe duties to INDIVIDIUAL shareholders. (In this case negotiations were not disclosed)
EXCEPTION:
Coleman v Myers: The director must have been in direct and close contact with the individual member so that the director caused the member to act in a certain way which turned out to be detrimental (The court was prepared to acknowledge that a fiduciary relationship may arise in **special circumstances**. A fiduciary relationship was found where the shareholders relied heavily on the director for their information - *selling their shares; relying on the knowledge of family; got lower price than they could have).*
Brunninghausen v Glavanics: Depending on the nature of the transaction, the director may owe duties to individual shareholders if the director possessed special knowledge and the opportunity wasn't taken up by the company. *"A fiduciary duty was owed by directors to the shareholders where there are **negotiations for a takeover** or an acquisition of the company's undertaking would require the directors to loyally promote the joint interests of all shareholders".*
IF IT IS HARD TO SHOW FIDUCIARY RELATIONSHIP/ALTERNATE ROUTE:
S232: Members can seek relief if controllers, such as directors, are acting oppressively. This provision provides that Shareholders have an avenue, which means they do not have to rely in finding a fiduciary relationship and can hence actively seek relief ***(Buttonwood Nominees).***
(b) Interests of the creditors: Where the company is insolvent, the *creditors'* interests override those of the shareholders ***(West Mercia Safetywear v Dodd)*** In Australia, the interests of the creditors must be considered by the directors if the company is near insolvency ***(Nicholson).*** Hence, where a company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the shareholders ***(Re New World Alliance).*** Despite this, there is no statutory duty to creditors under section 588G, however creditors may be assisted under section **288FB ('Uncommercial transactions')** and **588FE(6A) ('Unreasonable director-related transaction').**
(c) Interests of employees, customers/suppliers, environment (Stakeholders)
[CSR TOPIC HERE]: REASONABLY INCIDENTAL TEST - It is the general doctrine that the company may only spend money if it is for the purposes which are reasonably incidental to the carrying on of the business of the company ***(Hutton v West Cork Railway Co).***

DODGE v FORD MOTOR CO CASE

The plaintiff shareholders (Dodge) brought an action against the defendant corporation (Ford) to force the defendant to pay a more substantial dividend to the shareholders and to change questionable business decisions (mainly ford's philanthropic attitude):
Lowering Car prices from $900 to $360
Spreading Benefits of the industrialised society with as many people as possible
Shareholder were not receiving and 'equitable sized' dividend
HELD: [SHAREHOLDER THEORY] The purpose of a corporation is to **make a profit for the shareholders**, but a court will not interfere with decisions that come under the business judgment of directors.

CORPORATE GIFT GIVING:

***AP Smith Manufacturing Co v Barlow*: "WAS THE GIFT IN THE BEST INTEREST OF THE COMPANY?"** $1,500 gift went from the company to Princeton University. The gift was a valid expenditure of company funds as it was beneficial to the company's reputation and incidental business. There is no difficulty in sustaining the power of corporations to contribute corporate funds within reasonable limits in support of academic institutions.
Re M & W Roith: Managing director passed away, leaving a widow who was receiving a pension from the company. The company went into decline ant liquidator challenged the pension on the basis that it was not in the best interest of the company. HELD: Board had not properly considered the interests of the company as the deceased was no longer contributing to the company – pension revoked.
Parke v The Daily News: Newspaper closed down and gave the employees gratuitous payments. Court held that these payments were not made in the best interests of the company and hence, were stopped.
HOWEVER:
Teck Corporation v Miller: Directors can observe a "**decent respect for other interests lying beyond those of the company's shareholders in the strict sense**, that will not leave directors open to the charge that they have failed in their fiduciary duty to the company.
(d) Interests of corporate groups (WHERE A COMPANY IS IN A GROUP OF COMPANIES): every company is a separate entity and hence, its interests must be considered in all transactions even though it may be part of a group. Therefore, directors should look after the interest of shareholders and creditors of their own individual company and not of the group of companies ***(Bell Group v Wetpac Banking Corp).***
IF THERE IS A SUBSIDIARY/HOLDING COMPANY RELATIONSHIP:
Subsidiary companies, although are indeed 'creatures' of their parent companies, are in fact separate entities ***(Adams v Cape Industries)*** **HOWEVER - S187:** A director of a corporation that is a wholly-owned subsidiary is taken to act in the interests of the subsidiary if: (a) constitution authorises to act in best interests of HC (b) director acts in good faith in best interest of HC and (c) the subsidiary is not insolvent because of the director's act.

(ii) Duty to use powers for proper purposes (s181 equivalent)

(iii) Duty not to fetter discretion (arranging to vote in a certain way)

Directors cannot reach a prior agreement or contract as to how they will vote at board meetings. The director must always observe and act in what they believe to be the best interests of the company at the time. Hence, directors must be independent in their decision-making ***(Thorby v Goldberg).*** Therefore, if a director agrees to carry out duties to the instructions of another rather than in guidance of their own consciousness or conscientious judgement, it is a breach of duty because the director is subordinating the interests of someone else ***(Boulting).***

(iv) Duty to avoid conflicts of interests (ss184, 207 and 191-196 overlap)

A person in a fiduciary capacity must not make a profit out of his trust, which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may not conflict ***(Boardman v Phillips).*** **[SEE STATUTORY EQUIVALENT 191-196]**

STATUTORY DUTIES

S 180(1) CPP – Care and Diligence

Director (or other officer) must exercise powers and discharge duties with the care and diligence of a reasonable person in their position. If directors permit the company to fall foul of provisions in the Act, that is not only a breach by the company but a negligence action under 180(1) may be bought against the director ***(Forlescue).***
TO HELP DETERMINE IF THE DIRECTOR WAS NEGLIGENT, WE APPLY AND ANALYSE THE CRITERIA FROM *Re City Equitable Fire Insurance Co Ltd:*

1. **Reasonable care:** care an ordinary man might be expected to take in the circumstances *(What would a reasonable person done in the CIRCUMSATANCES?)*

2. **Exercise of skill:** Director does not need to exercise a greater level of performance or skill than may reasonably be expected from a person of his knowledge and experience *(Has the client exercised the expected amount of skill?)*

3. **Attention to company affairs:** Directors are not bound to give continuous attention to the affairs of his company. His duties are of an 'intermittent' nature to be performed at periodical board meetings and committee meetings.

4. **Delegation of duties:** Directors are justified in leaving duties to other officials if they believe they can 'trust that official to perform such duties honestly'.

[NEGLIGENT] ***Dorechester Finance Co Ltd Stebbing:*** Two directors with accounting experience failed to check the activities of a fraudulent director. They had signed blank cheques and made it easy for the other director to lend corporate funds imprudently.
[NEGLIGENT] ***Re Australasian Venezolana:*** Director who was responsible for the preparation of the company's accounts was liable for not enquiring into the reasons for certain company payments or adequately familiarising himself with the company's books so that he could assess the true nature of these payments.
Gold Ribbon v Sheers: A non-executive director who has special skills or experience in the company's business has a duty to give the company the benefit of that skill or experience.
[NEGLIGENT] ***Smith v Van Gorkom:*** Directors approved to buy out the company at $55 per share. This was proven to be a shockingly low undervalue of the shares and hence, the directors were negligent. The directors also only considered the matter for 2 hours despite no sense of urgency, which was also negligent. [BJR DID NOT APPLY]
[NEGLIGENT] ***Re James Hardie Industries:*** **[FALSE ASX ANNOUNCEMENTS]**
Directors of listed companies should ensure that there is an appropriate and documented approval process in place for Board approval of ASX announcements **-** JH was major materials company that made products from asbestos, however the population were aware of the consequences at the time. In 1987, JG ceased asbestos manufacturing. They had long been aware of the dangers of asbestos use. JH set up a fund for current and future claims, however they were short by $1bn. JH assured that the trust was fully funded, which was false and misleading announcement to the investors in JHI. HC HELD: 7 non-executive directors who approved the misleading announcement were negligent – the foundation was badly underfunded. Hence, contravention of S 180(1).
[NO NEGLIGENCE] ***Turquand v Marshall:*** Board made an improper loan to one of their fellow directors who was insolvent. This did not amount to negligence, you could not expect more from people on the board – it was a misfortune that the company chose unwise directors.
[NO NEGLIGENCE] ***Pavlides v Jensen:*** The Company has to put up with the board even if they are "a set of amiable lunatics".
[NO NEGLIGENCE] ***Barnes v Andrews:*** Made president of the board when he was 6 months old. Because he had no knowledge about the gross irregularities in the books and the company affairs, he could not be held accountable and hence not liable for negligence.
[NO NEGLIGENCE] ***Norman v Thrdore Goddard:*** Surveyor appointed to the board for expertise as a property developer. Company invested money off-shore and lost it. Held that surveyor was appointed for property work, not offshore tax advice and hence, consideration of his subjective position lead to the finding that he was not negligent.

'NON-EXECUTIVE DIRECTORS' (NOT A DEFENCE to NEGLIGENCE)

DANIELS v ANDERSON: The responsibilities of directors require that they take reasonable steps to place themselves in a position to guide and monitor the management of a company. Directors **cannot rely on the fact that they are non-executive directors** and that they have no knowledge in a particular area. An integral part of accepting the position of a director is to acquire at least a rudimentary understanding of the business of their company and to maintain this familiarity.
- Be familiar with the company's business
- Continuing obligation to make inquiries and stay informed of business operations
- Be familiar with the company's financial position by reviewing financial statements
- If appointed because of certain skill – be aware of business outside expertise.
- Can make business judgements and commercial risks
- Cannot claim they did not see misconduct and 'not have a duty to look'.
- Generally monitor company affairs
- Cannot rely on other's judgement/risky behaviour when delegating.
- Same standard of care for executives and non-executives.

(a) Directors delegation and limits on reliance

S 189: If a director relies on information or professional expert advice, that reliance is taken to be reasonable.
S198D(1): The directors of a company may delegate any of their powers to: Committee of directors; a director; an employee; any other person.
S190(1): If the directors delegate their powers, the director is responsible for the exercise of that power as though the power had been exercised by the directors. Directors cannot abdicate their responsibility by delegating to fellow directors ***(ASIC v Hellicar).*** At common law, a director is entitled to rely without verification on the judgement, information and advice of management and other officers appropriately so entrusted ***(ASIC v Adler).*** HOWEVER, *Reliance would only be unreasonable where the director was aware of circumstances of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence, acting on his behalf, would have relied on the particular judgement, information and advice of the officer* ***(Daniels v Anderson).*** **[APPLICATION]** *Is it clear that this was an individual that should not have been relied upon?*
James Hardie: non-executive directors were not able to blindly rely on management to approve the press release about the company's responsibilities.

(b) Understanding of Company's financial affairs (and 588G provisions)

The directors declaration under S294(4), that the company's financial statements are in accordance with accounting standards and present a true and fair value, requires a level of financial expertise and competence in the directors. Hence, directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the Board's responsibilities as with the reporting obligations ***(ASIC v Healey).*** **HENCE THEY CAN BE LIABLE IN CIRCUMSTANCES OF INSOLVENT TRADING AS THEY HAVE A DUTY TO BE INFORMED OF THE FINANCIAL POSITION OF THE COMPANY.**
ASIC v Healey: 8 directors did not properly read and understand the financial statements of the company. The directors negligently signed off on the annual accounts, which did not disclose $2bn liabilities and $1.7bn guarantee agreements. The Act places upon the Board and each director the specific task of approving the financial statements. Consequently, each member of the board was charged with the responsibility of attending to and focusing on these accounts and, under these circumstances, could not delegate or 'abdicate' that responsibility to others.
ASIC v Hellicar: The court held that the non-executive directors of James Hardie had breached s 180(1) when they approved what they knew to be a misleading statement that the fund for asbestos sufferers was adequate. The draft ASX announcement had been tabled and approved at a board meeting. HELD: that a reasonable person in the position of non-executive director of a company like this in these circumstances would not have voted for such a misleading announcement going to the ASX.
Forlescue Metals Group: ASIC bought action against F and MD accusing that F had not continuously kept the marked involved (as per s674) and hence, alleging that the chair was in breach of s180(1). The Chairman had announced to the public that binding contracts were in place for building of port and railway infrastructure. However they were only in the process of negotiating these contracts. HELD: Investors reading this information were more savvy and not gullible. Hence, they had not been misled or deceived – they were sceptical to see through the looseness of the language.

S 180(2) Business Judgement Rule

MUST BE A 180(1) BREACH TO APPLY THIS

The business judgement rule protects directors that have made decisions that were reasonable in a business sense, but were not successful. If the decision was reasonable, there will be no breach of s 180(1). Hence, for the BJR to apply, it must be shown that a decision was made on some principle of business.
S180(2): *A director or other officer of a corporation who makes a business judgement is taken to meet the requirements of (1) if they (a) make the decision in **good faith/proper purpose** (b) do not have **material personal interest** (c) **inform themselves** to subject matter and (d) believe that the judgement is in the best interests of the corporation.*
An 'unadvised' business judgement will not shield a board of directors. However, this standard presumes the decision made is an informed one and the decision made must meet the standard of 'gross negligence' ***(Smith v Van Gorkom)***
[NO BJR] ***Smith v Van Gorkom:*** Directors approved to buy out at $55 per share, however this was a gross undervalue in comparison to the market value of the shares. The directors only met for 2 hours on this issue and there was no sense of urgency. **HELD:** failure to inform themselves of all information reasonably available to make the decision and a failure to disclose information to shareholders. BJR was not available as the directors did not use any 'business judgement' when they came to their decision.
Brehm v Eisner: A $140million payout was given to a top executive that the board wished to remove after 13 months. The shareholders objected to this and bought an action under 180(1). Court did not find negligence here, hence did not look at the BJR. They had done all the correct things and there was no intentional misconduct. Exemplifies that the US courts tent to leave companies to make mistakes without looking over their shoulders constantly, which is a different approach than Australia.

S 588G(1) Duty to prevent insolvent trading (PERSONAL LIABILITY)

S588G: APPLIES WHERE -
(a) A person is a director when the company incurs a debt,
(b) The company is insolvent at that time or becomes insolvent by incurring that debt and
(c) At the time there are reasonable grounds for suspecting insolvency.
S95A: Insolvent trading occurs where a company trades during a time where their liabilities exceed their assets and hence, is unable to pay debts when they become due and payable.
Commonwealth Bank of Australia v Friedrich: Eise was the part-time chairman of the (NSC), a non-profit company limited by guarantee. Friedrich was CEO of NSC. The State Bank of Victoria lent money to the NSC at a time when its liabilities exceeded assets. However the NSC's accounts showed an excess of assets over liabilities. This was due to the fraudulent activities of Friedrich. 2 E had signed the directors declaration saying that the company is solvent, which represented that the board knew the company financial affairs. This money was used to purchase firefighting planes with water-drop features. When the bank was informed of their insolvency, they bought an action against the directors (F) and the Chair for $97million. Upon this action, F took his life, hence E was solely liable although he was the least negligent, but signing the documents was a clear abuse of the letter of law.

Defences to 588G

1) There were Reasonable grounds to expect that the company was solvent
2) Show you delegated and could rely on others