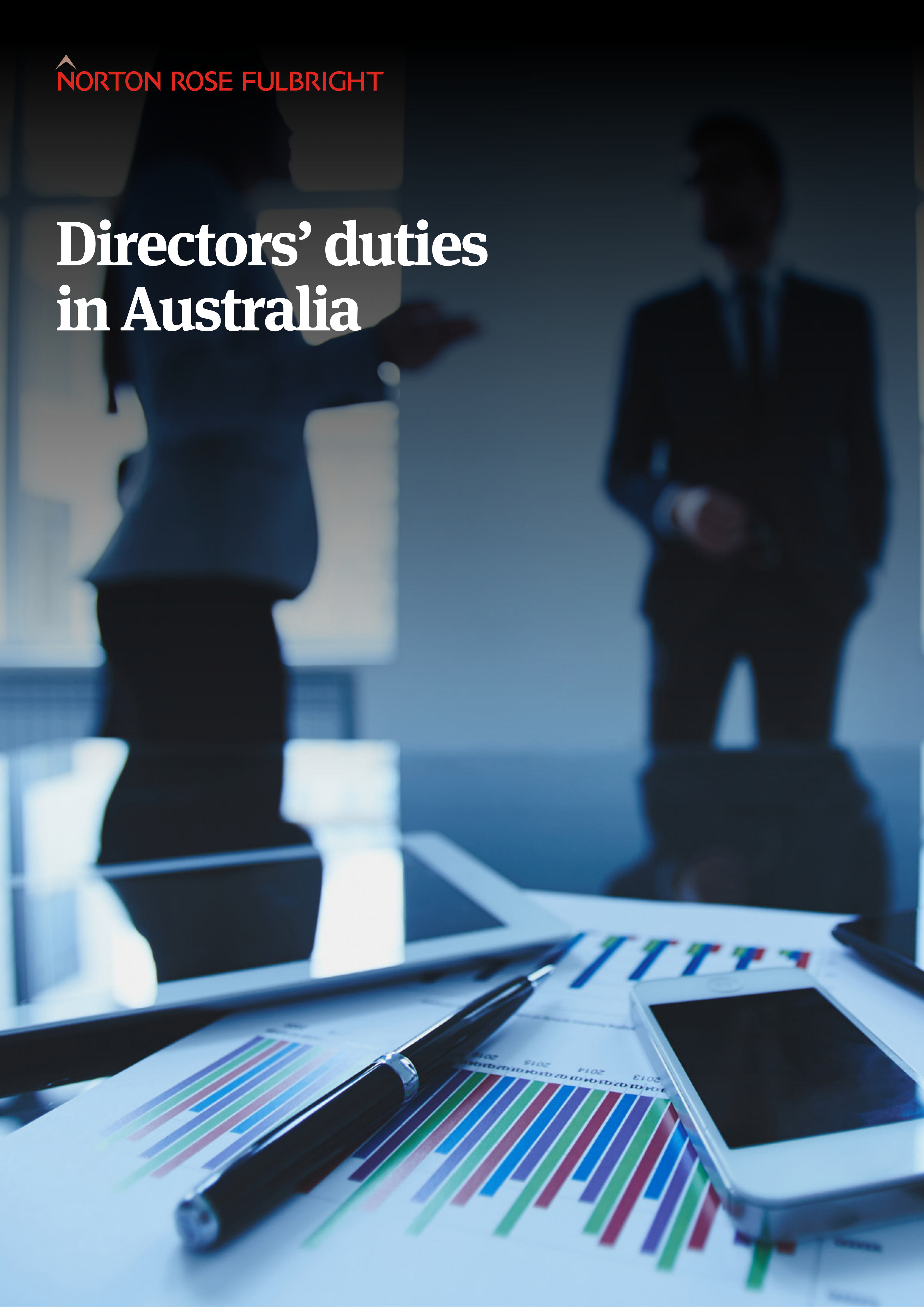
NORTON ROSE FULBRIGHT

Directors’ duties in Australia



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Directors' duties in Australia

This guide sets out some of the duties that apply to directors of Australian incorporated companies that are listed on ASX.

It covers the general directors' duties under the common law and the *Corporations Act 2001* (Cth) (**Corporations Act**), as well as the additional requirements under the ASX Listing Rules (**Listing Rules**).

Do directors' duties apply to you?

Directors' duties apply to executive directors, non-executive directors, nominee directors, alternate directors, de facto directors and shadow directors.

Similar duties apply to other officers of the company, including the chief executive officer, chief financial officer, company secretary and others who are involved in decisions affecting a substantial part of the company's business.

Non-executive directors

The law does not distinguish between executive, non-executive and independent directors.

However, the required standard to which a particular director must perform their duties depends on that director's responsibilities within the company.

Nominee directors

A director may be appointed to represent the interests of another party, such as a major shareholder. The director must reconcile obligations owed as a representative of a shareholder with the overriding duty to the company as a whole.

Where a conflict arises, the director must usually disregard the interests of their appointor. However, Australian courts have provided some indication that a director may consider the interests of somebody other than the company where there is no actual conflict of interest and:

- the company's constitution authorises that consideration;
- it is in the interests of the company as a whole that the extraneous interests should be considered; or
- the director, in good faith, reasonably concludes that those interests are compatible with the interests of the company as a whole.

Alternate directors

An alternate director, exercising the rights of a director of the company in accordance with the terms of their appointment and the company's constitution, has the same legal duties and obligations as any other director.

The personal interests of the director who has appointed an alternate director do not disqualify the alternate director from voting on matters related to those interests (unless the alternate director is acting as an agent of the director who appointed them).

What are your general duties?

A director must (among other things) perform the duties set out below. These duties apply to all directors of Australian companies under the Corporations Act.

Care and diligence

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 that company; and
- occupied the office held by, and had the same responsibilities as, the director.

The standard for this duty also takes into account the director's personal background and experience. However, a director lacking business experience or practical expertise is not excused from exercising the common sense, practical wisdom and informed judgment of an ordinary prudent person.

To discharge their duty of care and diligence, a director needs to:

- take reasonable steps to be in a position to guide and monitor the company's management;
- acquire a working knowledge of the fundamentals of the company's business;
- keep informed about the company's activities and assesses whether the business practices of management are safe and proper;
- monitor corporate affairs and policies, though a detailed inspection of day to day activities is not required;
- be able to read and understand the company's accounts and be familiar with the financial status of the company by regularly reviewing the financial statements; and
- make further enquiries if the circumstances indicate the need to do so and, in particular, make any necessary enquiry into matters revealed by the financial statements.

Good faith

Directors must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.

The interests of shareholders

- Within a group of companies, each company is a separate and independent legal entity. Each company must be treated as having its own interests, even when it is a wholly owned subsidiary.
- Often the interests of companies within a group will coincide with the group's interests, so that considering the interests of the group will not result in a breach of duty.
- A lack of regard for the interests of the company entering the transaction may result in a breach of duty. This issue often arises in relation to intra-group loans.

The interests of creditors

- When a company is insolvent or nearing insolvency, the directors' duty to act in the company's best interests includes a duty to consider the interests of creditors.

No improper use

Being a fiduciary of the company, a director may only exercise their powers for the purposes for which they were given.

Directors must not improperly use their position or information obtained through their position to:

- gain an advantage, for themselves or someone else; or
- cause detriment to the company.

Whether or not a particular act in exercise of a power by a director is for a proper purpose will largely be determined by an assessment of the substantial motivating purpose in the particular case. If that purpose was proper, the fact that other adverse consequences eventuate will not make the exercise of power improper.

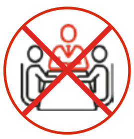
Conflict of interest

A director must avoid any actual or potential conflict between their obligations owed to the company and their personal interests or other duties to which they may be subject.

It is, however, common for a company's constitution to permit the company to enter into a contract, agreement or arrangement in which a director is interested, but preclude the director from voting if it amounts to a material personal interest and require the director to declare the conflicting interest.

A director must disclose to the board any material personal interest that they may have in connection with the affairs of the company.

A director of a public company who has a material personal interest in a matter that is being considered at a directors' meeting must not:



be present while the matter is being considered

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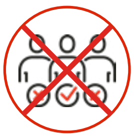


vote on the matter

A director of a public company may be present and vote in the above circumstances where the other directors, who do not have such an interest, resolve that the interest should not disqualify the director from voting or being present.

What is my role in preventing insolvent trading?

Directors have an ongoing duty to prevent the company from trading while insolvent.

To satisfy that duty, directors must consider the company's solvency before allowing the company to incur further debts and must satisfy themselves that it is objectively and reasonably likely that the company is able to pay its debts as and when they fall due.

This duty may be breached if:

1. the company incurs a debt while insolvent or:
    a) becomes insolvent by incurring the debt; or
    b) becomes insolvent by incurring that debt and other debts at the same time;
2. there are reasonable grounds for suspecting that the company is insolvent or the company would become insolvent as a result of incurring that debt; and
3. either the director is aware that there are such grounds for suspecting insolvency, or a reasonable director would be aware that there are such grounds for suspecting insolvency.

Where the above circumstances exist, directors may be able to rely on the "safe harbour" provisions to avoid a breach of their duty to prevent insolvent trading. Those provisions are discussed further below.

If civil proceedings against a director are commenced for a contravention of the duty to prevent insolvent trading, certain rebuttable presumptions of insolvency apply, including:

- a presumption that the company was insolvent throughout any period for which proper accounting records are not held; and
- where it is proved that the company was insolvent on any day in the 12 months preceding the winding up, a presumption that the company was insolvent from that day until the day winding up commenced.

A holding or parent company may be liable for any insolvent trading by the company.

Directors who fail to prevent insolvent trading may be held personally liable for the debts incurred by the company whilst it was insolvent.

What is insider trading?

A person is prohibited from dealing in financial products where the person:

- possesses information which is not generally available and if the information were generally available, a reasonable person would expect such information to be price sensitive; and
- knows or ought reasonably to know the information is not generally available and that if the information were generally available it might be price sensitive information.

The insider trading prohibitions also extend to:

- causing or procuring another person to deal in financial products; and
- communicating the information to another person if the person ought reasonably to know that the other person would be likely to deal in the financial products or procure a third person to deal in the financial products.

Contravention of the insider trading provisions is an offence and civil remedies are also available against contraveners.

How do I defend against potential breaches of my duties?

Safe harbour for insolvent trading

A director will not breach their duty to prevent insolvent trading if:

- once the director starts to suspect the company may be or become insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company than the immediate appointment of a voluntary administrator or liquidator; and
- the debt is incurred directly or indirectly in connection with any such course of action during the period starting at that time, and ending at the earliest of:
    - a reasonable period after the director fails to take any such course of action;
    - when the director ceases to take any such course of action;
    - when any such course of action ceases to be reasonably likely to lead to a better outcome for the company; and
    - the appointment of an administrator, or liquidator, to the company.

To determine if a course of action is reasonably likely to lead to a better outcome for the company, a director must:

- be properly informed of the company's financial position;
- take appropriate steps to:
  - prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts;
  - ensure that the company is keeping appropriate financial records having regard to the size and nature of the company;
- obtain advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; and
- develop or implement a plan for restructuring the company to improve its financial position.

The safe harbour protection will not apply in all circumstances. In particular, the safe harbour protections are not available to directors of companies who have failed to pay employee entitlements as and when they fall due, or failed to comply with all of its tax reporting obligations.

Directors seeking to rely on the safe harbour provisions should proceed with caution and should ensure that:

- the company keeps appropriate financial accounts and records;
- they have access to accurate and up-to-date information;
- the company is up to date with its tax reporting obligations and all employee entitlements are paid on time;
- they are taking appropriate steps to prevent misconduct that could adversely affect the company's ability to pay its debts;
- they are obtaining appropriate advice from an appropriately qualified entity (or entities);
- they regularly assess, test, adapt and implement the company's plan to restructure and improve its financial position;
- the company engages appropriately with stakeholders; and
- any material developments are appropriately disclosed (but noting that reliance on the safe harbour provisions is not a matter, in and of itself, that requires disclosure).

Delegation

Delegation of a director's powers to a committee, another director or employees, does not relieve the director of their duty and they will be responsible for the exercise of that power by the delegate as if they had exercised it themselves.

However, a director is not responsible for the delegate's actions if the director believed on reasonable grounds that the delegate would exercise the power in conformity with the directors' duties imposed by the Corporations Act and the director believed:

- on reasonable grounds; and
- in good faith; and
- after making proper inquiry if the circumstances indicated the need for inquiry,

that the delegate was reliable and competent in relation to the power delegated.

Reliance on information provided by others

Where a director relies on information provided by an employee, another director or officer, or professional or expert advice, it will be presumed that the director's reliance is reasonable (unless the contrary is proved) where the reliance was made:

in good faith

AND

after making an independent assessment of the information or advice having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation.

This presumption only applies in the context of the director's duties contained in sections 181 to 184 of the Corporations Act (eg. duties with respect to care and diligence, good faith, use of position and use of information) and the equivalent general law duties.

Reliance ceases to be reasonable when a director is aware (or should be aware) of plain circumstances that would cause a prudent person to question what he or she was being told.

Statutory obligations, such as the requirement to approve financial reports and matters of great significance to the company, are non-delegable, and the directors are ultimately responsible for them.

It is important to implement proper procedures at board meetings, such as ensuring formal resolutions are tabled and voted upon, and if you are a dissenting or abstaining director make sure that is reflected in the minutes. Directors should never approve something they have not read and understood and must make inquiries when they don't fully understand.

Business judgment rule

Directors can discharge their duty of care and diligence in respect of a business judgment if they:

- make the business judgment in good faith for a proper purpose;
- do not have a material personal interest in the subject matter of the business judgment;
- inform themselves about the subject matter of the business judgment to the extent they reasonably believe to be appropriate; and
- rationally believe that the business judgment was in the best interests of the corporation.

The business judgment rule presumes that a director's belief that the judgment is in the best interests of the company is a rational one, unless no reasonable person in the position of the director would hold that belief. The onus remains on directors to establish the four elements of the rule.

The rule enables risk taking, as long as an adequate degree of care is taken in making business decisions.

Case law provides the following guidance on the operation of the rule:

- the business judgment rule is only available to a director who proves they acted for a proper purpose;
- the extent to which directors must inform themselves about the subject matter of the judgment should be assessed by reference to a range of factors, including:
  - the importance of the decision;
  - the time available for obtaining information;
  - the costs related to obtaining information;
  - the state of the company's business at the time; and
  - the nature of competing demands on the board's attention;
- a director's judgment would be a rational one if it was based on reason or reasoning (irrespective of whether the reasoning was objectively convincing or reasonable); and
- there must be a conscious decision to take or not to take action so that judgment has actually been exercised. A director will not be able to invoke the defence in the case of an omission or failure to act, unless there is evidence that a judgment was in fact made.

The rule relates only to a director's duty of care and diligence. It does not apply to a director's duty to act in good faith and for a proper purpose. It does not apply to the insolvent trading duties placed on directors, liability for misleading or deceptive conduct or other specific areas of liability.

Restructuring plan

In addition to the safe harbour provisions discussed above, the Australian government has introduced a formal debt restructuring process. This process allows directors of eligible companies to retain control of their business while developing a plan to restructure their debts with the assistance of a small business restructuring practitioner. To use this formal debt restructuring process the company's total liabilities must not exceed $1 million. It is therefore unlikely to be relevant to most listed companies, since their liabilities would typically exceed this threshold.

What are my additional requirements as a director of a listed company?

For directors of ASX listed companies, additional requirements apply under the Corporations Act and ASX Listing Rules.

Disclosure of any relevant interests (Appendices 3X, 3Y and 3Z)

A director must disclose details of their relevant interests in the securities of the company or a related body corporate.

A director must also disclose any contracts to which the director is a party or under which the director is entitled to a benefit and that confer an interest in the company or a related body corporate. An example of this is an option over unissued shares in the company.

A director must disclose these things:

- on their appointment, by publicly releasing an Appendix 3X;
- on a change to their notifiable interests, by publicly releasing an Appendix 3Y; and
- on ceasing to be a director, by publicly releasing an Appendix 3Z.

These notices must be given within 5 business days of the relevant change occurring.

Disclosure of substantial holdings (ASIC Forms 603, 604 and 605)

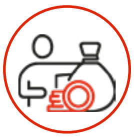
If a director and their associates begin to have a relevant interest in 5% or more of the total votes attached to the voting securities in the listed company, they must give a substantial holding notice. This is done by giving an ASIC Form 603 to the company and ASX for public announcement.

If the director's and their associates' interests then increase or decrease by 1% or more, they must give another substantial holding notice using ASIC Form 604.

A final notice needs to be given if the director's and their associates' interests fall below 5%, using ASIC Form 605.

Transactions involving persons in a position of influence

Transactions involving the company's related parties and substantial shareholders need shareholder approval (unless a relevant exemption applies), for which an independent expert's report is required. Shareholder approval must be obtained for a listed entity or its subsidiary to:



acquire or dispose of a substantial asset (valued at 5% or more of the equity interests of the company) to or from a related party or a person with at least a 10% shareholding in the company or their associates

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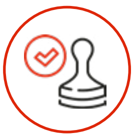

issue shares to a related party or a person whose relationship with the listed company requires shareholder approval

Directors or their associates are related parties and cannot acquire shares without shareholder approval, unless an exception in the ASX Listing Rules apply. For example, a pro rata issue of shares. An increase in the aggregate fees paid to non-executive directors will also require shareholder approval.

The company is required to disclose these activities by lodging the relevant form (eg. Appendices 3B and 2A regarding the issue and quotation of shares) or a bespoke ASX announcement.

Continuous disclosure

In accordance with the Corporations Act and ASX Listing Rules, listed companies must disclose any information not generally available and that a reasonable person would expect to have a material effect on the price or value of the company's securities if that information was generally available. This may include material changes to the business, a material acquisition or disposal, details of a material agreement, under or over subscriptions to an issue of securities, or a takeover bid.

The continuous disclosure obligations are a key regulatory requirement for listed companies, and the directors are responsible for making timely disclosures to support informed trading.

Relevant information should be assessed immediately as to whether it ought to be disclosed. If there is any doubt, the company should consider whether it would be appropriate to enter into a trading halt until the matter can be determined and any required disclosures made.

However, disclosure of information is not required if all the following circumstances are satisfied:

- a reasonable person would not expect the information to be disclosed;
- the information is confidential and ASX has not formed the view that the information has ceased to be confidential; and
- one or more of the following applies:
  - disclosing the information would be a breach of law;
  - the information concerns an incomplete proposal or negotiation;
  - the information comprises matters of supposition or is insufficiently definite to warrant disclosure;
  - the information is generated for internal management purposes; or
  - the information is a trade secret.

Where there is no ASX form relating to the particular disclosure such as an Appendix 3B for a proposed issue of securities, disclosure of the information can be made by way of the company releasing an ASX announcement.

If ASX considers that there is, or is likely to be, a false market in a company's securities, it can require the company to give ASX the information required to correct or prevent the false market.

A person involved in a disclosing entity's contravention of the continuous disclosure provisions can be personally liable for the contravention and liable to a civil penalty.

A person (eg. the director) will not be liable if the person proves that they:

- took all steps (if any) that were reasonable in the circumstances to ensure that the disclosing entity complied with its continuous disclosure obligations; and

- after doing so, believed on reasonable grounds that the disclosing entity was complying with its continuous disclosure obligations.

Periodic disclosure

Listed companies must provide the ASX with regular reports, including annual and half-yearly reports, which must be accompanied by ASX Appendix 4E or 4D. The annual report must contain detailed information in relation to directors' interests and remuneration. It must also be accompanied by a corporate governance statement disclosing the extent to which the company followed the best practice recommendations set by the ASX Corporate Governance Council.

Directors of a listed company must ensure these reports and statements are not misleading or deceptive and that audited financial statements present a true and fair view of the company.

Additionally, directors must take all reasonable steps to comply with, or secure compliance with, the financial reporting obligations under the Corporations Act. Directors must have the financial literacy to understand accounting concepts and must carefully read and understand the financial statements to ensure that they are consistent with their own knowledge of the company's financial position before making the declaration required under section 295(4) of the Corporations Act.

ASX Corporate Governance Principles and Recommendations

The ASX Corporate Governance Principles and Recommendations are a set of governance principles and recommendations that the ASX Corporate Governance Council believes will achieve the outcome of good corporate governance and meet the expectations of investors.

Whilst following these recommendations is generally not mandatory, the company must annually provide an explanation as to why any of the recommendations have not been adopted. This is done using an Appendix 4G – Corporate Governance Statement.

Entities in the S&P /ASX 300 Index must have:

- an audit committee comprised solely of non-executive directors a majority of whom are independent directors and an independent chair who is not the chair of the board;
- a remuneration committee comprised solely of non-executive directors; and
- a measurable objective for achieving gender diversity in the composition of its board of not less than 30% of its directors of each gender.

At a minimum, the company is expected to publish the following documents on its public website:

- code of conduct
- continuous disclosure policy
- securities trading policy
- diversity policy
- whistleblower policy
- anti-bribery and corruption policy
- board charter
- audit and risk committee charter
- nomination and remuneration committee charter
- corporate governance statement

Directors need to be familiar with the ASX Corporate Governance Council's recommendations and carefully consider whether it is appropriate to comply with these recommendations.

Cyber security

Cyber security is an increasing concern for all companies. ASIC expects directors and management to address cyber security as part of the legal compliance obligations of the company, and it should be considered as part of the disclosure requirements for listed companies.

Climate change

ASX and ASIC expect directors and management to consider climate change risks and disclose these to investors.

Fundraising

Directors of listed companies should be aware of their potential exposure to personal liability in the context of fundraising as a result of an offer of securities under a defective disclosure document (eg. a prospectus). Therefore, all statements (particularly statements regarding future matters) in a disclosure document need to be verified. Typically, directors and senior managers will be required to sign-off that these documents, to the best of the signatory's knowledge, do not contain any information that might mislead or deceive shareholders and potential investors.

It is a defence to liability for a prospectus under section 729 of the Corporations Act if the director proves that:

- they made all enquiries that were reasonable in the circumstances; and
- believed on reasonable grounds that the prospectus was not defective.

What other obligations might apply?

Tax

There are a number of provisions that impose obligations on directors in relation to the company's Commonwealth, State and Territory taxes.

Other legislation

Directors may also be personally liable for non-compliance by the corporation with a wide range of legislation, including tax, trade practices, occupational health and safety, environmental protection, equal opportunity, customs and excise, superannuation, tax and state fair trading.

What are the consequences for breaches of your director's duties?

Corporations Act and general law

Contraventions of the Corporations Act can lead to civil and criminal penalties. Directors can be liable for individual contraventions, for example, by breaching their general directors' duties or duty to prevent insolvent trading, or be liable for a contravention of the company as an accessory (civil liability) or accomplice (criminal liability).

Contraventions of a director's general law duties may lead to the director being liable to account for all profits made, pay compensation for any loss suffered or return any property acquired as a result of the breach.

Other legislation

Directors should also be aware of their civil and criminal liability arising under other legislation, including the ATO director penalty regime, environmental protection penalties and work health and safety penalties.

Insurance and indemnities

It is usual for companies to indemnity their directors for liabilities to third parties and to take out directors' and officers' insurance to cover directors' liability to the company or a third party, within certain limits prescribed by the Corporations Act.

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