

Duties of Directors & Officers: Recent Cases & Regulatory Developments

Dominique Hogan-Doran SC
dhdsc.com.au @DHoganDoranSC

UNSW Centre For Law, Markets & Regulation
2017 Practitioners' Forum – 10 March 2017

About the presenter

Dominique Hogan-Doran SC specialises in commercial, corporate and financial services law and regulation. She maintains chambers in Sydney, Adelaide & Canberra and has appeared in many of Australia's most high profile public inquiries, related disputes and enforcement action.

Recognised in *Doyle's Guide to the Australian Legal Profession 2016* as a Recommended Leading Commercial Litigation & Dispute Resolution Senior Counsel, Dominique received the Barrister of the Year Award in the *Lawyers Weekly Australian Law Awards 2016*.

A qualified arbitrator and mediator, Dominique is a member of the Arbitration Panels for the National Broadband Network and for the Essential Services Commission of South Australia for determination of wholesale access disputes. She also serves as a trustee of a licensed industry superannuation fund with \$2.2 billion FUM, with appointments to its Audit & Risk, Investment, and Insurance & Claims committees.

Prior to the Bar, Dominique was a lawyer with Mallesons Stephen Jacques and Research Director to the Chief Justice of New South Wales, the Hon. Murray Gleeson AC. She is an honours graduate in law from the University of Sydney and the University of Oxford, where she was the Sir Robert Menzies Memorial Scholar.

Expectation Gap

AICD Course

2013/2014

“The essence of a director’s role is to ensure risk and legal exposure is identified and managed and to monitor the effectiveness of the procedures put in place to deal with them. Complementary to this is making sure the organisation’s hard won reputation is maintained.

The board sets the policies about how the organisation will operate in its particular legal environment, communicates those policies, makes certain they filter down through the organisation and monitors how compliance systems are implemented and reassessed regularly.

Ultimately, an organisation’s directors set the tone for all staff. Their commitment and visible involvement is the most important single factor in encouraging a corporate culture and commitment to minimising risk and compliance with laws.

Directors must lead, support and encourage the appropriate culture in regard to the legal environment for the organisation.”

Director questions

Mervyn King

Addressing the following questions with intellectual honesty will satisfy the duties of care, skill, diligence and good faith:

1. Is there any conflict?
2. Do I have all the facts to enable me to make a decision?
3. Is this a rational decision based on all the facts?
4. Is the decision in the best interests of the company?
5. Is the communication to stakeholders transparent?
6. Is the organisation acting in a socially responsible way?
7. Am I a good steward of the organisation's assets?
8. Would the board be embarrassed if its decision and the process employed in arriving at its decision appeared on the front page of a national newspaper?

Regulatory Enforcement Priorities

ASIC Enforcement Outcomes

Lifting the standards of governance:

ASIC's focus in recent years

- Initial focus on conduct of directors and officers of public companies
- Increasingly approach enforcement activities with more thematic intent

ASIC Enforcement Strategy

public company
breaches of duty of care

- *HIH - Adler v ASIC* (2003) by related party transactions in public insurance company
- *One.Tel - ASIC v Rich* (2004) in appointment of liquidator to telecommunications company when director, *inter alia*, failed to take reasonable steps to monitor company's management and assess financial position of company
- *ASIC v Vines* (2005) in preparation of misleading response to takeover bid for company
- *James Hardie – ASIC v Macdonald* (2009) by approving misleading public statements issued to ASX
- *Centro - ASIC v Healey* (2011) by approving misleading financial statements
- *AWB - ASIC v Lindberg* (2012) *ASIC v Ingleby* (2013) in relation to roles in AWB exporting wheat to Iraq and making disguised payments in breach of UN trade resolutions

ASIC Enforcement Priorities

REP513

8 March 2017

Serious breaches where these indicate:

- poor corporate culture
- poor governance/management systems that result in the market not being properly informed **[new]**
- poor listing standards, especially of emerging markets issuers **[new]**
- misuse of cross-border services and transactions;
- failure by corporations to respond appropriately to the threat of malicious cyber activity
- misalignment between company disclosures, product design, and investor understanding and expectations
- rogue insolvency practitioners **[new]** and others who facilitate serious illegal 'phoenix' behaviour and improper transactions in the face of insolvency.

ASIC Enforcement Objectives

2014 Review

ASIC's preferred regulatory outcomes:

- Disqualification order – most frequent
- Pecuniary penalty order – next most frequent
- Compensation order - sought in less than 1/3 of all cases; never sole order sought.

Source: Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42(1) Fed. L. Rev. 217.

ASIC v Managed Investments Ltd and Ors (No 9)
[2016] QSC 109

MFS Group – subsequently known as Octaviar – collapsed in 2008, owing \$2.5 billion.

Civil penalty proceedings successfully brought against five senior officers pursuant to Part 5C.2 (regulates registered managed investment schemes).

Earlier class action:

- *Mercedes Holdings Pty Limited v Waters (No 6)* [\[2012\] FCA 1412](#)
- *Hodges v Waters (No 4)* [\[2014\] FCA 472](#)
- *Hodges v Waters (No 7)* [\[2015\] FCA 264](#) at [92]

Contraventions included fact that their role in creation of false documents, and use made of information contained in the documents, constituted both:

- primary contraventions of duties and obligations:
 - as officers of MFSIM to act honestly (s 601FD(1)(a)) and
 - as officers of MFSIM to take all reasonable steps that a person in their position would take to secure compliance by MFSIM with Act (s 601FD(1)(f))
- primary contraventions to take all reasonable steps to ensure compliance by MFSIM with its obligations in parts 2M.2 and 2M.3 of Act to keep accurate financial records and produce accurate financial reports (s 344)

Penalty hearing heard in October 2016: judgment reserved

ASIC v Flugge & Geary [2016] VSC 779

- ASIC alleged former chairman & director, along with former senior officer, breached duties due to payments of 'transportation' fees by AWB to Iraq under contracts for sale of wheat, which was contrary to UN sanctions.
- ASIC alleged conduct caused considerable damage to reputation and assets of AWB, that Flugge and Geary knew/ought to have known of improper conduct by AWB and failed to stop the conduct in breach of their duties
- Flugge: failed to make adequate enquiries about propriety of payment of inland transportation fees and as a consequence, failed to stop AWB engaging in improper conduct in paying the inland transportation fees.
- Geary: did not breach in any of the 3 ways ASIC alleged.

ASIC v Drake (No 2) [2016] FCA 1552

- ASIC alleged Director and CEO breached duty of care and diligence by approving increase to loan to related company in LM Group. Said director caused LMIM, corporate trustee of unregistered managed investment scheme the Managed Performance Fund, to breach its duties.
- Edelman J rejected ASIC's case entirely
- ASIC never explained what a prudent trustee in LMIM's position would have done
- Trust instrument applicable to LMIM had excluded duty to act prudently
- ASIC expert "incredible" "preposterous" "unsupported leaps of logic"

Breach of Duty of Care & Diligence

ASIC v Cassimatis (No 8) (2016) 336 ALR 209; [2016] FCA 1023

- Directors contravened s180(1) by exercising their powers in way which caused or ‘permitted’ (by omission to prevent) inappropriate advice to be given to relevant investors by Storm Financial
- A reasonable director with responsibilities of the directors would have known that the ‘Storm model’ was being applied to the relevant investors and that its application would lead to inappropriate advice and consequences catastrophic for Storm
- Dismissed exoneration defence, concluding their conduct involved a ‘high degree of departure’ the requisite standard and role so significant and the contraventions sufficiently serious that ought not fairly be excused

ASIC v Padbury Mining Ltd (2016) 116 ACSR 208

- Directors breached duties of care and diligence by approving announcement that was misleading and deceptive, and led to Padbury Mining breaching its continuous disclosure obligations.
- Directors admitted their approval of defective announcement was potentially harmful to Padbury Mining's reputation and exposed Padbury Mining to litigation and regulatory action.
- Directors disqualified from managing corporations for 3 years and ordered to pay \$25,000.

ASIC v Sino Australia Oil and Gas Ltd (in liq) (2016) 115 ACSR 437

- Non-English speaking foreign national director of Sino Australia breached his duty of care by exposing Sino Australia to liability through his approval of deficient prospectus documents. D
- Failed to inform himself about Sino Australia's disclosure obligations
- Failed to understand Sino Australia's prospectus documentation
- Attempted to transfer \$7.5 million from Sino Australia's Australian bank accounts to accounts in China for the purpose of advancing a loan to a Chinese-based subsidiary, in circumstances where the loan would have been irrecoverable.
- 20 year disqualification; \$800,000 pecuniary penalty

ASIC v Ostrava Equities Pty Ltd [2016] FCA 1064

Carried on business of providing financial services in connection with establishment and administration of SMSFs. Substantial range of contraventions found, including contravened s 180 by:

- failing to take reasonable steps to prevent company from committing contraventions s 286, 911A, 911B, 941B; 942C, 946A, 946C, 1041G, 1041H of the Corporations Act, s 12DA and 12DB ASIC Act, s 29 *National Consumer Credit Protection Act 2009 (Cth)* and reg 7.7.09C of *Corporations Regulations*
- failing to take reasonable steps to prevent company from committing the contraventions of s911A (carry on financial services business without a licence)
- failing to take reasonable steps to prevent licensee from committing contravention of s 952E (giving defective Financial Services Guide)

Breaches by Directors of Aboriginal Corporations

[Registrar of Aboriginal and Torres Strait Islander Corporations v Monaghan \(No 2\) \[2016\] FCA 1143](#)

Obtained declarations & disqualification orders for contraventions of *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) by 3 former directors of Southside Housing Aboriginal Corporation; also obtained pecuniary penalties against 2 of those directors

- Section 265-1(1) imposes a duty to act with care and diligence (mirrors s 180(1))
- Section 265-10(1) relates to the use inter alia of a director's position (mirrors s 182)
- Section 363-1(1) in Chapter 7 imposes a duty to take all reasonable steps to comply or to secure compliance with Pts 7-2 and 7-3 of the CATSI Act (which impose obligations in relation to record keeping and reporting)
- Chapter 8 of *CATSI Act* establishes a civil penalty regime that is based on Pt 9.4B of the Corporations Act

Bywater Investments
Limited v Commissioner
of Taxation; Hua Wang
Bank Berhad v
Commissioner of Taxation
[2016] HCA 45 at [80]

In context of determining corporate
residence for income tax purposes

“There is little which is uncertain about the difference between a board of directors that actually meets and makes independent judgments, and a board whose meetings are mere window dressing comprised of rubber-stamping decisions actually made elsewhere by others. **In Australia, directors of a corporation are required by law to inform themselves about the subject matter of decisions relating to the corporation to the extent that they reasonably believe is appropriate and to make decisions on the basis of what they rationally believe is in the best interests of the corporation.** Similar obligations apply in the United Kingdom. Experience suggests that there is no particular difficulty in determining whether or not directors have complied with those obligations, still less in determining whether a board has so abrogated its decision-making power as to become in effect a mere puppet or cypher for the implementation of instructions from another. Civil actions and prosecutions for breach of directorial duties are routinely prosecuted on that basis.”

Breach of duties: diverse scenarios

Many cases dealing with s 180(1) and not all will involve the national regulator.

Company's circumstances and role and responsibility of the relevant director — and whether they measured up — vary from case to case.

Necessary to examine peculiar facts and circumstances and assess, according to the test, whether director or officer measured up.

Most cases under s 181(1), which concerns the separate duties of (a) (bests interests of the company) and (b) (for a proper purpose), involve an assessment of a positive act or decision made by a director or officer.

The quality of the decision is then tested.

The common law duties are equivalent.

No third party
private cause of
action for damages
for breach of duty

Day v Woolworths Ltd & Ors [2016] QCA 337

Highlights that properly construed, ss 180(1) and 181(1) do not create a private cause of action for damages for breach other than where there is an express provision of the Corporations Act provides for it.

Slip & fall appeal from District Court

Sought to add Woolworths directors and company secretary as respondents to claim

No statutory cause of action conferring a right to damages or compensation upon a third party in plaintiff's position for breach of officer's general duties under ss 180(1) or 181(1).

Two reasons:

- Loss suffered by third party is not loss "suffered by the corporation" within meaning of s 1317H(1)
- Only ASIC or the corporation may apply for a compensation order under s 1317J.

Failure to protect income stream

Strategic Management Australia AFL Pty Ltd v Precision Sports & Entertainment Group Pty Ltd; Chillimia Pty Ltd v Same (2016) 114 ACSR 1

- Alleged former managing director and officer breached their duties of care and diligence.
- Sifris J: directors failed to ensure Strategic Management's income stream was adequately protected.
- Strategic impoverished and suffered loss and damage as a result of the conduct of directors, entitled to order for damages to compensate loss.

Failure to monitor & enquire

Australian Staging & Rigging: Events P/L (recs apptd to assets) (in liq) v Elite Systems Australia P/L [2016] SASC 204

- Damages claim, received \$200 000 in unlawful disbursements from ASR Events.
- Director of ASR Events breached duty of care and diligence by failing to monitor bank account, or make further enquiries.
- Elite System accessorially liable as intentionally assisted the director in director's breach.
- Nb undefended by company; director affidavit contained helpful admissions

Breaches of Duty by Liquidators

Asden Developments Pty Ltd (in liq) v Dinoris (No 3) (2016) 114 ACSR 347

- Former liquidator breached s180(1) (“officer”).
- Failed to take adequate steps to recover funds transferred out of Asden’s bank account and failed to properly supervise sale of boat it owned.
- Liquidators under same statutory duty as directors, but also required to meet high standard of care & diligence expected from professionals.
- However, application dismissed as found Asden not established any damage resulted to it from Dinoris’ conduct as required by s 1317H(1)
- Now on appeal, security ordered: [2017] FCA 37
- See also: *ASIC v McDermott, in the matter of Conalpin Pty Ltd (in liq)* [\[2016\] FCA 1186](#) (Court inquiry into conduct of liquidator)

Payments to Other Entities

Re Toppro Pty Ltd [2016] NSWSC 1399

- Highlights that duty of care can be breached even if no actual harm suffered as a result provided reasonably foreseeable might harm interests of the company
- Toppro alleged former general manager and director breached their duties by transferring money from its bank account to other entities.
- Payments not made in accordance with established internal procedures.
- Held: directors not breached their fiduciary and statutory duties. Payments made under a genuine consultancy agreement, which was reasonably entered into.
- Mere failure to adhere to established procedures does not of itself constitute a breach of duties.

- Central to director's fiduciary duties is not placing themselves in position where actual or sensible possibility of conflict between a personal interest or a duty owed elsewhere and director's duty to act in best interests of organisation.
- Even in circumstances where is fully informed consent, still possible for director to be in breach of this duty.
- Caution must be exercised.

- Three "rules":
 - "no conflict rule" – director must not have personal interest or inconstant engagement that is inconsistent with best interests of company
 - "no profit" rule – director must not misuse position to obtain advantage for themselves or third party without fully informed consent
 - "no misappropriation" rule - director must not misappropriate organisation property or business opportunities for own benefit or that of third party.

Conflicts of Interest: Dual Roles

Rinfort Pty Ltd v Arianna Holdings Pty Ltd (2016) 111 ACSR 607

- An alternate director of Rinfort was also a director of Arianna Holdings.
- The director caused Arianna Holdings to issue a letter of demand for repayment of a loan to Rinfort. This caused Rinfort to become insolvent.
- Director owed conflicting duties – the interest of Arianna Holdings was to achieve the winding up of Rinfort and the interests of Rinfort was potentially the opposite.

Conflicts of Interest: Competing businesses

Australian Careers Institute Pty Ltd v Australian Institute of Fitness Pty Ltd (2016) 116 ACSR 566

- AIF alleged director breached duties by setting up and promoting, in conjunction with ACI, competing fitness education business called Sage.
- AIF and Sage had overlapping staff with dual roles. Conduct created a real or substantial possibility of conflict between duties as director of AIF and personal interests in promoting Sage.
- ACI had knowledge of director's dishonest and fraudulent design and so liable to AIF for an account of profits.

Summary Judgment Refused

Edenham Pty Ltd v Meares (2016) 116 ACSR 261; [2016] WASC 301

- Alleged 2 former directors breached duties by concurrently carrying on business as directors of competitor.
- Factual issue of whether 2 companies in direct competition not evident with high degree of uncertainty. Directors' defence of informed consent not "hopeless."

Golden Taste Investment Pty Ltd v Laurence [2016] VSC 250

- Alleged 2 former directors breached fiduciary and statutory duties ss 180-183 of the *Corporations Act*.
- Complex facts giving rise to claims & complex issues directors wished to raise.

Transfer of Property for No Consideration

Brentwood Village Ltd (in liq) v Terrigal Grosvenor Lodge Pty Ltd (No 4) [2016] FCA 825

- Brentwood alleged director contravened s 181(1) and s 182(1) by transferring property to companies controlled by family members for no consideration, or under market value.
- Markovic J: Not possible for a director to act in good faith if they transfer a significant asset of a company for no consideration, especially if that transfer was to a company in the control of other family members.

Diversion of Profits

Re B Personal Pty Ltd [2016] VSC 211

- Former director of B Personal, Johann, alleged payments made by B Personal to SB Group, which was controlled by another former director of B Personal, Shane, were wrongfully diverted from B Personal.
- Payments were purportedly for consultancy services provided by Shane. The VSC noted that the payments practically functioned as a dividend of B Personal's profit.
- Even if Shane did consultancy services, they were in the line of B Personal's business and should have been opportunities undertaken on its behalf.

Mishandling Finances

Re Amazon Pest Control Pty Ltd [2016] NSWSC 609

- Amazon alleged two former directors breached their duties by mishandling company finances.
- NSWSC agreed with Amazon.
- Directors had used Amazon's accounts to pay for personal expenses, such as children's school fees, and mis-described those expenses in Amazon's financial records.

Tax Evasion

BCI Finances Pty Ltd (in liq) v Binetter (No 4) [2016] FCA 1351

- Liquidators alleged directors breached their duties by participating in scheme for purpose of evading income tax liability.
- DCT issued revised tax assessment notices, and ensuing tax liabilities meant BCI Finances was placed in voluntary administration.
- Gleeson J: directors who participated, and knew of, scheme were liable for breaches of their general law fiduciary duties. Did not address *Corporations Act* duties.

Misappropriating Funds

KQ International Trading Pty Ltd v Yang [2016] VSC 146

- Former director breached duties under s 181-182 of the *Corporations Act* by misappropriating substantial funds, failing to respond to correspondence and failing to attend director's meetings.
- *"It is easy to identify"* a breach of s 181 of the *Corporations Act* *"because, simply put, it is clear that the director is doing the wrong thing."*

Pursuit of proposal

Hart Security Australia Pty Ltd v Boucousis [2016] NSWCA 307

- HSA involved in negotiations to provide security services to Northern Territory Airports.
- Without knowledge of HSA, director entered into a 'secret' proposal under which new company would be incorporated and shares would be issued so would be holding company of HSA.
- Neither new entity or HSA gained contract.
- HSA alleged director breached his fiduciary and statutory duties breaches of his fiduciary and ss 181(1), 182(1) and 183(1)
- HWL Ebsworth partners who advised HSA joined for knowing assistance & involvement in contraventions

- NSWCA confirmed director in breach of fiduciary duty in pursuing proposal involving new entity.
- Pursuit by a fiduciary of personal gain in circumstances where is actual or substantial possibility of conflict constitutes a breach of fiduciary obligation irrespective of actual motive of fiduciary and, in the case of a director, is to be assessed without reference to their subjective view as to what is in the best interests of the company: [109].
- Proposal involved significant personal benefits to director and his pursuit of that proposal in face of conflict between his interest and duties was a breach of his fiduciary obligation: [120]-[123].

- Where sole director proposes to issue shares in circumstances where that will result in a change of control in company, and dilution of its existing shareholder's interest to nil, the matters that director might reasonably have to consider in discharge of duty include how that share issue will affect existing shareholder and whether it should be made aware of proposed share issue so as to be given opportunity to propose some other means of providing funds or other financial support: [113], [121].
- No error in findings director not liable for breach of statutory duties. No challenge to findings that director did not use his position as a director, or use any information he obtained by virtue of being a director, improperly in order to gain an advantage for himself or new entity.

Conflicts of Interest: Role of Disclosure

Duncan v Independent Commission Against Corruption [2016] NSWCA 143

- ICAC investigation into circumstances in which NSW Govt issued coal exploration licence to Cascade (2011).
- ICAC found that Obeid family interests owed a large portion of land within tenement.
- Cascade Coal began negotiations with White Energy for the sale of Cascade shareholdings. Prior to the sale, the directors removed the Obeid family interests.
- ICAC findings of 'corrupt conduct' against directors based on failure to reveal information about involvement of Obeid family interests to independent board committee set up on behalf of White Energy.

NSWCA:

- director's duties pursuant to s 184(1) may not be fully satisfied by directors removing themselves from positions of potential conflict. Act also imposes positive duties of disclosure on company directors
- contravention of s 184(1) requires intentional dishonesty or recklessness, which involves a finding that the conduct complained of was dishonest according to ordinary community standards, and known by the director to be so
- deliberate failure to disclose relevant information in circumstances where is a duty of disclosure and with full knowledge of relevant facts could be seen to be “intentionally dishonest”.

Looking forward

Regime Proliferation

- Aboriginal Corporations
- Superannuation Industry
- Charities & Not for Profits
- Strata Schemes

Directors' Duties and Corporate Culture

Will poor corporate culture lead to claims of breach of directors duties?

- Maintained as ASIC Enforcement Priority Rep513

Greg Medcraft comments:

- “The board plays an important role in setting the tone, influencing and overseeing culture.”
 - “Board members may be ‘hands off’ but I do think they should have their ‘noses in.’”
 - “We recognise that culture is not something that can be regulated with black letter law.”
- Prof Robert Baxt: Cth Criminal Code.
- John Colvin: no universal definition of corporate culture.

Directors' Duties and Climate Risk

Will failing to take account of climate change risks lead to claims of breach of directors duties?

Oct 2016 Centre for Policy Development and the Future Business Council Memorandum (Noel Hutley SC and Sebastian Hartford-Davis):

- Climate change risks may be relevant to a director's duty of care to the extent that those risks intersect with the interests of the company.
- It is conceivable that in the future, directors who fail to consider climate change risks could be found liable for breaching their duty of care.

Directors' Duties and Cyber Risk

Will data breaches lead to claims of breach of directors duties?

- Increasing concern re risks associated in cybercrime and cyber terrorism leading to:
 - Serious reputational damage
 - Corporate and customer financial harm
 - Compromise of confidential data
- Fraud in technology (e.g. Volkswagen diesel cars).
- USA lawsuit against retailer Target after security breaches resulted in customer data being compromised.
 - \$US 10 million settlement.

Questions?
