

**ADAPTIVE DIRECTORSHIP:
GOVERNING FOR THE UNPREDICTABLE**

Board Sub Committees Are a Risk! There is a better way!

Victor Hamit B.Ec (Acc), LLB, FAICD, CTA.
Wentworth Lawyers
Level 40
140 William Street
MELBOURNE 3000
Email: admin@wentworthlawyers.com.au

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GOVERNING FOR THE UNPREDICTABLE**

**Board Sub Committees Are a Risk!
There is a better way!**

**In preparation for this interactive presentation please
use your smart devices to follow the link below:-**

pollev.com/bbsubcommittees

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This will be controversial !



It will challenge some traditional thoughts on Board Sub Committees.

The law on Directors duties has evolved, we need to ADAPT as Directors.

Which NFP sectors are represented today?

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How many Sub Committees did your organization have in the past 12 months
(standing or specific limited time and purpose)

- 1 **A**
- 2-3 **B**
- 3-5 **C**

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What is the purpose of Sub Committees?

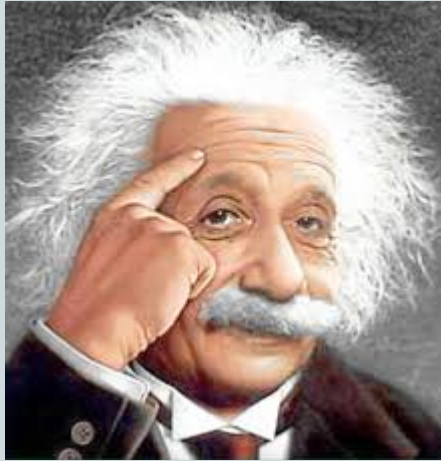
Common Answers:

- Share the workload
- More Board time for strategy
- Efficient use of time
- More in depth study
- Specialized work
- Reduce the time at Board Meetings

But what do we actually see?

- More work
- Less Board time for strategy
- Inefficient use of time
- Greater risk for Directors
- Ignoring good governance frameworks
- Empire building and loss of focus
- Missing valuable contributions from non-Sub Committee Board members

The Framework



The primary purpose of Sub Committees must be:

assist better board decision making
to
discharge Director duties
in
achieving organizational purpose

Directors Duties (recap):

1. Fiduciary
 - to act in good faith and for a proper purpose;
 - to act with due skill, care and diligence;
 - not to misuse information or position; and
 - disclose and manage conflicts of interest.

(for Incorporated Associations on a State by State basis the following is a useful resource:- **Not-for-profit Law Information Hub, Legal Information for Community Organizations** www.nfplaw.org.au)

Directors Duties (recap) (Cont.):

1. Corporations Act

- with the degree of care and diligence that a reasonable person would exercise if they were a Director of the corporation (**Sec. 180**);
- in good faith in the best interests of the corporation and for a proper purpose (**Sec. 181**);
- not use the position improperly to gain advantage for themselves or cause detriment to the corporation (**Sec. 182**); and
- not use information obtained from the position to gain advantage for themselves or cause detriment to the corporation (**Sec. 183**).

Directors Duties:

Key Message:

Delegate but don't abdicate.

Delegation by Board

- Unless not permitted by the Company's Constitution the Board may delegate any of their powers to:
 1. a committee of directors; or
 2. a director; or
 3. an employee of the company; or
 4. any other person.
- The delegate must act in accordance with the terms of the delegation.
- The exercise by the delegate of the power is as effective as if the directors had exercised it.
- The delegation must be recorded in the minute book.

(Corporations Act 2001 - Sec 198D)

But.....

The Directors remain responsible for the delegate's exercise of power UNLESS:-

- a) the Director believed on reasonable grounds, at all time, the delegate would act in conformity with duties imposed by the Corporations Act and the Company's Constitution; and

- b) the Director believed:-
 - (i) on reasonable grounds;
 - (ii) in good faith; and
 - (iii) 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.

(Corporations Act 2001 - Sec 190)

Reliance on Advice

Directors may rely on information, professional or expert advice where the Director believes:-

1. on reasonable grounds that employee, professional adviser or expert is competent; and
2. A committee of directors (on which the Director did not serve) was acting within authority.

Provided that the reliance was made in:-

- (i) Good faith; and
- (ii) *“after making an **independent** assessment of the information or advice, having regard to director’s knowledge of the corporation and the complexity of the structure and operation of the corporation”*

(Corporations Act 2001 - Sec 189)

Directors Duties Cases

- *ASIC v Hellicar & Ors* [2012] HCA 17 (3 May 2012) (the James Hardie Case).
- *ASIC v Healey & Ors* [2011] FCA 717 (27 June 2011) (the Centro Case).
- *ASIC v Sino Australian Oil and Gas Ltd (in Liq.)* [2016] FCA 934 (11 August 2016)
- *and*
- *ASIC v Sino Australian Oil and Gas Ltd (in Liq.)* [2016] FCA 1488 (8 December 2016) (the Sino Case).

Directors Duties Cases (cont.)

James Hardie Case

- Directors authorized release of announcement to ASX that establishment of foundation for asbestos claims for next 50 years was “*fully funded*” and had “*sufficient funds to meet all legitimate compensation claims anticipated*”.
- In fact underfunded by more than \$1billion.

Held

- Directors breached their duties of care and diligence (Sec 180).
- Directors could not “*abdicate responsibility by delegating his or her duty to a fellow director*”.
- Directors could not avoid liability by reliance on management or expert advisers.
- “*the task of approving the draft ASX announcement involved no more than an understanding of the English language used in the document*”.

Directors Duties Cases (cont.)

Centro Case

- Directors miscategorised a short term liability of about \$1.5billion as non-current.
- Failed to disclose guarantees of about \$1.7billion post balance date.
- Financial statement prepared by management and independently audited then approved by Directors.

Held

- Breach of duty of skill and care (Sec 180).
- Honest mistake, but it was information known or should have been known to the Directors.
- Directors must focus attention and apply themselves.
- Errors were “*so obvious*” that Directors had abdicated their responsibility.

Directors Duties Cases (cont.)

Centro Case (cont.)

At [22] Middleton J stated:-

“A reading of the financial statements by the directors is not merely undertaken for the purposes of correcting typographical or grammatical errors or even immaterial errors of arithmetic. The reading of financial statements by a director is for a higher and more important purpose: to ensure, as far as possible and reasonable, that the information included therein is accurate. The scrutiny by the directors of the financial statements involves understanding their content.”

Directors Duties Cases (cont.)

Sino Case

Australian Securities and Investments Commission (“ASIC”), in the matter of *Sino Australia Oil and Gas Limited (in liq.) v Sino Australia Oil and Gas Limited (in liq.)*

[2016]FCA 934 (11 August 2016)

[2016]FCA 1488 (8 December 2016) (*Sino*)

- ASIC alleged that Mr Shao, former Executive Director and Chairman of Sino was involved in a failure of information provided in a prospectus and the failure to make continuous disclosure to the ASX therefore breached his duties as a director of Sino.
- Mr Shao admitted that he did not understand English and did not obtain a full Chinese translation of each prospectus document before signing and authorizing release.
- ASIC made other allegations about Mr Shao’s conduct as a director.
- Mr Shao claimed he relied on and trusted his advisers and Australian resident directors.

Directors Duties Cases (cont.)

Sino Case (cont.)

The Court held:-

“The fact that Mr Shao was not an English speaker or writer and did not understand Australian legal requirements did not mean that he could just leave it all to others and did not excuse him from performing his own duties with reasonable care and diligence.....By failing to inform himself about the disclosure requirements, Mr Shao did not discharge the degree of care and diligence that a reasonable person would exercise as director and Chairman....”

Penalties:-

1. Sino pay a penalty of \$800,000
2. Mr Shao disqualified from managing corporations for 20 years.
3. Mr Shao to pay compensation to Sino of \$5,539,758.

Directors Duties Cases (cont.)

Sino Case (cont.)

Australian Securities and Investments Commission v Citofresh International Ltd (No 2) [2010] FCA 27 was referred to in the Sino Case.

In this case a director argued that his relative lack of experience in the governance of public companies, and that Citofresh had engaged the services of a consultant to provide corporate governance advice and to prepare company announcements should mitigate his duties.

Goldberg J stated at [53]:-

“[The director] may have had a background in abalone processing and may not have been a professional director with public company experience, but that does not excuse him from exercising the appropriate degree of skill and care required of a company director especially one who was a managing director and chief executive officer. Further, he was not entitled to rely on the drafting undertaken by the “experts” who were retained by [the company]. The circumstances required him to have an active participation in the drafting and to exercise, a considerable amount of skill and care.....”

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The Missing Link



How do we reconcile our duties as Directors with Sub Committees?

- Cases and resources (at the end of this paper) stress that decision making is ultimately the responsibility of the Board.
- Due skill, care and diligence.

A Solution



Whole of Board Sub Committees

Benefits:-

- all directors have access to information;
- directors not on a sub committee can still enrich decision making;
- facilitates discharge of director duties;
- can assist focus of Board between compliance and strategy;
- more efficient;
- avoids repetition;
- avoids “executive” sub committees;
- reduces time demands on directors;
- avoids empire building in sub committees;

Whole of Board Sub Committees (Cont.)

- precedes Board meeting agenda (i.e. effectively held as one stream);
- can still be chaired by different person;
- can still appoint skilled independent participants (e.g. I.T, accountants, lawyers, communications);
- possible “nursery” for future directors;
- can still be used in conjunction with limited time and purpose sub committees;
and
- Special Board Meetings

Whole of Board Sub Committees

Disadvantages:-



The Compromise



The Compromise

If you consider whole of Board sub committees do not work for you then consider the following characteristics of a sub committee:-

- assist better board decision making;
- assist discharge of duties;
- assist in achieving organizational purpose;
- is it too important to delegate;
- carefully define the purpose and document (charter or by laws);
- carefully consider the benefits;
- consider membership;
- quality of reporting to Board (query is this sufficient to allow directors not on the sub committee to reasonably discharge their duties);
- consider limited time and purpose (ad hoc) committees (working parties) and
- consider Special Board Meetings.

N.B. clearly defined terms of reference are paramount.

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A final word(s):-

- understand;
- be diligent;
- apply; and
- question.

As a Director you are responsible!

Q&A





We would appreciate your digital feedback on this presentation.

You can provide your feedback via the conference app found at:

www.pheedloop.com/bbc17

Thank You

Victor Hamit

Wentworth Lawyers Pty Ltd

Tel: +61 3 9607 8380

Email: admin@wentworthlawyers.com.au

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Further Information

Australian Institute of Company Directors

aicd.companydirectors.com.au

Audit Committees – A Guide to Good Practice

Second edition, a Joint Publication from Auditing and Assurance Standards Board, Australian Institute of Company Directors and the Institute of Internal Auditors Australia.

Duties and Responsibilities of Directors and Officer

21st edition, Professor Robert Baxt AO

Company Directors, Principles of Law and Corporate Governance

RP Austin, HAJ Ford AM, IM Ramsay, Lexis Nexis Butterworths 2005.

Boards that Work, a New Guide for Directors

G Kiel and Gavin Nicholson, The McGraw-Hill Companies Inc 2004.

Australian Institute of Company Directors

- Board Committee series (Part 1- Building the Right Foundations, Part 2 – In depth look at different types of committees and Part 3 – Performance for Excellence) Webinars 5 May 2016, 30 May 2016 and 7 July 2016 facilitated by S Cobb.*
- Role of Board Committees, 19 July 2016*

** AICD member access*

ASX: Corporate Governance Principles and Recommendations

Third Edition (27 March 2014), ASX Corporate Governance Council.



Further Information (Cont.)

See also:-

Australian Prudential Regulation Authority

www.apra.gov.au

Chartered Accountants Australian and New Zealand

www.charteredaccountantsanz.com

Governance Institute of Australia

www.governanceinstitute.com.au

For USA experience see:-

BoardSource

www.boardsource.org

For information on Incorporated Associations on a state by state basis the following is a useful source:-

Not-for-profit Law Information Hub, Legal Information for Community Organizations

www.nfplaw.org.au

For information on charities the following may be a useful resource:-

Australian Charities and Not-for-profit Commission, ACNC Governance Standards Guidance, August 2013.