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'To be Active or Inactive': Is this a 'New' Question for Company Directors?

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'Either the name "director" means something or it means nothing. If the directors are to rely entirely on the manager or secretary, what is the use of directors?'.[1]

I INTRODUCTION

The title 'director' implies a position that is highly eminent and prestigious. The most distinguished directors are those of large companies, who lead the top businesses and whose management is influential in the business world. Such companies often have a significant number of shareholders, hundreds of employees and large groups of management executives. On the other hand, there are those who manage companies that are smaller in size, commonly family companies, which are involved in more modest operations. Members of such companies are often directors and their paid-up capital is much smaller than that of the larger companies.

Having said that, no matter how prominent the title 'director' may sound, the law does not treat the position as just another step up the management ladder. Indeed, a director's duty of care and diligence is a fundamental, irreducible requirement of participation in the management of the company. As with its United Kingdom (UK) counterpart, this requirement is one of the factors underlying the current Australian position, especially within the scheme for insolvent trading, and the view is often supported that the liability of directors for negligence in the conduct of the management of a company should be increased, particularly in the light of the high volume of liquidations that are taking place.[2]

But what is the level of involvement in the management of a company that a director is expected to have? The position in both Australia and the UK suggests that legislative change and judicial decisions over the recent years have intensified the view that there is an irreducible requirement that directors will be involved in the management of their companies. Several common law authorities in both jurisdictions clearly suggest that liability can arise where the company is insolvent, or nears insolvency,[3] and the

striking feature of the past few years is that a director can be found liable not only for actually *making* a particular decision (including a decision not to take action) but also when there is a *complete* failure to act.

Thus, it is essential for directors to be aware of the courts' approach, especially if there is, prima facie, no intention to take an active role in the company's affairs, as unexpected and rigorous consequences could follow, particularly if the company goes into liquidation. Inactivity and lack of involvement in the company's affairs, is an issue not taken lightly by the courts. In the UK, it is becoming clear that inactivity is now a major ground for disqualification under s 6 of the *Company Directors Disqualification Act 1986*.[4] A director could also be personally liable if he or she failed to take the necessary, required steps, prior to the company's insolvent liquidation.[5] In Australia, recent cases suggest that there is a core expectation of involvement in the management of companies.[6]

But is this attitude of the courts part of a 'new thinking'? Or is it fair to say that historically, have the courts always displayed high expectations of participation in management by those who accept the title of 'director'? It is often stated that the older cases failed to impose high expectations of involvement in the company.[7] However, a chronological analysis of the cases in the area of care, skill and diligence, suggests otherwise.[8] Since traditionally the propositions of Romer J in the case *Re City Equitable Fire Insurance Corporation Ltd*,[9] have been accepted as an accurate summary of the case law as received and applied in Australia,[10] this article will first examine examples of reported, older cases which show this ongoing attitude of the courts. The cases, starting from the first reported case of its kind in 1742,[11] establish that liability for inactivity is not a new phenomenon. The discussion will concentrate on the 'forgotten' aspects of these cases, which highlight that historically, the courts were willing to impose some very high requirements of involvement in the management of companies. After, this article will examine two recent Australian cases which continue the trend, and which reinforce the courts' high requirements of involvement, an attitude that undeniably began long before many suggest.

II THE TREATMENT OF INACTIVITY IN THE OLDER CASES

Historically, there have been several UK common law authorities that have been sending serious warning lights to directors not to be passive in the performance of their functions. Reported cases from the 18th, 19th and 20th centuries, clearly highlight this point. Indeed, in the earliest case on the duties of care, skill and diligence, *Charitable Corporation v Sutton*,[12] reported as early as 1742, the directors, or 'committee-men' as they were then called, were found liable for *inactivity*. When the company, which was a chartered corporation, suffered a loss of approximately £350,000, a very substantial figure at that time, the fifty committee-men of the corporation were found liable by the court for failing to ensure that the activities of a warehouse-keeper who was responsible

for making loans to poor people on the security of suitable pledges, were properly supervised. Despite the fact that only five out of the fifty committee-men were actively involved in the affairs of the corporation, the remaining forty-five were found guilty of *crassa neglentia* or gross 'negligence' on the ground that their inactivity enabled the five to cause a serious loss to the corporation.

Lord Hardwicke held that committee-men are most properly agents to those who employ them and who grant them the power to manage the affairs of the corporation and for this reason, they may be guilty of acts of commission or omission, or malfeasance or non-feasance. He then explained two situations: on the one hand there are those occasions where acts are executed within the directors' authority, such as making orders. In these cases, he stated that even though they were attended with bad consequences, it will be very difficult to determine that these are actual *breaches of trust* since it is not proper for a judge, after bad consequences arise from such authority, to state that the committee-men should have predicted what was going to happen. On the other hand, there are those cases where some committee-men leave everything to be managed entirely by others through their non-attendance.[13] He found the five that were engaged in the confederacy were liable to make good the losses that the corporation had sustained in the first place. The rest of the committee-men who were not partners in this affair were held to be liable in the second degree 'by conniving at the affair, and not making use of the proper power invested in them by the charter, in order to prevent the ill consequences arising from such a confederacy.'[14]

Trebilcock writes that the *Charitable Corporation* case 'has been regarded as something of a high point in the duty of care the law has demanded of directors'.[15]

Further, in a subsequent case, *Joint Stock Discount Company v Brown*,[16] one of the directors was constantly absent from the meetings of the company. Even though the judge held that there was lack of sufficient evidence to hold him responsible, Sir W M James, VC decided not to grant him his costs, due to his inactivity and his lack of interest on the affairs of the company. The judge said that even though the particular director was entitled to say that he had not paid the slightest attention to a transaction of this kind, or that he had a sort of vague notion of what was going on, it was not too heavy a penalty for him to pay for his neglect of duty by paying for the costs of the proceedings himself. Regarding another director in the company, the judge said that he could not say, 'I signed that cheque as a mere matter of form; the secretary brought it to me; a director signed it before me; two clerks countersigned it; I merely put my name to it.'[17] The court could not accept that had the defendant director made enquiry, he would have been given a plausible but false reason by his fellow directors, or would not have realised that the payment was improper. The judge added:

If he had taken the slightest pains to inquire he would have found out that there was no completed transaction binding the company and he must have known he had as much

power of interfering and putting a stop to it, as any other director who had previously taken part in it.[18]

Similarly to *Joint Stock Discount Company*, while not finding the director liable for gross 'negligence' in *Re Denham & Co*,[19] Chitty J said that he showed considerable 'negligence' in not attending board meetings, and justice would not be done if the court were to award him costs.[20] Thus, in both cases, though the directors were not found liable, the court decided that it would not be fair to award them his costs. In *Re Kingston Cotton Mill (No 2)*[21] Vaughan Williams J held that when no limits are placed in the trust that directors show to their subordinates, and when they show reckless neglect of duty and wilfully shut their eyes, their acts amount to misfeasance.

Re City Equitable Fire Insurance Co Ltd,[22] is another significant example of the strict expectations of the courts with regards to the question of inactivity. This is a case that has been criticised as taking a lenient approach on the duties of care, skill and diligence.[23] However, even though Romer J stated that a director can rely on other officers or experts before the judges' approach is criticised, one has to remember that Romer J found the directors liable in 'negligence' and made it clear that unlike *Re Brazilian Rubber Plantations*,[24] if it was not for the presence of the exculpatory article, liability would have been imposed for passing on all the responsibility and leaving the control of the company's funds to the managing director, who fraudulently misapplied them. In this respect, it could be argued that the judges' approach was far from tolerant.

However, in the older cases, the courts were also careful not to deter good individuals, or all men who have any character to lose, from becoming directors of companies at all. For example, in *Forest of Dean Coal Mining*,[25] the judge stated that if there has been any error at all in the course taken by the Courts of Equity against trustees, it has been in pressing honest trustees too far, one result of which has been that it is now very difficult to get people to accept offices of trust for which they receive no remuneration and in respect of which they may be placed under great liabilities. He added:

I have always thought it would have been much more wise if Courts of Equity had been less strict as regards mere omissions, or even what they have chosen to call neglect, on the part of persons who endeavour honestly and faithfully to perform their trust, but who notwithstanding, either from some mere mistake, or some error in law or judgment … have been made liable sometimes for vast sums of money, although they have taken every possible pains to … engage proper agents to advice them… .[26]

As noted by Neville J in *Re Brazilian Rubber Plantations & Estates Ltd*,[27] directors are not 'bound to take part in the conduct of the company's business'[28] and only in so far as they do, they are required to exercise any care in the performance of their duties. However, even though the courts were also careful not to impose too high a duty when there is evidence of inactivity, what is clear from several reported cases is that, in

finding directors liable for breach of the duty of care, skill and diligence, the courts were not as reluctant to find directors liable for inactivity or 'neglect of duty', as is generally perceived. One possible reason might be that in the reported cases of the 18th, 19th, and 20th centuries, directors were treated as trustees for the corporation, and as such, they were subject to very strict standards of diligence and good faith. Sealy suggests that the origins of the concept are to be found in the fact that in the past 'the director was a trustee in the full technical sense' and that it is claimed that during the 150 years when most companies were unincorporated and established by a deed of settlement, the deed treated directors as being trustees of the funds and property of the undertaking. Thus, naturally the courts held them liable to 'account on this strict basis'.[29]

III THE TREATMENT OF INACTIVITY IN AUSTRALIA

Historically then, the examined cases show that directors were found liable for inactivity on strict legal principles. Though the high level of involvement in the management of companies is not a new phenomenon, it could be argued that it does need reinforcement, as it is a concept easily ignored. If no emphasis is placed on the courts' attitude towards inactivity, there could be a general misconception of the expectation of directors, that inactivity is very much 'a forgiven sin'.

Traditionally, the propositions of Romer J in the case *Re City Equitable Fire Insurance Corporation Ltd*,[30] have been accepted as an accurate summary of the case law as received and applied in Australia. These propositions impose partly subjective and partly objective requirements of care, skill and diligence, and assess the directors' conduct subjectively and objectively, ie according to personal characteristics of the particular director *and* the actions of a reasonable man. In 1959, Sir Douglas Menzies noted that higher standards of care, skill and diligence would be expected of directors and 'as more is now expected of directors, so more will be required of them.'[31] Indeed, though historically expectations of participation were imposed on directors, more recent Australian decisions have, since *Re City Equitable*, clarified the law in this regard and emphasised the stringent standards that can now be imposed on directors for inactivity. With the exception of *AWA Ltd v Daniels*,[32] many of these cases were not concerned with breaches of the general law or statutory duties of care, skill and diligence, but with breaches of the insolvent trading provisions, emphasising that long periods of inactivity and non-attendance will not be treated lightly by the courts.[33]

By the early 1990s, it had become clear in Australia that directors were expected to be proactive and to participate in the management of companies. This was provoked by the series of company collapses in the 1980s, following which it was felt that measures had to be taken to protect members and creditors against dishonest or negligent directors. One such measure related to the strengthening of the standards of care, skill and diligence which company directors are expected to satisfy when exercising their duties.

Legislation has been enacted which amended the wording of the statutory duties of care, skill and diligence. Section 180 of the *Corporations Act* now clearly imposes an objective standard of care and diligence on company directors, providing that a director's conduct will be measured against that of a 'reasonable person'. Major reforms in the legislative and corporate insolvency arena were under consideration at the same time as the expectations of skill and diligence was being clarified and statutory and common law duties of directors were expanded in a process influenced to a substantial degree by the negative effects of corporate insolvency. [34] Insolvent trading cases such as *Morley v Statewide Tobacco Services*,[35] *Metal Manufacturers Ltd v Lewis*,[36] and *Commonwealth Bank of Australia v Friedrich*,[37] resulted in a strengthening of the standards of participation and diligence, demonstrating that ignorance will no longer necessarily be a defence to proceedings brought against a director. Rather, directors must, in some respects at least, ensure that they are informed about the affairs of the company.

Daniels v Anderson[38] epitomises the judicial and legislative activity in Australia. This case, which has been described as a landmark decision, established that directors are required to have a real understanding of the company's business and will not be able to rely on the maxi 'ignorance is bliss'. Clarke and Sheller JJA emphasised that that this duty includes that of acting collectively to manage the company, and added:

The law of negligence can accommodate different degrees of duty owed by people with different skills but *that does not mean that a director can safely proceed on the basis that ignorance and failure to inquire are a protection against liability for negligence*.[39]

IV AND THE TREND CONTINUES – TWO RECENT AUSTRALIAN CASES

Edmunds and Lowry state that in the past, when companies failed, directors were free to move on to their next sinecure. In stark contrast, things were different with sole traders, because if they negligently mismanaged their business, they would suffer the stigma and financial consequence of bankruptcy. The authors continue:

These concerns are not of purely historical interest. The types of directors and corporate enterprises may now be different but the controversy about how stringent a director's negligence liability should be has continued unabated in both the law reports and academic journals.[40]

Indeed, if one agrees with this view, new cases target the possibility of 'rendering the "pluralist" and "ornamental" director liable to the company for inactivity'.[41] Two recent Australian cases further reinforce the position formed years back, ie that there are many perils in being a sleeping director. This way, the trend towards demanding that directors play an active role in the management of companies continues unabated. First, in *Deputy Commissioner of Taxation v Clark*,[42] the New South Wales Court of Appeal (NSWCA), considered the position of the 'sleeping director' and affirmed the essential

and irreducible requirement of participation in company management. The Court decided that a total failure to participate, for whatever reason, should not be regarded as a 'good reason' under the statutory defence present in s 588FGB of the *Corporations Act 2001*. The inactive director, who said that she would usually have 'a frying pan in one hand and be signing with the other',[43] was found liable for the various breaches of the *Corporations Act 2001*, regardless of the fact that she did not take part in the management of the company. In fact, she was merely appointed director at the request of her husband, who was also a director of the company. The director was personally liable to indemnify the Australian Tax Office (ATO) for payments made by way of group tax and under the prescribed payments scheme.

Mrs Clark became a director when one of the directors resigned, and on her husband's belief that the company required two directors. Mrs Clark, who lacked any business experience, had never been a director of any other company, since she spent her time being a mother and housewife. As part of her functions, she often agreed with her husband and signed company documents that were not explained to her. In the Supreme Court of NSW, Palmer J made a declaration against Mr Clark, however one was not made for Mrs Clark as it was decided that her non-participation came within the defence available to a director in such proceedings against the director for indemnity provided by s 588FGB(5) of the Act. Section 588FGB(5) states that:

It is a defence if it is proved that, because of illness or some other good reason, the person did not take part in the management of the company at the payment time.

In the Supreme Court, it was found that due to the fact that Mrs Clark failed to understand the company's matters; her husband's failure to explain the nature of the responsibilities of directorship; her belief that she was not required to participate in the management of the company, as well as the fact that her husband induced these beliefs, there was 'some other good reason' for the purposes of s 588FGB(5). [44]

Palmer J said:

The law recognises that the relationship of trust and confidence between married people may lead to one of them to undertake responsibilities or liabilities which would not have been undertaken but for the relationship. That reality of human experience, when it produces financial liability for the unsuspecting or incautious spouse, has recently acquired a provocative tag of 'sexually transmitted debt'.[45]

His Honour then referred to the literature of 'sexually transmitted debt' and concluded that the law should recognise that a wife's failure to appreciate the reality of her responsibilities as a director due to deferral to her husband, may be a 'good reason' for failing to participate in management for the purposes of the defence under ss 588H(4) and 588FGB(5). Palmer J continued that such recognition will not undermine the policy

of the law that those who accept office as a director are expected to act with competence and diligence in discharging their duties of their office. He added:

Whether the wife has truly failed to appreciate her responsibilities and whether such failure has anything to do with trust and confidence in the marital relationship are questions of fact in each case. So, for example, if a woman already has some knowledge and experience of business and of the responsibilities of a company director before she accepts a directorship at her husband's request, it will be very difficult indeed for her to convince the Court that she had a 'good reason' for not participating in management simply because she left business matters to her husband. In those circumstances, she would be expected to know that her duties as a director overrode the exigencies of the marital relationship.[46]

However, it may be said that Palmer J's findings are not easy to reconcile with Australian case law regarding the level of participation required for a director to discharge his or her duties with due skill and care. It could also be said that in many ways, his views are in direct contrast to the landmark decision in *Daniels v Anderson*.[47] In this regard, it is not surprising that Palmer J's views were not supported when the issue came before the New South Wales Court of Appeal. Spiegelman CJ (with Handley and Hodgson JJA concurring) stated that the determination of what may be a good reason for not participating in the management of a company is illuminated by the requirements of standards of care and skill by directors. The symbiotic interaction between legislative change and judicial decisions relating to directors' participation in the management of the corporation also informs the interpretation of the defence in s 588FGB(5). Legislative development and case law indicate that the expectation that directors will participate in management has intensified over time.[48]

Further, it was emphasised that one aspect of the directors' duty of care and diligence is a core, irreducible requirement of participation in the management of the company. Such a requirement is one of the factors underlying the scheme for insolvent trading of which s 588FGB is a part, and the participation is a basal structural feature of Australian corporations law.[49]

Finally, it was emphasised that a total failure to participate, for whatever reason, should not be regarded as a 'good reason' within s 588FGB(5). The express reference to 'illness' in s 588FGB(5) does not assist. The *ejusdem generis* rule is not applicable unless two different species are identified, because it is not then possible to determine a relevant genus for the purpose of reading down general words which follow. Nor is it appropriate to interpret the general words so broadly as to invoke other areas of the law in which a person may be excused from the legal consequences of his or her acts. The words 'good reason' must be read down in accordance with the scope and purpose of the *Corporations Act*.

The Court explained that the statutory defence operates on the assumption that every director will be involved in the management of the company. The particular defence focuses on the failure to participate on a particular point in time, and the words 'good reason' must be read in such a manner that they do not conflict with the obligation of directors generally to participate in the management of the company. Therefore, directors cannot rely on the defence if, for different reasons, they never participate in the management of a company. Moreover, in a judgment that emphasised the risk of reinforcing gender stereotypes, the court concluded that the recognition of complete abandonment of directors' responsibilities as a 'good reason' for the purposes of strengthening the statutory defence, could result in a reinforcement of gender stereotypes and could undermine the confidence with which potential creditors will deal with small companies in which women participate with their husbands.

The Court of Appeal's decision limits the extent of the possible arguments to justify non-participation by a director in the management of a company. Even though the Court of Appeal did not specifically exclude the availability of arguments based on duress, undue influence, deceit, misleading and deceptive conduct or unconscionable conduct, it limited the ambit of the statutory defence of 'good reason'. Therefore, an argument that tries to rationalise the situations where a director has never participated in the management of the company, will not be successful and will not constitute a 'good reason'. As noted by Hodgson JA:

Whether a director knows it or not, he or she has a duty to exercise reasonable care and diligence in the discharge of his or her duties, with the standard of reasonableness being largely an objective one. A director's non-participation in the management of the company will usually involve a breach of that duty, whether the director is aware of this or not; although if the non-participation is because of illness or for some other good reason, then there will not be a breach of duty if the illness or other good reason is such as to make the non-participation reasonable, on the same standard of reasonableness. In my opinion, a director's non-participation in the management of a company at a particular time will be 'because of illness or for some other good reason' within s 588FGB(5) of the *Corporations Act* only if the illness or other good reason is of this character, that is, such as to make the non-participation reasonable (on the appropriate standard) and thus not a breach of the director's duty to exercise reasonable care and diligence.[50]

The second examined case, *ASIC v Plymin*,[51] involved the successful prosecution of two directors for failing to prevent insolvent trading, thus once again highlighting the demanding standards of competence expected of directors. Here, ASIC brought an action against Mr Plymin, the former chairman of Water Wheel Mills Pty Ltd and Water Wheel Holdings Limited (Water Wheel), and the non-executive director, Mr John Elliot,[52] under the civil penalty provisions of the Act, alleging that they allowed Water

Wheel to trade while insolvent. Mandie J of the Victoria Supreme Court found that Mr Elliot, as a non-executive director, had failed to prevent a company from incurring debts at a time when it was insolvent and had contravened the civil penalty provision, s 588G of the *Corporations Act*.

According to the court, 'reasonable' imports the standard which is appropriate to a director of reasonable competence and diligence. To succeed, ASIC had to establish that, on the balance of probabilities, the company was insolvent at the time when debts were incurred; at the time there were reasonable grounds to suspect that the company was or would become insolvent; and that the directors were, or a person in a like position would have been aware that there were reasonable grounds for suspecting insolvency.

As far as the 'reasonable grounds for suspecting insolvency', Mandie J emphasised that this is an issue to be determined by an objective standard of reasonableness, appropriate to a director or non-executive director. With regards to non-executive directors, the judge said:

A non-executive director is expected to take steps to put himself in a position to monitor the company and to exercise and form an independent judgment and to take a diligent and intelligent interest in the information either available to him or which he might with fairness demand from the executives or other employees and agents of the company.[53]

A defence available under s 588H(3) provides that at the time when the debt was incurred, the director (a) had reasonable grounds to believe, and did believe, that a competent and reliable person was responsible for providing to the director adequate information about the company's solvency; (b) that the informant was fulfilling that responsibility; and (c) that the director expected, on the basis of the information supplied, that the company was solvent and would remain solvent even if it incurred debts. Mr Elliot said that he was not alerted to the insolvent state of Water Wheel, and that he relied on the information and reports that were supplied by Mr Plymin and others within the company.

According to the Mandie J 'a reasonable director, one would have thought, would have been alerted to an important concern and acted accordingly.'[54] Her Honour concluded that she was not satisfied that Mr Elliot had reasonable grounds to believe that Mr Plymin, or management generally, was fulfilling the responsibility of providing adequate information to him about whether the company was solvent. On the contrary, in the judges' view, Mr Elliot did not have reasonable grounds to believe, and that such information as was provided to him, was not sufficient enough to provide such reasonable grounds. She later expressed her surprise that Mr Elliot, an experienced businessman and company director, who showed himself to be a very intelligent and

astute individual, did not know at all relevant times that he could and should have obtained from management on a regular basis, information about the debtors, creditors, etc. Mandie J continued that she was not satisfied that Mr Elliot believed that Mr Plymin, and management in generally, were competent and reliable persons who were fulfilling the responsibility to provide him with adequate information about whether the company was solvent.[55] She then added:

Indeed, having seen and heard Elliot give evidence, I consider that Elliot turned a blind eye to the details of Water Wheel's liquidity crisis in the hope that 'something would turn up' to rescue the company and his own associated financial interest. In any event, I consider that the evidence negatives the existence of reasonable grounds for Elliot to believe that Plymin was a competent and reliable person within the meaning of s 588H(3).[56]

Elliot was banned from holding a company directorship for 4 years, and he was also ordered to pay a $15,000 penalty and $1.43 million in compensation to the company.

Both *ASIC v Plymin* and *DCT v Clark* highlight the firm approach that the courts have recently followed on the expectations of company directors and reinforce the importance and absolute nature of the duties of directors, especially the expectation that they shall participate in the company's management. There may have been a time when there was some doubt as to whether a director could plead 'ignorance' of the company's affairs to avoid liability. However, through the recent cases, it is becoming clear that company directors are expected to play an active role in the management of companies, and the courts will not hesitate to punish those who fail to come up to the mark. Indeed, if the law renders directors liable for inactivity, this may increase their sense of accountability and reinforce their responsibility for corporate decisions. The examined cases show that the trend towards demanding that directors play an active role in the management of companies, continues strongly.

The high profile ASIC 'prosecution' involving businessman Mr John Elliot, strengthens the clear, strong message that even non-executive directors of large public companies owe a duty to actively monitor solvency or face exposure to insolvent trading claims. When Mandie J said that Mr Elliot had turned a blind eye to the company's financial difficulties, it was clear that this was no defence to the claim against him, and that mere inactivity will not suffice to establish a defence to a claim of insolvent trading. Non-executive directors will need to be able to show that in cases of financial distress, they have a sufficient (objective) basis to conclude that the company is not, and is not likely, to become insolvent. In concluding this, they cannot blindly rely on others, but will need to ensure that they are sufficiently informed by competent and reliable managers, seek external advice and give proper consideration to all matters related to the financial state of the company. The effect of the Elliot decision is that the statutory defence will not be easy to establish and does not alleviate directors from the requirement to monitor and

actively seek information as to the company's financial position. This is a case that reinforces the increasingly high standards of conduct imposed on all directors and serves as a warning to non-executive directors that they should not rely on financial information provided by others in the company without fully satisfying themselves as to the company's financial state.

Moreover, the decision in *DCT v Clark* serves as a warning to spouses that the total reliance on their partners, and the belief that their appointment is only a formality, will not constitute a 'good reason' as to why inactive spouses should not be liable. The message that no director can afford to treat their position as a token appointment without responsibility, continues unabated through the decision in *Clark*, where the wife was ordered to pay $208,000 to the Deputy Commissioner. Mrs Clark made the mistake of treating her position as a non-executive director in the company as a mere formality, leaving all matters to be dealt with by her husband. Overall, this decision has significantly curtailed the availability of the 'good reason' defence to directors who take no active role in a company's management. In reaching the decision, the Court of Appeal re-affirmed the principle that all directors have a core and irreducible duty to participate in company management. In the words of Spiegelman CJ, non-participation is impermissible, and total abdication of the duties of a director in reliance on the conduct of a spouse, is not consistent with the duties imposed upon directors by the statute and by case law as each had developed to date. In addition, the recognition of complete abdication of responsibilities as a director as a 'good reason', for the purposes of the statutory defences, carries with it the risk of reinforcing gender stereotypes and undermining the confidence with which potential creditors will deal with small companies where women participate with their husbands.[57]

Both cases, which are in the context of the insolvent trading defences, emphasise that whether it is a small business, or a large public company, every director who fails to properly discharge his or her duties, whether executive or non-executive, has potential personal exposure, and in many cases, liability for considerable sums of money. This might not necessarily be 'new thinking', but the message from the examined cases is clear: they serve as a warning to corporate Australia that there is a core, irreducible requirement of involvement in the company's management and an argument that a director should be excused because they failed to participate, is not sustainable. It may be that the judges have been influenced by the substantial number of corporate collapses in Australia, and hence, are strengthening the position that defaulting directors who breach the legislation and common law can expect little leniency from the courts. Whatever the reasons, there can be little doubt that on the one hand, ASIC will be seeking to impose tough penalties against directors who do not comply with their obligations, especially in relation to insolvent trading, and on the other, the court will continue emphasising their readiness to promote the coherence between appearance and reality in corporate practice.

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[1] *Land Credit of Ireland v Lord Fermoy* (1870) 5 Ch App 763, 770 (as stated by Counsel for the plaintiff).

[2] For a general discussion, see Andrew L Mackenzie, 'A Company Director's Obligations of Care and Skill' [1982] 1 *Journal of Business Law* 460, John E Parkinson, *Corporate Power and Responsibility - Issues in the Theory of Company Law* (1994); The Rt Hon Lord Hoffmann, 'The Fourth Annual Leonard Sainer Lecture: The Rt Hon Lord Hoffmann' (1997) 18 *The Company Lawyer* 194, Douglas Menzies, 'Company Directors' (1959) 33 *The Australian Law Journal* 156.

[3] For example, see *West Mercia Safety Wear v Dodd* [1988] 3 BCLC 25 (CA); *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (NZ HC), *Australian Securities Commission v Gallagher* [1994] 11 WAR 105, *Biala Pty Ltd v Mallina Holdings Limited* (No 4) [1994] 13 WAR 11, *Dempster v Mallina Holdings Limited* [1994] 13 WAR 124.

[4] See *Re Barings Plc & Others (No 5)* [1999] 1 BCLC 433; *Re Park House Properties Ltd* [1997] 2 BCLC 530; *Re Continental Assurance Co of London plc* [1997] 1 BCLC 48; *Burnham Marketing Services Ltd* [1993] BCC 518.

[5] Demetra Arsalidou, 'The Impact of Section 214 of the Insolvency Act 1986 on the Directors' Duties to the Company' (2001) 22 *The Company Lawyer* 19.

[6] *ASIC v Rich & Ors* [2003] NSWSC 186; *ASIC v Plymin* [2003] VSC 123, *Deputy Commissioner of Taxation v Clark* [2003] NSWCA 91.

[7] A similar view is expressed in Rod Edmunds and John Lowry, 'The Continuing Value of Relief for Directors' Breach of Duty' (2003) 66 *The Modern Law Review* 195, 200.

[8] See Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (2001).

[9] [1925] 1 Ch 407.

[10] When applying the relevant standards, Romer J considered certain directors prima facie liable for breach of duty in relation to certain transactions. However, as they did not act wilfully, in the end they escaped liability due to the operation of a wide exemption clause in the articles. In other words, even though the tests outlined in the case were not especially onerous, the directors would have been found liable for breach of duty if they were not protected by article 150 which exempts directors from liability for losses unless wilful neglect or default can be shown.

[11] *Charitable Corporation v Sutton* [1742] EngR 111; (1742) 2 Atk. 400.

[12] [1742] EngR 111; (1742) 2 Atk. 400.

[13] Ibid 406.

[14] Ibid.

[15] Michael J Trebilcok, 'The Liability of Company Directors for Negligence' (1969) 32 *Modern Law Review* 499.

[16] (1869) LR 8 Eq 381.

[17] Ibid.

[18] Ibid 405.

[19] (1884) 25 Ch D 752.

[20] Ibid 768.

[21] [1896] 1 Ch 331.

[22] [1925] 1 Ch 407.

[23] See for example Mackenzie, above n 2.

[24] [1911] 1 Ch 425.

[25] (1878) 10 Ch D 450.

[26] Ibid 454.

[27] [1911] 1 Ch 425.

[28] Ibid.

[29] Len S Sealy, 'The Director as Trustee' (1967) 26 *Cambridge Law Journal* 83.

[30] [1911] 1 Ch 425.

[31] Menzies, above n 2.

[32] (1992) 7 ACSR 759.

[33] See for example, *Vrisakis v Australian Securities Commission* (1993) 11 ACSR 162; *Permanent Building Society v Wheeler* (1994) 14 ACSR 109; *Metal Manufacturers Ltd v Lewis* [1988] 13 NSWLR 315.

[34] Arsalidou, above n 8, Chapter 7.

[35] [1993] 1 VR 451.

[36] [1988] 13 NSWLR 315.

[37] (1991) 5 ACSR 115.

[38] (1995) 16 ACSR 607; [1995] 37 NSWLR 439.

[39] *Daniels v Anderson* [1995] 37 NSWLR 439, 450.

[40] Edmunds and Lowry, above n 7, 200.

[41] Ibid.

[42] [2003] NSWCA 91.

[43] Ibid [10].

[44] *Southern Cross Interiors Pty Ltd & Anor v Deputy Commissioner of Taxation and Ors* [2001] NSWSC 621, [137].

[45] Ibid [129]-[130].

[46] Ibid [134]-[135].

[47] (1995) 16 ACSR 607.

[48] See *Metal Manufactures Limited v Lewis* [1988] 13 NSWLR 315; *Morley v Statewide Tobacco Services* [1993] 1 VR 451; *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 and *Group Four Industries Pty Ltd v Brosnan* [1992] 59 SASR 22.

[49] The cases *AWA Limited v Daniels* (1992) 7 ACSR 759; *Daniels v Anderson* (1995) 37 NSWLR 438; *Australian Securities Commission v Gallagher* [1994] 11 WAR 105; *Biala Pty Ltd v Mallina Holdings Limited* (No 4) [1994] 13 WAR 11; and *Dempster v Mallina Holdings Limited* (1994) 13 WAR 124 were discussed.

[50] [2003] NSWCA 91, [174]– [175].

[51] [2003] VSC 123.

[52] Demetra Arsalidou, 'Opening the Door for Unsecured Creditors in Australia: The Water Wheel Holdings Collapse' (2003) 24 *The Company Lawyer* 12.

[53] [2003] VSC 123, [560].

[54] Ibid [565].

[55] Ibid [560].

[56] Ibid.

[57] [2003] NSWCA 91.