1. WHAT ARE ‘DIRECTORS’ DUTIES’?

Directors owe fiduciary duties. A fiduciary duty means the ‘duty to act with fidelity and trust towards a party in respect to whom the duty is owed’. Directors’ duties may be imposed by either or both the Corporations Act 2001 (Cth) (Act) or under the common law.

2. TO WHOM ARE DIRECTORS’ DUTIES OWED?

Each director owes fiduciary duties to the Company and to the members of the Company as a whole. (The Act and common law impose similar duties on officers of the Company, other than directors). In some circumstances, the duties may include future members, creditors and those who lend money to the Company. In the event of insolvency, duties owed to creditors of the Company may rank ahead of duties to the member.

3. PRIMARY DIRECTORS’ DUTIES

For each of the primary duties (refer below), both the Act and common law principles apply. Given the nature of directors’ duties, if a director is found to be in breach of one duty, it is likely that that director will be in breach of others as well.

3.1 Duty to act with care and diligence

Section 180(1) of the Act provides that:

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:

• were a director or officer of a corporation in the corporation’s circumstances; and
• occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

The common law recognises a similar duty. The Courts have decided that the care and diligence standard will be the same under the Act and common law. The standard of care has been explained as follows:

In determining whether a director has exercised reasonable care and diligence, one must ask what an ordinary person, with the knowledge and experience of the defendant, might be expected to have done in the circumstances if he or she was acting on their own behalf.

The standard of skill or care, therefore, requires a basic understanding of the financial affairs of the Company and of the Company’s business. At a minimum, ‘due diligence’ requires directors to stay informed of any changes in the business of the Company and inquire into matters where necessary, to attend board meetings regularly, and to be in a position to guide and monitor the business of the Company. Ignorance about matters that the director should be aware of is no defence.

The standard required may be higher for executive directors and for directors who have been appointed because of special skills which they possess (and it is those skills that are relevant to the subject matter of the act or omission(s)). The Court will assess the responsibilities owed by a particular director by having regard to their skills, experience and qualifications. However, the duty may vary depending on the size and type of business undertaken by the company.

A director may invoke a defence known as the ‘Business Judgment Rule’ to protect themselves from being liable for a breach of section 180(1) of the Act. A ‘Business Judgment’ is any decision to take or not to take action in respect of a matter relevant to the business operations of the relevant corporation. The defendant must show that there was an actual business judgment made. Pursuant to section 180(2) of the Act, the defence will apply if:

• the judgment is made in good faith for a proper purpose;
• the director does not have a material personal interest in the subject matter of the judgment;
• the director informs himself or herself about the subject matter of the judgment to the extent he or she reasonably believes to be appropriate; and
• the director reasonably believes that the judgment is in the best interests of the company. In this regard, the Act also states that this belief will be considered to be a rational one, unless it is one which no reasonable person in the director’s position would possibly hold.

If each of the above four criteria are satisfied, the director will not be liable for a breach of section 180(1) of the Act. However, this defence does not apply to any other offences under the Act.

3.2 Duty to act in good faith and in the best interests of the company and for a proper purpose

Section 181 of the Act states that:

• A director or other officer of a company must exercise their power and discharge their duties:
  • in good faith in the best interests of the company; and
  • for a proper purpose.

The common law duty also incorporates a duty of skill.
A mere sense of honest purpose does not satisfy this duty. The duty requires, at a minimum, a consideration of all relevant information or materials by a director. If a director does not give proper consideration to all relevant facts or fails to exercise their independent discretion, for example, by doing what that director considers the majority of members want, then that director will be in breach.

The scope of 'proper purpose' has been the subject of some recent cases. It is generally accepted that 'proper purpose' requires consideration of all of:

- the nature of the power in question;
- the limits within which the powers may be exercised; and
- the 'real' purpose for which the directors exercised the power, by reference to all of the circumstances.

If it is determined that the real purpose does not fall within the power in question, a director may be in breach of his or her duty. It is also important to note that if a majority of Board members act for a proper purpose, but a minority act for an improper one, provided that the majority had no knowledge of the improper purpose, the resolution will not be invalidated. However, the directors who acted for an improper purpose may still be liable personally for a breach of duty.

Where a director recklessly or intentionally breaches either its duty to act in good faith and in the best interests of the company or the duty to act for a proper purpose, the reckless or intentional breach attracts criminal liability under section 184(1) of the Act.

3.3 Duty to avoid a conflict of duty and interest

Sections 191-195 of the Act impose an obligation on directors not to permit a conflict of duty or interest to arise and sets out certain procedures which must be complied with if a conflict or potential conflict arises. There must be a 'real and sensible possibility of conflict'.

A director must notify the Board of any personal interest in a matter that relates to the affairs of the Company, as soon as possible. Where a potential conflict arises, the director must provide information about the relevant interest. In both cases, the interest must be a 'material' one. A 'material' interest has not been defined in the Act, but it has been suggested that an interest will be material where it has the capacity to influence the vote of the particular director, or if the director's interest would be substantially affected by the outcome of the Board's deliberations.

The director interested in a transaction usually cannot vote on it. The safe course is for the director to leave the meeting. Canvassing individuals prior to the meeting is dangerous.

In some instances, disclosure is not enough. In certain circumstances, there may be a duty on a director in a position of power and influence to take positive steps to protect the Company's interest and not merely remain silent even when bound by a duty of confidentiality. Where resolution of the conflict is impossible, resignation may be required.

There are certain exceptions to this obligation set out in section 191(2) of the Act.

3.4 Duty not to misuse information or the position of Director

This is commonly linked to the duty to avoid a conflict of interest. Section 182 of the Act prevents a director from making improper use of his or her position to gain an advantage for him or herself or for any other person, so as to cause detriment to the Company. There need not be an intention to cause detriment to the Company in order for the director to be liable for such a breach.

'Improper use' has been explained by the Courts in the following terms:

When impropriety is said to consist of an abuse of power, the state of mind of the alleged offender is important: the alleged offender's knowledge or means of knowledge of the circumstances in which the power is exercised and his purpose or intention in exercising the power are important factors in determining the question of whether the power has been abused. But impropriety is not restricted to abuse of power. It may consist in the doing of an act which a director or officer knows or ought to know that he has no authority to do.

In addition, section 183 of the Act imposes a duty on directors not to make improper use of information acquired because of their position, either to gain directly or indirectly, an advantage for the director or a person linked to them or to cause detriment to the Company. Even if the use of the information or position has been unsuccessful and no actual advantage has been gained, there will still be a breach if the director intended to gain from the use of information or position.

A breach of sections 182 and 183 of the Act will attract criminal liability if the director has, with dishonesty, done so intentionally or recklessness (under sections 184 (2) & (3) of the Act). These duties continue even after a director leaves the Board or an executive director ceases employment.

3.5 Duty not to abuse a corporate opportunity

A director must not take advantage of a business opportunity at the expense of the Company. For example, if a director learns of a contract that may be won by the Company and decides to divert that contract to another company,
or to other interests associated with that director, there will be a breach of the duty to act honestly. The result is that the members can sue the director and force him or her to disgorge any profits made from the particular investment opportunity or contract.

3.6 Day-to-day duties

These duties are wide-ranging. Where duties are delegated, the director has a duty to ensure that each person to whom a task is delegated has the necessary skills, knowledge and appreciation of his or her responsibilities to carry out the delegated tasks. Whilst it is permitted for directors to delegate under section 190 of the Act, the director will remain responsible unless they reasonably believed that the delegate would act in conformity with the duties imposed on directors and did so in good faith and on the understanding that the delegate is competent and reliable. Care must therefore be taken with respect to how the delegation is put into place, the nature of the authority given, and the review process adopted to ensure appropriate flows of information and checks and balances on those to whom duties have been delegated.

4. PENALTIES

All of the statutory duties listed above correspond to civil penalty sections and can give rise to:

- pecuniary penalty orders (i.e. fines);
- disqualification orders; and/or
- compensation orders.

Further, all statutory duties (except section 180) carry criminal penalties where it is shown that the director was reckless or dishonest.

5. OTHER MATTERS

5.1 Directors’ Obligations

The Act imposes a number of obligations regarding financial matters, disclosure of information and the like.

Some of these obligations are:

- to take all reasonable steps to comply with or to secure compliance with the requirements of the Act regarding financial records, financial report and audit (Part 2M.2, 2M.3 and s.344 (1));
- to comply with all requirements regarding the annual report, the directors’ statement and the directors’ report (Part 2M.3);
- to ensure that the company’s financial statements comply with all prescribed requirements including all applicable accounting standards (Part 2M.3);
- to ensure that false and misleading information is not disseminated in certain circumstances (sections 1308 and 1309);
- to provide certain information to enable the company to maintain proper records regarding its directors (section 205C); and
- to convene a general meeting upon receiving a requisition to do so from members (section 249D).

5.2 Reliance on information or advice provided by others

Directors are able to rely on information or professional or expert advice given or prepared by employees, professional advisers, experts and other directors.

Where a director relies in good faith on the information after having made an independent assessment, such reliance will be considered reasonable, unless the contrary is proved, where the director has relied on:

- employees, where the director believes on reasonable grounds that the person is competent and reliable in relation to the matters concerned; or
- professional advisers and experts, where the director believes on reasonable grounds that the subject of the advice or information is within the person’s professional or expert competence; or
- another director or officer, where the matter is within the director or officer’s authority or a committee of directors on which the director did not serve and where the matter is within the committee’s authority.

As a result of the Centro Group case, form your own opinion about the truth and fairness of financial statements.

5.3 Insolvent trading

The Act places an obligation on directors to ensure that the Company does not continue to trade whilst in dire financial circumstances. This is designed to minimise harm to members and to creditors of the Company. Specifically, section 588G of the Act imposes an obligation on directors to prevent the company from engaging in insolvent trading.

Insolvent trading provisions generally apply where:

- a person is a director of the Company at the time when the Company incurs a debt;
- the Company is insolvent at the time or becomes insolvent by incurring that debt(s); and
- at the time, there are reasonable grounds for suspecting that the Company is or would become insolvent.

The contravention occurs where there is a failure to prevent the Company incurring the debt, and the director was aware that there were reasonable
grounds to suspect insolvency or a reasonable person in a like position in the Company's circumstances would be so aware.

5.3.1 What is solvency?
A company is solvent if it is able to pay all of its debts as and when they become due and payable (section 95A). A company which is not solvent is deemed insolvent.

5.3.2 What are the consequences for a director if insolvent trading occurs?
There are civil and criminal consequences (i.e. fines can be imposed, convictions recorded).
Directors can be held personally liable to compensate the Company for any loss or damage it may suffer, or to pay the relevant debt(s) to a creditor(s).
Directors should also be aware that section 588V of the Act provides that a holding company can be held liable for the insolvent trading of its subsidiary in similar circumstances.

5.3.3 Can a director defend an insolvent trading claim?
Yes, if:
• he/she can establish that they had reasonable grounds to expect and did expect that the Company was solvent at the time the debt was incurred and would remain so thereafter;
• he/she can establish that they had reasonable grounds to believe and did believe that there was a competent and reliable person maintaining the Company's solvency and that information received from that person showed that the Company was solvent at the time the debt was incurred and would remain so thereafter;
• he/she can establish that at the time the debt was incurred, they did not take part in the management of the Company because of illness or for some other good reason;
• he/she took all reasonable steps to prevent the Company from incurring the debt. In determining whether reasonable steps were taken, the appointment of an administrator indicates reasonableness, and the timing and results of taking the action will be relevant.

5.4 Potential personal liability of directors in relation to tax
Although rare, in circumstances where a director has acted dishonestly/intentionally, proceedings can be instigated against that director under the Crimes Act 1958 in relation to the handling of the Company's tax affairs (e.g., false accounting, embezzlement, destruction of evidence, blackmail etc). Criminal penalties can apply in these circumstances, including substantial pecuniary penalties and/or imprisonment.
The Income Tax Assessment Act 1997 (Cth), the Income Tax Assessment Act 1936 (Cth) and the Taxation Administration Act 1953 (Cth) also contain a number of provisions which relate to federal offences regarding tax: there are a number of other “tax offences” which a corporation can be liable for under these Acts. Relevantly, section 8Y of the Taxation Administration Act 1953 provides as follows:

Where a corporation does or omits to do an act or thing the doing or omission of which constitutes a taxation offence, a person (by whatever name called and whether or not the person is an officer of the corporation) who is concerned in, or takes part in, the management of the corporation shall be deemed to have committed the taxation offence and is punishable accordingly.

For the purposes of this section, an officer of a corporation (which includes a director or secretary) is presumed, unless the contrary is proved, to be concerned in, and to take part in, the management of the corporation.

Directors may also have exposure under each State’s and Territory’s taxation regime. For example, section 61 of the Taxation Administration Act 1997 (Vic) provides that a person must not deliberately (by act or omission) evade or attempt to evade tax.

From a practical point of view, significant concerns for directors arise from the recent amendments to the director penalty regime, which have resulted in greater exposure to personal liability for directors. The key piece of legislation is the Tax Laws Amendment (2012 Measures No. 2) (Cth). Schedule 1 of this Act extends the director penalty regime to make directors personally liable for their company’s unpaid superannuation guarantee amounts, in addition to their liability for PAYG withholding amounts.

The superannuation guarantee charge is treated as payable on the day the employer is required to lodge their superannuation guarantee statement for the quarter to the Commissioner. Where the Company has not paid the associated superannuation guarantee charge (or PAYG instalments), its directors are liable to a director penalty equal to the amount of non-payment.

Directors and their associates (which include family members potentially) who are entitled to PAYG withholding credits may be liable to pay PAYG withholding non-compliance tax, essentially cancelling the benefit of any such PAYG withholding credits. The ATO has a discretion to reduce a director’s entitlement to PAYG withholding credits.

Where a new director is appointed after the Company failed to meet its liability for the superannuation guarantee charge and/or PAYG non-compliance...
tax, a different set of liability rules apply. The new director will become liable for the Company’s liabilities, if the Company does not satisfy the liabilities within 30 days of the new director's appointment.

On becoming an officer of the Company, it is critical to ensure that all tax related liabilities have been met by their due dates or action is taken to satisfy any unpaid liabilities within this 30 day grace period. Failure to discharge the existing liabilities will make the director personally liable.

5.5 Workplace Health and Safety (WH&S)

It is beyond the scope of this summary to provide details on each State and Territory's WH&S legislative regime, however, it is important for directors and officers of a company to be aware that they may be held personally and criminally liable for breaches of WH&S laws and that this liability (being criminal in nature) is not covered by directors’ and officers’ insurance.

In the case of proven breaches of a director’s obligations under these laws very substantial monetary penalties can and are imposed in addition to criminal convictions being recorded (and the threat of up to 5 years’ gaol in the most serious cases).

In most States and Territories directors have positive duties under the WH&S laws to inform themselves of all relevant matters regarding health and safety at the workplace. To ensure compliance with this positive duty new directors are well advised to take steps to understand the scope of their WH&S responsibilities. Directors should ensure that the Company has appropriate policies and procedures in place to identify and manage any risks in the workplace and that suitable reporting mechanisms exist to guarantee that the Board is aware of any WH&S matters of concern.

6. SUMMARY

As a director of the Company, at a minimum:

- you should acquire, at least, a rudimentary understanding of the business of the Company. Accordingly, you should become familiar with the fundamentals of the Company's business;
- you are under a continuing obligation to keep informed about the activities of the Company. This does not require a detailed inspection of the day-to-day activities but rather a general monitoring of corporate affairs and policies. Accordingly, you are well advised to attend Board meetings;
- you are obliged to have an understanding of the health and safety issues in the workplace. You should take steps to understand the scope of your responsibilities in this regard and ensure that appropriate systems are in place to make sure that you and the Company are complying with all WH&S obligations;
- whilst you are not required to audit Company books, you should maintain familiarity with the financial status of the Company by a regular review of financial statements;
- if you have been appointed to the Board because of your special expertise in an area of the Company’s business, this does not relieve you of the duty to pay attention to the Company’s affairs which might reasonably be expected to attract inquiry, even if they are outside your area of expertise.

The items below will assist in the above connection:

- Familiarise yourself with the Company’s Constitution.
- Make every reasonable effort to learn about and understand the operations and business activities of the Company.
- Read Board papers, agendas and minutes and all other relevant documentation and prepare for directors’ meetings.
- Ensure all Board members are aware of and understand their positive WH&S obligations.
- Keep abreast of the financial position of the Company and make sure you understand the financial statements, know the Company’s financial advisers and communicate with them whenever necessary.
- Ensure that appropriate and competent senior management are appointed and understand what they are required to do.
- Be conscious of the need to avoid conflicts and declare them as soon as they are apprehended or ought to be.
- Ask questions and communicate concerns and object to Company policy or conduct as necessary.
- Resign if there is no alternative.
- Obtain directors’ and officers’ insurance.
- If in doubt, seek appropriate legal and financial advice.