

2012: SIMPLY SUPER

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UNDERSTANDING THE IMPACT OF RECENT CASES ON DIRECTORS DUTIES

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Introduction

I have been asked to deal with the impact of recent cases on directors' duties and address the question whether they have changed the law. I have also been asked to address the interaction of the standards for conduct of directors established under the Corporations Act with the "fit and proper" operating standards established under the Superannuation Industry (Supervision) Act 1993 (Cth) ("SIS Act"). I will focus on the impact of cases arising under the Corporations Act upon directors of corporate trustees of superannuation funds², in the context of the applicable statutory covenants under the SIS Act. I will also deal with amendments to be made by the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (introduced and read in the House of Representatives a week ago, on 16 February 2012) which will have a significant impact in this area.

First, I will deal with the care, skill and diligence covenant under SIS Act s 52(2)(b) and the duty to exercise care and diligence under the Corporations Act.³ This subject inevitably requires consideration of the recent decisions in the *James Hardie* and *Centro* cases. I will also deal with duties in respect of financial accounts⁴ in this context. Second, I will turn to the "best interests" covenant under SIS Act s 52(2)(c) and the duty to act in good faith under the Corporations Act.⁵ Third, I will refer to conflicts of interest, directors' duties not to improperly use their position to gain an advantage for themselves or anyone else or cause a detriment to the company⁶ and not to improperly use information obtained as a director to gain an advantage for themselves or anyone else or cause a detriment to the company under the Corporations Act⁷ and the covenant under SIS Act s 52(2)(e).

SKILL, CARE AND DILIGENCE

The trustee's duty of care and diligence and the care, skill and diligence covenant under SIS Act s 52(2)(b)

This audience will already be familiar with the trustee's duty of care and diligence in equity and the covenant arising under s 52(2)(b) of the SIS Act.⁸ However, I should commence at this point since these duties will in turn affect the content of the duty of care owed by directors of trustee companies.

¹ A Judge of the Supreme Court of New South Wales.

² See generally PF Hanrahan, "Directors' liability in superannuation trustee companies" (2008) 2 *J of Equity* 204; PF Hanrahan, *Funds Management in Australia: Officers' Duties and Liabilities*, 2007.

³ Corporations Act s 180(1).

⁴ Corporations Act s 344.

⁵ Corporations Act s 181(1).

⁶ Corporations Act s 182(1).

⁷ Corporations Act s 183(1).

⁸ See generally, E Liondis, "Errors, breaches and covenants – common threads from the s 52(2) cases" (2007) 18 *ABLR* 81; LM Butler, "The super standard of care – How high should superannuation trustees jump?" (2008) 2 *J of Equity* 225; M Scott Donald, "The competence and diligence required of trustees of a 21st century superannuation fund" (2009) 37 *ABLR* 50.

The covenant imposed by SIS Act s 52(2)(b) requires a trustee to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as an ordinary prudent person⁹ would exercise in dealing with property of another for whom the person felt morally bound to provide. The intent of that covenant is to provide a minimum rule.¹⁰ The reference to provision for another reflects the formulation in *Re Whiteley; Whiteley v Learoyd* (1886) 33 Ch D 347 that:

The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.

It seems that the duty owed under the “ordinary prudent person” standard will, in the case of professional trustees, be increased to a higher standard of care reflecting the special knowledge and skill which it claims to have: *Wilkinson v Feldworth Financial Services Pty Ltd* (1998) 29 ACSR 642 at 693; *ASIC v Parker* [2003] FCA 262; (2003) 21 ACLC 888 at [7]; *ASIC v AS Nominees Ltd* (1995) 18 ACSR 459 at 470-471.

In *Auton v APRA* [2005] AATA 32, the Administrative Appeals Tribunal observed that the covenant imposed under s 52(2)(b) required a trustee to exercise “the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide”. The Administrative Appeals Tribunal referred to the definition in the Oxford English Dictionary of “prudent” as of “persons sagacious in adopting means to ends; careful to follow the most politic and profitable course; having or exercising sound judgment in practical affairs; circumspect, discrete, worldly wise”. The Tribunal held that errors made by the trustee in that matter did not involve any lack of prudence and did not breach the standard.

In *VCA v APRA* [2008] AATA 580, the Administrative Appeals Tribunal expressed the view that the covenants under the SIS Act could not be regarded merely as a restatement of the previous law and that:

... we consider that Parliament intended to base the covenants in the SIS Act on those under the general law but to extend their ambit and to do so in an entirely new context. It is a context that is intended to ensure that the covenants are met and not merely that the trustee is able to establish that it exercised its discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was given. (at 328)

The Tribunal pointed to several differences between the general law and the scope of the covenant implied under SIS Act s 52(2)(b), which it characterised as “small but significant” as follows:

Whereas s 52(2)(b) refers to the care, skill and diligence exercised by an “ordinary person” dealing with property of another for whom that person felt morally bound to provide, the general law refers to an “ordinary prudent person **of business**” who is engaged in a business making “... an investment for the benefit of other people for whom he felt morally bound to provide”. While s 52(2)(b) refers to the duty “in relation to **all matters affecting the entity**”, the general law refers to it in authorities such as *Speight v Gaunt* as applying in “managing trust affairs”. Whether “managing trust affairs” extends to the whole gamut of matters that may have an impression on the management of a trust’s affairs would be a matter of debate. By providing that the duty extends to all matters affecting the entity, s 52(2)(b) must be incorporating a reference to the management of its business, and so to the management of

⁹ The Government’s response to the Cooper Review proposes to increase the standard of care owed by a trustee to that of a prudent person of business, reflecting the general law standard which applies for professional trustees of funds outside a superannuation context: *Fouche v Superannuation Fund Board* (1952) 88 CLR 609 at 641; *Government Employees Superannuation Board v Martin* (1997) WAR 224 at 273; *Jacobs’ Law of Trusts in Australia*, 2006, [2921] (7th ed).

¹⁰ Law Reform Commission, *Collective Investments: Superannuation, Report No 59*, 1992, [9.23].

the trust affairs as part of its business, as well as those matters that affect it as the entity and so as a corporate body (at [325]).

The Tribunal also observed that the “ordinary prudent person” standard under s 52(2)(b) is directed to “the care, skill and diligence of the sort that an ordinary person who is careful, astute and exercises sound judgment would show, in dealing with property, which is not his or her own but which belongs to another and which the person feels morally bound to preserve” (at [347]). On the other hand, in *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204; (2011) 282 ALR 167, the Court of Appeal observed that s 52(2)(b) does not “materially add to breach by the [trustee] of its general law duty to exercise reasonable care”.

The Government Information Pack (21 September 2011) issued in response to the Super System Review Final Report (30 June 2010) indicated that the Government would increase the standard of care, skill and diligence required of trustees to that of a prudent person of business. The formulation of the covenant in s 52(2)(b) in the Bill introduced in the House of Representatives differs from that contained in the Exposure Draft and would require the trustee:

“to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments.”

The term “superannuation trustee” will be defined in SIS Act s 52(3) as a person whose profession, business or employment is or includes acting as a trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity. This standard no longer refers to the interests of beneficiaries for whom the trustee is “morally bound to provide” and is therefore less likely to be read by reference to the formulation in *Re Whiteley*. This provision sets an objective standard as to the degree of care, skill and diligence required, being that which, in effect, a prudent professional trustee would exercise in respect of the specified matters.

Duties applicable to directors of a corporate trustee

The covenants applicable to corporate trustees of a superannuation fund under SIS Act s 52(2) presently operate as a covenant by each of the directors of the corporate trustee to exercise a reasonable degree of care and diligence for the purpose of ensuring that the corporate trustee carries out its covenant.¹¹ The reference to a “reasonable degree of care and diligence” is defined as a reference to the degree of care and diligence that a reasonable person in the director’s position would exercise in the trustee’s circumstances.¹²

The present position would be significantly changed by the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012. Proposed s 52A will replicate many of the covenants in proposed s 52(2) but impose them directly on directors of corporate trustees of RSEs. The duty of care, skill and diligence imposed under proposed s 52A(2)(b) will require directors to exercise:

... the same degree of care, skill and diligence as a prudent superannuation entity director [as defined¹³] would exercise in relation to an entity where he or she is a director of the trustee of the entity and that trustee makes investments on behalf of the entity’s beneficiaries.

¹¹ SIS Act s 52(8).

¹² SIS Act s 52(9).

¹³ The term “superannuation entity director” would in turn be defined in proposed s 29VO as a person whose profession, business or employment includes acting as a director of a superannuation trustee and investing money on behalf of beneficiaries of the superannuation entity.

The standard to be applied under proposed s 52A(2)(b) appears to be a wholly objective standard. This is a different approach to that which is currently adopted in Corporations Act s 180 where the standard is qualified both by reference to the corporation's circumstances and by reference to the office and responsibilities of the particular director. It also differs from the approach currently adopted in SIS Act s 52(9) which has regard to the director's particular circumstances by reference to a "reasonable person *in the position of the director*". It seems the standard under proposed s 52A(2)(b) would be the same irrespective of the role occupied by the particular director, so that a person who is a non-executive director and a person who is an executive director with specialist financial qualifications would be held to the same objective standard. By contrast, the approach adopted in the Corporations Act allows the standard applicable to a particular director to rise if he or she has particular qualifications.¹⁴

A director will also be required to exercise a reasonable degree of care and diligence for the purposes of ensuring the corporate trustee carries out the covenants referred to in proposed s 52: proposed s 52A(2)(f). That standard is defined as the standard of care and diligence which a prudent "superannuation entity director" (as defined) would exercise in the circumstances of the corporate trustee: proposed s 52A(5).

Liability for loss suffered as a result of a contravention

A person must not contravene a covenant contained or taken to be contained in the governing rules of the superannuation entity.¹⁵ Such a contravention is not an offence and does not result in invalidity of the transaction.¹⁶ However, a person who suffers loss or damage as a result of a contravention may recover the amount of that loss or damage by action against the contravener or a person involved in the contravention: SIS Act s 55(3). There are defences under SIS Act s 55(5)-(6) to an action for loss or damage as a result of the making of an investment or the management of reserves in specified circumstances. However, these defences are directed to the covenants in respect of formulation of an investment strategy and a strategy for management of reserves under SIS Act s 52(2)(f)-(g) and do not apply to breach of the care, skill and diligence covenant under s 52(2)(b): *Apolstolovski v Total Risk Management Pty Ltd* [2010] NSWSC 1451 at [45].

Indemnification

An entity's governing rules may provide for a director to be indemnified out of fund assets for any liability incurred under s 55, but not where that liability arose out of a failure to act honestly in a matter concerning that entity or an intentional or reckless failure to exercise the degree of care and diligence that a director is required to exercise. The Court has a discretionary power to relieve against liability under SIS Act s 310 but there is authority that power does not extend to granting such relief in favour of a corporate trustee: *Apolstolovski v Total Risk Management Pty Ltd* above at [51]. There are also defences to liability based on reasonable mistake, reasonable reliance and due diligence under s 323 of the SIS Act; there are no corresponding defences to the corresponding provisions of the Corporations Act.

¹⁴ The Explanatory Memorandum notes that newly appointed directors of a corporate trustee "will not be expected to have the level of skill and knowledge of an experienced director immediately". The application of an objective standard without reference to the circumstances of the particular director does not facilitate that sensible result.

¹⁵ SIS Act s 55(1)

¹⁶ SIS Act s 55(2)

Statutory duty of care and diligence under the Corporations Act

Section 180(1) of the Corporations Act requires a director or officer to exercise his or her powers and discharge his or her duties with the degree of care and diligence which a reasonable person would exercise if he or she:

- was a director or officer of a corporation in the corporation's circumstances; and
- occupied the office within that corporation held by the director or officer, and had the same responsibilities within the corporation as the director or officer.

The statutory duty of care and diligence overlaps with directors' duty of care arising in negligence¹⁷ and in equity.¹⁸

Section 180 does not seek further to define the standards which are to be applied in determining whether the conduct of a director or officer meets the standard of care and diligence which a reasonable person would exercise in the relevant circumstances. On appeal in *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR 438 at 504; 118 FLR 248; 16 ACSR 607, the Court of Appeal's decision noted that "the director's duty of care is not merely subjective, limited by the director's knowledge and experience or ignorance or inaction" (at 666) and that the common law duty of a director "will vary according to the size and business of the particular company and to the experience or skills that the director held himself or herself out to have in support of appointment to the office" (at 668). It follows that any special qualifications of the director will be relevant to determining the scope of his or her duty of care.

The duties imposed on trustees will affect the content of the duties owed by directors of a trustee company because the statutory duty of care and diligence is determined by reference to the circumstances of the relevant company. The content of the statutory duty of care and diligence under the Corporations Act will also be influenced by the fit and proper person requirement in respect of an RSE licence imposed under SIS Act.¹⁹

An early and important example of the interaction of a trustee's duties and statutory duties under the Corporations Act is *ASIC v Parker* [2003] FCA 262; (2003) 21 ACLC 888, where ASIC sought a disqualification order against a director in respect of a contravention of the duty of care under the predecessor section to Corporations Act s

¹⁷ *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR 438 at 504; 118 FLR 248; 16 ACSR 607; 13 ACLC 614.

¹⁸ A duty of care which was equitable, but not a fiduciary obligation, was recognised in *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187 at 238 per Ipp J (with whom Malcolm CJ and Seaman J agreed); 14 ACSR 109; 12 ACLC 674, approved in *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262 at 274 per Spigelman CJ (with whom Priestley & Meagher JJA agreed); 29 ACSR 148. See A Goldfinch, "Trustee's Duty to Exercise Reasonable Care: Fiduciary Duty?" (2004) 78 ALJ 678 at 681; JD Heydon, "Are the Duties of Company Directors to exercise care and skill fiduciary?" in S Degeling & J Edelman, *Equity in Commercial Law*, 2005, pp185 - 237; WM Heath, "The Director's 'Fiduciary' Duty of Care and Skill: a Misnomer" (2007) 25 C&SLJ 370 at 370 - 371.

¹⁹ See N Davis, "APRA licensing of trustees" (2006) 17 *Australian Superannuation Bulletin* 97. The current requirements as to the fitness and propriety of RSE licensees and individual directors are contained in SIS Regulations r 4.14 (which requires an RSE licensee to possess specified attributes that enable it to properly discharge its duties and responsibilities in a prudent manner, including character, competence, experience, integrity, honesty, judgment and relevant technical qualifications, knowledge and skill) and Prudential Practice Guide SPG 520 *Fitness and Propriety*. APRA's Discussion Paper, *Prudential Standards for Superannuation* (28 September 2011) indicates that it proposes to introduce a new Prudential Standard SPS 520 *Fit and Proper* although the requirements in that standard will broadly be consistent with the existing standard.

180 in respect of a decision to make loans without adequate investigation of the borrower's financial position. The company was the trustee of a regulated superannuation fund. Drummond J observed at [114] that:

"The content of the obligation imposed by this provision to exercise care and diligence is, as the section indicates, governed by the particular corporation's circumstances and how a reasonable person in the defendant's position in the particular corporation would conduct himself. ... [The company] was bound to comply with the statutory covenants in s 52(2) [of the SIS Act] in conducting its business as trustee of the fund; [the director] was bound by s 52(8) to exercise a reasonable degree of care and diligence for the purpose of ensuring that [the company] itself satisfied those statutory covenants. In consequence, the content of the fiduciary duties on [the director] as a director required of him a higher standard of care and diligence in performing his duties, including his duty to bring loan proposals suitable for consideration by the Board before it, than is the nature of a fiduciary duty on a director of an ordinary trading company."

His Honour also observed that other directors breached their duties in committing the fund to commercial lending when the Board lacked expertise in that area and had not put adequate prudential controls in place (at [138]).

The impact of the duties arising under the Corporations Act can be illustrated by considering their potential application in regulatory actions that have involved the exercise of the disqualification power. In the well-known decision in *Re Preuss and APRA* [2005] AATA 748, 87 ALD 629, the applicant was a director of a corporate trustee of a superannuation fund for employees of his law firm and was also a director of another company which was investment manager of the fund. APRA found that Preuss should be disqualified under s 120A of the SIS Act²⁰ on the basis of a failure to comply with the covenant implied under SIS Act s 52(2)(b) and also found that his failure to have appropriate management arrangements in place or be significantly involved in the trustee's performance of its role indicated that he did not satisfy the "fit and proper person" standard.

On appeal to the AAT, Member Allen observed that "[I]t seems clear that the duty of a trustee in the context of covenants such as the one in s 52(2)(b) is one that requires a standard of care, skill and diligence that is in excess of that normally imposed on a trustee" (at 646). The AAT pointed to structural weaknesses and conflicts in the dealings between the trustee and the investment manager and to the fact that the investment management agreement was not on arm's length terms and the trustee had failed to ensure that the investment manager obtained insurance. The AAT affirmed the disqualification, noting that it was appropriate having regard to the nature of the breaches, the applicant's failure to accept responsibility and the importance of superannuation to the community. A disqualification application could now be brought by APRA in the Federal Court of Australia in similar circumstances under s 126H of the SIS Act.²¹ However, proceedings could also be brought by the Australian Securities &

²⁰ That section was repealed by the Financial Sector Legislation Amendment (Review of Prudential Decisions) Act 2008. Prior to its repeal, the section permitted APRA to disqualify an individual if he or she contravened the SIS Act; was a responsible officer of a corporate entity at a time when the entity contravened the SIS Act; or was otherwise not a fit and proper person. In order to disqualify an individual by reason of his or her or the relevant entity's contravention of the SIS Act, APRA was required to be satisfied that the nature, seriousness and number of contraventions justified disqualification.

²¹ Following amendments made by the Financial Sector Legislation Amendment (Review of Prudential Decisions) Act 2008, the Federal Court may, if it is satisfied of specified matters, order the disqualification, for a period that it considers appropriate, of (1) the trustee of particular superannuation entity, class of superannuation entities or any superannuation entity (other than a self-managed superannuation fund); and (2) a responsible officer of a body corporate that is trustee,

Investments Commission against a director in these circumstances for breach of the statutory duty of care and diligence under s 180 of the Corporations Act, on the basis of allegations of failure to have management arrangements in place or to be sufficiently involved in the trustee's business.

The case law in the Corporations Act context has important implications for the role of executive directors in superannuation funds. A leading case is *ASIC v Vines* [2005] NSWSC 738; (2005) 55 ACSR 617; 23 ACLC 1387, on appeal as [2007] NSWCA 75; (2007) 62 ACSR 1; 25 ACLC 448. Vines was the chief financial officer of the GIO Group when AMP launched a hostile takeover bid in 1998; he had general responsibility for the company's financial affairs and he also undertook specific responsibilities in relation to GIO's response to the takeover, including coordinating the work of a Due Diligence Committee set up in relation to the Part B statement. ASIC alleged that Vines had breached the statutory duty of care and diligence in respect of a profit forecast contained in the GIO Group's Part B Statement. At first instance Austin J held that an executive officer was subject to a duty of care and diligence, and that the statute adopted an objective standard of care measured by reference to what a reasonable person of ordinary prudence would do, which could be more demanding in circumstances where the individual has been appointed by reference to a particular skill possessed by that individual. His Honour held that Vines had breached that duty and, in a second judgment (reported at [2005] NSWSC 1349; (2005) 65 NSWLR 281; 224 ALR 499; 56 ACSR 528) rejected Vines' application for relief from liability under ss 1317A and 1318.

The Court of Appeal partly allowed an appeal against the judgment finding Vines to have contravened the statutory duty of care and dismissed the appeal from the judgment relating to relief from liability. The majority held that Vines had contravened the duty of care in giving a management sign-off to the Due Diligence Committee without taking positive steps to advise that Committee of the basis of assumptions underlying the profit forecast; in accepting advice given by another executive without further inquiry where warning signs existed which required him to take steps to verify that advice; and by failing to ensure that adequate arrangements were in place to monitor the profit forecast after the Part B Statement was released. Santow JA dissented on the basis that Vines' role as chief financial officer was supervisory rather than operational and he was entitled to rely on the other executive's advice unless he had grounds for suspicion (at [723]ff). These findings anticipate the somewhat similar findings in respect of executives in the *James Hardie* case. They have important implications for the position of persons who are both directors of a superannuation trustee and executives of an associated entity.

The facts of *Re VBR and APRA* [2006] AATA 710²² also illustrate an area of potential overlap between the duties arising under the SIS Act and the Corporations Act in respect of directors of superannuation trustees and their directors. That case concerned a decision by a superannuation trustee, made at the end of the 2002 financial year, to discontinue an existing smoothing rate policy and apply a new crediting rate policy for that financial year. APRA criticised several aspects of that decision, relating to its timing; the absence of legal advice as to the trustee's obligations regarding the proposed change; a suggested failure to consider other alternatives such as applying the change prospectively or seeking additional employer contributions; and the manner in which the trustee had communicated the decision to members, and disqualified 7 of 9 directors of the trustee of a superannuation fund. That decision was overturned by the Administrative

investment manager or custodian of superannuation entity (other than a self-managed superannuation fund): SIS Act s 126H.

²² For a detailed analysis of this decision, see S Ferris & P Gillies, "The legal obligations of superannuation fund trustees: The VBN v APRA litigation" (2010) 21 *JBFLP* 214.

Appeals Tribunal on the basis that, although there had been a breach of the trust deed (in respect of the application of a negative crediting rate) and inadequacies in the information provided to members of the fund, the trustee had not breached the statutory covenants under SIS Act s 52 and the directors could not be disqualified in reliance on such a breach. In particular, the AAT held that the trustee had not breached the care and skill covenant implied under SIS Act s 52(2)(b) where it had sought, carefully considered in investment subcommittee and board meetings and ultimately followed actuarial advice in seeking to balance the competing interests of groups of members. The AAT also held that the process adopted for determining the disclosure to be made in respect of an offer made by the employer to transfer members from a defined benefit to an accumulation fund had complied with the care and skill covenant, where a subcommittee had been appointed comprised of employer representatives and the offer documents had been the subject of legal review.

The criticisms of the process adopted by the trustee made in that case could have been formulated as a breach of the duty of care and diligence owed by its directors under s 180(1) of the Corporations Act. However, a case put on that basis is not likely to have succeeded if a case for breach of the care and diligence covenant under SIS Act s 52(2) and its extension to directors under SIS Act s 52(8) would not have succeeded.

In *ASIC v Rich* [2009] NSWSC 1229; (2009) 236 FLR 1; 75 ACSR 1, ASIC was unsuccessful in proceedings brought against Messrs Rich and Silbermann, the former joint chief executive and a director of One.Tel and the former finance director of One.Tel respectively, essentially because it failed to establish the factual basis of its claims. Austin J observed that the reference to a “corporation’s circumstances” in s 180 of the Corporations Act required that consideration be given to the type of company involved, the size and nature of its business, the provisions of its constitution, the composition of the board and the distribution of the work between the board and other officers (at [7201]). His Honour observed that it was necessary to have regard to whether the company was listed or unlisted and, in the case of a parent company, to have regard to the size and nature of the businesses of its subsidiaries if they are under the parent’s general supervision.

Austin J observed that the statutory duty incorporates a minimum standard of diligence, which at least requires every director or officer, including a non-executive director:

- to become familiar with the fundamentals of the business or businesses of the company;
- to keep informed about the company’s activities;
- to monitor, generally, the company’s affairs;
- to maintain familiarity with the company’s financial status by appropriate means, including (in the case of a director) review of the company’s financial statements and board papers, and make further inquiries into matters revealed by those documents where it is appropriate to do so; and
- in the case of a director, and at least some officers, to have a reasonably informed opinion of the company’s financial capacity (at [7203]).

Austin J observed that, in the case of non-executive directors, the objective duty of minimum skill and competence may not extend much beyond financial matters, but in the

case of an executive director, the statutory standard reflects what is objectively expected of a person appointed to the designated executive office (at [7206]). His Honour also observed that terms of an employment contract that an employee should act with reasonable care, diligence and skill would affect the content of the statutory duty of care and diligence: *ASIC v Rich* at [7212]. His Honour also emphasised that the question in respect of a contravention of s 180(1) was not whether company officers made mistakes or held different opinions from those of the Court, but whether they failed to meet the standard of care and diligence, and this was to be assessed with regard to the circumstances existing at the relevant time, without the benefits of hindsight and with the distinction between negligence and mistakes or errors of judgment firmly in mind (at [7242]). It seems to me that at least one observation in this judgment also anticipates observations in the *Centro* case, namely that the duty of skill and competence owed by non-executive directors extended at least to financial matters.

At first instance in *ASIC v Macdonald (No 11)* [2009] NSWSC 287; (2009) 256 ALR 199; 71 ACSR 368, the Supreme Court of New South Wales (Gzell J) held that the chief executive officer, chief financial officer, company secretary/general counsel and several non-executive directors of James Hardie had, inter alia, breached the statutory duty of care and diligence in approving an ASX announcement concerning the establishment and funding of the Medical Research and Compensation Foundation, and two overseas non-executive directors had breached their duty of care in joining in the resolution to approve that announcement without first having obtained a copy of it. The Court also found contraventions of s 180 by the chief executive officer and general counsel in failing to advise the board appropriately in several respects. On appeal in *Morley & Ors v ASIC* [2010] NSWCA 331; (2010) 274 ALR 205; 247 FLR 140; 81 ACSR 285, the Court of Appeal of the Supreme Court of New South Wales allowed appeals by the non-executive directors against the findings of contravention and pecuniary penalties and disqualification orders made against them, holding that ASIC had not established that the directors had in fact approved the ASX announcement. Importantly, the Court of Appeal observed that a contravention of the statutory duty of care and diligence *would* have been established if it had been established that the non-executive directors had in fact approved the announcement, where the circumstances were not such as to allow directors to rely on management and the matter required the directors application of directors' own minds (at [810], [817], [821]) and that the two overseas directors would also have contravened that duty in those circumstances and should have refrained from voting if they were not familiar with the terms of the announcement (at [868]).

The Court of Appeal also upheld the finding at first instance that the chief financial officer had contravened the statutory duty of care and diligence by his failure to advise the board of the limited nature of external review of a cashflow analysis commissioned by the company in respect of the funding of the Foundation. The company secretary/general counsel's appeal succeeded in part, but the Court of Appeal upheld the finding at first instance that he had contravened the statutory duty by failing to advise the board of the need to consider whether to disclose a significant corporate restructure to ASX. The High Court has heard, but not yet delivered its decision on, ASIC's appeal from the Court of Appeal's decision in respect of the former non-executive directors and company secretary/general counsel.

The facts giving rise to the proceedings in *ASIC v Healey* [2011] FCA 717; (2011) 83 ACSR 484 are well known and have been the subject of media and professional

comment.²³ The directors of Centro Property Group (“CNP”) and Centro Retail Group (“CER”) approved the relevant companies’ financial reports at board meetings held on 6 September 2007. The Corporations Act requires that a company’s financial reports comply with the accounting standards; AASB 101 deals with the classification of liabilities as current or non-current and the notes to the accounts of CNP and CER each summarised the basis of that classification; and AASB 110 deals with disclosure of post-balance date events. CNP’s annual report incorrectly classified about \$1.5bn of short-term liabilities as non-current and the notes to the accounts did not refer to a guarantee given by CNP after the balance date of a debt of a US joint venture to which it was party. CER’s accounts incorrectly classified about \$500m of short-term liabilities as non-current. ASIC sought declarations that the directors of CNP and CER had contravened ss 180(1), 344(1) and 601FD(3) of the Corporations Act and orders that the directors pay pecuniary penalties and be disqualified from managing corporations.

The main emphasis in the decision is upon the need for directors personally to engage with the content of the company’s financial reports. His Honour noted that a board may be made up of persons drawn from different commercial backgrounds but also observed that each director’s duty extends beyond his or her particular field of expertise (at [18]). His Honour’s observed that, obviously enough, directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. However, his Honour noted that:

“What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information and apply an inquiring mind to the responsibilities placed upon him or her. Such a responsibility arises in these proceedings in adopting and approving the financial statements. Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in those financial statements call for such enquiries” (at [20]).

His Honour also noted it was not suggested that directors did not need to read and consider the company’s financial statements before approving or adopting them and that process was directed to ensuring:

“...as far as possible and reasonable, that the information contained in them is accurate. The scrutiny by the directors of the financial statements involves understanding their content. The directors should then bring the information known or available to him or her in the normal discharge of the director’s responsibilities to the task of focusing upon the financial statements. These are the minimal steps a person in the position of any director would and should take before participating in the approval or adoption of the financial statements and their own directors’ reports” (at [22]).

His Honour also noted that:

“Directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the Board’s responsibilities as with the reporting obligations. The Act places upon the Board and each director the specific task of approving the financial statements. Consequently, each member of the Board was charged with the responsibility of attending to and focusing on these accounts and, under the circumstances, could not delegate or ‘abdicate’ that responsibility to others” (at [175]).

There are several comments in the decision which emphasise the desirability of directors’ having knowledge of accounting standards although it seems to me they are not essential to the result of the case. Middleton J observed at [124] that:

²³ C Kelso, “The landmark Centro judgment: Roles and responsibilities of directors in relation to financial reporting” (2011) *BCLB* [496]; M McLennan & J Morgan, “Demanding duties: Approving financial statements after Centro” (2011) 49 *LSJ* (No 9) 57; P Turner, “How much is enough? The Centro decision and directors’ involvement in carrying out a superannuation trustee’s covenants” (2011) *ASLB* 58.

“The objective duty of competence requires that the directors have the ability to read and understand the financial statements, including the understanding that financial statements classify assets and liabilities as current and non-current, and what those concepts mean. This classification is relevant to the assessment of solvency and liquidity. Equally, a director should have an understanding of the need to disclose certain events post balance date.”

His Honour also observed that “[i]t may well be that directors should have a degree of accounting literacy that requires a knowledge of accounting practice and accounting standards” (at [206]). His Honour also rejected an argument that the volume of board papers may be difficult for the directors to perform their duties, observing that the Board had the ability to determine what information was provided to it (at [298]).

However, it seems to me the decision ultimately rests on the factual findings which his Honour made rather than on any expansion of the scope of directors’ duties. His Honour found that the relevant directors knew the relevant entities’ debt maturity profiles, knew of negotiations to extend the maturity of those debt facilities and also knew the basis on which debts were to be classified as non-current as set out in the notes to CNP’s and CER’s accounts. His Honour also found that, given knowledge of those matters, an adequate reading of the draft financial reports would have led the directors to make inquiries of management, the audit committee and the board and to ensure the financial reports were corrected before they were approved. Middleton J also found that the directors also knew of the relevant guarantees and they (or most of them) knew of the need to disclose post-balance sheet events. In the result, his Honour found that the directors had breached the statutory duty of care and diligence under s 180 by not properly considering the content of the financial statements for themselves and relying on the company’s processes and external advisers to the exclusion of such consideration (at [569]). Middleton J held that the directors had also contravened s 601FD(3) (applicable to their role as directors of a responsible entity) of the Corporations Act and the chief financial officer had contravened ss 180(1) and 601FD(3) of the Corporations Act.

The decision in *ASIC v Healey* also points to the importance of s 344 of the Corporations Act (and the corresponding provision in s 601FD(1)(f) in respect of responsible entities) which is contravened by a director who fails to take all reasonable steps to comply with, or secure compliance with, Pt 2M.2 (financial records) or Pt 2M.3 (financial reporting) of the Corporations Act. The test to be applied in determining whether a director contravened this section is an objective test, which is applied by reference to the particular circumstances of the case.²⁴ The Courts have emphasised that a director’s failure to properly discharge his or her duties in respect of the preparation and release of annual reports risks undermining the public confidence in published accounts that is essential for the orderly conduct of financial markets and is a serious matter.²⁵ In *ASIC v Healey*, Middleton J observed that the requirement to “take reasonable steps” under s 344 required that “at a minimum, that directors take a diligent and intelligent interest in the information either available to them or which they might appropriately demand from the executives or other employees or agents of the company” (at [143]). His Honour held that the directors had contravened the requirements of the section.

There are several practical lessons of the decision in *ASIC v Healey* for directors of corporate superannuation trustees and directors generally, none of which may seem to me to be particularly novel:

²⁴ *Australian Securities Commission v Fairlie* (1993) 11 ACLC 669 at 681; *Australian Securities and Investments Commission v Loiterton* [2004] NSWSC 172 at [44].

²⁵ *R v Hodgson* [2002] SASC 349; (2002) 84 SASR 168 ; 135 A Crim R 92; *R v Williams* [2005] NSWSC 315; (2005) 216 ALR 113; 53 ACSR 534 at [27].

- A director will benefit from financial literacy. The Courts have for many years expected that directors will have or acquire sufficient knowledge of concepts of solvency and insolvency to perform their duties and it is not surprising that knowledge of other key accounting concepts will also assist.
- A director will be expected to know the company's own key accounting policies which will, of course, typically be explained in the notes to the company's financial report.
- Directors should actively assess the content of financial reports against their own knowledge of the company's affairs, allowing themselves sufficient time to do so and actively assessing their content. This might seem a wholly uncontroversial observation. However, such a requirement is inconsistent with directors' relying on the fact that management have prepared the financial statements or on the company's processes to the exclusion of directors' personal consideration of the content of the financial statements. Second, such a requirement would require reassessment of timetables for production and approval of accounts which do not allow sufficient time for their careful review by directors and may create practical issues where persons are directors of numerous entities within a corporate group and may not have sufficient time personally to review the accounts of those entities.
- His Honour's emphasis on the fact that directors have control of the form in which information is provided to them suggests that directors should be conscious of the desirability of key information (a traditional example would be information relating to an entity's solvency and others might include information as to assets, liabilities and liquidity) being provided in a form which is readily digestible rather than only in voluminous board papers.
- The obligations of directors under s 344 of the Corporations Act (and the corresponding provision in s 601FD(1)(f) in respect of responsible entities) is not limited by the business judgment rule under Corporations Act s 180 or the protection for reasonable reliance on others under Corporations Act s 189 (which I will address below.)

In dealing with penalties in *ASIC v Healey (No 2)* [2011] FCA 1003; (2011) FCR 430, Middleton J did not grant relief from liability under ss 1317S or s 1318 of the Corporations Act and made declarations of contravention in respect of each director. He imposed no further penalty on the non-executive directors; a penalty of \$30,000 on the chief executive officer; and disqualified the chief financial officer from managing a corporation for two years but did not impose a pecuniary penalty upon him.

The Courts have rejected the proposition that every breach of the Corporations Act (or, by extension, the SIS Act) amounts to a breach of directors' duties although some breaches may do so. In *ASIC v Maxwell* [2006] NSWSC 1052; (2006) 59 ACSR 373; 24 ACLC 1308, Brereton J observed that a director or officer may breach his or her duties by allowing a company to contravene the Corporations Act, but only where that contravention is likely to result in jeopardy to the company's interests. His Honour rejected the proposition that the directors' duties provisions will necessarily be breached by a director permitting a company to breach another provision of the Corporations Act, so as to give rise to accessorial liability even if the Corporations Act does not provide for it. This decision was followed by the Federal Court in *ASIC v Warrenmang Ltd* [2007] FCA 973; (2007) 63 ACSR 623; 25 ACLC 1589 at [27] and by the Supreme Court of New South Wales (Hamilton J) in *ASIC v Sydney Investment House Equities Pty Ltd* [2008] NSWSC 1224; (2008) 69 ACSR 1 at [51].

Business judgment rule

The Australian courts have expressed a reluctance to interfere with directors' judgments in questions of business management.²⁶ Section 180(2) of the Corporations Act provides that a director or other officer of a corporation who makes a business judgment, as defined, will be taken to meet the requirements of the duty of care and diligence in s 180(1) of the Act, and their equivalent duties at common law and in equity, in respect of that judgment in certain circumstances. The term 'business judgment' is defined in s 180(3) as any decision to take or not take action in respect of a matter relevant to the business operations of the corporation. In order to obtain the benefit of the business judgment rule, a director or other officer:

- must make the judgment in good faith for a proper purpose;
- must not have a material personal interest in the subject matter of the judgment;
- must inform himself or herself about the subject matter of the judgment to the extent he or she reasonably believes to be appropriate; and
- must rationally believe that the judgment is in the best interests of the corporation.

In *ASIC v Rich* [2009] NSWSC 1229; (2009) 236 FLR 1; 75 ACSR 1, Austin J took a reasonably expansive view of the business judgment defence which will allow it real practical effect. His Honour held that the "business judgment rule" in s 180(2) can apply where a director's belief that a decision is in the best interests of the corporation is "rational" although it may be objectively unreasonable and therefore contravene the statutory standard (at [7242]). His Honour held that decisions taken in planning, budgeting and forecasting, including decisions as to what information should be obtained, are matters of "business judgment" within the scope of s180(2).

In order to have the protection of the business judgment rule, the director must establish that he or she had informed himself or herself about the subject matter of the judgment to the extent he or she reasonably believed to be appropriate. In *ASIC v Rich* at [7283], his Honour accepted a submission that relevant matters included the importance of the business judgment to be made; the time available for obtaining information; the cost related to obtaining information; the director or officer's confidence in those exploring the matter; the state of the company's business and the nature of competing demands on the board's attention; and whether or not material information is reasonably available to the director. His Honour observed that the requirement in s180(2)(d) that the director or officer rationally believes that the judgment is in the corporation's best interests is satisfied if the evidence shows that a defendant believed that matter, and that belief was supported by a reasoning process sufficient to warrant describing it as a rational belief, whether or not the reasoning process was objectively a convincing one; and that approach scope for the operation of s180(2) where, in its absence, there would arguably be a contravention of s180(1) (at [7290]).

The business judgment rule is limited to protecting a decision to take or not take action in respect of a matter relevant to the business operations of the corporation, and does not apply, for example, to the making of a misstatement in a prospectus or takeover

²⁶ *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483 at 492; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832; *Idameneo (No 123) Pty Ltd v Symbion Health Ltd & Ors* [2007] FCA 1832; (2007) 64 ACSR 680.

document which does not involve such a decision. In *Re HIH Insurance; ASIC v Adler* [2002] NSWSC 171; (2002) 168 FLR 253; 41 ACSR 72 at [453], Santow J held that the business judgment rule would not apply if a director failed to make a business judgment, or made a judgment that was not in good faith or for a proper purpose. A note to s 180(2) confirms that the business judgment rule only operates in relation to duties under s 180 and their equivalent duties at common law and in equity (including the duty of care which arises under common law principles governing liability for negligence) and does not operate in relation to duties under any other provision of the Corporations Act or any other laws.

If a director cannot establish each of the matters necessary to fall within the business judgment rule, he or she can still defend an allegation of breach of s 180(1) or breach of the general law duty of care by putting the plaintiff to proof of its case for breach of duty, or by affirmatively proving that he or she exercised the degree of care and diligence which a reasonable person would exercise in the relevant circumstances.

Delegation of duties

A question arises under the general law and the SIS Act in relation to the extent to which the trustee may delegate its functions. At general law, a trustee could not delegate its duties but could appoint agents where it was necessary or in accordance with common usage to do so. The trustee's power to appoint an agent is recognised by the Trustee Acts of the states.²⁷ Section 52 of the SIS Act does not prevent a superannuation trustee from engaging or authorising persons to do acts or things on the trustee's behalf.²⁸ The superannuation trustee's obligation to formulate and give effect to an investment strategy is in turn recognised by the covenant arising under SIS Act s 52(2)(f) and SIS Act s 102 contemplates the appointment of an investment manager and deals with reporting obligations under the agreement making such an appointment.

A different question arises under the Corporations Act, in respect of the internal management of the corporate trustee, as to when directors may delegate their powers to other directors, management and advisers. Section 198D of the Corporations Act provides that, unless the company's constitution provides otherwise, the directors of a company may delegate any of their powers to a committee of directors, a director, an employee of the company or any other person. That delegate must exercise the powers delegated in accordance with any directions of the directors: s 198D(2). The exercise of the power by the delegate is treated as being as effective as if the directors had exercised it: s 198D(3).

If the directors delegate powers to a committee, a director, an employee or any other person under s 198D, they are responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves: s 190(1). That provision appears to extend a director's liability for conduct of his or her delegate beyond the position at general law, as expressed by *Dovey v Cory* [1901] AC 477. Section 190(2) provides a limited safe harbour, stating that a director is not responsible for the exercise of a delegated power if:

- the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by the Corporations Act and any constitution of the company; and

²⁷ For example, Trustee Act 1925 (NSW) s 53, Trustee Act 1958 (Vic) s 28.

²⁸ SIS Act s 52(3).

- the director believed on reasonable grounds, 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.

In *ASIC v Adler* [2002] NSWSC 171; (2002) 168 FLR 253; 41 ACSR 72 at [451], Santow J held that the requirements of s 190(2) were not satisfied by the delegation of matters in respect of the relevant transaction by Williams, the managing director of HIH, to Adler in circumstances that Adler had a conflict of interest and the transaction proceeded contrary to the company's usual procedures for approval. In *ASIC v Greaves*, [2004] NSWSC 836; (2004) 50 ACSR 500; (2004) 22 ACLC 1232, White J noted that the powers delegated by directors to management are subject to the directors' ultimate responsibility for oversight of the company; and noted that "those who have delegated their powers have a duty to exercise reasonable care and diligence to ensure that the powers delegated are being efficiently discharged" (at [87]).

DUTIES OF GOOD FAITH

Best interests covenant under SIS Act s 52(2)(c)

The best interests covenant implied under the SIS Act will in turn influence the content of the duty of good faith imposed under the Corporations Act. Section 52(2)(c) of the SIS Act inserts into the governing rules of each superannuation fund a covenant by the trustee to ensure that its duties and powers are performed and exercised in the best interests of the beneficiaries.²⁹ The language of that covenant reflects the decision in *Cowan v Scargill* [1985] Ch 270 at 287 where Sir Robert Megarry V-C observed that:

The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests.

The requirements of the general law have variously been formulated as involving impartiality and the exercise of the trustee's powers for a proper purpose³⁰ and as a duty of loyalty and as a duty to pursue the beneficiaries' interests "to the utmost with appropriate diligence and prudence".³¹ In *Re VBR and APRA* [2006] AATA 710, the Administrative Appeals Tribunal held that a trustee had not contravened the best interests covenant implied under s 52(2)(c) of the SIS Act, where a change in policy as to the crediting rate for a fund disadvantaged a group of members but was in the interest of members as a whole. In *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204; (2011) 282 ALR 167 at [103]-[104], the Court of Appeal observed that the statutory covenant did not materially alter a trustee's general law duty to act in beneficiaries' best interests, and the words "to ensure" did not impose strict liability but emphasised the seriousness of the covenant and the requirement that it be strictly observed.

²⁹ See generally M Stone, "The superannuation trustee: Are fiduciary obligations and standards appropriate?" (2007) 1 *J of Equity* 167; GW Thomas, "The duty of trustees to act in the 'best interests' of their beneficiaries" (2008) 2 *J of Equity* 177; M Scott Donald, "'Best' interests?" (2008) 2 *J of Equity* 245.

³⁰ *Edge v Pensions Ombudsman* [1999] 4 All ER 546; *Knudsen v Karakar* [2000] NSWSC 715.

³¹ *Invensys v Austrac Investments* [2006] VSC 112; (2006) 198 FLR 302 at [107].

One commentator has observed that the reference to a duty to act in the best interest of beneficiaries in that quotation is to a combination of the established duties (1) to have regard, in exercising fiduciary powers, to the interests of the beneficiaries and not to extraneous considerations and (2) to act with reasonable care and diligence.³² The Final Report of the Super System Review pointed to uncertainty as to the meaning of the best interest covenant under s 52(2)(c) and pointed to two elements of the duty, for trustees to place member interests ahead of other interests and actively endeavour to achieve the best outcome for members.³³

Duty of good faith under the Corporations Act

At general law, the directors of a company are under a duty to act in good faith for the benefit of the company.³⁴ Section 181(1) in turn requires a director or other officer of a corporation to (1) exercise his or her powers and discharge his or her duties in good faith in the best interests of the corporation and (2) for a proper purpose.

The first limb of Corporations Act s 181(1), imposing the duty to exercise the directors' duties in good faith in the best interests of the corporation, involves a mixed subjective and objective test, which requires that a court first assess whether a director's exercise of power was made honestly, looking to his or her intention; and, second, assess that exercise of his or her power against objective criteria, determining whether the decision is one that a reasonable director could have reached. In *Chew v R* (1991) 5 ACSR 473 at 499, Malcolm CJ summarised the requirements of that duty as being that directors (1) must exercise their powers in the interests of the company, and must not misuse or abuse their power; (2) must avoid conflict between their personal interests and those of the company; (3) must not take advantage of their position to make secret profits; and (4) must not misappropriate the company's assets for themselves. The additional language "best interests of the corporation" may require consideration of which constituencies are relevant, for example, the company's shareholders as a whole, its creditors in the case of a company that is insolvent or close to insolvency, and possibly its employees.

The second limb of s 181(1), relating to the exercise of the director's powers or duties for a proper purpose, will pick up existing case law as to the requirement of proper purposes. In particular, directors' powers may be exercised only for the purpose for which they were conferred and not for any improper purpose. In *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187 at 218; 14 ACSR 109; 12 ACLC 674, Ipp J (with whom Malcolm CJ and Seaman J agreed) noted that the fiduciary powers and duties of directors may be exercised only for the purpose for which they were conferred and not for any collateral or improper purpose. His Honour also noted that honest or altruistic behaviour will not prevent a finding of improper conduct on the part of directors if that conduct was carried out for an improper or collateral purpose; and whether acts were performed in good faith and in the company's interests is to be determined objectively, although statements by directors about their subjective intentions or beliefs would be relevant to that inquiry. In *Re HIH Insurance; ASIC v Adler* [2002] NSWSC 171; (2002) 168 FLR 253; 41 ACSR 72 at [738]-[739], Santow J observed that whether a director has acted for a proper purpose within s 181 was to be determined objectively and a subjective belief by a director that his purpose was proper was not sufficient to satisfy that requirement. The two limbs of s 181 leave open the possibility that particular

³² J Lehane, "Delegation of Trustees' Powers and Current Developments in Investment Funds Management" (1995) 7 *Bond LR* 36 at 38

³³ Super System Review Final Report [2.2.1]

³⁴ *Ngurli v McCann* (1953) 90 CLR 425.

conduct will contravene s 181, although directors had acted in good faith in the interests of the company, because that conduct involves a failure to act for a proper purpose.³⁵

These duties may have particular application in complex restructuring proposals. For example, in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239; (2008) 39 WAR 1; 225 FLR 1; 70 ACSR 1 (currently on appeal), the Supreme Court of Western Australia considered a restructuring and extension of Bell Group's facilities, during which security over key assets was taken by the lenders to Bell Group extending to assets of companies which had not previously given security and all intragroup debt was to be subordinated. The liquidator of Bell Group alleged that directors of the relevant companies had not given consideration to the interests of the particular companies and that their decision to enter into the transaction was made for a collateral or improper purpose. The Court held that the Australian directors of The Bell Group companies had breached their duties by, inter alia, (1) failing to consider the interests of the individual companies; (2) causing companies which did not have a pre-existing obligation to give security over their assets in the interest of other Bell Group companies that were insolvent, nearly insolvent or of doubtful solvency; (3) not having critical financial information for each company which entered into the transaction; (4) not identifying which creditors of the companies which might be affected by the transaction; (5) for some directors, exercising their powers for an improper purpose of protecting Bond Corporation; and (6) authorising the giving of the securities without a sufficient restructuring plan.

While this decision has its most immediate application to restructurings within a corporate group, issues of similar difficulty could arise where decisions have to be made that affect several funds that have a degree of interdependence. Important implications of the decision include that any implications of the decision would need to be considered by reference to each affected fund separately and not only collectively; and that, where disadvantage is to be incurred to facilitate a restructuring, that restructuring must be sufficiently developed to allow its prospects of ultimate success to be properly assessed.

CONFLICTS OF INTEREST

Improper use of position

At general law, the rule against conflict of interest requires a company director to avoid situations in which there is a "real and sensible possibility" of conflict between the director's personal interests and the company's interests. A director who makes a profit by use of his or her position as a director, or who undertakes business activities on his or her own account which are in conflict with his or her duty to the company, is liable to account to the company for that profit, but may be allowed reasonable remuneration for his or her efforts in connection with the transaction.³⁶ At general law, a director is also prohibited from using information acquired as director to benefit himself or herself.³⁷

The general law rule against conflict of interest is reinforced by ss 182 and 183 of the Corporations Act. Section 182(1) prohibits a director, secretary, officer or employee of a corporation from improperly using his or her position to gain an advantage for himself or herself or someone else, or cause detriment to the corporation. The test whether a

³⁵ W Heath, "The Corporations Act, section 181: A Two-Edged Sword" (2000) 18 C&SLJ 377

³⁶ *Furs Ltd v Tomkies* (1936) 54 CLR 583; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134; *Phipps v Boardman* [1967] 2 AC 46n; *Paul A Davies (Aust) Pty Ltd v Davies* (1983) 8 ACLR 1.

³⁷ *Regal (Hastings) Limited v Gulliver* [1967] 2 AC 134.

director or officer has improperly used his or her position to gain an advantage for himself or someone else, or cause detriment to the corporation, is an objective test and does not depend on that person's intention or purpose.³⁸ In *Doyle v ASIC* [2005] HCA 78; (2005) 223 ALR 218; 56 ACSR 159, the High Court observed that the relevant conduct would be improper if it amounted to:

“a breach of the standards of conduct which would be expected of a person in [the director's] position by reasonable persons with knowledge of the duties, powers and authority of his position as a director, and the circumstances of the case, including the commercial context.”

Section 183(1) of the Corporations Act in turn prohibits a person who obtains information because he or she is, or has been, a director or other officer or employee of a corporation from improperly using that information to gain an advantage for himself or herself or someone else, or to cause detriment to the corporation.

Issues of conflict of interest can arise where directors serve on boards of trustees of potentially competing superannuation funds. At general law and under the Corporations Act, it appears that a director does not breach the rule against conflict of interest merely by being appointed as a director of a competing company, provided that he or she does not disclose confidential information that has come to him as a director of the first company to the competing company.³⁹ However, difficult issues can arise when a conflict arises between the directors duties owed to the two entities. In that situation, the director's withdrawing from any decision as to which the conflict exists is likely to be the minimum that is required; resignation may sometimes be required; and neither solution will necessarily avoid difficulty.

Conflicts may also arise in the superannuation context because of conflicting interests of an employer or sponsor of the fund and members of the fund. For example, the decision in *Re VBR and APRA* [2006] AATA 710 (to which reference was made above) concerned a decision by the trustee, made at the end of the 2002 financial year, to discontinue an existing smoothing rate policy and apply a new crediting rate policy for that financial year. The Administrative Appeals Tribunal overturned the disqualification of two of the directors of the trustee of a superannuation fund by reason of a suggested failure to manage conflicts of interest arising from their roles with the employer, and a suggestion that they had promoted the employer's interests over interests of members of the fund. The decision is important for its focus on whether the conflict had been properly managed.

A conflict of interest may also arise in respect of outsourcing decisions, particularly where functions are outsourced to related companies of a trustee, and where a director of the corporate trustee of the fund is employed by a related company which provides services to the fund or by that company's parent company.⁴⁰ A conflict of interest can

³⁸ *R v Byrnes*; *R v Hopwood* (1995) 17 ACSR 551; *R v Cook*; *ex parte Commonwealth Director of Public Prosecutions* (1996) 20 ACSR 618, 14 ACLC 947; *R v Towey* (1996) 21 ACSR 46; *ASIC v Adler* [2002] NSWSC 171; (2002) 168 FLR 253; (2001) 41 ACSR 72; *Lawfund Australia Pty Ltd v Lawfund Leasing Pty Ltd* [2008] NSWSC 144; (2008) 66 ACSR 1.

³⁹ *London & Mashanoland Exploration Co Ltd v New Mashanoland Exploration Co Ltd* [1891] WN 165; *Bell v Lever Bros Ltd* [1932] AC 161 at 194; [1931] All ER Rep 1; *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150 at 161, where Mahon J noted “the latitude which the law seems to extend to the practice of a director holding office in two companies which might wholly or partly be in competition”; *On The Street Pty Ltd v Cott* (1990) 101 FLR 234; 3 ACSR 54 at 61.

⁴⁰ The current requirements relating to outsourcing for RSE licensees are contained in SIS Act ss 29H and 29P and SIS Regulations r 4.16 which deals with the content of outsourcing agreements. APRA has issued, inter alia, Superannuation Guidance Note 130.1 *Outsourcing* and SPG 200 *Frequently*

also arise in respect of investments of the fund in products issued by related companies of the trustee. This issue is specifically addressed by s 109 of the SIS Act which, broadly, requires investments of superannuation entity to be made and maintained on arm's length basis. This section is similar to, and in the case of a corporate trustee that is a public company will overlap with, the requirements of Ch 2E of the Corporations Act which deals with related party transactions generally.

The case law in respect of Corporations Act Ch 2E indicates that the "arm's length" standard requires a comparison of the transaction in question with a hypothetical dealing at arm's length that takes place between the particular parties in the same circumstances. The adequacy of the documentation of the arrangements and the protection of the trustee's rights are likely to be relevant factors⁴¹. In *ASIC v Australian Investors Forum Pty Ltd & Ors (No 2)* [2005] NSWSC 267; (2005) 53 ACSR 305 at [455]-[458], Palmer J observed that the corresponding provision (s 210 of the Corporations Act) requires the Court to assess the terms of the relevant transaction against objective standards, by reference to a comparator transaction entered into by a public company that is unrelated to the other party to the transaction in any way, financially or through ties of family, affection or dependence; free from any undue influence or pressure; through its relevant decision-makers, sufficiently knowledgeable about the circumstances of the transactions, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgment as to what was in its interests; and concerned only to achieve the best available commercial result for itself in all of the circumstances. In *Orrong Strategies Pty Ltd v Village Roadshow Ltd* (2007) 207 FLR 245; [2007] VSC 1 at [717]ff, the Supreme Court of Victoria observed that the concept of "arm's length" involves "the relationship which exists between parties who are strangers to each other, and who bear no special duty, obligation, or relation to each other" or "the standard under which unrelated parties, each acting in his or her own self-interest, would carry out a particular transaction".

Requirements for dealing with conflicts under the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

The Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 proposes to introduce a specific covenant dealing with conflicts of interest in proposed s 52(2)(b).⁴² The formulation of that covenant in the Bill introduced in

asked Questions (FAQs) on Outsourcing. APRA's Discussion Paper, *Prudential Standards for Superannuation* (28 September 2011) indicates that it also proposes to introduce Prudential Standard SPS 231 *Outsourcing* dealing with appointment of service providers which will initially be based on the content of CPS 231 which applies to other APRA regulated entities.

⁴¹ *Re HIH Insurance Ltd (in prov liq) and HIH Casualty and General Insurance Ltd (in prov liq): ASIC v Adler & Ors* [2002] NSWSC 171; (2002) 168 FLR 253; (2002) 41 ACSR 72.

⁴² APRA's Discussion Paper, *Prudential Standards for Superannuation* (28 September 2011) indicates that it also proposes to introduce Prudential Standard SPS 521 *Conflicts of Interest* which would require an RSE licensee to develop and maintain a conflicts management framework comprising internal controls and reporting, directed to ensuring that all directors understand the circumstances which might give rise to a conflict; undertake thorough inquiries to identify any conflicts; adopt procedures for the disclosure of interests; and maintain a record of how actual conflicts are managed. SPS 521 would also contain requirements as to the content of a conflict management policy and give examples of situations giving rise to conflicts, including a situation where an individual director holds multiple RSE licensee directorships, a single corporate entity is both RSE licensee and responsible entity of a managed investment scheme or a director who sits on the board of a service provider also sits on the trustee's board. SPS 521 would require registers of duties of the RSE licensee and individual directors on the one hand and material interests of directors and senior management on the other.

the House of Representatives significantly differs from the Exposure Draft.⁴³ The covenant will require a trustee:

where there is a conflict between the duties of the trustee to the beneficiaries, or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee:

- (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
- (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and
- (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
- (iv) to comply with the prudential standards in relation to conflicts.

The first requirement, to give priority to beneficiaries' interests, corresponds to the obligation presently imposed on the responsible entity of a managed investments scheme to give priority to members' interests if there is a conflict between its interests and the members' interests (Corporations Act s 601FD(1)(c)). The obligations to ensure that the duties to the beneficiaries are met and that the interests of the beneficiaries are not adversely affected focus upon the outcome of the trustees' conduct in a situation of conflict. Steps of the kind taken by financial services licensees to manage conflicts of interest (as required by Corporations Act s 912A(1)(aa)) are likely to assist in meeting this standard. The duty to give priority to beneficiaries would override any conflicting duty which an executive officer or employee of the trustee has under Corporations Act Part 2D.1 and the Commonwealth Authorities and Companies Act 1997 Part 3 Div 4: proposed s 52(4). The general law duties of executive officers are not overridden by proposed s 52(4) in its present form, although they overlap with directors' duties under Corporations Act Part 2D.1.

The proposed new covenant applicable to directors in respect of conflicts under proposed s 52A(2)(d) takes substantially the same form as the duty imposed on trustees under proposed s 52(2)(d). The covenant will require directors:

where there is a conflict between the duties of the director to the beneficiaries, or the interests of the beneficiaries, and the duties of the director to any other person or the interests of the director, the corporate trustee or an associate of the director or corporate trustee:

- (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
- (iii) to ensure that the duties to the beneficiaries are met despite the conflict; and

⁴³ The Exposure Draft previously included a covenant requiring a trustee to do all things reasonably practicable to avoid a conflict between the interests of beneficiaries and the interests of the trustee (or its associates) or the trustee's duty to any other person which has been omitted from the version introduced in the House of Representatives. The question of what was "reasonably practicable" in particular circumstances would have involved difficult judgments – for example, would it extend to steps which could be taken at very substantial cost or to substantial restructurings of funds or their investments? In circumstances where a trustee is trustee of two funds and a conflict between their respective interests has arisen, would that require its resignation as trustee of one of both funds or something less such as the creation of separate sub-committees of directors to represent the interests of the respective funds?

- (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
- (iv) to comply with the prudential standards in relation to conflicts.

The duty of a director of a corporate trustee to give priority to their duties to and the interests of beneficiaries will also override any conflicting duty that a director of the corporate trustee has under Corporations Act Part 2D.1 and the Commonwealth Authorities and Companies Act 1997 Part 3 Div 4: proposed s 52A(3). Again, the general law duties of directors are not overridden by proposed s 52A(3) in its present form, although they overlap with directors' duties under Corporations Act Part 2D.1.

Other covenants applicable to directors under the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

The Government Information Pack (21 September 2011) issued in response to the Super System Review Final Report (30 June 2010) indicated that the Government would also clarify the duties applying to individual directors of corporate trustees to act honestly and exercise independent judgment. The proposed new covenants applicable to directors under proposed SIS Act s 52A will, inter alia, also require directors to act honestly; perform the director's duties and exercise the director's powers in the best interests of the beneficiaries; and not enter into a contract or do anything else which will prevent the director or trustee from performing or exercising their functions and powers.

These covenants are a significant change from the present structure under the SIS Act. The present structure requires directors to take steps to ensure that the trustee complies with duties which are imposed upon it. To put it another way, the trustee owes the relevant duties and the director's duty is to take reasonable steps to ensure the trustee complies with them. The redrafting imposes those duties upon the directors personally. A director will, as noted above, also be required to exercise a reasonable degree of care and diligence to ensure that the corporate trustee carries out the covenants referred to in s 52: proposed s 52A(2)(f).

Additional obligations in respect of MySuper products

Proposed sections 29VN and 29VO will impose additional obligations on trustees and directors in respect of MySuper products.⁴⁴ It is proposed that those duties would apply from 1 July 2013. Trustees of an RSE which offers a MySuper product will be required to promote the financial interests of the MySuper beneficiaries and in particular net returns (after the deduction of fees, costs and taxes): s 29VN(a).⁴⁵ Proposed s 29VN(b) will require trustees of a regulated superannuation fund that includes a MySuper product to determine, annually, whether the beneficiaries of the fund are disadvantaged, by comparison with the beneficiaries of other funds holding MySuper products, because their financial interests are affected by specified matters.⁴⁶ Each director of a corporate

⁴⁴ The obligations imposed by the covenants in the amended s 52 and the additional obligations imposed under proposed s 29VN would be referred to as "enhanced trustee obligations": proposed s 10(1).

⁴⁵ The reference to "financial interests" may borrow from the language used by Sir Robert Megarry V-C in *Cowan v Scargill* [1985] 1 Ch 270 where his Honour observed that trustees power of investment "must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question" and noted that the return from an investment would be judged by reference to both income yield and capital appreciation.

⁴⁶ The provisions in the Bill introduced in Parliament differ from those contained in the Exposure Draft, which had generated a degree of controversy that I should leave others to address: see, for example,

trustee of a RSE that offers a MySuper product must exercise a reasonable degree of care and diligence⁴⁷ to ensure that the trustee carries out its obligations under proposed s 29VN: proposed s 29VO(1).

A person who suffers loss or damage as a result of another person contravening its obligations under s 29VN or s 29VO may recover the amount of loss or damage by action against that person or any person involved in the contravention: proposed s 29VP. The application of this section in respect of duties arising under s 29VO involves at least a practical change to the general law position, where directors of trustee companies owed their duties to the trustee company rather than to beneficiaries of the trust, by allowing beneficiaries of the trust direct claims against directors in respect of a contravention of that section. The obligations under proposed ss 29VN and 29VO would override any inconsistent provision of the governing rules of an RSE offering a MySuper product: proposed s 29VQ.

Submission of the Law Council of Australia in respect of the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, 13 January 2012.

⁴⁷ The reference to a reasonable degree of care and diligence is the degree of care and diligence that a “superannuation entity director” would exercise in the corporate trustee’s circumstances: proposed s 29VO(2). The term “superannuation entity director” is in turn defined as a person whose profession, business or employment is or includes acting as a director of a corporate trustee of a superannuation entity and investing money on behalf of beneficiaries of that entity: proposed s 29VO(3).