

A PRACTICAL GUIDE TO DIRECTORS' DUTIES

A COURTESY GUIDE PREPARED BY SWAAB ATTORNEYS

2018

TYPES OF DIRECTOR

The test for being a director is related to the function you perform, not your designation. A director includes a person:

- > appointed as a director;
- > appointed as an alternate director;
- > who acts in the position of a director (even though not formally appointed); and/or
- > on whose instructions the directors of a company are accustomed to act.

There are several different types of director:

- > **Defacto director** – a person who acts as a director even though he/ she has not been formally appointed.
- > **Shadow director** – a person who stands behind an appointed director and gives him/ her instructions which are usually followed.
- > **Executive director** – a director who is also an employee of the company and who carries out the day-to-day management delegated to him/ her by the board.
- > **Non-executive director** – a director who is not involved in the day-to-day management of the company but who has a supervisory, monitoring and advisory role.
- > **Alternate director** – a person who is appointed to take the place of an appointed director who is unable to attend a board meeting.
- > **Nominee director** – a person appointed to represent the interests of certain shareholders or creditors.

APPOINTMENT AND REMOVAL

APPOINTMENT OF DIRECTOR

A proprietary company must have at least one director and at least one director must ordinarily reside in Australia. The Corporations Act provides the director must:

- > be an individual of at least 18 years of age; and
- > not be disqualified from managing corporations unless ASIC or the court, depending upon which body disqualified the person, grant permission.

A public company must have at least three directors, of which at least two must ordinarily reside in Australia. The appointment of a new director may be made by the members or by the directors. Usually the directors of the company resolve to appoint a new director having received the proposed director's signed consent to act as director.

Resignation or retirement should be in accordance with the requirements of the company's constitution and may also be subject to the requirements of any shareholders' agreement which may be in effect. The removal of a director may be by a resolution passed at a meeting of the members or, if approved by the constitution, by directors.

DUTIES OF DIRECTORS

STATUTORY DUTIES

1. A director must exercise their powers and discharge their obligations with reasonable care (*Section 180 of the Corporations Act 2001*)
2. A director and other officers must exercise their powers and discharge their duties in good faith in the best interests of the Company and for a proper purpose (*Section 181 of the / Corporations Act 2001*)
3. An officer must not improperly use their position to gain advantage for themselves or someone else, or to cause detriment to the corporation (*Section of the Corporations Act 2001*)
4. An officer must not make improper use of information for personal advantage or to the detriment of the corporation (*Section 183 of the Corporations Act 2001*)
5. A duty to act honestly and in good faith (*Section 184 of the Corporations Act 2001*)

6. An officer who delegates any of their powers to someone else is responsible for the actions of the delegate, as though the action had been taken by the officer themselves (*Section 190 of the Corporations Act 2001*)
7. A duty to disclose all material personal interests to the company (*Section 191 of the Corporations Act 2001*)
8. A duty to keep proper books and records that explain transactions and the financial position of the company (*Section 286 of the Corporations Act 2001*)
9. A duty to avoid insolvent trading (*Section 588G of the Corporations Act 2001*).

COMMON LAW DUTIES

Similar fiduciary duties exist in common law and equity. These include:

1. A duty to act in good faith in the interest of the company as a whole
2. A duty not to act for an improper purpose
3. A duty of care and diligence
4. A duty to retain discretion
5. A duty to avoid conflicts of interest
6. A duty to not disclose confidential information
7. A duty not to abuse corporate opportunities.

BUSINESS JUDGEMENT RULE

Section 180(2) of the Corporations Act 2001 provides that a director is deemed to have discharged his/ her obligations with reasonable care if:

- a. they have made a judgement in good faith for a proper purpose, and
- b. they do not have a material interest in the relevant matter, and
- c. they have informed themselves about the subject matter to the extent they reasonably believe is appropriate, and
- d. they reasonably believe their judgement is in the best interests of the company.

This exemption applies to equivalent common law and fiduciary duties in the same way as it applies to Section 180.

DUTIES OWED TO THIRD PARTIES

These include:

1. A duty to ensure that all relevant information is notified to the Australian Securities and Investments Commission (**ASIC**)
2. Various duties under the *Corporations Act 2001* relating to reporting, maintaining company registers and holding company meetings
3. (Where the company is a trustee) a duty to ensure that the company is indemnified from the assets of the trust for any loss incurred while acting as trustee.

HOW DIRECTORS' DUTIES AFFECT PARTICULAR ASPECTS OF A BUSINESS

Trade practices

Directors must ensure the company complies with its obligations in relation to consumer protection, product liability and proper disclosure of information.

Tax

Directors must ensure the company complies with its tax obligations (including filing returns and payment).

Insurance

Directors may in certain circumstances be found to be negligent if they fail to ensure the company has adequate insurance cover.

Work Health and Safety

Directors must be aware of the relevant legislation to ensure that the company complies.

Industrial relations

Directors must be aware of the relevant legislation, as there are circumstances where employees can bring claims directly against a director.

Environment

Directors will be personally liable for certain offences.

Finance

Directors have certain responsibilities in relation to the maintenance of the company's banking and finance arrangements.

Intellectual Property

Directors should ensure that all of the company's intellectual property rights are protected, and that the company is not breaching the rights of a third party.

Criminal activity

Directors will be personally liable for most types of fraudulent behaviour. Specific legislation exists in relation to misappropriation or misuse of company property, falsifying company records and publishing fraudulent statements.

Trading

Directors must ensure that all agreements entered into by the company are for the commercial benefit of the company and that the company does not trade whilst it is insolvent.

PENALTIES FOR BREACH OF DUTY

Personal actions against a director can be initiated by any of the following:

- > the shareholders collectively
- > the company (i.e. the board of directors)
- > a liquidator of the company
- > another director
- > an employee
- > a competitor or the ACCC (for restrictive trade practices)
- > the government (for breach of legislation, such as environmental protection legislation)
- > ASIC
- > a third party (for negligent actions leading to loss)
- > a creditor.

Where a director is found guilty of a breach of duty, he/ she may be liable in damages to the party who suffered the loss. In addition the *Corporations Act 2001* imposes penalties for

breaches of certain duties. These include fines, imprisonment and disqualification as a director.

PROTECTION FROM LIABILITY

There are several ways in which a director can protect themselves from liability:

- > Directors will not be held liable where they have made a business judgement in good faith for a proper purpose and rationally believed it to be in the best interests of the company.
- > Directors are allowed to rely on advice or information from experts as long as they believe on reasonable grounds that the person relied on is reliable and competent.
- > Directors should put compliance plans in place to ensure that the company complies with all relevant legislation.
- > Directors should ensure that D&O (Directors & Officers) insurance is in place in relation to their appointment. The premiums for this insurance can be paid by the company, and the cover may protect against breaches of duty by the directors.
- > Directors should also ensure that a Deed of Indemnity is entered into with the company. These deeds provide that the company indemnifies the director against any liabilities and costs incurred by him/ her acting properly in their capacity as a director of the company.
- > If a problem comes to the attention of a director, he/ she should convene a board meeting immediately to discuss the matter, and if necessary seek legal advice.

CONTACT US

The corporate team at Swaab Attorneys is committed to working with companies to help them meet their ambitions. If we can help you with any of the issues raised in this Guide, please contact Alistair Jaque. We would be very pleased to discuss any issues with you



Alistair Jaque
PARTNER
T 61 2 9777 8363 (direct)
E afj@swaab.com.au

For more information or for copies of other Swaab publications please visit our website www.swaab.com.au

This Guide is only intended to give an overview of the issues involved. It is not intended to be fully comprehensive or to be a substitute for legal advice.

Swaab

ABN 71 028 846 652

Level 1, 20 Hunter Street, Sydney NSW 2000

DX 522 Sydney NSW

T +61 2 9233 5544

F +61 2 9233 5400

www.swaab.com.au