

Last week, the Australian Federal Court provided some further guidance on directors' duty to exercise due care and diligence in performing their roles and the potential ramifications of breaching s 180 (1) of the Corporations Act 2001 (Cth) (Act).<sup>1</sup> The declarations made by the court and the pecuniary penalties imposed against the defendant director serve as a reminder of the scope of relief available to the Australian Securities and Investments Commission (ASIC) in its pursuit of corporate misconduct.

In this case, the corporate regulator was seeking declarations establishing various breaches of directors' duties, and civil and pecuniary penalties, as well as the imposition of disqualification orders pursuant to ss 206C and 206E of the Act. The alleged breaches concerned communications and information provided by a director of Tennis Australia Ltd to the chief legal and commercial director of the Seven Network during the negotiation of a new broadcast rights deal concerning the Australian Open. The Federal Court was satisfied that:

- None of the communications ultimately caused any damage to Tennis Australia
- The director's conduct was not motivated by anything other than his perception that he thought it was in the interests of Tennis Australia to consummate a deal sooner rather than later

The court, nonetheless, determined that the communications:

1. Disclosed internal deliberations of Tennis Australia to the broadcaster that it would not have otherwise been privy to, and
2. Gave rise to reasonably foreseeable harm being caused to Tennis Australia even though that was not the purpose of the director.

In making that determination, the court indicated that it was satisfied the director's mindset was *bona fide* in the sense that he sought to act in the interests of Tennis Australia. However, the director's subjective motivations for acting as he did on the one hand, and the objective characterisation and effect of his conduct on the other hand, were two quite different things. In addition, the director's *bona fides* were not a sufficient answer to the contraventions alleged by ASIC.<sup>2</sup>

Accordingly, the court made declarations finding breaches of the Act. It then weighed whether the general deterrence, specific deterrence and protective objectives of the court under the Act would be served by imposing all of the sanctions sought by ASIC. The court ultimately determined that the contraventions were serious enough to warrant the imposition of pecuniary penalties even though the second limb of the test in terms of materially prejudicing the interests of Tennis Australia had not been established.<sup>3</sup> As such, in lieu of orders disqualifying the director, the court issued pecuniary penalties payable to the Commonwealth.

## Duties May Be Breached Even If No Harm Is Incurred and No Ill-intention Is Established

The Federal Court's decision is a timely reminder that in order for breaches of directors' duties to be established (particularly the duty to exercise care and diligence), it is not always necessary to prove that actual harm has been incurred or that a director acted with an improper purpose.

The exchange of information, particularly during the negotiation of agreements whereby assets are being valued or acquired, is a potential minefield in terms of the duty of care and diligence being breached. This is particularly so in circumstances where one entity (and its directors) has a premeditated and perhaps inflated sense of inevitability about a deal being done such that information is shared overzealously. In contrast, the counterparty may be proceeding with far more reservation without outwardly demonstrating the same.

<sup>1</sup> *Australian Securities and Investments Commission v. Mitchell* (No 3) [2020] FCA 1604

<sup>2</sup> *Australian Securities and Investments Commission v Mitchell* (No 2) [2020] FCA 1098

<sup>3</sup> *ASIC v. Mitchell* (No 3), at [18]

## Directors Need to Be on the Same Page

The proceedings against the Tennis Australia directors also demonstrate the importance of directors pulling in the same direction and reading off the same page. In this case, the court was satisfied that although there was no ill-intention evident (or required) on the part of any of the directors, it was clear that the actions (and communications) of one director had the tendency to undermine the stance and approach of the other key director.<sup>4</sup>

The complications arising from the different standpoints of the two directors was obvious to the court and partly stemmed from their different internal functions. One was a director and vice president with little to no involvement in the day-to-day management of the company. The other was the CEO with expansive management responsibilities and whose internal communications were being disclosed to a counterparty in the middle of a negotiation and tender process.

There is, or at least should be, an obvious implied level of trust, confidence and uniformity between directors in an organisation. However, the reality, particularly in large complex organisations with diverse business interests, is that although directors might be taking part in the same meetings and considering the same board packs, their individual assessments of things, including on how issues should be resolved, will differ greatly. Those differences are often healthy and lead to good commercial debates and robust decision-making processes. However, sometimes they can lead to complications for companies, including the potential disclosure of compromising internal communications in the course of a key negotiation or process.

## COVID-19 Disruptions Will Continue to Put Pressure on Boards and Directors

An end to the pandemic is still a long way off and as the government and private sector support measures continue to be phased out, the fallout will place new and perhaps significant pressures on many boards. In order to manage and overcome the inevitable disruptions, it is important that boards forecast and prepare for what is to come. At the same time, prudent directors should keep their duties under the Act in mind and consider the ways in which they may be breached, including inadvertently.

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<sup>4</sup> ASIC v. Mitchell (No.2) at [17]