

BOARD SUBCOMMITTEES ARE A RISK!

THERE IS A BETTER WAY!

The following Article is a summary of a presentation given to the Better Boards Australasia Conference 2017 at Brisbane Convention Centre on 29 July 2017. Click [here](#) for a full copy of the presentation.

The traditional view of purposes of Subcommittees are often stated as following:-

- Share the workload.
- More Board time for strategy.
- Efficient use of time.
- More in depth study.
- Specialised work.
- Reduce the time at Board Meetings.

However, in our experience, too often we have seen the following:-

- More work results.
- Less Board time for strategy.
- Inefficient use of time.
- Greater risk for Directors.
- Ignoring Good Governance Frameworks.
- Empire building and loss of focus.
- Missing valuable contributions from non-subcommittee board members.

We frequently see one of two options with Subcommittee reports to the Board. Firstly, the Board simply accepts the Subcommittee's recommendations without any queries or real consideration. Generally, the argument is not to query the work of the Subcommittee because their purpose is to reduce the work of the Board.

Or secondly, the entire Subcommittee discussions are repeated, thereby doubling the workload.

We advise NFP's that the primary purpose of Subcommittees must be:-

assist better board decision making
to
discharge Director duties
in
achieving organizational purpose

Director's duties

At common law, a Director holds a fiduciary (trust) relationship to the company and its members. Principally, a fiduciary must:-

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

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

Companies limited by guarantee are governed by the *Corporations Act (2001) Cwth* which has codified the duties of Directors ensuring that they must:-

- act with a degree of care and diligence that a reasonable person would exercise if they were a Director of the Corporation (**sec. 180**);
- act in good faith in the best interests of the Corporation and for a proper purpose (**sec. 181**);
- not use the position improperly to gain advantage for themselves or cause detriment to the corporation (**Sec. 182**); and
- not use information obtained from the position to gain advantage for themselves or cause detriment to the corporation (**Sec. 183**).

Delegation by the Board

The Corporations Act (**Sec. 198D**) permits the Board to delegate their powers to:-

- a committee of directors; or
- a director; or
- an employee of the company; or
- any other person.

The exercise by the delegate of the power is as effective as if the Directors had exercised it. However the delegate must act in accordance with the terms of the delegation and the delegation must be recorded in the minute book.

But, the Directors remain responsible for the delegate's exercise of power.

Directors may rely on information, professional or expert advice (**Sec. 189**) provided that the reliance was made in good faith and after making an independent assessment of the information or advice.

Accordingly, the key message for Directors from the law and the cases is that Directors can delegate but they can't abdicate responsibility.

Directors duties cases

James Hardie Case (see our Article [here](#))

[ASIC v Hellicar & Ors \[2012\] HCA 17 \(3 May 2012\)](#)

- 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 the foundation was 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”.

Centro Case (see our Article [here](#))

[ASIC v Healey & Ors \[2011\] FCA 717 \(27 June 2011\)](#)

- 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.

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 breaching 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.

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.

How do we reconcile our duties as Directors with Subcommittees?

One suggestion that has been put forward is that there are whole of Board Subcommittees which may precede (or succeed) a Board Meeting. Such a Subcommittee can still have skilled independent participants (e.g. IT, Accountants, Lawyers or communications experts). The Subcommittee meeting can be chaired by someone other than the Board Chair.

Another alternative may be where a Subcommittee exists that items on the Agenda may be deferred to the full Board for consideration because the matter is of considerable importance, and would benefit from input from all Directors. Therefore should assist better board decision making with the discharge of Director's duties whilst achieving organizational purpose. The quality of reporting to the Board is of paramount importance. The query should be is this reporting sufficient to allow Directors not on the Subcommittee to reasonably discharge their duties.

Accordingly, in our view, simply saying that Subcommittees can “share the workload” or “reduce the workload” of Boards is too simplistic. The role of Subcommittees must be to assist better board decision making to discharge Director duties in achieving organizational purpose.

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