Duties of Care and Skill
(a common law and statutory duty)

Duties of care & skill

1. Duty to exercise reasonable care, skill and diligence when acting as director; and

2. Duty to prevent insolvent trading by co.

Duties of care & skill

1. Duty of care, skill and diligence arises under:
   (1) executive director’s contract of employment (cf. non-executive ones);
   (2) general law (law of torts and equity): or
   s 180(1)

• Important to note the distinction with the first group of duties- this is not a fiduciary category

   ➢ The result of a successful claim under torts is sue for damages not for end to contract (rescission) or account of profits
1. Duty of care, skill and diligence

S 180 (1) sets out:

- A director or 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

Objective and reasonable test

- General tort law principles apply to determine what the standard or degree of care is.
Duties of care & skill

1. Duty of care, skill and diligence – scope of duty of care
   
   Daniels v Anderson (1995) minimum standard of care for non-executive directors
   
   • NSW CA held that directors of listed public co’s had to take reasonable steps to place themselves in a position to guide and monitor co’s management.
   • In particular:
     ➢ Directors must become familiar with co’s business when they join the board;
     ➢ They must regularly review co’s financial statements to be aware of its financial situation;
     ➢ Those appointed because of their special skills or experience in one aspect of co’s business must look at other aspects too;
     ➢ They are allowed to make business judgments and take commercial risks; and
     ➢ They cannot shut their eyes to corporate misconduct and raise ignorance as a defence.

Duties of care & skill

1. Duty of care, skill and diligence – scope of duty of care
   
   • Care
     ➢ Director must take reasonable care in performance of executive duties – ASIC v Adler (2002)
   • Skill
     ➢ Directors must possess certain basic skills in relation to financial statements and affairs of co. – Cth Bank v Friedrich (1991)
     ➢ Must comply with a “core, irreducible requirement of skill” involving “an objective test, such as ‘ordinary competence’ or ‘reasonable ability’” – DCT v Clark (2003); ASIC v Vines (2003)
     ➢ Must exercise degree of skill expected of a director with same level of knowledge, experience or expertise: Re City Equitable Fire Insurance Co Ltd (1925)

Duties of care & skill

1. Duty of care, skill and diligence – scope of duty of care
   
   • Diligence
     ➢ They must be able to monitor and guide co’s management: Daniels v Anderson (1995)
     ➢ Diligence includes:
       (1) attendance at all board and committee meetings (except illness and being interstate or abroad);
       (2) basic understanding of co’s business; and
       (3) continued obligation to keep informed about and monitor financial and general affairs of co: ASIC v Adler (2002); ASIC v Rich (2003).
Duties of care & skill

1. Duty of care, skill and diligence –
   Entrepreneurial risk taking
   - s 180(2) contains a business judgment rule to
     protect directors from liability for decisions that were
     bad but made in an honest, informed and rational way
     and in co’s interests.
     - If it is fulfilled (ie s 180(2)) then the business
       judgement cannot be reviewed by the courts

Duties of care & skill

1. Duty of care, skill and diligence –
   s 180(2) – “safe harbour” provision
   - (2) a director or other officer of a corporation who makes a
     business judgement is taken to meet the requirements of [s
     180 (1)] and their equivalent duties at common law and in
     equity if they:
       ➢ made the jdt in good faith and for a proper purpose
       ➢ do not have a material interest in the subject matter of
         the jdt
       ➢ inform themselves about the subject matter of the jdt to
         the extent that they reasonably believe to be appropriate
       ➢ Rationally believe that the jdt is in the best interests of
         the company
   - If this is made out then not liable under s 180 (1)
   - ONLY applies to s 180 or GL duty of care, skill and
diligence

Duties of care & skill

1. Duty of care, skill and diligence –
   Business Judgement Rule
   - S 180 (3) defined what a business judgement is
     ➢ Means any decision to take or not to take action in
       respect of a matter relevant to the business
       operations of the corporation
     ➢ Business operations do not include decisions made
       by directors such as the power to issue shares or
       pay dividends
Duties of care & skill
1. Duty of care, skill and diligence –

Ability of Director to rely on others

- S 189:
  - if in a court case (proceedings) about the director possibly having breached a duty, the issue of whether it was reasonable for a director to rely on another person’s information

Duties of care & skill
1. Duty of care, skill and diligence –

Ability of Director to rely on others

- S 189:
  - reasonable if it was prepared:
    - by an employee of the company who the director believes on reasonable grounds is reliable and competent;
    - a professional adviser or expert who the director believes is giving advice within their expertise;
    - another director in relation to matters within that director’s authority
    - a committee of directors on which the directors did not serve and in relation to matters within that committee’s authority
  - AND the reliance was made
    - in good faith; and
    - after making an independent assessment of the information having regard to the directors knowledge of the corporation and the complexity of the corporation

Duties of care & skill
1. Duty of care, skill and diligence –

Responsibility for delegates

- s 190D allows directors to delegate their functions to others in co., subject to any contrary provisions in co’s constitution.
- s 190(1) makes directors responsible for actions of their delegate/s.
- s190(2) absolves directors from liability if they believed that delegate would exercise power in conformity with director’s instructions, and they also believed: (1) on reasonable grounds; and (2) in good faith; and (3) after making proper inquiry if circumstances so warranted, delegate was reliable and competent.
Duties of care & skill

2. Directors duty to prevent insolvent trading

S 588G – the requirements
- If a person is a director of a company at a time when a company incurs a debt
- the company is insolvent at the time, or becomes insolvent by incurring that debt
- at the time there were reasonable grounds for suspecting that the company was insolvent or would so become insolvent

Subsection (2) then makes the person (director) liable if
- the person was aware there were the grounds to suspect insolvent (ie actual knowledge)
- or a reasonable person in a like position in the company's circumstances would have been aware (constructive knowledge)

Subsection (3) makes it an offence to do all of the above plus element of dishonesty

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Duties of care & skill

2. Directors duty to prevent insolvent trading

What is insolvent?
- S 95A : a person is solvent if they are able to pay their debts as and when they become payable
- It is enough if the company incurred several debts at the same time, none of which in isolation would push it over the edge
- Presumption of insolvency: s 588 E
  - Continuing insolvency: if prove in the last 12 months ending on relation back day remained insolvent thereafter
  - if failed to keep adequate records under s 286

ASIC v Plymin [2003]

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Consequences of breach of duty
Consequences of breach of duty

- General law breaches of fiduciary duty
  - Equitable compensation or damages
    - where breach of fiduciary duties
  - Account of profits
    - where undisclosed profits from undisclosed conflicts
  - Rescission of contract
    - where undisclosed interest in contract
  - Constructive trust
    - where director misappropriates property or misapplies money
  - Injunction

Consequences of breach of duty

- Statutory breaches of duty (ss 180-183, s 588G)
  - Civil penalties
    - ASIC must make a declaration first: s 1317E (1)
    - ASIC asks for a pecuniary penalty order of up to $200,000: s 1317 G and/or
    - Disqualification order: s 206C
    - Court may order the person contravening CA to compensate the company for damage suffered: s 1317H
    - ASIC usually applies but company can also be heard on all matters except whether the actual declaration or order can be made: s 1317J
    - Company can apply for compensation for contravention of civil penalty: s 1317H, 1317 J (2)

Consequences of breach of duty

- Criminal penalties under the Act
  - Note not in general law unless there is an offence under criminal code or state law
  - Contravention of good faith (s 181), use of position (s182), use of info. (183) may in certain circumstances be criminal offence: s 184 (1) – (3)
    - Is with dishonesty and intent/recklessness
  - S 184: may be imprisonment up to 5 years and/or $200,000 fine
  - S 206B(1): a person automatically disqualified if convicted of criminal offence under s 184
  - NOTE s 184 does not apply to s 180 duty of care, skill and diligence, 180 is a civil obligation only
### Summary of Director’s Duties

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