Forgiving a Director’s Breach of Duty:
A review of recent decisions

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Introduction

Amid fears of a global recession, directors may well be concerned that their conduct will be scrutinised should they be involved in a corporate collapse. Honest directors risk becoming embroiled in litigation and face “the associated reputational damage and the potential for ultimate financial ruin”\(^2\).

A director must make commercial decisions. These decisions often involve some form of commercial risk and are sometimes made on the basis of limited information.

It would be unjust to hold directors personally liable for a breach of duty, regardless of the situation.

Section 1318 of the Corporations Act 2001 (Cth) (Corporations Act) provides some protection for company officers\(^3\) against the consequences of a breach of duty in limited circumstances\(^4\). The section confers a discretionary power on courts, which reads:

\[
\text{If, in any civil proceeding against a person to whom this section applies for negligence, default, breach of trust or breach of duty in a capacity as such a person, it appears to the court before which the proceedings are taken that the person is or may be liable in respect of the negligence, default or breach}
\]


\(^3\) Section 1318 applies to an officer or employee of a corporation, an auditor of a corporation, an expert and a receiver, a receiver and manager or a liquidator. The focus of this paper is on company directors. I have used the term “director” instead of “person” or “company officer”.

\(^4\) Section 1317S provides similar relief against breaches of civil penalty provisions. Section 1317S(7) states that nothing in this section limits, or is limited by, section 1318.
but that the person has acted honestly and that, having regard to all the circumstances of the case, including those connected with the person’s appointment, the person ought fairly to be excused for the negligence, default or breach, the court may relieve the person either wholly or partly from liability on such terms as the court thinks fit.

Courts have confirmed the policy considerations behind section 1318. In Daniels v Anderson⁵, Clarke and Sheller JJA said:

The purpose of this section is to excuse company officers from liability in situations where it would be unjust and oppressive not to do so, recognising that such officers are business men and women who act in an environment involving risk and commercial decision making.

These considerations serve a broader public good. In Edwards v Attorney-General (NSW)⁶ Young CJ said:

The purpose of the Corporations Act and its predecessor was for permitting the economy to be advantaged by such entrepreneurial ventures with limited liability and to regulate the rights of members inter se, the rights between and creditors of corporations.

However, courts must strike a balance between allowing directors entrepreneurial freedom and holding delinquent directors liable for their mistakes. The indulgence sought under section 1318 must be appropriate in the circumstances to avoid undermining the requirements of the Corporations Act. The policy considerations behind the Act do not authorise the court lightly to set aside its requirements where they have not been observed⁷.

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⁵ (1995) 37 NSWLR 438 at 525
⁶ (2004) 50 ACSR 122
⁷ Re Wave Capital Ltd (2003) 47 ACSR 418 at [29]
Distinguishing the business judgment rule

Section 1318 is conceptually distinct from the business judgment rule. Section 180(2) of the Corporations Act provides that directors or other officers of a corporation who make a business judgment are taken to meet the requirements of the statutory duty to exercise care and diligence, and the equivalent duties at common law and in equity, in respect of any decision if they:

- make the judgment in good faith for a proper purpose;
- do not have a material personal interest in the subject matter of the judgment;
- inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- rationally believe that the judgment is in the best interests of the corporation.

The business judgment rule does not require the exercise of discretion and vindicates the director’s decision. It only operates in respect of the statutory duty of care and diligence and the equivalent duties at common law and equity.

In contrast, section 1318 presupposes that the director is otherwise liable and is discretionary only.

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8 Section 180(1) of the Corporations Act
Advantages of section 1318

The scope of section 1318 is potentially broader than the business judgment rule. The sleeping director who did not make an informed decision when it was required but who acted honestly may still have section 1318 to call in aid whereas the business judgment rule would not help because the decision making process was flawed\textsuperscript{10}.

Section 1318 also provides remedial flexibility. Courts can tailor relief “on such terms as the court thinks fit”. For example, in \textit{Scott v Williams}\textsuperscript{11} a director was partially successful under section 1318. Lander J had regard to other settlements the liquidator had entered into with other directors, including the Chief Executive Officer. His Honour used the settlements as a benchmark. He ordered judgment against the director in the amount of $200,000 less than the benchmark. This was because the director acted honestly and did not have the same degree of involvement and knowledge as the Chief Executive Officer\textsuperscript{12}.

\textit{Hall v Poolman}\textsuperscript{13} is another illustration of the flexibility of the relief. Directors of a group of companies found to be trading whilst insolvent were partially excused. Palmer J limited the directors’ liability to the period of time during which they knew or ought to have known that the group of companies was insolvent.

Another significant advantage is that a company director may apply for relief under section 1318(2) before commencement of proceedings. Where a person has reason to apprehend that any claim will or might be made against


\textsuperscript{11} (2002) 224 LSJS 393

\textsuperscript{12} Clarke J, \textit{The Harmer Recommendations and the Corporate Reform Bill 1992}, (2003) 4(1) INSLB 1

\textsuperscript{13} (2007) 65 ACSR 123
him or her in respect of any negligence, default, breach or trust or breach of
duty, the person may apply to court for relief and the court has the same
power to relieve as it would have had under section 1318(1).

Disadvantages of section 1318

There are disadvantages with section 1318, which detract from it being an
entirely appropriate substitute for a business judgment rule\textsuperscript{14}. Although,
there are only a few cases in which the business judgment rule has been
discussed in any detail\textsuperscript{15}. In each of these cases the defendants were denied
the benefit of the business judgment rule.

The disadvantages with section 1318 are:

- The uncertainty of outcome. Section 1318 is discretionary.

- The “stigma factor”. There is considerable difference between
preventing liability from attaching to a business decision and a
discretionary power given to courts which only arises once a finding
of breach of duty has been made. This has reputational consequences
for directors.

- The uncertainty as to the test and the absence of established use.

Before the commencement of the Corporations Act, commentators noted that
there has been no decided case in Australia where section 1318 or its
predecessors has been successfully used\textsuperscript{16}. In the absence of such decisions,
directors will have little guidance as to the circumstances in which the relief
may be available.

\textsuperscript{14} Law, L, The Business Judgment Rule in Australia: A Reappraisal Since the AWA Case, (1997) (15) CSLJ 174

\textsuperscript{15} Australian Securities & Investments Commission v Adler (2002) 41 ACSR 72; Gold Ribbon (Accountants) Pty Ltd
(in liq) v Sheers [2006] QCA 335; Deangrove Pty Ltd v Buckby (2006) 56 ACSR 630

180 and Cooper, N, If a company trades while insolvent company directors can be personally liable, (2002) Law
Society Bulletin (Oct) 12
It is useful to survey cases since the commencement of the *Corporations Act* to discern any trends in the exercise of judicial discretion under section 1318. The exercise of the discretion must be consistent and reasonably predictable if it is to be of any use or comfort to company officers.

Before embarking on this survey, it is convenient to examine a brief comparative history of section 1318 and its predecessors.
Legislative history

Section 1318 stems from an early concern to protect honest and prudent officers of a company from the inflexible operation of penal provisions in companies legislation\textsuperscript{17}.

Section 1318 is based on section 32 of the English Companies Act 1907 (\textbf{1907 Act}), stemming from the report of the Reid Committee \textsuperscript{18}. Section 32 of the 1907 Act applied only to directors, and required the directors to have acted reasonably as well as honestly, and only applied to proceedings for “negligence or breach of trust”.

Section 32 of the 1907 Act was replaced in England by the Companies Act 1929 (\textbf{1929 Act}), following recommendations by the Company law Amendment Committee chaired by Mr Wilfred Green KC (\textbf{Greene Committee}). The 1929 Act modified the 1907 Act in three respects namely;

- The words “default” and “breach of duty” were added to “negligence” and “breach of trust”. In \textit{Lawson v Mitchell}\textsuperscript{19} the Supreme Court of Victoria said the reason for the wider language was to permit exoneration where the articles of association would previously have given protection.

- The protection was extended from “directors” to “officers”, “managers” and “auditors”.

- Reference to all the circumstances of the case was expressed to specifically include circumstances connected with the persons appointment. The Greene Committee explained that “such a

\textsuperscript{17} Salter, B, \textit{Civil Liability for errors and omissions in information memoranda in the wholesale debt capital markets}, (2003) 14 JBFLP 61

\textsuperscript{18} Austin, Ford and Ramsay, \textit{Company Directors Principles of Law & Corporate Governance}, Butterworths, Australia, 2005.

\textsuperscript{19} [1975] VR 579, contrast to \textit{Customs and Excise Commissioner v Hedon Alpha} [1981] 2 All ER 697 where the Court of Appeal held the section applied to directors discharging statutory obligations
provision would meet the case of a director who has been appointed because of his special knowledge or for a special purpose and not to direct the business of the company generally”.

The 1929 Act was adopted in Australia and remained in force (eventually as section 365 of the *Uniform Companies Act 1961* (NSW)) until the national co-operative companies scheme enacted by the *Companies Act 1981* (Cth) (*1981 Act*). The 1981 Act saw the introduction of section 535. Section 535 was different in three respects namely:

- the protection was expressly limited to “civil proceedings”
- the protection was extended to “employees”; and
- the reference to acting “reasonably” was removed.

The Explanatory Memorandum to the *Companies Bill 1981* did not explain why the requirement to act “reasonably” was removed. Clauses 1163-4 reads:

1163. Where there are proceedings actual or anticipated, for negligence, default, breach of duty or breach of trust against officers and certain other persons who have functions to perform in relation to a corporation, the court will be able to relieve that person of liability where it appears to the court that he acted honestly and ought fairly to be excused.

1164. These powers to grant relief are based on those in ICAC CAs s 365 except that the requirement that the person appear to have acted “reasonably” as well as honestly has been omitted – the NCB cl 561 also required reasonableness.

It has been suggested that the amendment resolved the apparent difficulty of finding that a director has acted negligently but reasonably\(^\text{20}\).

\(^{20}\) See *Dimond Manufacturing Co Ltd v Hamilton* [1969] NZLR 609 at 645
Section 535 was adopted upon the introduction of the *Corporations Law* in 1991 and renumbered as section 1318. The Explanatory Memorandum to clause 1318 reads:

3933. *This provision is based on CA s 535.*

3934. *Under this clause the Court will be empowered to provide relief for officers and other persons who have been charged with offences involving negligence, default, a breach of duty or breach of trust, where it appears to the Court that such a person acted honestly and ought fairly be excused.*

Section 1318 has not changed substantively in the transition from the *Corporations Law* to the *Corporations Act.*
Survey of recent cases

Since the commencement of the Corporations Act, there have been 23 relevant cases regarding relief under section 1318.

The following points should be noted about the comprehensiveness of the survey:

- The date range for the survey was from January 2001 to September 2008.
- It included decisions of all State and Territory Supreme Courts and superior courts. It did not include tribunals or lower courts.
- It included decisions where section 1318 was substantively relied upon as a defence. It excluded cases where only passing reference was made to section 1318. For example, the decision of Environmental & Earth Sciences Pty Limited v Vouris\(^ {21} \) was excluded. In that case, Graham J did not order an administrator to pay the legal costs on an originating process that was misconceived. The administrator relied upon legal advice before commencing the process. Counsel for the administrator drew the Court’s attention to section 1318 noting that an administrator falls within the purview of the section. Similarly, section 1318 has been raised in relation to subpoenas\(^ {22} \), applications to adduce expert evidence\(^ {23} \) and security for costs applications\(^ {24} \).

\(^{21} \) [2006] FCA 771

\(^{22} \) Iraklis Roussos Nominees Pty Ltd v Roneso Proprietary Ltd [2008] NTSC 9

\(^{23} \) Schmierer v Keong [2005] NSWSC 1081

\(^{24} \) Mt Nathan Landowners Pty Ltd (in liquidation) v Morris [2006] QSC 225
The results

Since the commencement of the Corporations Act, section 1318 has not been successfully relied upon to fully exonerate a company officer. Several cases have resulted in partial relief.

The main reason for the refusal to grant relief is the failure to show that the company officer “acted honestly”. Other reasons include a lack of evidence (leading to an abandonment of the defence at trial), a failure to prove that the company officer “ought fairly to be excused” and a failure to show that the dispute fell within the scope of section 1318.

The table below summarises the results of the survey:

<table>
<thead>
<tr>
<th>Result</th>
<th>No of decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relief granted under section 1318</td>
<td>0</td>
</tr>
<tr>
<td>Relief partially granted under section 1318</td>
<td>3</td>
</tr>
<tr>
<td>Relief refused because company officer failed to “act honestly”</td>
<td>8</td>
</tr>
<tr>
<td>Relief refused on discretionary grounds</td>
<td>4</td>
</tr>
<tr>
<td>Relief refused because matter outside the scope of section 1318</td>
<td>4</td>
</tr>
<tr>
<td>Relief sought under section 1318 abandoned at hearing</td>
<td>4</td>
</tr>
</tbody>
</table>
Analysing the trends in each group of decisions reveals the requirements of the test and may provide some guidance and insight into the exercise of judicial discretion.

Each group of decisions is now analysed in the context of the requirements of the test under section 1318. Any trends in the exercise of judicial discretion are highlighted.

The requirement to have “acted honestly”

The first group of cases is where relief under section 1318 was refused because the applicant has been found to have failed to act honestly.

The test

In Hall v Poolman25 Palmer J was cognisant of the plain and pejorative meaning in the phrases “dishonesty” and “failing to act honestly” and the associated reputational consequences of being publicly branded as “having failed to act with honesty”. His Honour favoured the following definition of “honesty”:

In my view when considering whether a person has acted honestly for the purposes of the defence under ss 1317S(2)(B)(i) or 1318 of the CA, the court should be concerned only with the question whether the person has acted honestly in the ordinary meaning of that term, that is, when the person has acted without deceit or conscious impropriety, without intent to gain improper benefit or advantage for himself, herself or for another, and without callousness or imprudence to such a degree as to demonstrate that no genuine attempt at all has been to carry out the duties and obligations of his or her office imposed by the Corporations Act or the general law.

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25 (2007) 65 ACSR 123 at [325]
In *ASIC v Adler* Santow J held that there is an onus on the defendant to show honesty. There must be a positive finding of honesty. Simply failing to find dishonesty is not sufficient.

Whether a director has acted honestly depends on the circumstances. Relevant considerations are whether the director:

- took advantage of indulgent creditors;
- was negligent in the performance of duties; or
- had any financial interest in the outcome of the decision.

The importance of financial interest

The trend in recent cases is that the financial interest in the outcome of the decision is significant in the finding of a failure to act honestly. The common theme in the majority of cases where the defendant has been found not to have “acted honestly” is a finding that the defendant or a related party stood to gain a financial advantage from the breach. This appears to be a sufficient but not necessary factor in a finding that a company director has not “acted honestly”.

A good example of this is the different findings as to honesty that were made against three company officers (Mr Adler, Mr Williams and Mr Fodera) in *Re HIH Insurance Ltd; ASIC v Adler*. The court decided disqualification orders for these company officers arising from a series of financial transactions that had the effect of maintaining and stabilising the faltering HIH share price.

Mr Adler was disqualified for 20 years. He was not contrite and personally benefited from the transactions (which had apparent dishonesty in them).

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26 (2002) ACSR 80 at [166]-[169]
27 Clarke J, *Directors’ liability for insolvent trading – to trade or not to trade?*, (2002) 3(3) INSLB 41
28 (2002) 42 ACSR 80
Mr Williams was disqualified for 10 years. Santow J did not consider it appropriate to exercise the discretion under section 1318 because of elements of “impropriety and gross neglect…clearly pointing to lack of candour at the very least and some elements of concealment”\textsuperscript{29}. Interestingly, his Honour noted that Mr Williams (unlike Mr Adler) did not sell his shares in HIH and thus did not profit by any market stabilisation\textsuperscript{30}. Santow J stopped short of finding that Mr William’s “impropriety can be reconciled with acting honestly”\textsuperscript{31}.

Mr Fodera did not stand to make a personal profit. He knew about the transactions but did not want any involvement because he sensed its impropriety. He attempted to keep a safe distance. He knew that the transactions constituted an undocumented loan to a fellow director in breach of a conflict of interest and that the transaction proceeded without going to the investment committee or board. Santow J held that sensing impropriety of another falls short, by itself, of a finding that the person has acted honestly within the meaning of section 1318. However, in circumstances where Mr Fodera gave no direct evidence, the jurisdiction to give dispensatory relief did not arise\textsuperscript{32}.

Obtaining a personal financial advantage from the breach has been a consistent theme since the commencement of the \textit{Corporations Act}. To illustrate this point, take four cases decided from 2001 to 2007.

In \textit{Orrong Strategies Pty Ltd v Village Roadshow Ltd}\textsuperscript{33} a director sought to avoid the consequences of a breach of section 208 by reliance on section 1318. Habersberger J held that the director’s failure to obtain shareholder approval

\textsuperscript{29} (2002) 42 ACSR 80 at [151]
\textsuperscript{30} (2002) 42 ACSR 80 at [152]
\textsuperscript{31} (2002) 42 ACSR 80 at [151]
\textsuperscript{32} (2002) 42 ACSR 80 at [168]
for termination and performance bonuses to a related party could not be described as a product of honest error or inadvertence. The director was “an expert taxation law and corporations law lawyer and a highly qualified accountant”. He knew that the directors had to have the approval of shareholders to receive the bonuses.

In *ASIC v Edwards (No.3)* a director was disqualified for 10 years after findings that he had breached section 588G on several occasions. Barrett J held that a party may fail to act honestly without having any subjective intention to deceive. On six occasions the director knew that there were reasonable grounds for suspecting the company was insolvent. He allowed the innocent creditor to embark on a course of conduct that would be to its disadvantage and to the benefit of the director’s personal interest. His Honour described this conduct as “not straightforward”, “morally wrong” and contained elements of “unconscionability” and “moral turpitude”.

In *Schmierer v Taouk* a director and 50% shareholder was ordered to return company funds to the liquidator. The funds were in payment for contributions to the acquisition and development of a property owned by the company. The payment was not authorised or ratified by the company’s other director and 50% shareholder. The liquidator argued that the director had breached his fiduciary duty by preferring his personal interests to that of the company. The director relied on section 1318. White J held that the director had not satisfied a precondition for relief because he had not acted honestly in applying company money to himself.

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33 [2007] VSC 1  
34 [2007] VSC 1 at [793]  
35 [2007] VSC 1 at [791]  
36 (2006) 57 ACSR 209  
37 (2006) 57 ACSR 209 at 223  
38 (2004) 207 ALR 301
In *Powell v Fryer*\(^\text{39}\), the Court of Appeal in South Australia upheld a trial judge’s finding that directors facing an insolvent trading claim had not acted honestly. The directors ran a business manufacturing and wholesaling yachts. The Court of Appeal held that the trial judge’s conclusion was demanded by the evidence because the directors were negligent and, indeed, reckless with respect to the company’s financial position and capacity to trade. They did not act fairly but took advantage of indulgent creditors. In this case “honesty” meant acting bona fide in the interests of the company, including the interests of unsecured creditors. Instead, the directors preferred their own financial interest.

A final point is that the requirement to “act honestly” may be couched as a factor in the exercise of the discretion “to be excused”. In *Green v Wilden Pty Ltd*\(^\text{40}\) Hasluck J found that directors did not make full and candid disclosure of information relating to pursuing collateral personal benefits. The defendants were directors of three trusts held by trustee companies. Resolutions were passed allotting units and options to family companies of certain directors. His Honour held that these acts of bad faith amounted to fraud in equity and declared the resolutions to have no force and effect. The directors sought to be excused pursuant to section 1318. Hasluck J held that where fiduciary duties have been breached in circumstances amounting to a fraud in equity it cannot be said the directors “ought fairly be excused”\(^\text{41}\). Although this case was decided on the discretion under the “ought fairly to be excused” limb of section 1318, it could have been decided on the basis that the directors failed to “act honestly”.

\(^{39}\) (2001) 37 ACSR 589 at [111] to [112]

\(^{40}\) [2005] WASC 83

\(^{41}\) [2005] WASC 83 at [857] and [866]
Ought fairly to be excused – The unsuccessful cases

The next group of cases is where the defendant has “acted honestly” but relief is refused on discretionary grounds.

It is difficult to find a factor that is determinative. The cases in this group are decided on specific facts and circumstances.

There are, however, common themes. These are the “reasonableness” of director’s conduct and “knowledge”. The circumstances “connected with the person’s appointment” is also expressly relevant under section 1318.

The test

The test for “ought fairly to be excused” involves consideration of a non-exhaustive list of factors.

Some of these factors were set out in ASIC v Vines42. In that case, two company officers (Mr Vines and Mr Robertson) found to have breached their respective statutory duties of care and diligence applied for relief under section 1318. The third company officer, Mr Fox, was found (and did not contend otherwise) to have failed to act honestly preventing him from relying on section 1318.

ASIC did not contend that either Mr Vines or Mr Robertson failed to act honestly and the application proceeded on the question of whether they “ought fairly be excused”.

Austin J identified the following factors43:

- post contravention conduct (including the absence or presence of contrition);

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42 (2005) 65 NSWLR 281
43 (2005) 65 NSWLR 281 at [51] to [52] and [57]
the importance of the provision contravened, in terms of public policy;

- the degree of flagrancy of the contravention;

- the consequences of the contravention in terms of harm to others;

- whether the person concerned obtained and followed competent advice before acting in contravention;

- whether the conduct was in accordance with some established practice; and

- whether the person concerned was paid for undertaking the contravening conduct.

His Honour held that no guiding principle could be derived from other areas of the law (including director and trustee liability, business judgment or relief to avoid oppression)\(^{44}\).

After balancing a number of these factors, Austin J found that this was an inappropriate case in which to grant relief under section 1318, either wholly or in part, with respect to Mr Vines and Mr Robertson.

Mr Vines was a Chief Financial Officer who failed to disclose certain financial information to the Board. This was a serious contravention as Mr Vines’ pattern of contraventions undermined the efficacy of Corporate Boards\(^{45}\). The defective disclosures related to matters within Mr Vine’s personal knowledge, in circumstances where the other directors were relying on him to make timely, accurate and completed disclosure or material matters\(^{46}\). This outweighed any factors in favour of Mr Vines\(^{47}\).

\(^{44}\) (2005) 65 NSWLR 281 at [66], [70] and [74]

\(^{45}\) (2005) 65 NSWLR 281 at [90]

\(^{46}\) (2005) 65 NSWLR 281 at [87]
Like the contraventions by Mr Vines, Mr Robertson’s conduct reflected a pattern of defective disclosure. These were serious contraventions going to the adequacy and quality of information presented to the Board. These factors outweighed considerations in Mr Robertson’s favour such as the notoriously difficult nature of profit forecast and re-insurance and his willing and open co-operation with ASIC after the contravention.

These factors have been adopted and expanded in subsequent decisions. In Plymin v ASIC, an insolvent trading claim, a director of an insolvent company (Mr Elliott) was found to have acted honestly and Mandie J considered whether he ought “fairly” be excused. It was held that the court could take into account the way in which the breach occurred, any action taken to appoint an administrator, the timing and result of such action and the particular circumstances of the person seeking to be excused. While administrators were appointed, the court considered that the appointment was made too late and Mr Elliott fully disregarded the position of unsecured creditors. On appeal, Warren CJ and Charles and O’Bryan JJ concurred with Mandie J’s decision.

**Acting reasonably**

As previously explained, the reference to acting “reasonably” was removed from section 535 by the 1981 Act. No explanation was given in the Explanatory Memorandum.

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47 (2005) 224 ALR 499 at [121]
48 (2005) 224 ALR 499 at [145]
49 (2005) 224 ALR 499 at [146]
50 (2005) 224 ALR 499 at [163]
51 (2005) 224 ALR 499 at [126]
52 (2004) 10 VR 368
The amendment did not appear to have any significant effect on the application of section 535. In *Commonwealth Bank v Friedrich* Tadgell J noted the removal of the word “reasonably” but said that “in having regard to all the circumstances of the case, it will be permissible and appropriate, and usually necessary, to consider whether the defendant acted reasonably”.

This raises the issue of the way in which “reasonableness” is relevant to the exercise of discretion in cases decided after the commencement of the Corporations Act.

In *ASIC v Vines*, Austin J explained the significance of “reasonableness” in the following way:

> However, “reasonableness” is not a black and white concept. It seems to me sensible, and relevant to the exercise of the statutory discretion, to consider the degree to which the defendants’ conduct has fallen short of the statutory standard of reasonable care and diligence. In that sense reasonableness (more precisely, the degree of unreasonableness) is relevant for consideration when considering whether to relieve a defendant from contravention of the statutory duty of care and diligence. That, it seems to me, is the concept underlying the judicial pronouncements that reasonableness is still a factor to be considered in applying the exoneration provision, notwithstanding the removal of the word “reasonably”.

This explanation is supported by several decisions.

In *Wall v Timbertown Community Enterprises*, the New South Wales court of appeal upheld a decision of a trial judge refusing a director relief under section 1318 because the director failed to act “reasonably” in allowing a

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54 (1991) 5 ACSR 115 at 196
55 (2005) 224 ALR 499
56 (2005) 224 ALR 499 at [39]
57 (2002) 42 ACSR 1
misrepresentation to be made as to the amount of share subscriptions. The amount of share subscriptions was relevant to whether a council would grant the company a lease. The council would only grant the lease if share subscriptions reached a certain level. The appellant knew that some investors had dropped out. However, he did not tell the council in the hope that, in due course, the company would be able to obtain the share subscriptions. The Court of Appeal held that, although there was no argument as to the director’s honesty, in these circumstances, his conduct was not reasonable58.

Similarly, in Manpac Industries Pty Ltd v Ceccattini59 Young J held that although section 1318 does not expressly contain a requirement that the director act reasonably, such was a relevant consideration in the exercise of discretion.

In that case, the directors of a building company sought to be relieved from liability for insolvent trading. There was no argument that the directors acted honestly60. However, the directors left the matter of insolvency to hope. The company staved off winding up but did not fulfil promises to its workers compensation insurer, consistently met creditor’s claims with allegations of set-off and it knew it was in trouble with the banks61. His Honour held62:

*The essence of the matter is that the law provides limited liability to people carrying on business using a corporate vehicle because it is to the community interest that people should venture and take commercial risks in their trade without the constant worry of being personally liable for any risk*

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58 (2002) 42 ACSR 1 at [43]
59 (2002) 20 ACLC 1304
60 (2002) 20 ACLC 1304 at [72]
61 (2002) 20 ACLC 1304 at [77]
62 (2002) 20 ACLC 1304 at [78]
which happens to go wrong. However there is a limit to that protection and
the limit is reached where directors have reasonable grounds to believe the
company is no longer solvent. When that point is reached, the field of
limited liability to a degree evaporates unless the directors can demonstrate
some special circumstances as to why they should still be protected. In the
instant case they have not.

Notwithstanding the 1981 Act, the requirement of “reasonableness” remains
significant in the exercise of discretion. This may explain why relief is rarely
granted in insolvent trading cases or breach of section 180 cases. A defence
pursuant to section 1318 is not likely to be effective once it has been proven
that the directors had reasonable grounds to believe that the company was
no longer solvent. Similarly, it is difficult to reconcile a director acting
negligently but reasonably (or almost reasonably).

This also raises an issue as to whether expert evidence can be adduced to
determine what is “reasonable”. One of the factors identified by Austin J in
ASIC v Vines is whether the conduct was in accordance with some
established practice. In principle, expert evidence could be adduced to
identify such a practice. However, there has been no case since the
commencement of the Corporations Act where a defendant has adduced
evidence from other “expert” company directors to the effect that they would
have done the same thing in the circumstances.

Knowledge

The concept of knowledge is relevant to assessing the “reasonableness” of a
director’s conduct. Conduct may be “reasonable” depending on what the
director knew.

63 Sahathevan, G, The statement of cash flow as a tool to determine solvency, (2005) 16 JBFLP 93
64 (2005) 224 ALR 499
Knowledge includes what the director “actually knew” and also what “he ought to have know”. In ASIC v Vines\textsuperscript{65}, Mr Robertson’s disclosure to the board was assessed according to his level of knowledge. Austin J said\textsuperscript{66}:

\begin{quote}
The second aspect is that the contraventions all relate to inadequacy of disclosure on those important occasions, the inadequacy being of one of four kinds. First, at the meeting with PWC on 7 December he failed to query or correct statements that were wrong or open to question, \textit{having regard to the level of knowledge he possessed}. Second, on various occasions he made general oral or written statements which were incorrect in the absence of some appropriate qualification. Third, on various occasions he failed to disclose additional information that was material to the matters under consideration. Fourth, on various occasions \textit{he ought to have made further inquiries, having regard to what he knew}, before making the statements that he made.
\end{quote}

(emphasis)

Similarly, Santow JA said, in obiter, in Deputy Commissioner of Taxation v Dick\textsuperscript{67}:

\begin{quote}
Suffice it to say that while one may have sympathy for the position the respondent found himself in, this was a case where \textit{he was aware at least from August 2002 that the company was in serious financial difficulty} and not paying its debts as they fell due. The respondent was also aware from that same date that the company had not been \textit{remitting deductions of PAYG} which it had made from payments of salary and wages. Yet the respondent did not himself take any steps to address the situation or cause the company to comply with s 222AOB.
\end{quote}

\textsuperscript{65} (2005) 224 ALR 499
\textsuperscript{66} (2005) 224 ALR 499 at [144]
\textsuperscript{67} (2007) 242 ALR 152 at [134] to [135]
Further, the respondent was on notice from receipt of penalty notices in November 2002 and January 2003 that the company had not been remitting its PAYG but still did not take any appropriate steps to cause the company to comply with s 222AOB(1).

In those circumstances, there would be formidable difficulties in the way of any favourable exercise of discretion even were s 1318 capable of application.

(emphasis)

In certain circumstances, “ignorance” will not excuse a director’s conduct. In Hudson Investments Group Ltd v Australian Hardboards Ltd68 two directors (Mr McLeod and Mr Holland) of a publicly listed company were found to have breached their fiduciary duties in preferring the interests of a particular company in the group in relation to a proposed share purchase agreement. Both directors sought to be excused from the breach pursuant to section 1317S or 1318. Einstein J refused the discretionary relief. In relation to Mr McLeod, his Honour said that given Mr McLeod’s material state of mind and pivotal position in the deal there are no grounds for the court acceding to the application69. The position with respect to Mr Holland was considerably different. Mr Holland acted in ignorance at the dictate of Mr McLeod. His Honour said:

[Mr Holland] occupied an important position as a director of HIG, a public listed company. Shareholders were entitled to his attention being given to his acts as director. His general approach having been found to simply act unthinkingly at the direction or dictate of Mr McLeod, the particular circumstances revealed in the evidence make it clear that the discretion to excuse would also not have been exercised in his case.

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68 [2005] NSWSC 716
Although Mr Holland did not actually know, his conduct amounted to “wilful blindness”. Actual knowledge could be imputed. In other words, the director’s ignorance was not “reasonable”.

The concept of “knowledge” activates particular concern for senior directors, such as Chairmen and Chief Executive Officers of large corporations. These officers are usually not involved in the day to day operation of the company. Their level of actual knowledge is determined by the information provided to them by senior management. However, the trend of recent cases requires directors to actively seek knowledge in circumstances where they “ought to have known” or are “put on notice”. This causes a tension between the role of the board and the role of senior management in large corporations.

**Circumstances of appointment**

The 1929 Act specifically included the circumstances connected with the person’s appointment as a factor to be considered in the exercise of discretion.

Earlier decisions made it clear that there is no difference in the standard to be expected of the part-time non-executive director of a company not for profit and any other director. In *Commonwealth Bank v Friedrich* Mr Eise was a part-time non-executive director who failed to investigate certain matters regarding the company’s solvency. This was sufficient to persuade the court not to exercise the discretion in his favour. The court did not distinguish between executive and non-executive directors, or between part-time and honorary directors.
In recent decisions, the circumstances of appointment is relevant but not determinative one way or the other. In *Reiffel v ACN 075 839 226 Ltd*\(^71\) the discretion under section 1318 was not exercised to relieve experts who prepared a prospectus of liability for misleading and deceptive conduct. Gyles J held\(^72\):

> Acceptance of responsibility by an expert for the opinion expressed is an important aspect of protection for investors…This was a conventional professional assignment, undertaken for reward, under circumstances where the expert expressly consented to use the Report in its very context. The Report was voluntarily and deliberately made. Failure to comply with the relevant accounting standards is not critical to the liability that I have found…The discretion to be exercised according to the section is wide and I decline to exercise it.

\(^{71}\) (2003) 132 FCR 437

\(^{72}\) (2003) 132 FCR 437 at [65]
**Ought fairly to be excused – The partially successful cases**

In recent times, courts have granted partial relief sparingly. Fine lines are drawn in the favourable exercise of discretion. However, the themes of “reasonableness”, “knowledge” and “circumstances connected with the person’s appointment” strongly feature in the exercise of discretion.

**Acted reasonably and knowledge**

*Hall v Poolman*[^73] is a rare case where the company officer’s had reasonable grounds to suspect insolvency but acted reasonably in continuing to trade for a limited period of time.

The facts were as follows. The insolvent trading claims were brought by the liquidator of a group of companies, funded by a litigation funder. The group (Wines and Vineyards) owned and operated vineyards and a winery in New South Wales. When the company became insolvent, it was in dispute with the ATO regarding its tax liabilities.

Mr Irving was the Chairman of directors. The liquidators conceded that Mr Irving “acted honestly” in permitting the company to continue trading in the sense that he did not personally gain or intend to cheat creditors[^74]. The case turned on whether he “ought fairly be excused”. Palmer J partially excused Mr Irving’s conduct from October 2002 up to 5 February 2003. His Honour said[^75]:

> Experienced company directors such as Mr Irving would appreciate that, in some case, it is not commercially sensible to summon the administrators or to abandon a substantial trading enterprise to the liquidators as soon as any liquidity shortage occurs. In some cases a reasonable time must be allowed

[^73]: (2007) 65 ACSR 123
[^74]: (2007) 65 ACSR 123 at [316]
[^75]: (2007) 65 ACSR 123 at [331] to [335]
to a director to assess whether the company’s difficulty is temporary and remediably or endemic and fatal…

I accept that reasonable commercial people could decide to wait to see whether the written submission lodged by Deloitte with the ATO on 15 November 2002 produced a quick and positive response such as to enable an asset sale programme and a restructuring to restore solvency to the Reynolds Group…

In my opinion, it was on 5 February 2003 that Mr Irving ought to have appreciated that there was no reasonable prospect of the Reynolds Group resolving in the short term its dispute with the ATO, and of Wines and Vineyards being able to realise assets quickly enough to pay their debts as they fell due…”

Palmer J applied the same reasoning process in relation to two other directors, Mr Martini (Chief Executive Officer) and Ms Yates. His Honour excused breaches up to 8 February 2003 and 28 February 2003, respectively. In relation to Mr Martini, Palmer J held that as Chief Executive Officer he was no mere employee of Wines and Vineyards. As Chief Executive Officer, he was not subservient to Mr Irving and the law does not permit him to abrogate his responsibility to form his own judgment as to the solvency of the group by obeying a direction from Mr Irving76. In relation to Ms Yates, his Honour inferred that at the end of February 2003 she knew or ought to have known that the decision from the ATO was months away77.

This reasoning process reveals the court assessing whether the director acted reasonably and commercially.

76 (2007) 65 ACSR 123 at [457]
77 (2007) 65 ACSR 123 at [495]
Palmer J said that the following factors were relevant to the exercise of discretion of sections 1317S and 1318:

- Mr Irving had no directors and officers liability insurance. But there was no evidence as to his personal financial situation.  
- The quantum of creditors to the dividend. Palmer J noted a “disquieting aspect of the litigation”. The true beneficiaries of this litigation were not the creditors but the litigation funder and liquidator. Why should Mr Irving suffer a heavy judgment and those who have suffered, the creditors, get very little or nothing in the result? He cannot say that the policy of the law discountenances such proceedings or are an abuse of process. Palmer J could not hold that a nil or negligible return to creditors may be taken into account as affording a discretionary defence.

Interestingly, in relation to Ms Yates there is a fine distinction drawn between having reasonable grounds for “suspecting that the company is insolvent” (see 588G(1)(c)) and knowing (or ought to know) that a decision from the ATO was months away. It is important to bear in mind that the inquiries are directed at different matters. The first directs attention to whether there is a breach of section 588G. The second assumes there are reasonable grounds for suspecting the company is insolvent but nevertheless it is reasonable not to call in the administrators.

78 (2007) 65 ACSR 123 at [341]
79 (2007) 65 ACSR 123 at [17]
80 (2007) 65 ACSR 123 at [368]
81 (2007) 65 ACSR 123 at [379]
Circumstances of appointment

As previously stated, the circumstances of appointment is relevant but not determinative one way or the other.

In *Perkins v Viney*82 Judge Burley granted partial relief to a director whose association with the company was that of an advisor, brought in to provide calm to an unruly board. The director had no financial interest in the company and was not remunerated for his services83.

The circumstances in which a director can be relieved are referable to:

- the circumstances of the person becoming a director;
- any action the director took with a view to appointing an administrator or other from of insolvency appointment;
- when that action was taken; and
- the result of that action84.

His Honour held85:

> There is no doubt that Mr Clark acted bona fide. He had no financial stake in the company. The circumstances relating to his becoming a director are important. He was brought in, initially, to provide calm to an unruly board. He soon became an adviser but no more. He had no financial interest in the company, nor was he remunerated for his services. In my view, a proper balance is struck if Mr Clark’s liability is limited to what he would have been required to contribute if there had been a joint judgment against all 4 directors.

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82 (2001) 216 LSJS 201  
83 Cooper, N, *If a company trades while insolvent company directors can be personally liable*, (2002) Law Society Bulletin (Oct) 12 at 14  
84 Clarke J, *Directors’ liability for insolvent trading – to trade or not to trade?*, (2002) 3(3) INSLB 41  
85 (2001) 216 LSJS 201 at [64]
This illustrates the fine lines drawn in the exercise of discretion. Compare *Perkins v Viney* with *Commonwealth Bank v Friedrich*. Mr Eise was an honorary and part time chairman of the National Safety Council of Australia. He, together with other directors, was duped by Mr Friedrich into believing the company was in good financial shape. However, Mr Eise had not done enough to check the reports prepared by Mr Friedrich and the auditors. It turned out the company was trading whilst insolvent. Tadgell J held that the section could not apply to Mr Eise because he was not dealing with a “default” or “breach of duty”. He was dealing with a situation where creditors were being given a direct right to seek recoupment from the directors86.

His Honour, held in obiter, that Mr Eise could not be excused because he was a part-time, honorary director, performing a public or community service. This illustrates that a fine line is drawn between a director who receives no remuneration and a director who receives modest remuneration.

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The scope cases

The next group of cases is where relief has been refused because the dispute falls outside the scope of section 1318.

Some issues of scope have been resolved. There was a “sterile” debate as to whether section 1318 also applies to an insolvent trading case. In *Hall v Poolman*[^87] Palmer J said that ultimately it does not matter whether section 1318 applies concurrently with section 1317S to a contravention of section 588G because under both sections the court will have regard to the same considerations. Section 1317S provides similar relief against breaches of civil penalty provisions. But nothing in section limits, or is limited by, section 1318[^88].

The scope cases are analysed according to the construction of relevant phrases in section 1318.

“In any civil proceeding”

Section 1318 begins with the phrase “in any civil proceeding”. An application for a pecuniary penalty, disqualification order and compensation order was considered to be a civil proceeding for the purpose of section 1318[^89].

*Porteous v Donnelly*[^90] provides a concise example of where relief was refused because the dispute was not “in any civil proceeding”. In that case, the applicant sought to expunge a proof of debt lodged against the estate of Lang Hancock. The basis for the debt was the sale of a Life Governor’s Share, which the applicant alleged was overvalued. The respondent company claimed that, if the share was overvalued, it was caused by Mr Hancock in

[^87]: (2007) 65 ACSR 123 at [311] to [314]
[^88]: Section 1317S(7)
[^89]: Australian Securities and Investments Commission v Vines (2005) 56 ACSR 528
[^90]: [2002] FCA 862
breach of his director’s duties to the respondent. The applicant sought to rely on section 1318. Stone J held:\[2002\] FCA 862 at [78]:

*The short answer to this claim is that this is not a civil proceeding brought against Mr Hancock. Even if Mr Hancock could have sought relief under this section in his lifetime the section is not relevant after his death and especially where his estate is now being administered under the provisions of the Bankruptcy Act 1966 (Cth). Even if that analysis is not correct I do not see any basis for allowing the issue of exoneration to be pleaded by a person who, if there were such a proceeding, would not be party to it.*

**An expansive reading of “in any civil proceeding”**

The decision in *Deputy Commissioner of Taxation v Dick*\[2007\] 242 ALR 152 leaves open the possibility that section 1318 provides a generalised defence to liability for breach of statutorily imposed directors’ duties beyond the *Corporations Act 2001*.

In that case, the applicant sought relief under section 1318 for failure of his company to remit tax monies withheld from employees under the PAYG system in breach of the *Income Tax Assessment Act 1936* (ITAA). The primary judge held that the court had a discretion to grant relief to the applicant under section 1318. In allowing the appeal, Spigelman CJ held that:

*Although words such as “breach of duty” and “default” are capable of extending, respectively, to a breach of statutory duty to a contravention of a statutory provision, there are textual and contextual reasons for concluding that that was not the intention behind the use of these particular words in s 1318.*

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91 [2002] FCA 862 at [78]
92 (2007) 242 ALR 152
93 Baxt, B, *Using s 1318 to try to forgive directors – another case of the section’s shortcomings*, (2007) 3(6) The Baxt Report (November) 1
First, words such as “negligence” and “breach of trust”, according to their natural meaning do not extend to statutory obligations.94

Secondly, nothing in the scope and purpose of the Corporations Act suggests a legislative intention to qualify every statute which imposes obligations on company directors. It is unlikely parliament intended a wide ranging application to other statutes, which have statutory objects distinct from the Corporations Act.95

Thirdly, the ITAA regime serves a revenue purpose, not a corporations law purpose.96

But Santow JA did not foreclose on the possibility that breaches or defaults under other Commonwealth legislation imposing duties on directors (or officers) may be within the scope of dispensation. His Honour held that the use of the word “for” in s 1318 before the expression “civil proceedings” did not render the section incapable of application to default by a director under Div 9 of the ITAA.97 The issue turned on whether the ITAA left open some scope for the operation of section 1318. His Honour held that it did not. Invoking section 1318(2) would subvert the intended stringency of Divs 8 and 9 of the ITAA. The ITAA is a code and that code is exhaustive, leaving no room for s 1318 to apply.98

Basten JJA similarly held that:

This statutory scheme is inconsistent with an intention to allow a court to exercise a broad discretionary power to grant relief to a director in

95 (2007) 242 ALR 152 at [18]
96 (2007) 242 ALR 152 at [21]
97 (2007) 242 ALR 152 at [94]
98 (2007) 242 ALR 152 at [132]
99 (2007) 242 ALR 152 at [152]
circumstances where the Assessment Act has otherwise imposed liability, subject to its own regime of defences.

In the earlier decision of Deputy Commissioner of Taxation v Keck\textsuperscript{100} a defence relying on section 1318 was withdrawn during the course of the hearing of an application. The application was for penalties under the ITAA on directors of companies who allegedly did not remit group tax. MacDougall J held\textsuperscript{101}:

As I have noted, the defendants pleaded a defence based on s 1318 of the Corporations Act. That appeared to me, and I must say still appears, to be wholly misconceived. Section 1318(1) empowers the Court to relieve a person of the consequences, in civil proceedings, of “negligence, default, breach of trust or breach of duty” in some circumstances. It may be doubted whether section 1318 has any application at all in the context of the ITA Act; in particular, so far as s 222AOE is concerned, because there is a separate defence provided by s 222AOJ which has not been pleaded. But in any event, it is quite apparent that there is no relevant “negligence, default, breach of trust or breach of duty” to which s 1318, if otherwise applicable, could attach in the circumstances of this case.

Given the reasoning which followed in Deputy Commissioner of Taxation v Dick, the defendant’s concession was properly made. However, MacDougall J’s comments are limited to the context of the ITAA and, in any event, his Honour only doubted that section 1318 has application. The possibility still exists that breaches or defaults under other Commonwealth legislation imposing duties on directors (or officers) may be within the scope of section 1318.

\textsuperscript{100} (2006) ATC 4377
\textsuperscript{101} (2006) ATC 4377 at [44]
“Negligence, default, breach of trust or breach of duty”

In Commonwealth Bank v Friedrich102, Tadgell J held that section 535 did not apply to insolvent trading cases because of the construction of “default” or “breach of duty”. The issue was debated in a series of cases 103. However, the power of the court to grant relief in respect of liability for insolvent trading now seems beyond doubt as a result of the introduction of section 1317JA104. Nevertheless, the phrase “negligence, default, breach of trust or breach of duty” remains a bar to the grant of relief. In Re Vouris: Epromotions Australia Pty Ltd v Relectronic-Remech Pty Ltd (in liq)105 an administrator faced a disciplinary proceeding commenced by ASIC because he was one day late in convening a meeting of creditors. The administrator sought relief from Campbell J under section 1318. His Honour declined to grant relief because the power of a court is one which can only be exercised in a “civil proceeding”, “for negligence, default, breach of trust or breach of duty”. The disciplinary proceeding were not proceedings “for negligence, default, breach of trust or breach of duty”. Even if section 1318 applied, professional disciplinary proceedings are not the type of proceedings which could be brought in a court defined by section 1318106.

“Before which the proceedings are taken”

The phrase “before which the proceedings are taken” in section 1318 suggested the possibility to obtain orders that give relief from future liability under the section. This has been rejected.

102 (1991) 5 ACSR 115
105 (2003) 47 ACSR 155
106 (2003) 47 ACSR 155 at [119]
In *Edwards v Attorney-General (NSW)*\(^{107}\) directors of the embattled Medical Research and Compensation fund, formed by James Hardie Industries to administer the payment of compensation arising from asbestos related wrongful death and injury suits, applied for relief extended to past and prospective breaches. The directors were worried that continuing to pay current claims would exhaust the fund and might expose them to personal liability from future claimants. One solution was to appoint an external administrator. The plaintiffs argued that although there has never been an order made pursuant to section 1318(2) relieving liability for future claims, it was possible because of the wide meaning of “apprehended”.

The Court was sympathetic to the directors predicament. Young CJ recounted the situation as follows\(^{108}\):

>This is a situation where directors are highly skilled company directors, there is an awkward problem of corporate administration, they have given evidence as to why they wish to continue to use their skills in their role as directors, they have taken legal advice on their position, considered all available options, their motives are honourable and altruistic, each wishes to see the best outcome for all stakeholders. However, they have been unable to obtain insurance, there is a personal risk that they may have breached some duty to someone along the line, so that their personal fortune is at risk. This is quite unfair they say.

In relation to past liability, the court exercised the power to excuse past acts. Spigelman CJ listed five reasons, namely\(^{109}\):

- the group of potential future claimants will be quite small on a per capita basis;

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\(^{107}\) (2004) 50 ACSR 122

\(^{108}\) (2004) 50 ACSR 122 at [110]

the future claimants may not receive any advantage from any alternative scheme;

the balance of convenience between persons who are ill and persons who may become ill falls in favour of the former;

the costs and delays associated with a provisional liquidation should be avoided; and

given the inquiry process, it is strongly desirable that the status quo be maintained.

In relation to future liability, their Honours held that such an order could only extend to exclude past liability and did not extend to discharge prospective liability\textsuperscript{110}. The requirement to have regard to “all the circumstances of the case” strongly indicates the power is concerned with past conduct.

Young CJ held that a person has reason to apprehend that a claim might be made against him or her with respect to past or continuing breaches. No application can be entertained under section 1318 merely for an anticipated breach\textsuperscript{111}.

\textsuperscript{110} See Dharmananda, K and Gardner S, Directors’ duties and corporate governance, (2005) 23 C&SLJ 205

\textsuperscript{111} (2004) 50 ACSR 122 at [132] to [133]
The abandoned cases

The final group of cases reveal that sometimes section 1318 is pleaded without any hope of success. These cases should not be considered when evaluating whether section 1318 is achieving its legislative purpose.

Cases have been abandoned at the hearing where no evidence was led\(^\text{112}^\), where there was never even the remotest prospect that the defence could be sustained\(^\text{113}^\) or where reliance was wholly misconceived because of the scope of the protection\(^\text{114}^\).

For example, in *ASIC v West*\(^\text{115}^\) the director abandoned any pretence of a defence in the proceedings. This was an application by ASIC for winding up orders against a company operating an alleged unregistered managed investment scheme. The director claimed that any proven failure to register the alleged scheme was a breach by him only and from which he should be relieved.

\(^{112}\) *Al McLean Pty Ltd v Hayson* [2008] NSWSC 927 at [215]

\(^{113}\) *Williams v Scholtz* [2008] QCA 94 at [51] to [53]

\(^{114}\) *Deputy Commissioner of Taxation v Keck* (2006) ATC 4377 at [44]

\(^{115}\) [2008] SASC 111 at [219]
Conclusion

The purpose of section 1318 is to protect honest and prudent directors from the unfair operation of penalty provisions in companies legislation. It recognises directors must take risks in making commercial decisions.

A survey of cases since the commencement of the Corporations Act reveals that complete success is unheard of in recent times. Partial success under section 1318 is rare. This raises the question of whether section 1318 is accomplishing its legislative purpose.

There may be legitimate reasons why applications under section 1318 have enjoyed limited success. A good proportion of applications are abandoned. A significant proportion of applications do not even get past the first hurdle of “acted honestly”. The scope of section 1318 is also confined.

Nevertheless, the exercise of judicial discretion under section 1318 must be consistent and predictable to be of any use in accomplishing its legislative purpose.

Some trends in the exercise of judicial discretion can be identified. In summary, a director may partially succeed under section 1318 if:

- the director (or a related party) did not stand to personally benefit from the breach;
- the director did not actually know or was not wilfully blind as to the “wrongfulness” of his conduct;
- the director did not deviate greatly from commercial standards of reasonableness; and
- there are other sympathetic factors (such as receiving no remuneration for the appointment).

1 December 2008
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