

# Directors' Duties



- **Sources of duties**
  - Common law
    - to act in good faith for the benefit of the company as a whole
    - to exercise powers only for proper corporate purposes
    - to avoid conflicts of interest between duties owed to the company and other duties or interests
    - not to make personal gain in the course of one's duty as a director
    - not to use information obtained as a result of performing one's position as a director for the purposes of personal gain
    - to give appropriate and adequate consideration to all relevant matters and to retain discretion
  - Statutory



- **To whom are the duties owed**
- **General duties under the Corporations Act**
  - **Section 180:** to act with due care and diligence
  - **Section 181:** to act in good faith in the best interests of the corporation and for a proper purpose
  - **Section 182:** not to make improper use of position
  - **Section 183:** not to make improper use of information

- **Other duties under Corporations Act**
  - **Section 191:** to disclose material personal interests
  - **Section 588G:** to prevent insolvent trading
  - **Section 292:** to comply with accounting and reporting requirements (directors' reports)
- **Other duties for directors:** Trade practices, taxation, workplace health and safety and environmental protection.
- **Civil/criminal liability**

- “Director” as defined under Section 9:
  - appointed directors
  - alternate directors
  - act in position of a director
  - someone in accordance with whose instructions and wishes the directors of the company are accustomed to act
- “Officer” as defined under Section 9:
  - someone who participates in making decisions that affect a substantial part of the business of the corporation; or
  - someone who has the capacity to affect significantly the corporation’s financial standing



- *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* [2007] FCA 963 (trader found not to be an officer)
- *ASIC v MacDonald (No 11)* [2009] NSWSC 287 (James Hardie) (General Counsel found to be an officer)
- *Buzzle Operations Pty Limited (In Liq) v Apple Computer Australia Pty Ltd* [30/3/2010] NSWWSC 233 (Apple found not to be a shadow director)

*“It is not enough that a third party imposes conditions on their ongoing support, and it is left to the directors to discharge their own duties to the company to decide whether or not to comply, even if they feel they have ‘no choice’”*



## Section 180 - Care and diligence

*“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:*

- (a) *were a director or officer of a corporation in the corporation’s circumstances; and*
  - (b) *occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.”*
- *ASIC v Rich (2003) 175 FLR 128 – Chairman has special role*



## **Business judgment rule**

*“A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:*

- (a) make the judgment in good faith for a proper purpose; and*
- (b) do not have a material personal interest in the subject matter of the judgment; and*
- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and*
- (d) rationally believe that the judgment is in the best interests of the corporation.”*



- *ASIC v Rich* (2009) NSWSC 1229 – Reliance on BJR

*Austin J – Business Judgement Rule:*

- Onus is on the directors to establish that the rule applies
- It only applies to decisions to act or not act and not to the general monitoring rule – can't get the benefit of the BJR unless you can show you have actually made decisions
- Your belief that you are acting in the best interest of the company must be rational, but not necessarily reasonable - subjective test as opposed to the objective test of the overlying duty



## *Austin J – minimum standard of diligence:*

- Become familiar with the fundamentals of the business of the corporation
- Keep informed about the corporation's activities
- Monitor, carefully, the corporation's affairs
- Maintain familiarity with the financial status
- Have a reasonably informed opinion of the company's financial position
- Importance of good corporate governance



## **Section 181 – Good faith and proper purpose**

*“A director or other officer of a corporation must exercise their powers and discharge their duties:*

- (a) in good faith in the best interests of the corporation;  
and*
- (b) for a proper purpose.”*

- *Ralph v Diakyne Pty Ltd [2010] FCAFC 18*



## **Section 182 – Use of position**

*“A director, secretary, other officer or employee of a corporation must not improperly use their position to:*

- (a) gain an advantage for themselves or someone else;  
or*
- (b) cause detriment to the corporation.”*

- *Doyle v ASIC [2005] HCA 78*

## **Section 183 – use of information**

*“A person who obtains information because they are, or have been, a director or other officer or employee of a corporation must not improperly use the information to:*

- (a) gain an advantage for themselves or someone else;  
or*
- (b) cause detriment to the corporation.”*

- *ASIC v Vizard (2005) 54 ACSR 394*

## Possible defences for directors

- Business judgement rule – Section 180 only
- Sections 1317S and 1318
  - Extract from 1317S:

*"If:*

(a) *eligible proceedings are brought against a person; and*

(b) *in the proceedings it appears to the court that the person has, or may have, contravened a civil penalty provision but that:*

(i) *the person has acted honestly; and*

(ii) *having regard to all the circumstances of the case (including, where applicable, those connected with the person's appointment as an officer, or employment as an employee, of a corporation or of a Part 5.7 body), the person ought fairly to be excused for the contravention;*

*the court may relieve the person either wholly or partly from a liability to which the person would otherwise be subject, or that might otherwise be imposed on the person, because of the contravention."*



## Possible defences for directors (cont'd)

- Section 1318 – Power to grant relief
- *Hall v Poolman* (2007) NSWSC 1330

Palmer J – “acting honestly”:

*“Where there is no deceit or conscious impropriety and no intent to gain improper advantage or benefit and no carelessness or imprudence showing no attempt to carry out duties even though there were errors of judgement”*

- *McLennan, in the matter of the Stake Man Pty Ltd* [2009] FCA 1415



## Proposals for reform

- Australian Institute of Company Directors – push for a general BJR
- 2007 – Commonwealth Treasury – Review of Sanctions
- January 2010 – Corporate Insolvency Law Reform Package:
  - modified BJR (safe harbour while acting in good faith); or
  - moratorium on director's duty not to trade while insolvent provided the company had publicly discloses it was trading while insolvent and was attempting reorganisation.
- CAMAC report – June 2010
- ASIC Regulatory Guide 217 – August 2010



# The James Hardie Decision

Implications for directors and officers



# Overview

- Background
- ASIC allegations
- Decision
- Impact of decision on statutory duty of care and diligence
- Potential implications

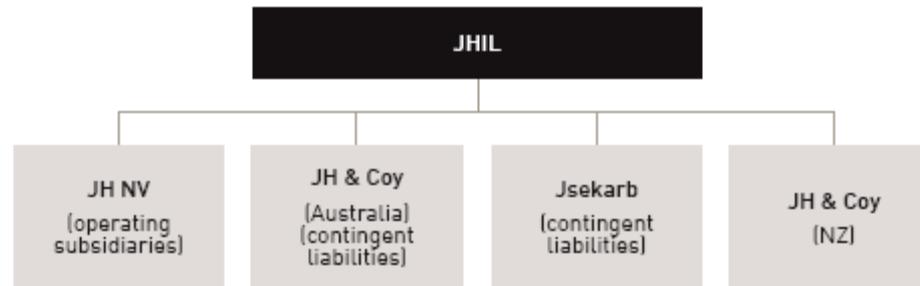


Date	Event
1937-1987	James Hardie Group manufactures asbestos products (through operating subsidiaries Coy and Jsekarb)
2000	Trowbridge Report on extent of asbestos liability – best estimate NPV \$294m
17 Jan 2001	James Hardie Industries Limited Board Meeting – Management tries to persuade Board to accept Coy and Jsekarb NTA of \$214m  <i>The Chairman noted that the concept appeared to have some merit, but that the question of funding for the Company required more work. He requested management to continue developing the concept and to report progress, particularly in relation to funding, at the February meeting.</i>
13 Feb 2001	Trowbridge Report – best estimate NPV \$286m
15 Feb 2001	JHIL Board Meeting – Separation of JH asbestos manufacturing subsidiaries from JHIL to Foundation (total assets = \$293m: \$214m + \$79m Deed of Indemnity)  The concept of the Foundation was that Coy and Jsekarb would remain responsible to claimants in respect of asbestos-related liabilities, to the extent of their existing assets, but ownership of Coy and Jsekarb would pass from JHIL to the Foundation which was unrelated to JHIL, the principal purpose of which was to compensate victims of asbestos-related diseases.
16 Feb 2001	ASX Announcement which Jackson Royal Commission later found:  <i>... its terms conveyed that the Foundation had been provided with sufficient funds to meet all legitimate future asbestos-related claims, and that accordingly there was "certainty" for persons who might suffer from such diseases and for JHIL shareholders. They also conveyed the impression that JHIL's determination of the amount of funding needed for the Foundation had been checked by independent experts. In each of these respects they were seriously misleading.<sup>3</sup></i>
16 Aug 2001	Trowbridge Report – best estimate NPV \$574m
11 Oct 2001	Court approval of JHIL Scheme of Arrangement  Exposure Draft [ED 88] for a new Australian Accounting Standard, expected to come into force.
28 Oct 2002	Trowbridge Report – best estimate NPV \$752m
Mar 2003	Partly paid shares cancelled (JHIL released James Hardie Industries NV from \$1.9 billion obligation)
Sep 2003	Trowbridge Report – best estimate NPV \$1,090m
Feb 2004	Jackson Royal Commission announced
Sep 2004	Jackson Report issued
Feb 2007	ASIC commences legal proceedings against JHIL directors/officers
Apr 2009	Judgment delivered

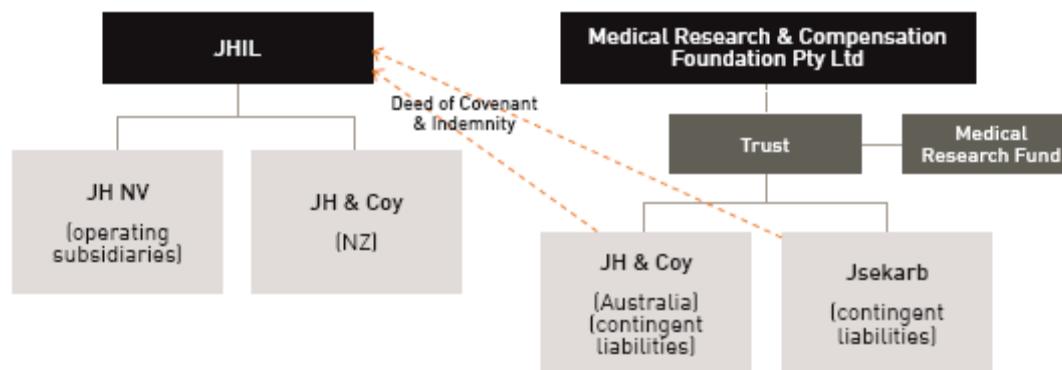


JHIL pre and post Foundation establishment:

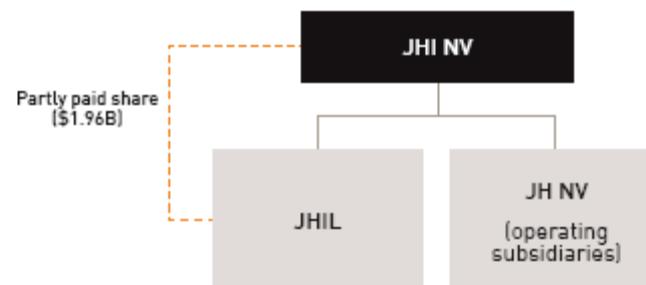
Before



After Foundation



After Scheme



# ASIC Allegations

- Misleading and deceptive
- Breach of directors' duties of care and diligence





**James Hardie**

# media release

16 February 2001

## **James Hardie Resolves Its Asbestos Liability Favourably for Claimants and Shareholders**

James Hardie Industries Limited (JHIL) announced today that it had established a foundation to compensate sufferers of asbestos-related diseases with claims against two former James Hardie subsidiaries and fund medical research aimed at finding cures for these diseases.

The Medical Research and Compensation Foundation (MRCF), to be chaired by Sir Llewellyn Edwards, will be completely independent of JHIL and will commence operation with assets of \$293 million.

The Foundation has sufficient funds to meet all legitimate compensation claims anticipated from people injured by asbestos products that were manufactured in the past by two former subsidiaries of JHIL.

JHIL CEO Mr Peter Macdonald said that the establishment of a fully-funded Foundation provided certainty for both claimants and shareholders.

"The establishment of the Medical Research and Compensation Foundation provides certainty for people with a legitimate claim against the former James Hardie companies which manufactured asbestos products," Mr Macdonald said.

"The Foundation will concentrate on managing its substantial assets for the benefit of claimants. Its establishment has effectively resolved James Hardie's asbestos liability and this will allow management to focus entirely on growing the company for the benefit of all shareholders."

A separate fund of \$3 million has also been granted to the Foundation for scientific and medical research aimed at finding treatments and cures for asbestos diseases.

The \$293 million assets of the Foundation include a portfolio of long term securities, a substantial cash reserve, properties which earn rent and insurance policies which cover various types of claims, including all workers compensation claims.

Towers Perrin has been appointed to advise the Foundation on its investments, which will generate investment income and capital growth.

In establishing the Foundation, James Hardie sought expert advice from a number of firms, including PricewaterhouseCoopers, Access Economics and the actuarial firm, Trowbridge. With this advice, supplementing the company's long experience in the area of asbestos, the directors of JHIL determined the level of funding required by the Foundation.

"James Hardie is satisfied that the Foundation has sufficient funds to meet anticipated future claims," Mr Macdonald said.

The initial \$3 million for medical research will enable the Foundation to continue work on existing programs established by James Hardie as well as launch new programs.

When all future claims have been concluded, surplus funds will be used to support further scientific and medical research on lung diseases.

Mr Macdonald said Sir Llewellyn Edwards, who has resigned as a director of James Hardie Industries Limited to take up his new appointment as chairman of the Foundation, has enjoyed a long and distinguished career in medicine, politics and business.

His experience with James Hardie will assist the Foundation to rapidly acquire the knowledge it needs to perform effectively. Sir Llew is a director of a number of organisations including Westpac Banking Corporation and is also Chancellor of the University of Queensland.

The other Foundation directors are Mr Michael Gilt, Mr Peter Jollie and Mr Dennis Cooper.

Ends.

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**This document is available from the Investor Relations Section of the James Hardie website – [www.jameshardie.com](http://www.jameshardie.com).**

This document contains forward-looking statements. Forward-looking statements are subject to risks and uncertainties and, as a result, readers should not place undue reliance on such statements. The inclusion of these forward-looking statements should not be regarded as a representation that the objectives or plans described will be realised.

# Decision

- JHIL – engaged in misleading and deceptive conduct
- NEDs – all 7 breached section 180(1) by approving announcement
- Officers – CEO and General Counsel breached section 180(1) by failing to advise board appropriately and by approving announcement
- Information memorandum not false or misleading



# Impact of Decision – Duty of Care and Diligence

- Circumstances of the particular corporation concerned are relevant
- Reasonable degree of skill expected only
- Duty owed to company
- What would an ordinary person do?



# Impact of Decision – Duty of Care and Diligence

*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:*

- (a) *were a director or officer of the corporation in the corporation's circumstances; and*
- (b) *occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.*



# Impact of Decision – Duty of Care and Diligence

- The role of a NED is to guide and monitor the management of the company rather than to be involved on an operational level
- If the functions performed by an individual include participation in the making of policy or decisions of the type referred to in the statutory definition, that individual will be subject to the same duties as directors



# Impact of Decision – Duty of Care and Diligence

- Directors should have known potential harm.
- Directors not entitled to rely on co-directors more concerned with communications as was key statement
- Not a case of reliance upon management or experts



# Practical Implications – Conduct of Board Meetings

- Chairmen should ensure that formal resolutions are put on all matters arising for board decision, in order to focus properly the directors' attention
- All board members should insist that the formal procedure is followed

# Practical Implications – Directors Not Physically Present

- The standard of care expected is the same
- All directors should have before them the same materials
- Individual directors should focus on the circumstances when they should abstain on a vote rather than '*going along*' with an otherwise collective decision, and when they should request that the minutes record not only their abstention but their reasons for abstention
- Similarly, individual directors should in appropriate cases request that the minutes record their reasons for opposing a motion



# Practical Implications – Recording of Board Decisions

- Statutory presumption under s.251A(6) to be strictly applied
- Directors should carefully review the draft minutes before they are approved
- How best to record minutes
- Ensure compliance with s251A
- Minimalist approach under pressure



# Practical Implications – Review of Announcements

- ASIC sought to establish breaches of the duty of care and diligence by showing that the directors approved release of an ASX announcement which was misleading and deceptive
- Directors should treat the terms of draft ASX announcements with the same degree of care as the underlying substantive board decisions



# Practical Implications – Delegation of Authority to Review

- s.198D, supported by the provisions of ss.189 and 190, create a regime under which a director acting in good faith has the benefit of statutory protections if reasonable reliance is placed on a delegate
- A board may properly delegate to management or a disclosure committee the task of settling the form of an ASX announcement following an important board decision
- However, there is an underlying suggestion that there may be matters of such fundamental importance that they should not be left to others



# Practical Implications – External Opinions

- Current practice to get sign-offs for transaction
- Advice of external counsel is sometimes obtained on the terms of draft announcements
- Not much to be gained by use of external opinions on announcements

