



Fiduciary and Statutory Duties for Directors of Ability Centre Australasia Limited

Ability Centre Australasia Ltd is run by a Board comprised of people with various interests and skills drawn from both the community and the organisation's membership base.

Under the organisation's Memorandum and Articles, members of the organisation have an opportunity to be considered for election as Directors of the Board when vacancies arise.

An appointment to the Board carries with it many serious responsibilities and obligations. Lack of knowledge of those responsibilities can damage both the individual and the organisation for whose performance they are accountable. Members also have responsibilities under The Corporations Law which is the key legislation covering the organisation as a Public Company.

A very important rule of company law is that a company is a separate legal "entity" to which duties are owed by its directors and other officers, regardless of the reasons for its establishment. In relation to some matters, such as the use of money and other property of a company, the law takes a very strict approach. The duties owed by directors and other officers are viewed as virtually the same as the duties owed by a trustee of the estate of a deceased person. While the test applied by the law in other situations, for instance in deciding the correctness of the day to day business decisions of a company, may not appear to be as strict, it must be remembered that in every situation directors and other officers are expected to have regard to the best interests of the company rather than to their own personal interest or advancement.

It is, therefore, vital that anyone currently nominating or newly-chosen for such an important position fully understands the scope of the task so that they are able to contribute in a meaningful and positive way to the administration of the organisation.

This document aims to give a general overview of the various obligations and responsibilities of Directors of the organisation. Should you require further information please contact the Chairman or the Chief Executive Officer.

FIDUCIARY AND STATUTORY DUTIES

Introduction

The duties imposed on Directors are based on the traditional rules dealing with fiduciary relationships and are wide ranging.

Under general law principles, a Director must act honestly; exercise reasonable care and skill; and be diligent, aware of and understand the fiduciary responsibilities of their position. This can be summarised as the duty to:

- (i) Act bona fide in the interests of the organisation (act in good faith);
- (ii) Exercise care, skill and diligence;
- (iii) Exercise the powers for the purpose for which they are conferred;
- (iv) Retain their discretionary powers; and
- (v) Avoid conflicts of interest.

In addition to the fiduciary duties owed by Directors, there are extra statutory duties imposed under the Corporations Act. The ACNC Governance Standards replace most requirements relating to Director duties. However, some criminal offences and similar duties under common law continue to apply.

The following requirements of the Corporations Act still apply to directors of companies that are registered charities:

criminal offences relating to breaches of duties of good faith and acting for a proper purpose and misuse of position or information (under section 184 of the Corporations Act), and

the duty to prevent insolvent trading (under section 588G of the Corporations Act) – this duty is also included under governance standard 5.

The statutory duties are in addition to, and in no way derogate from, the general law as below.

General Law Duties

Duty to Act in Good Faith in the Best Interests of the Organisation

It is clear that a Director is required to act honestly in dealings with the members to ensure that members are not misled. When members are approached for approval, they must receive all the information necessary to enable them to make a fully informed decision. However, honesty, although necessary, is not enough. The standard formulation of their duty is that Directors must act bona fide in what they consider – not what the court may consider – is in the best interests of the organisation. However, many cases have held that Directors may breach their duty even if they are acting in what they genuinely consider to be an honest manner, because they have failed to give proper consideration to the interests of the organisation. Situations of this kind tend to arise when circumstances induce Directors to believe that the organisation's interests correspond with their own interests or with the interests of some other person. In these circumstances, Directors then act without considering the organisation's interests as a separate entity.

Another troublesome issue concerns what is meant by the words "the organisation". Depending on the circumstances, various entities could be considered to be part of "the organisation", namely existing members, future members, creditors and employees, customers, contractors and the community. The basic principle is that the interests of an organisation are generally those of its members, especially the existing members. However, problems may arise when trying to balance the interests of members with the overall interests of the organisation.

Duty to Act for a Proper Purpose

In exercising their powers, Directors must be motivated to act in the organisation's interests, and not for some other purpose or in their own self-interest.

The following principles are to be applied in determining whether Directors have acted for an improper purpose:

- (i) fiduciary powers granted to Directors are to be exercised for the purpose for which they were given, not collateral purposes;
- (ii) it must be shown that the substantial purpose of Directors was improper or collateral to their duties as a Directors. The issue is not whether business decisions were good or bad; it is whether Directors have acted in breach of their fiduciary duties;
- (iii) honest or altruistic behaviour does not prevent a finding of improper conduct. Whether acts were performed for the benefit of the organisation is to be objectively determined. However, evidence as to the subjective intentions or beliefs is relevant; and
- (iv) the courts must determine whether, but for the improper or collateral purpose, the Directors would have performed the act in dispute.

Duty to Exercise Care, Skill and Diligence

A Director is expected to display a degree of care that is reasonable to expect from a Director of that type of organisation.

The duty to exercise care, skill and diligence requires a Director of an organisation to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- (i) were a Director of an organisation in the organisation's circumstances; and
- (ii) occupied the office held by, and had the same responsibilities within the organisation as, the Director.

A Directors performance is to be judged objectively, but with consideration in each case to the position of the Director in relation to the organisation, and the organisation's circumstances.

In determining whether a Director has breached the statutory standard of care and diligence, the court will have regard to the organisation's circumstances and the Director's position and responsibilities within the organisation. While it is not always possible for Directors of a large organisation to have a hands-on approach to all the affairs of the organisation, they should have a general understanding of the business of the organisation. Non-executive Directors are distinguished from executive Directors in that they are not bound to give continuous attention to the affairs of an organisation, but rather, their duties are of an intermittent nature to be performed at periodic Board meetings and at meetings of any Committees of the Board they sit upon.

The word "diligence" imports application of skill where required but says nothing as to the degree of skill required. However, to understand the meaning of the duty it is necessary to refer to the standards embodied in case law.

It has been held that the responsibilities of Directors require that they take reasonable steps to place themselves in a position to guide and monitor the management of the organisation. The case law suggests that:

- (i) a Director should acquire at least a rudimentary understanding of the business of the organisation. Accordingly, a Director should become familiar with the fundamentals of the business in which the organisation is engaged;
- (ii) Directors are under a continuing obligation to keep informed about the activities of the organisation;
- (iii) directorial management does not require a detailed inspection of day to day activities, but rather a general monitoring of corporate affairs and policies. Accordingly, a Director is well advised to attend Board meetings regularly; and
- (iv) whilst Directors are not required to audit corporate books, they should maintain familiarity with the financial status of the organisation by a regular review of financial statements.

A Director may be appointed to a company because of his or her special expertise in an area of the company's business, in which case, whether the Director has breached the duty of care will be tested by reference to the knowledge and expertise possessed by other people with that same skill and expertise. That is, if the Director does possess special knowledge they will be expected to use it in the affairs of the company. Also, if a Director possesses special expertise, this does not relieve the Director of the duty to pay attention to the company's affairs that might reasonably be expected to attract inquiry, even outside the area of the Director's expertise.

Delegation and Reliance

In some cases, it is necessary and acceptable for Directors to rely on the advice and conduct of others within (or even outside) the company. But Directors are expected to recognise situations in which it would be dangerous to rely on others.

A Director may be responsible for the exercise of power by a delegate if the Director knew, or by the exercise of ordinary care should have known, any facts that would deny reliance on a delegate.

Duty to Avoid a Conflict of Duty and Interest

There is a general prohibition on Directors placing themselves in a position of conflict between their personal interests and their duty to the organisation, except where the Director has the fully informed consent of the organisation. The obligation aims to prevent Directors improperly making a profit from their office, but goes even further to prevent Directors from putting themselves in a position where it appears that they may act in their own interests. There are three rules surrounding interests including the conflict rule, the profit rule and the misappropriation rule.

(i) Conflict Rule

The conflict rule provides a general prohibition on Directors placing themselves in a position of conflict whereby a personal interest or duty conflicts with their duty to the company. The courts have adopted a pragmatic approach to the scope of the conflict rule by requiring a "real sensible possibility of conflict" before a breach may be established.

The conflict rule has its most obvious application in cases where a Director enters into a transaction, directly or indirectly, to which the company is a party. The clearest case of the Director having a conflict is when a Director enters into a transaction with the company under which the Director stands to make a direct personal gain.

What action, beyond disclosure, the Director must take will vary from case to case depending on matters such as the degree to which the Director has been involved in the transaction, and the gravity of possible outcomes for the Association. It may not be enough for the Director to refrain from voting or absent himself or herself from the meeting. The circumstances may require the Director to take some positive action to suggest a course of action to limit any possible harm to the company.

It is not necessary that the conflict between interest and duty cause either a loss to the company or a profit to the Director.

(ii) Profit Rule

The profit rule states that a fiduciary is accountable for profits made in connection with their fiduciary office.

The profit rule attempts to ensure that when acting for the company, Directors are not tempted by the prospect of deriving benefits for themselves. This equitable principle applies even where the company has not suffered any loss, indeed it may even have benefited. Further, there is a breach of duty even if the transaction was fair from the company's point of view. Directors must be seen to act in good faith – they cannot place themselves in a position where it may appear that they are motivated by considerations other than what is in the best interests of the company.

The application of the profit rule to Directors raises special problems because it seems to be acknowledged that Directors may make profits through investments and sometimes through their own private businesses. There is no absolute duty on a Director to abstain from engaging for their own benefit in the same kind of business as that carried on by the company where there is no likelihood of confidential company information being misused. Nevertheless:

- a) Directors are accountable to the company if they divert business opportunities away from the company and into their own business;
- b) it is no answer to a breach of fiduciary duty that the profit made was of a kind that the company could not have obtained;
- c) Directors cannot avoid liability under the conflict or profit rules and retain the benefit of a transaction by proving that the transaction was fair to the company;
- d) a Director who derives an undisclosed personal benefit is in breach of duty, irrespective of whether the company suffered loss as a result.

However, there may be some instances where Directors can exploit corporate opportunities that come to them in their private capacity.

(iii) Misappropriation Rule

A Director may not apply company property either for the Director's personal benefit or for the benefit of any other person without the authority of the company.

On this principle, Directors are restrained from taking remuneration or other benefits from the company's resources unless authorised by law, by the company's constitution or with the fully informed consent of the company in general meeting.

Duty not to Fetter Discretions

Because Directors cannot act for their own benefit but must act for the benefit of the company, they have a fiduciary duty to give adequate consideration and a duty to retain discretions.

Because Directors are fiduciaries acting for another person, Directors are required to exercise an active discretion; they will be in breach of duty for letting things slide or for improperly acting blindly at the discretion of another person.

The duty to retain discretions involves precluding a Board from delegating without authority and from fettering its future exercise of discretions in the absence of authority.

The duty to retain discretions does not prevent Directors from contracting to exercise their powers in the future, provided that in deciding to make the contract they give proper consideration to the desirability of entering the contract and they decide to do so in what they believe in good faith to be the interests of the company as a whole.

Statutory Requirements Under the Corporations Act

Care and Diligence

Section 180 of the Act requires Directors to act honestly and exercise their powers and discharge their duties with the degree of care and diligence a reasonable person would expect them to exercise. Sections 137.1 and 137.2 of the Criminal Code Act (Cth) (1995) create criminal offences for providing false or misleading information in documents. Section 1309 also creates offences when false or misleading information is made available to members of the company.

Good Faith

Section 181 requires Directors to exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.

Use of Position or Information

Section 182 requires Directors to refrain from improperly using their position as Directors or officer of a company to gain an advantage for themselves or someone else or cause detriment to the company. Section 183 of the Act provides that Directors must also not improperly use information they have acquired as a Director, officer or employee of another organisation to gain an advantage for themselves or someone else or cause detriment to the company.

Disclosure of Interests

Section 191 of the Act requires any Director who has any material personal interest relating to the affairs of the company, to disclose the nature and extent of their interest as soon as they become aware of that interest. Disclosure is not required if the interest only exists by virtue of the fact the Director is a member of a class of persons for whose benefit the association is established.

Voting on Matters in which a Director has an Interest

Section 195 of the Act provides that any Director who has any material personal interest in a matter being considered by the Board of Directors, not be present while that matter

is being considered at the meeting or vote on the matter unless their participation is approved by other directors.

Trading Whilst Insolvent

Section 588G of the Act provides that a director is under a duty to prevent the organisation from trading whilst insolvent. A director breaches this duty if he/she fails to prevent the organisation incurring debts if there are reasonable grounds for suspecting that it is insolvent. The duty to prevent insolvent trading applies to a person who is a director at the time when the organisation incurs the relevant debt. The duty is imposed only on directors because they control the management of the organisation and have the ultimate power to prevent debts being incurred. Directors should take all reasonable steps to prevent debt being incurred and primarily the principles of duty of care, skill and diligence will prevail in building a defence if required. Section 588G applies if:

- (i) a person is a director of a company at the time when the company incurs a debt; and
- (ii) the company is insolvent at that time, **or becomes insolvent by incurring that debt**, or by incurring at that time debts including that debt; and
- (iii) at that time, there are reasonable grounds for suspecting that the company is insolvent, **or would so become insolvent**, as the case may be.

ACNC Governance standard 5: Duties of directors

This standard requires charities to take reasonable steps to make sure that the following duties apply to responsible persons and that they follow them. The duties can be summarised as follows:

- (i) to act with reasonable care and diligence;
- (ii) to act honestly and fairly in the best interests of the charity and for its charitable purposes;
- (iii) not to misuse their position or information they gain as a responsible person
- (iv) to disclose conflicts of interest;
- (v) to ensure that the financial affairs of the charity are managed responsibly; and
- (vi) not to allow the charity to operate while it is insolvent.

Generally, the duties mean that responsible persons should act with standards of integrity and common sense.

Consequence of a Breach of Duty

Breaches of statutory duties are in addition to breaches of other types of law relating to duty or liability because of their position in a corporation and do not prevent the commencement of civil proceedings. Breach of a general law duty owed to the company may render a Director liable to compensate the company for any damage caused by the breach. Breach of a fiduciary duty may also render a Director liable to account to the Company for any profits received as a result of the breach, or to compensate the Company for any loss it incurs as a result of the breach. Breach of a statutory duty can result in a penalty of up to \$200,000 under section 5.3 of the Corporations Act