

QUESTION: In *ASIC v Healey* [2011] FCA 717 at [14] Middleton J stated:

A director is an essential component of corporate governance. Each director is placed at the apex of the structure of director and management of a company. The higher the office held by a person, the greater the responsibility that falls on him or her. The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.

Under the Corporations Act 2001 anyone who is over 18 and not disqualified can be a director. Is it appropriate that there be no qualifications for directors? Should there be different requirements for directors of proprietary companies and directors of public companies?

ANSWER

Sections 201B(1) and 201B(2) of the *Corporations Act 2001* stipulate that directors must satisfy a minimum age requirement of 18 years and are ineligible for appointment if they are disqualified from managing corporations. This qualifies a large proportion of the Australian population. Nonetheless, it is appropriate that there be no qualifications for directors; the corporate form should be available to everyone. The onerous obligations imposed on directors set a high benchmark for Australian directorship. To require positive qualifications would disqualify many competent directors. Qualifications would be inappropriate in many business contexts because the skills required of directors are specific to the corporation. Directors can rely on the expertise of employees with legal and financial qualifications in the performance of their duties. If qualifications were imposed on directors, a higher standard should be required of those in public companies.

The actions of directors have a profound influence on the community, yet '[a director] is not bound to bring any special qualifications to his office.'<sup>1</sup> In *AWA Ltd v Daniels*,<sup>2</sup> Rogers CJ stated that, the standard required of a director is 'dependent...upon the actual knowledge and experience of the individual director.'<sup>3</sup> The Corporations and Securities Industry Bill of 1976, would have enabled regulations specifying 'the qualifications and experience to be possessed by directors of corporations,'<sup>4</sup> had it been successful. On July 1 2004, s 300(10)(a) of the *Corporations Act 2001* took effect, requiring that the annual report for a public company disclose 'each director's qualifications, experience and special responsibilities.' It is evident that a higher standard is required of directors presently than in the past: '[a]s the complexity of commerce has gradually intensified...the community has of necessity come to expect more than formerly from directors.'<sup>5</sup> Directors are at least expected to fulfil a minimum role<sup>6</sup>. The standard expected of directors by the *Corporations Act 2001* is comparable to international standards, such as the OECD Corporate Governance Principles and the United Kingdom Corporate Governance Combined Code.<sup>7</sup>

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<sup>1</sup> *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch 425, 437 per Neville J.

<sup>2</sup> (1992) 7 ACSR 759.

<sup>3</sup> *Ibid* 864; *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

<sup>4</sup> Clause 284(1)(g).

<sup>5</sup> *Commonwealth Bank of Australia v Friedrich & Ors* (1991) 5 ACSR 115, 126; *AWA Ltd v Daniels* (1992) 7 ACSR 759, 865.

<sup>6</sup> *AWA Appeal* (1995) 16 ACSR 607, 657.

<sup>7</sup> Neil Young, 'Has directors' liability gone too far or not far enough? A review of the standard of conduct required of directors under sections 180-184 of the Corporations Act' (2008) 26 *Company and Securities Law Journal* 216, 229.

## IS IT APPROPRIATE THAT THERE BE NO QUALIFICATIONS FOR DIRECTORS?

The onerous obligations imposed on directors 'provide a standard by which the public's legitimate interest in accountability can be achieved.'<sup>8</sup> Invariably, directors must possess a certain degree of skill and competence to satisfy their obligations, thereby making positive qualifications unnecessary. Mr Loton, former Managing Director of BHP, stated that not all of the BHP directors have tertiary qualifications; the position is appointed to the 'best person available.'<sup>9</sup> Sections 180-184 of the *Corporations Act 2001* require directors to act reasonably, with care and diligence, in good faith, for proper purposes and in the interests of the company. Adherence to these legal standards is vital for Australian directors because their actions must be accountable to shareholders, employees, creditors and the public. Shareholder class actions are becoming increasingly prevalent, with companies such as Aristocrat Leisure Ltd and Multiplex being held accountable for providing misleading statements and failing to disclose material information. Hence, company directors are being subjected to increasing scrutiny.<sup>10</sup>

The courts have demonstrated that a director has a minimum responsibility: 'there is a basic duty on all directors to understand the financial position of the company, regardless of their financial sophistication and training in accounting.'<sup>11</sup> Directors need not be experts in accounting.<sup>12</sup> In *ASIC v Healey*<sup>13</sup>, Middleton J stated that 'a director should acquire at least a rudimentary understanding of the business'<sup>14</sup> and 'maintain familiarity with the financial status of the corporation.'<sup>15</sup> Thus, the legislative requirements ensure that the standard of conduct of Australian directors is sufficient without the need for professional qualifications. As noted in *ASIC v Healey*, many of the non-executive directors 'rose through the ranks of commercial life'<sup>16</sup> and did not have a tertiary education. In finding the directors liable, Middleton J stated that 'all that was required of the directors in this proceeding was the financial literacy to understand basic accounting conventions and proper diligence in reading the financial statements.'<sup>17</sup>

To impose formal qualifications on directors would eliminate a large proportion of capable candidates and reduce the variety of expertise in Australian corporate governance. For example, many directors in mining companies have science, engineering or geology degrees rather than qualifications in business, law or commerce. Practical, professional or academic qualifications would be 'counterproductive'<sup>18</sup> because 'many of today's highly successful company directors would be excluded from directorship,'<sup>19</sup> while particular groups within society would be prejudiced against.<sup>20</sup> For instance, many successful women in directorship lack formal qualifications<sup>21</sup>, as do successful directors in the rural

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<sup>8</sup> The Senate Standing Committee on Legal and Constitutional Affairs, Australian Senate, *Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989), 13.

<sup>9</sup> *Ibid* 135.

<sup>10</sup> Above n 7, 218.

<sup>11</sup> *ASIC v Vines* (2003) 48 ACSR 322, 327.

<sup>12</sup> *ASIC v Healey* (2011) 278 ALR 618.

<sup>13</sup> (2011) 278 ALR 618.

<sup>14</sup> *Ibid* 625.

<sup>15</sup> *Ibid* 621.

<sup>16</sup> *Ibid* 685.

<sup>17</sup> *Ibid* 750.

<sup>18</sup> Above n 8, 133, per Mayne Nickless Ltd.

<sup>19</sup> *Ibid* 135.

<sup>20</sup> *Ibid*.

<sup>21</sup> *Ibid*.

sector<sup>22</sup>. Companies would suffer from the loss of well-equipped directors with industry-specific experience, incapable of appointment merely due to formalities. Candidates satisfying the qualification criteria would not necessarily be the most appropriate for the position. Moreover, the implications for small private companies would be significant. Proprietary companies are often family-owned businesses, and their directors' expertise, knowledge and experience specifically suit the company involved. Many present directors of proprietary companies do not have formal qualifications. Additionally, the need for qualifications would create a higher demand for remuneration among directors of proprietary companies. Mandatory qualifications would threaten the existence of small, privately owned companies that are crucial to Australia's corporate sector.

Minimum qualifications for directors would be inappropriate because the skills required of directors varies with the corporation. Although the standard of care required of directors is an objective one of a reasonable person in a like position in a corporation,<sup>23</sup> 'the ambit of the duty and the standard of care depend upon particular circumstances.'<sup>24</sup> The courts do not expect directors to meet a uniform standard of conduct.<sup>25</sup> In *Re City Equitable Fire Insurance Co Ltd*,<sup>26</sup> Romer J noted that the conduct of directors depends on the nature of the business carried out by the company and the size of that business.<sup>27</sup> A director's conduct must be 'assessed with close regard to the circumstances existing at the relevant time.'<sup>28</sup> No uniform set of academic, practical or competence-based qualifications would be suitable for all directors; effective boards consist of directors who have company-specific knowledge, equipped with a comprehensive understanding of the nature of the business and its industry.<sup>29</sup>

Directors can delegate work requiring academic or technical qualifications to experts within the company, such as lawyers or auditors. Therefore, it is unnecessary that they possess these qualifications themselves in order to discharge their duties. This has particular relevance in today's 'modern conglomerates'<sup>30</sup>: the standard of directors has 'evolved in response to the demands of changing company structures and commercial practices.'<sup>31</sup> In *Vines v ASIC*,<sup>32</sup> Santow JA stated that the courts expect 'a level of scrutiny as befits supervision, not the detailed direct involvement that is associated with operational responsibility.'<sup>33</sup> Directors of large public companies must delegate their tasks by necessity; the larger the company, the less it is expected that directors are personally involved in the affairs of the company.<sup>34</sup> This reliance or delegation must be reasonable,<sup>35</sup> however, and this depends on factors such as the function delegated,<sup>36</sup> the

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<sup>22</sup> Ibid.

<sup>23</sup> *Gamble v Hoffman* (1997) 24 ACSR 369, 373.

<sup>24</sup> Ibid.

<sup>25</sup> Joanna Bird, 'The Duty of Care and the CLERP Reforms' (1999) 17 *Companies and Securities Law Journal* 141, 143.

<sup>26</sup> [1925] Ch 407.

<sup>27</sup> Ibid 426-427.

<sup>28</sup> *Trust Co of Australia v Perpetual Trustees WA Ltd* (1997) 42 NSWLR 237, 247-248.

<sup>29</sup> Newitt S, 'Compliant but Not Contributing: Why Australian Boards are Being Under-utilised as a Strategic Resource', Summary of PhD research.

<sup>30</sup> Above n 25.

<sup>31</sup> *AWA Ltd v Daniels* (1992) 7 ACSR 759, 865.

<sup>32</sup> (2007) 62 ACSR 1.

<sup>33</sup> Ibid 149.

<sup>34</sup> Above n 31.

<sup>35</sup> *ASIC v Adler* (2002) 41 ACSR 72, 166 per Santow J.

<sup>36</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

relationship between the director and the delegate<sup>37</sup>, and the nature of the transaction<sup>38</sup>. Despite this, directors must take responsibility in 'reading and understanding the financial statements'<sup>39</sup> because 'a director, whilst not an auditor, should still have a questioning mind.'<sup>40</sup>

Conversely, there are arguments in favour of directors requiring formal qualifications. The present duty of care of directors is more rigorous than previously.<sup>41</sup> The law is no longer tolerant of the passive or supine director<sup>42</sup> and mandatory qualifications for directors would uphold this. Moreover, for other roles in the corporate sector, such as auditors and liquidators, formal requirements must be satisfied. The eligibility of a company director should be controlled in a similar manner.<sup>43</sup> A great degree of power and control is vested in directors; they are often entrusted with large sums of money from shareholders.<sup>44</sup> Shareholders are in a vulnerable position, especially when dealing with large, multinational public corporations. Prerequisites for directors would reduce the prevalence of fraud and mismanagement in the corporate sector. Although mandatory qualifications would create a more demanding standard of care, directors are highly remunerated and liability insurance is available.<sup>45</sup>

## SHOULD THERE BE DIFFERENT REQUIREMENTS FOR DIRECTORS OF PROPRIETARY COMPANIES AND DIRECTORS OF PUBLIC COMPANIES?

It is appropriate that there not be mandatory requirements for directors; they would prove counterproductive and burdensome on public and proprietary corporations. If qualifications were imposed on directors, however, a more stringent standard should be required of directors of public companies because they are 'a much more powerful force in the community.'<sup>46</sup> They undertake work of a riskier nature, with the potential for very serious consequences. Directors of public companies must be accountable to shareholders who repose trust in the directors' abilities to manage their investments. Large corporate disasters such as those involving HIH, Harris Scarfe, and One Tel have caused financial losses to shareholders, creditors and employees.<sup>47</sup> Therefore, it is crucial that directors of public companies implement strict systems of control and supervision and discharge their duties with a high degree of skill, judgment and knowledge. The view of Mr Middleton, former National President of the Institute of Chartered Accountants, is that 'a pre-requisite to appointment as a company director should be experience in a successful business.'<sup>48</sup> With the increasing incidence of shareholder litigation, perhaps the economic climate will necessitate directors of public companies to have mandatory academic, practical or competence-based qualifications. Determining the nature and extent of these qualifications is likely to be a complex task.

## CONCLUSION

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<sup>37</sup> *Dempster & Biala Pty Ltd v Mallina Holdings Ltd* (1994) ACSR 1.

<sup>38</sup> *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109.

<sup>39</sup> Above n 13, 675.

<sup>40</sup> *Ibid* 626.

<sup>41</sup> Above n 25, 145.

<sup>42</sup> Above n 6, 663.

<sup>43</sup> Above n 8, 134.

<sup>44</sup> *Downey v Crawford* (2004) 51 ACSR 182 per Weinberg J.

<sup>45</sup> J E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1<sup>st</sup> ed, 1993) 106.

<sup>46</sup> Above n 8, 15.

<sup>47</sup> Above n 7, 233.

<sup>48</sup> Above n 8, 133.

The implications of qualifications for directors would be significant; a realistic balance must be established between 'measures necessary to promote corporate activity...and measures necessary to protect the bona fide shareholder, worker, consumer, financier, and the public at large.'<sup>49</sup> It is unnecessary for the law to require directors to have professional qualifications, as the quality of corporate governance in Australia is high and commensurate with international standards. Qualifications for directors would prove costly to the corporate sector and the general public.

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<sup>49</sup> Ibid 17.

## Bibliography

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*Re Property Force Consultants Pty Ltd* [1997] 1 Qd R 300

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### 3. Legislation

*Corporations Act 2001*

*Corporations and Security Industry Bill 1976*