

DIRECTORS' DUTIES: LESSONS FROM THE PAST TO GUIDE FUTURE CONDUCT FOR DIRECTORS – SOME PRACTICAL TIPS FOR NFPs

On 30 November 2017, we presented a webinar in partnership with Better Boards Australasia on *“Directors’ Duties: Lessons from the past to guide future conduct for Directors – some practical tips for NFPs”*.

The objective of the webinar was:-

“to gain a non-lawyers general understanding of a role of a Director in a modern incorporated entity, and to consider some strategies in fulfilling that role.”

The webinar considered Directors’ duties under:-

- Corporations Act 2001 (Cth);
- Associations Incorporation Reform Act 2012 (Vic); and
- Australian Charities and Not-for-profits Commission Act 2012.

The term “Director” was used in the webinar to include Directors, Officers, Officeholders and Committee Members.

The Webinar described the sources of Directors’ duties as being contained in:-

- General law – fiduciary;
- Statutory; and
- Constitution (of the organization).

The general law (fiduciary) Directors' duties can be defined as:-

- to act in good faith and for a proper purpose;
- to act with due skill, care and diligence;
- not to misuse information or position; and
- to disclose and manage conflicts of interest.

The webinar went on to discuss how these general duties are codified in various applicable legislation and in ACNC Governance Standard 5.

An explanation of the manner in which these duties have been interpreted by the Courts was provided in case study examples, principally from the following cases:-

- *ASIC v Hellicar & Ors [2012] HCA 17 (3 May 2012)* (the James Hardie Case).
- *ASIC v Healey & Ors [2011] FCA 717 (27 June 2011)* (the Centro Case).
- *ASIC v Sino Australian Oil and Gas Ltd (in Liq.) [2016] FCA 934 (11 August 2016)* and *ASIC v Sino Australian Oil and Gas Ltd (in Liq.) [2016] FCA 1488 (8 December 2016)* (the Sino Case).
- *Commonwealth Bank of Australia v Friedrich and Ors (1991) 9 ACLC 946* (the National Safety Council of Australia case)
- *Morley v Statewide Tobacco Services Ltd [1993] 1 VR 451* (the Morley case)

The key message of the webinar was that the Board can delegate but it can't abdicate responsibility. Similarly, a defence of "I am just a volunteer" is of itself not an adequate excuse.

The webinar also provided some practical tips in a checklist format to guide Directors of NFPs. If you would like to see the PowerPoint presentation slide deck please download below.

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Better Boards Australasia: Webinar Series

Directors' Duties: Lessons from the past to guide future conduct for Directors - some practical tips for NFPs

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Disclaimer: This presentation is of general nature only. Legal advice should be obtained in relation to any specific circumstances.

Webinar Objective

To gain a non-**lawyer's** general understanding of the role of a Director in a modern incorporated entity, and to consider some strategies in fulfilling that role.

N.B. we use the term “**Director**” to include Directors, Officers, Officeholders and Committee Members.

Wentworth Lawyers Pty Ltd

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Scope

Discussion Limited to:-

- Corporations Act 2001 (Cth) (**“Corporations Act”**) which applies to companies and typically in the NFP sector, companies limited by guarantee.
- Australian Charities and Not-for-profits Commission Act 2012 (Cth) (**“ACNC Act”**) but in particular note ACNC Governance Standard 5: Duties of Responsible Persons sets out the duties of officers (**“called Responsible Persons”**) which covers registered charities for ACNC Act purposes.
- Associations Incorporation Reform Act 2012 (Vic).

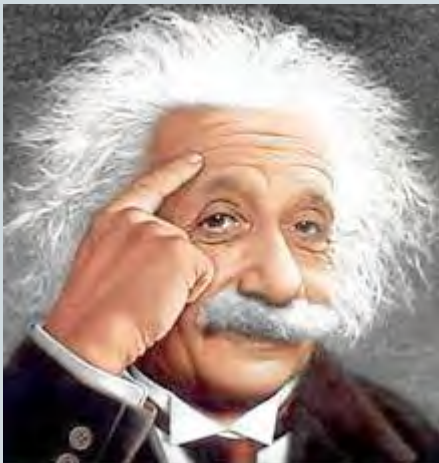
(for Incorporated Associations on a state by state basis the following is a useful resource:-

Not-for-profit Law Information Hub, Legal Information for Community Organizations
www.nfplaw.org.au)

Lessons to be learned

It is said that those who fail to learn the lessons from mistakes from the past are doomed to repeat those mistakes.

Another saying often attributed to Einstein is that the definition of insanity is doing exactly the same thing over and over again but expecting a different result.



Governance Responsibility

The Board of Directors of an organization has the ultimate responsibility for establishing and maintaining sound and effective corporate governance practice within that organization.

Sources of Directors duties: -

1. General Law - Fiduciary:

- General law is developed through custom and judicial precedent (i.e. by Court decisions).
- Fiduciary = trust relationship.

There is considerable overlap between these 2 concepts and we treat them as one for the purposes of this webinar.

2. Statutory:

- Created by Parliamentary legislation
- E.g. Corporations Act, Associations Incorporation Reform Act 2012 (Vic), and ACNC Act.

3. Constitution.

Sources of Directors Duties :

1. General Law - Fiduciary
 - to act in good faith and for a proper purpose;
 - to act with due skill, care and diligence;
 - not to misuse information or position; and
 - disclose and manage conflicts of interest.

Sources of Directors Duties (cont.):

2. Statutory

2.1 Corporations Act

- with the degree of care and diligence that a reasonable person would exercise if they were a Director of the corporation in the **corporation's** circumstances and had the same responsibilities (Sec. 180 - Civil Obligations);
- in good faith in the best interests of the corporation and for a proper purpose (Sec. 181 - Civil Obligations);
- not use the position improperly to gain advantage for themselves or cause detriment to the corporation (Sec. 182 - Civil Obligations);
- not use information obtained from the position to gain advantage for themselves or cause detriment to the corporation (Sec. 183 - Civil Obligations); and
- recklessly or dishonestly breaching good faith, use of position and use of information duties (Sec. 184 - Criminal Offenses).

Sources of Directors Duties (cont.):

2. Statutory (cont.)

2.2. Associations Incorporation Reform Act (Vic)

- not use the position improperly nor use information obtained from the position to gain advantage for themselves or cause detriment to the association (Sec. 83);
- with the degree of care and diligence that a reasonable person would exercise if they were an officeholder at the time with the same responsibilities (Sec. 84); and
- In good faith in the best interests of the association and for a proper purpose (Sec. 85).

(for Incorporated Associations on a State by State basis the following is a useful resource:- Not-for-profit Law Information Hub, Legal Information for Community Organizations www.nfplaw.org.au)

Sources of Directors Duties (cont.):

2. Statutory (cont.)

2.3. ACNC Act

- Governance Standard 5 Duties of Responsible Persons:
 - to act with reasonable care and diligence;
 - to act honestly and fairly in the best interests of the charity and for its charitable purposes;
 - not to misuse their position from information they gain as a responsible person;
 - to disclose conflicts of interest;
 - to ensure that the financial affairs of the charity are managed responsibly; and
 - not to allow the charity to operate while it is insolvent.

Sources of Directors Duties (cont.):

2. Statutory (cont.)

2.3. ACNC Act (cont.)

- **“generally**, the duties mean that Responsible Persons should act with standards of integrity and common sense.” - ACNC;
- Directors of charities **“may** already be subject to duties under other laws that apply to it. For example:-
 - equivalent duties existing in state or territory incorporated associations legislation - if your charity had its responsible persons comply with these duties, your charity will meet this standard.
 - for companies under the Corporations Act 2001 (Cth), the governance standards replace most requirements relating to director duties under this act. However, some criminal offenses under this act and similar duties under common law continue to apply.” - ACNC

Sources of Directors Duties (cont.):

3. Constitution

- Section 140 of the Corporations Act states that the Constitution of a company forms a contract between:-
 - the company and each member (shareholder);
 - the company and each Director and company secretary;
 - A member and each other member.
- Section 46 of the Associations Incorporation Reform Act (Vic) states the Rules are taken to constitute the terms of a contract between the association and its members.
- Consider constitutional requirements e.g. member approval for certain transactions, powers reserved to the members in general meeting.

Directors Duties:

Key Message:

Delegate but don't abdicate.

Delegation by Board

- Unless not permitted by the Company's Constitution the Board may delegate any of their powers to:
 1. a committee of directors; or
 2. a director; or
 3. an employee of the company; or
 4. any other person.
- The delegate must act in accordance with the terms of the delegation.
- The exercise by the delegate of the power is as effective as if the directors had exercised it.
- The delegation must be recorded in the minute book.

(Corporations Act - Sec 198D)

But.....

The Directors remain responsible for the **delegate's** exercise of power UNLESS:-

- a) the Director believed on reasonable grounds, at all time, the delegate would act in conformity with duties imposed by the Corporations Act and the **Company's** Constitution; and

- b) the Director believed:-
 - (i) on reasonable grounds;
 - (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.

(Corporations Act - Sec 190)

Reliance on Advice

Directors may rely on information, professional or expert advice where the Director believes: -

1. on reasonable grounds that employee, professional adviser or expert is competent; and
2. A committee of directors (on which the Director did not serve) was acting within authority.

Provided that the reliance was made in: -

- (i) Good faith; and
- (ii) ***“after making an independent assessment of the information or advice, having regard to director’s knowledge of the corporation and the complexity of the structure and operation of the corporation”***

(Corporations Act - Sec 189)

Reliance on Information or Advice

- Section 86 of the Associations Incorporation Reform Act 2012 (Vic) is in similar terms to Section 189 of the Corporations Act.

Insolvent Trading

1. General Law - Fiduciary

- to act with due skill, care and diligence.

2. Statutory

- Corporations Act
 - **Sec. 588G Director's Duty to Prevent Insolvent Trading;**
 - Sec. 588GA Safe Harbour - Taking course of action reasonably likely to lead to a better outcome for the company; and
 - ASIC Regulatory Guide 217 Directors duty to prevent insolvent trading.
- ACNC - Governance Standard 5.
 - See ACNC Guidance and Resources.

Penalties

A breach of duty (care and diligence, good faith, misuse of information or position, insolvent trading):

- Corporations Act
 - Civil Penalty
 - ❖ Up to \$200,000
 - ❖ Compensation
 - ❖ Disqualification
 - Criminal Penalty
 - ❖ Up to \$340,000
 - ❖ 5 years
- Associations Incorporation Reform Act
 - Up to \$20,000
 - Investigation by Consumer Affairs Victoria
- ACNC Act
 - Serious breach \$10,200
 - Consider consequences for charitable registration.

Penalties

NB. Personal liability on Directors and Officers may be imposed by over 550 laws as a result of a statutory breach by a company. Those laws impose liability in different ways, both within and across the commonwealth, states and territories and with varying classes of officers, court and different elements of offence and available defences.

See **“Protecting Your Position Commonwealth Laws Imposing Personal Liability on Directors and Officers”**,
March 2017, By Bruce Cowley & Steven Grant, Published by Minter Ellison.

Directors Duties Cases

- *ASIC v Hellicar & Ors* [2012] HCA 17 (3 May 2012) (the James Hardie Case).
- *ASIC v Healey & Ors* [2011] FCA 717 (27 June 2011) (the Centro Case).
- *ASIC v Sino Australian Oil and Gas Ltd (in Liq.)* [2016] FCA 934 (11 August 2016)
- *and*
- *ASIC v Sino Australian Oil and Gas Ltd (in Liq.)* [2016] FCA 1488 (8 December 2016) (the Sino Case).

Directors Duties Cases (cont.)

James Hardie Case

- Directors authorized release of announcement to ASX that establishment of foundation for **asbestos claims for next 50 years was “fully funded” and had “sufficient funds to meet all legitimate compensation claims anticipated”**.
- In fact underfunded by more than \$1billion.

Held

- Directors breached their duties of care and diligence (Sec 180).
- **Directors could not** “*abdicate responsibility by delegating his or her duty to a fellow director*”.
- Directors could not avoid liability by reliance on management or expert advisers.
- “*the task of approving the draft ASX announcement involved no more than an understanding of the English language used in the document*”.

Directors Duties Cases (cont.)

Centro Case

- Directors miscategorised a short term liability of about \$1.5billion as non-current.
- Failed to disclose guarantees of about \$1.7billion post balance date.
- Financial statement prepared by management and independently audited then approved by Directors.

Held

- Breach of duty of skill and care (Sec 180).
- Honest mistake, but it was information known or should have been known to the Directors.
- Directors must focus attention and apply themselves.
- **Errors were “so obvious” that Directors had abdicated their responsibility.**

Directors Duties Cases (cont.)

Centro Case (cont.)

At [22] Middleton J stated: -

“A reading of the financial statements by the directors is not merely undertaken for the purposes of correcting typographical or grammatical errors or even immaterial errors of arithmetic. The reading of financial statements by a director is for a higher and more important purpose: to ensure, as far as possible and reasonable, that the information included therein is accurate. The scrutiny by the directors of the financial statements involves understanding their content.”

Directors Duties Cases (cont.)

Sino Case

Australian Securities and Investments Commission (“ASIC”), in the matter of *Sino Australia Oil and Gas Limited (in liq.) v Sino Australia Oil and Gas Limited (in liq.)*

[2016] FCA 934 (11 August 2016)

[2016] FCA 1488 (8 December 2016) (Sino)

- ASIC alleged that Mr Shao, former Executive Director and Chairman of Sino was involved in a failure of information provided in a prospectus and the failure to make continuous disclosure to the ASX therefore breached his duties as a director of Sino.
- Mr Shao admitted that he did not understand English and did not obtain a full Chinese translation of each prospectus document before signing and authorizing release.
- **ASIC made other allegations about Mr Shao’s conduct as a director.**
- Mr Shao claimed he relied on and trusted his advisers and Australian resident directors.

Directors Duties Cases (cont.)

Sino Case (cont.)

The Court held:-

“The fact that Mr Shao was not an English speaker or writer and did not understand Australian legal requirements did not mean that he could just leave it all to others and did not excuse him from performing his own duties with reasonable care and diligence.....By failing to inform himself about the disclosure requirements, Mr Shao did not discharge the degree of care and diligence that a reasonable person would exercise as director and Chairman....”

Penalties:-

1. Sino pay a penalty of \$800,000
2. Mr Shao disqualified from managing corporations for 20 years.
3. Mr Shao to pay compensation to Sino of \$5,539,758.

Directors Duties Cases (cont.)

Sino Case (cont.)

Australian Securities and Investments Commission v Citofresh International Ltd (No 2)
[2010] FCA 27 was referred to in the Sino Case.

In this case a director argued that his relative lack of experience in the governance of public companies, and that Citofresh had engaged the services of a consultant to provide corporate governance advice and to prepare company announcements should mitigate his duties.

Goldberg J stated at [53]:-

“[The director] may have had a background in abalone processing and may not have been a professional director with public company experience, but that does not excuse him from exercising the appropriate degree of skill and care required of a company director especially one who was a managing director and chief executive officer. Further, he was not entitled to rely on the drafting undertaken by the “experts” who were retained by [the company]. The circumstances required him to have an active participation in the drafting and to exercise, a considerable amount of skill and care.....”

Volunteers, Silent and Passive Directors

- **The standard required of a Director is “that of an ordinary prudent person”.**
- Minimum Standards.
- Commonwealth Bank of Australia v Friedrich and Ors (1991) 9 ACLC 946
 - Safety Council of Australia (Victorian Division)
 - Award of \$97m against honorary chairman personally
 - Fraud
- Morley v Statewide Tobacco Services Ltd [1993] 1 VR 451
 - Mum was an uninvolved Director but son ran the business solely.
- **“I am just a volunteer” is not an excuse.**

Directors Duties (recap) - Lessons Learned

- Directors duties include: -
 - to act in good faith and for a proper purpose;
 - to act with due skill, care and diligence;
 - not to misuse information or position; and
 - disclose and manage conflicts of interest.
- Lessons for Directors: -
 - focus;
 - apply;
 - understand;
 - common sense;
 - actively consider issues within governance and risk protocols;
 - rely on expert advice but not to the extent of ignoring obvious errors that a person exercising reasonable care and diligence would query.

Directors Duties (recap) - Lessons Learned

What do the courts think?

A Director's duty to act with care and diligence requires that a Director: -

- become familiar with the fundamentals of the business (NFP);
- keep informed about activities;
- must monitor corporate affairs and policies by way of regular attendance at Board Meetings;
- must maintain a regular review and understanding of financial statements and affairs.

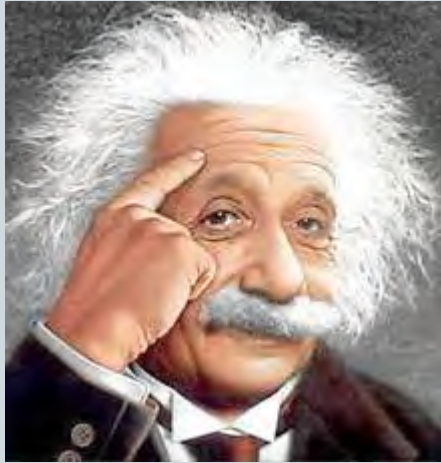
(A summary of Santow J comments in Re HIH Insurance Ltd and HIH Casualty and General Insurance Ltd; ASIC v Adler [2002] NSWSC 171)

Checklist

1. Why are we doing this?
2. Have I understood the issues?
3. What are the alternatives?
4. Which is the best alternative?
5. Am I satisfied with the information provided?
6. Do I need more info?
7. What additional information do I need?
8. Is the issue consistent with our purpose?
9. Do I have a material personal interest?
10. Would an independent observer agree that I have used an appropriate level of skill, care and diligence?
11. Would an independent observer consider that I have acted in good faith and for a proper purpose?
12. Would an independent observer consider that I had acted in the best interests of the organization.
13. Have I considered the solvency circumstances and impacts of the decision?

Other Relevant Considerations

- Directors and Officers Insurance;
- Risk Management Protocols;
- Delegation Matrix Protocols;
- Compliance Calendar; and
- Forward looking reporting.



Questions





Further Information

Protecting Your Position Commonwealth Laws Imposing Personal Liability on Directors and Officers

March 2017

By Bruce Cowley & Steven Grant

Published by Minter Ellison

ASIC Regulatory Guide 217: Directors Duty to prevent Insolvent Trading

<http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-217-duty-to-prevent-insolvent-trading-guide-for-directors/>

Audit Committees – A Guide to Good Practice

Second edition, a Joint Publication from Auditing and Assurance Standards Board, Australian Institute of Company Directors and the Institute of Internal Auditors Australia.

Duties and Responsibilities of Directors and Officer

21st edition, Professor Robert Baxt AO

Company Directors, Principles of Law and Corporate Governance

RP Austin, HAJ Ford AM, IM Ramsay, Lexis Nexis Butterworths 2005.

Boards that Work, a New Guide for Directors

G Kiel and Gavin Nicholson, The McGraw-Hill Companies Inc 2004.

ASX: Corporate Governance Principles and Recommendations

Third Edition (27 March 2014), ASX Corporate Governance Council.



Further Information (Cont.)

See also:-

Australian Prudential Regulation Authority

www.apra.gov.au

Chartered Accountants Australian and New Zealand

www.charteredaccountantsanz.com

Governance Institute of Australia

www.governanceinstitute.com.au

Australian Institute of Company Directors

<http://aicd.companydirectors.com.au>

For USA experience see:-

BoardSource

www.boardsource.org

For information on Incorporated Associations on a state by state basis the following is a useful source:-

Not-for-profit Law Information Hub, Legal Information for Community Organizations

www.nfplaw.org.au

For information on charities the following may be a useful resource:-

Australian Charities and Not-for-profit Commission, ACNC Governance Standards Guidance, August 2013.



Thank You

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