Directors Duties of Skill, Care and Diligence

Directors of companies are burdened by duties. Historically they were required to meet the equitable duty of care which was a subjective standard. Since that time Directors duties have been codified in the Corporations Act 2001 which employs an objective standard of Director's duties. Common Law still applies and has moved more towards an objective standard.

There is at present a complicated and extensive matrix of law governing the conduct of all Company Officers. Directors are subject to the law of negligence and it is clear from the cases decided by the Courts that an objective standard is now applied.

The Corporations Act 2001

The most relevant Law is found in the Act at sections 180 to 184. The objective standard of care under the Act is to be measured by reference to what a reasonable person of ordinary prudence would do, enhanced where appointment to a Board of Directors is based on the appointee having some special skill by an objective standard of skill referable to the circumstances.

Duty of care

• The standard of care for a non-executive Director is not as high as that for an Executive Director.
• The general proposition is that Directors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company.
• Directors, both executive and non-executive, have a duty of care to act in the best interests of the company.

A useful list of factors to be taken into account is set out by His Honour Santo J in the case of ASIC v Adler.

There are exceptions and there is some relief provided in section 1318 of the Corporations Act for the Court to grant relief to Company Officers where it appears that the decision taken by the Company Directors, whilst perhaps questionable and risky, was nevertheless made honestly and in good faith. The Law intends that recognition be given to the fact that company officers often have to make decisions quickly and under pressure. The Courts have exercised a lot of discretion in this regard. Clearly each case will turn upon its facts as to the issues being examined by the Court in relation to the conduct of a Director.

For example, a non-executive Chairman who is in charge of the Audit Committee, it was held by the Court that on a strike out application by the Director there was an arguable case that the Director has special responsibilities by reason of him heading up the Audit Committee.

Business Judgement Rule

There is further relief for Directors in the principle known as the "Business Judgement Rule". The Rule is contained in section 180(2) of the Act and has been dealt with in ASIC v Adler case. The main thrust of the Rule is that if business decisions are taken in good faith the Court will be reluctant to pass judgement on the merits of the decision. The elements of the Rule are that the Director must:-

a) make the judgement in good faith for a proper purpose;
b) not have a material personal interest in the subject matter of the judgement;
c) inform themselves of the matter of the judgement to the extent that he or she reasonably believes to be appropriate; and

d) rationally believe that the judgement is in the best interest of the corporation.

Conclusion

This is a complex area which has civil and criminal elements attaching to it. The facts of each case will bear heavily upon the outcome as to whether a Director has breached his or her duty or not.

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