

Directors' Duties and Obligations

Directors' duties largely govern the relationship between directors and the company of which they are directors. Accordingly, these duties are generally owed to the company as a whole. In times of financial difficulty, directors may also find themselves in a fiduciary position vis-a-vis the company's creditors. In addition, there are a limited number of circumstances under which directors have duties to individual shareholders.

The fundamental principle governing directors' responsibilities is that directors must comply with the *Corporations Act 2001* (Cth). Other legislation and common law principles also apply to them.

1. Summary

In summary, directors' responsibilities are as follows:

- 1.1. duty to act bona fide (in good faith) in the interests of the company as a whole;
- 1.2. duty not to act for an improper purpose;
- 1.3. duties of care and diligence;
- 1.4. duty to avoid conflicts of interest;
- 1.5. duty not to make improper use of position;
- 1.6. duty not to make improper use of information; and
- 1.7. duty not to trade while insolvent.

2. Legal Duties

The legal duties and responsibilities of directors are:

- 2.1. to act with reasonable care and diligence (s 180(1) of the *Corporations Act*). The standard of care required is the degree of care and diligence which a reasonable person would exercise if they were a director in the company's circumstances. Accordingly, in certain circumstances, the directors 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 of a company in the company's circumstances, and occupied the office held by, and had the same responsibilities within the company as, the directors. The business judgement rule may offer protection to directors for breach of this duty in (see section 6 below);
- 2.2. to act in good faith in the best interest of the company (s 181 of the *Corporations Act*). Directors must exercise their powers and discharge their duties in good faith in

- the best interest of the company. Directors must avoid conflicts of interest and disclose and manage conflicts if they arise. The duty to act in good faith also requires that directors act honestly and in a manner motivated by the company's best interests as would be determined by an intelligent director in the director's position;
- 2.3. to act for proper purposes (also s 181 of the *Corporations Act*). This means that directors must not do something that a reasonable person would perceive to be contradictory to the aims or actions of the company;
 - 2.4. not to use their position as a director for personal gain (s 182(1) of the *Corporations Act*). Directors must not improperly use their position to gain an advantage for themselves or for any other person, or to cause detriment to the company. This duty requires that directors must not misuse their position as a director for personal gain or for third parties;
 - 2.5. not to make improper use of information gained whilst acting as a director for personal advantage or for the detriment or disadvantage of the company (s 183(1) of the *Corporations Act*). Directors must not improperly use information obtained by virtue of their position to gain an advantage for themselves or for another person, or to cause detriment to the company.
 - 2.6. to disclose to the other directors, any material personal interest in a transaction involving the company. In order to determine whether an interest is material, it must be shown that there was a substantial likelihood that, under all the circumstances, the interest would have assumed actual significance in the deliberations of the directors about the matter;
 - 2.7. not to cause the company to conduct its affairs or to act or refrain from acting in such a manner that is either:
 - 2.7.1. contrary to the interest of the shareholders as a whole; or
 - 2.7.2. oppressive to, unfairly prejudicial to, or unfairly discriminatory against one or more shareholders (s 232 of the *Corporations Act*);
 - 2.8. to account for profit which arise by reason of and in the course of the director's office where:
 - 2.8.1. the benefit was obtained in circumstances where a conflict or the significant possibility of a conflict existed between the director's duty to the company and the director's personal interests; or
 - 2.8.2. the benefit was obtained or received by use or by reason of the office of director or of the opportunity or knowledge resulting from that position;
 - 2.9. to prevent the company from trading if it has become insolvent (s 558G of the *Corporations Act*). Insolvent means that a company is not able to pay its debts as and when they become due. A director would fail this duty if he was a director at the time that:

- 2.9.1. the company incurred a debt;
 - 2.9.2. the company was insolvent at that time or became insolvent as a result of incurring the debt; and
 - 2.9.3. there were reasonable grounds to suspect the company is or would become insolvent and the director was aware at the time that there were such grounds for suspecting insolvency or a reasonable person in a like position in the company's circumstances would have been so aware;
- 2.10. if there is a relationship of confidence and trust between directors and shareholders, the directors also have additional duties to the individual shareholders. This will depend on the special circumstances and nature of the relationship in each case, but will generally arise where there is:
- 2.10.1. dependence on information and advice;
 - 2.10.2. the existence of a relationship of confidence;
 - 2.10.3. the transaction is of particular significance to the shareholder; or
 - 2.10.4. positive action is taken by or on behalf of the directors to promote the transaction.

3. **Delegation**

Directors are permitted to delegate any of their powers, not only to a committee of directors but also to a single director, an employee of the company or any other person, subject to any restrictions in the constitution of the company (s 198D of the *Corporations Act*). However, a director who delegates any of the director's powers to someone else is responsible for the actions of the delegate, as though the action had been taken by the director himself (s 190 of the *Corporations Act*). Directors must accordingly keep themselves informed about, and scrutinise the activities of the business of the company. Directors must also take reasonable steps to place themselves in a position to monitor and guide the management of the company. This does not mean that directors require a detailed inspection of day-to-day activities, but rather a general monitoring of the company's corporate affairs and policies.

4. **Financial Duties**

Directors also have financial duties which involve driving and monitoring business performance. These include:

- 4.1. monitoring both financial and non-financial performance;
- 4.2. ensuring that the company keeps accurate financial records;
- 4.3. ensuring that the Australian Securities and Investments Commission ("ASIC") is kept up-to date with details of all current directors and the primary business address;

- 4.4. ensuring that the company is filing appropriate tax returns; and
- 4.5. preparing for the annual audit by the auditor in accordance with any audit requirements in the company's Constitution or any relevant Shareholders' Agreement.

5. Other Duties

- 5.1. Directors of companies, in common with other people involved in business, also have a number of further duties. These include:
 - 5.1.1. keeping ASIC informed of changes to company details;
 - 5.1.2. registering the company's website name and address and ensuring that the website does not contain any false or misleading information; and
 - 5.1.3. assessing business risks and taking out appropriate insurances.
- 5.2. Current and proposed occupational health and safety ("OH&S") legislation, such as the *Model Work Health and Safety Act 2010* (Cth), require directors and other officers of a company to:
 - 5.2.1. acquire and maintain current knowledge of OH&S matters;
 - 5.2.2. maintain an understanding of the hazards and risks associated with the company's business;
 - 5.2.3. ensure that the company has appropriate resources for OH&S matters; and
 - 5.2.4. adopt appropriate procedures for dealing with incidents and OH&S issues.

6. Business Judgement Rule

The protection given by the "business judgement rule" (s 180(2) of *the Corporations Act*) only applies in relation to the duty of care and diligence which directors must exercise (see item 2.1 above) and not to any other duty. Directors will be taken to have met the requirements of their duty to act with reasonable care and diligence, both under the *Corporations Act* and at general law, in making a business judgement if they:

- 6.1. make the judgement in good faith for a proper purpose;
- 6.2. did not have a material personal interest in the subject matter of the judgement;
- 6.3. informed themselves about the subject matter of the judgement to the extent that they reasonably believed to be appropriate; and
- 6.4. rationally believed that the judgement was in the best interest of the company.

The belief that a business judgement is in the best interest of the company will be taken to be a rational one unless the belief is one that no reasonable person in the director's position would hold.

7. **Reliance on Expert Advice in Certain Circumstances**

A director may, in certain circumstances, rely on information or professional or expert advice in determining whether the director has preformed one or other of the director's duties (s189 of the *Corporations Act*). A director's reliance on such information or advice is taken to be reasonable, unless the contrary is proved, if it was given or prepared by:

- 7.1. an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the mattes concerned; or
- 7.2. a professional advisor or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or
- 7.3. another director or officer of the company in relation to matters within that director's or officer's authority; or
- 7.4. a committee of directors on which the director did not serve in relation to the matters within the committee's authority.

In addition, it must be established that the reliance on the information or advice was made in good faith after making an independent assessment of the information or advice, having regard to the director's knowledge of the company and the complexity of the structure and operations of the company at the time.

8. **Remedies**

Fines and civil penalties may apply to breaches of duty. A declaration of contravention of a civil penalty provision in the *Corporations Act* may be made by the court. Only ASIC or a company damaged by contravention of a civil penalty provision, may seek these orders. A director may also be liable to compensate the company, and the director may also be disqualified from holding office if a civil penalty is imposed. Criminal penalties and/or equitable remedies may be appropriate in some circumstances.

Possible fines and penalties include:

- 8.1. personal fines up to \$200,000.00;
- 8.2. disqualification from acting as a director;
- 8.3. imprisonment of five (5) years, a fine of up to \$200,000.00 or both for insolvent trading;
- 8.4. derivative actions by shareholders;
- 8.5. actions by employees and creditors claiming personal liabilities; and

8.6. legal claims for damages.

In addition, where the company is found to have traded while insolvent, a director maybe required to pay damages to the company's creditors or the Federal Commissioner of Taxation for any loss suffered by them from the insolvent trading of the company.

March 2011

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