

## Good Governance for Lutheran Schools

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(This paper outlines the development of corporate governance and sets out the current rules that apply. By examining the decision in *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115, it looks at how the rules apply to volunteer directors. Finally, it suggests some guidelines for volunteer directors to ensure that they stay on the right side of the governance rules.)

### INTRODUCTION

The issue of best practice governance is an issue that is difficult enough for major corporations who are slowly coming to grips with it in their own way. For not-for-profit organisations generally, and I suspect for faith or value based organisations, the learning curve is much steeper.

In one way the response is quite simple — be diligent, do your best, take your responsibilities seriously and pay attention to the financial data. Perhaps most importantly, if you do not understand something ask questions and keep asking until you get the answers you need.

I must add that for the purposes of this paper I have not dealt with in any degree of specificity the role of the Lutheran Church of Australia ('LCA') or the local pastor and each of their roles in the administration, management and governance of Lutheran schools. Their role is significant and needs to be treated properly according to the rules of the Church; however, as far as the law is concerned, LCA is just another legitimate stakeholder with an interest in the governance of school boards. I will mention this again towards the end of the paper.

I said in my introductory remarks that it all seems quite easy. Sadly, in the real world, it is not so simple.

I will approach the topic by firstly defining some of the terms that are used around the concept of governance and indeed attempt to define governance itself. Then I want to look at what the role of a board is. It does not matter whether you are a board formed under the *Corporations Act 2001* (Cth) ('CA'), a committee of management pursuant to your

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state or territory's *Associations Incorporation Act* or merely a board of interested folk who have come together to assist in the management of the local school — the rules are more or less the same.

If you aim to achieve compliance with the highest benchmark, you should find yourselves in little trouble!

Recently there has been much discussion among those who work and conduct research in the not-for-profit sector as to whether or not the sector deserves its own regime for forming legal entities either with or without its own regulator. While this discussion has produced much debate both for and against this proposition, there has been little, if any, debate that I am aware of that focuses on the issues of the role and duties of directors of not-for-profit organisations and how the governance rules applicable in the corporate sector apply in the not-for-profit sector. The debate continues and so I say, 'Watch this space!'

#### DEFINITION OF TERMS

The *Board* is the governing body of the school,<sup>1</sup> who have ultimate accountability for and control over the school.

*Governance* is the general term used to describe the procedures and arrangements put in place by the school board to monitor and control the organisation. Governance is all about control and monitoring. Control here is used not in a pejorative sense but rather in the sense of oversight and the ability to correct and provide strategic direction.

Stakeholders are the members of the community who have an interest in the operation of the school and would include, the Church, parents, staff, pupils, the local community and government, at all levels.

With these brief and by no means comprehensive definitions in mind, let us now look at what it is that the Board is supposed to do.

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<sup>1</sup> David Fishel, *The Book of the Board: Effective Governance for Non-Profit Organisations* (2<sup>nd</sup> ed, 2008) 3.

## THE ROLE OF THE BOARD

The board is not the day-to-day management staff of the school!

The work of the Board adapts to the circumstances of the school. There are many theories as to what the proper role of the Board is, especially in small to medium size not-for-profit organisations. An important indicator as to the role of the Board in your school is determined by where the school as an entity sits in its evolutionary cycle. For example, if your school is relatively new, the role of the board might be more hands-on than a Board of a school that has been operating for some time. Another example of a more interventionist Board might be in the changeover period of principals or in a period of crisis or intensive major activity, such as significant changes to the scope of a school's programs or size.

Where we have a mature Board in a well run school, the Board may be more hands-off and concentrate on its strategic and monitoring role.

The Board's role is always to step back from the minutiae of the daily grind and to set the strategic direction for the school as well as monitor ongoing progress in accordance with the approved plan and, importantly in faith based organisations, in adherence to mission.

The role of the Board can be described by reference to five broad categories of activities:

- Articulate the Mission and values of the school
- Monitor and review performance
- Ensure compliance
- Set policies and direction for the principal and the school
- Provide strategic leadership

Two important areas of both strictly legal and moral accountability are financial accountability and the avoidance of the appearance of, and the actual occurrence of, conflicts of interests.

Now, I want to discuss a case study with you. It's the story of a not-for-profit organisation, with a considerable budget and a high profile and

charismatic chief executive in whom the Board reposed complete trust and confidence – for a while, as we shall see. It is important to note that the Board were all unpaid volunteer directors.

I refer of course to the *National Safety Council Case*, more formally known as:

*Commonwealth Bank of Australia v John Friedrich and Maxwell Eise and others* (1991) 5 ACSR 115 ('*Friedrich's Case*'). This case deals with the trials and tribulations of the National Safety Council of Victoria ('NSC'), who became insolvent after its chief executive officer obtained bank loans through fraud, which in the result were unable to be repaid. The issue was whether a member of the company's board could be made liable for those debts incurred when the company was insolvent, due to their acts and omissions in properly discharging their duties. Critically, the case is important because it involved non-executive, honorary directors who worked part-time and for no remuneration. The finding of liability has been viewed as somewhat harsh given those attributes and possibly highlights the deficiencies of having a uniform system of corporate regulation which gives inadequate consideration to the nature of the corporate entity and its directors.<sup>2</sup> The relevant law at the time was for our purposes, the same as the current law. Some amendments to the current law have attempted to address this perceived stringency,<sup>3</sup> but perhaps still fall somewhat short of community expectations. I suspect also that it does not accord with the expectations and desires of those of us who serve as volunteer directors on not-for-profit Boards.

#### A *The Factual Scenario*

John Friedrich was the full-time chief executive officer of the National Safety Council of Australia (Victorian Division) ('NSC'). NSC was a company limited by guarantee. This form of legal entity is freely available under the Corporations Law and is the favoured form of entity for most medium to large not-for-profits. Friedrich defrauded the State Bank of Victoria ('SBV') who ultimately morphed into the Commonwealth Bank of

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<sup>2</sup> See, eg, Sally Sievers, 'The *National Safety Council Case*' (1991) 9 *Company and Securities Law Journal* 338, 342.

<sup>3</sup> See, eg, *Corporate Law Economic Reform Program Act 1999* (Cth).

Australia ('CBA')). On 24 April 1989, NSC was wound up on account of being unable to pay its debts.

The Bank sought repayment of those debts incurred by Friedrich and each of the Board members of the National Safety Council who were the nine other co-defendants in the case, arguing that these debts were incurred at a time when there were *reasonable grounds* to expect that NSC would be unable to pay those debts as and when they fell due: This was of course an offence against the law that prevented trading while insolvent.<sup>4</sup>

Then NSC was indebted to the Bank in the amount of \$100 million. When applying for finance Friedrich represented NSC as solvent, though this was not the case and he supplied bogus evidence of its financial state.

The nine co-defendants to Friedrich were non-executive directors of the company, each of whom was working in an honorary, part-time capacity. None brought corporate financial management skills to the company and a pattern of complete deference to Friedrich emerged regarding most things, including all financial matters. Friedrich obtained finance for the company without any real supervision by the board and continued to exaggerate the company's financial health, to the Bank, to the Board and to others.

Eventually, Maxwell Eise, chairman of NSC, grew suspicious of Friedrich's activities and the NSC's viability. In spite of his reservations, he signed off on the annual accounts of NSC, *after* his suspicions had been aroused.

Summary judgment was entered against Friedrich who did not file an appearance, having disappeared by this time. The co-defendants argued that because of Friedrich's misrepresentations, they were ignorant of the company's insolvency. They sought to defend the proceedings on the basis that they did not have reasonable cause to expect that the company was insolvent.

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<sup>4</sup> *Corporations Act 2001* (Cth) s 558G.

The claims against all but one of the honorary directors were settled out-of-court and judgment was made against Eise alone. Mr Eise was the chair of the Board. Liability for insolvent trading was established against him, while the defence available under the law was rejected by the Judge. Eise was held personally liable for almost \$97 million.

## B *Procedural History*

This case was heard within the original jurisdiction of the Supreme Court of Victoria by Tadgell J. It has not been taken on appeal. Although it is now 17 years old, it is still the law as far as directors' duties are concerned, particularly with respect to trading while insolvent. It is now old law that has been applied and considered by other judges many times since the judgment was first delivered without, as far as I am aware, adverse comment or criticism.

The law, imposes personal liability on directors of the company at the time the debt(s) were incurred where 'there [were] reasonable grounds to expect that the company [would] not be able to pay all its debts as and when they [became] due'.<sup>5</sup> At the centre of this litigation is whether Eise ought to have so expected the insolvency of NSC, in light of the information known and *available* to him and as measured against the reasonable person in his place.

The Judge considered what would constitute such an expectation. For a claim to succeed against a non-executive director, his Honour stated, there must be such facts which, just prior to the relevant debt being incurred, 'gave a person seeking properly to perform the duties of a non-executive director of that company reasonable grounds to say: "I expect that the company will not be able to pay all its debts as and when they become due."' <sup>6</sup> Expectation in this sense is stronger than mere suspicion or anticipation, having a 'measure of confidence ... built in.'<sup>7</sup> It involves a prediction, nevertheless, but one which seems reasonably likely to transpire given the surrounding facts and circumstances.

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<sup>5</sup> This is the predecessor to the current *Corporations Act 2001* (Cth) s 588G.

<sup>6</sup> *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115, 124 ('*Friedrich's Case*').

<sup>7</sup> *Ibid* 126-7.

A series of actions and particularly *omissions* by the board led the Judge to find that the directors ought reasonably to have expected NSC's insolvency. A failure to comply with the law's stipulations as regards accounts and general meetings is particularly noted.<sup>8</sup> His Honour did not abide the directors being both uninformed as to the company's financial state and taking insufficient action to rectify their ignorance.<sup>9</sup> Eise and the other directors ought to 'have called for and considered both the accounts and the report within a relatively short time after the holding of the meeting that had purportedly received, approved and adopted them', so that they might have kept themselves abreast of the company's affairs and discharged their duties.<sup>10</sup> To have done so would have readily revealed to the directors, notwithstanding their lack of experience in corporate finance,<sup>11</sup> that NSC's assets barely outweighed its liabilities, that in the previous financial year the then current liabilities had exceeded its current assets, and so on.<sup>12</sup> In short, the available facts were sufficient to 'occasion anxious inquiry by a director properly performing his task as a director.'<sup>13</sup>

Tadgell J determined that the fact of NSC's liabilities not outweighing its assets would not preclude the reasonable expectation of insolvency.<sup>14</sup> The lack of share capital, the huge volume and increase in loan liabilities, the meagre cash flow and the failure and inability of the auditors, and moreover the company, to verify the ability to meet those liabilities – including the identification of supposed assets – all engendered a reasonable expectation of insolvency.<sup>15</sup> The expectation was furthermore strengthened by Friedrich's representations of good

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<sup>8</sup> Ibid 183.

<sup>9</sup> Ibid 183-4.

<sup>10</sup> Ibid 184.

<sup>11</sup> Ibid 185.

<sup>12</sup> See *ibid* 184 for a full summary of the financial statistics which Tadgell J cites as pointing towards reasonable grounds to expect the insolvency of NSC.

<sup>13</sup> Ibid 185.

<sup>14</sup> Ibid 186.

<sup>15</sup> Ibid.

financial health of NSC, despite facts pointing towards two past instances of him misleading company meetings on the point of auditor's reports.<sup>16</sup>

You might remember the television footage of serried ranks of shipping containers that supposedly contained assets of the National Safety Council including various sea craft and helicopters. When opened by investigators — note not the auditors, the bankers or company directors! — THEY WERE FOUND TO BE EMPTY!

One might think that even the most dilatory director might have made even the most cursory enquiries or even an inspection of the supposed assets, especially in light of the growing mistrust of the chief executive officer.

### *C No Reasonable Cause to Expect Insolvency*

The law provides a defence to a charge of trading while insolvent where the defendant themselves did not have reasonable cause to expect the company's insolvency. Tadgell J did not allow Eise to avail himself of this defence.<sup>17</sup>

The defence invites directors to demonstrate that the reasonable grounds to expect the insolvency of the company were in fact unknown to *them*: the particular defendant director raising the defence. Those attempting to rely on the defence can therefore adduce evidence of their actual state of knowledge at the relevant time, but this will not be determinative in rebutting reasonable cause to expect insolvency.<sup>18</sup>

It follows then that the defence is not entirely subjective. Regard must be had to both the defendant's actual knowledge and those facts of which the defendant ought *reasonably* to have known.<sup>19</sup> The same is true of the current defence under the CA and, it follows from a proper

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<sup>16</sup> Ibid 187.

<sup>17</sup> Ibid 188.

<sup>18</sup> Ibid 128.

<sup>19</sup> Ibid.

construction of that section's wording, there is therefore little room left for the defence to operate in practice.<sup>20</sup>

Eise submitted that the directors had no occasion to go behind the information as it was presented to them.<sup>21</sup> The Judge rejected this submission and held that the directors needed to be more proactive in discharging their duties by seeking out information to supplement their deficient understanding of the company's financial position as (mis)informed by the accounts.<sup>22</sup> Eise's ignorance of the contents of the 1986 and 1987 accounts, combined with 'his reliance on Friedrich's assertions, express or implied, and his own assumption that the company was financially sound, did not entitle him to say that he did not have reasonable cause to expect [insolvency].'<sup>23</sup>

Tadgell J also points out that, the same evidence proving liability goes a long way to also rebutting the lack of reasonable cause to expect insolvency on the part of any individual director.<sup>24</sup> Of particular importance were the reservations Eise expressed in relation to Friedrich and his actions on 21 December 1988.<sup>25</sup>

Finally, Tadgell J rejects that the inability to verify some of NSC's assets was insufficient to show Eise had no reasonable cause for expecting insolvency: 'A simple and prompt check could and should have been made which would have revealed that those assets were largely illusory.'<sup>26</sup>

#### D *Discretionary Relief of Faults of Directors*

Eise also sought to have his conduct excused under another exculpatory provision, which is available if the claim involves 'negligence, default,

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<sup>20</sup> Elizabeth Boros and John Duns, *Corporate Law* (2007) 54.

<sup>21</sup> *Friedrich's Case* (1991) 5 ACSR 115, 188.

<sup>22</sup> *Ibid* 189.

<sup>23</sup> *Ibid*.

<sup>24</sup> *Ibid*.

<sup>25</sup> *Ibid*.

<sup>26</sup> *Ibid* 191.

breach of trust or breach of duty.’ Claiming that the breach of trust or duty was that of Friedrich and that was what deceived him. That was not allowed by the Judge stating that it was not a defence to the charge of insolvent trading and that in any event it did not apply to the facts as shown in this case.

By way of dicta, Tadjell J found that, assuming the defence were available in such a case as this, it should not be made available to Eise.<sup>27</sup> Despite the lack of explicit expression in the legislation, his Honour concluded that it is necessary to consider the reasonableness of the defendant’s actions in deciding whether to exercise the discretionary jurisdiction under s 535.<sup>28</sup>

Counsel for Eise submitted that reference should be paid to his part-time, honorary capacity within NSC. This argument was rejoined with the following:

The Code does not in terms distinguish between executive and non-executive directors, or between paid and honorary directors. Again, the obligations cast by the Code on companies having the benefit of limited liability are in general applicable alike to companies not for profit and profit-making companies.<sup>29</sup>

Tadjell J is nonetheless sympathetic to counsel’s submissions. He states, *ex hypothesi*, the following:

I should think it legitimate to take into account Mr Eise’s position as a non-executive and part-time director, that he was unpaid, that as a director of the company he was motivated by a desire to involve himself in a useful community service, and that he did so involve himself. I should think it right that the courts should use the jurisdiction conferred by s 535 in an appropriate case to provide a flexible form of relief to voluntary, non-executive directors of companies not for profit. It is in the public interest that, while directors should be held accountable for their conduct, able people

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<sup>27</sup> Ibid 196.

<sup>28</sup> Ibid 196-7.

<sup>29</sup> Ibid 197.

should not be deterred from offering their voluntary services for want of appropriate protection.<sup>30</sup>

His Honour nevertheless holds that Eise's failure to inform himself of the details of the accounts and his signing off on those accounts despite his ignorance of their contents were completely unreasonable acts which allowed Friedrich to deceive for so long both SBV and the board members.<sup>31</sup> As such, his Honour believes that to apply the s 535 defence in Eise's favour, were it available, would be 'a serious disservice to the administration of the Code and to the commercial community.'<sup>32</sup>

The most interesting and significant issue to arise from *Friedrich's Case* is what standard does the law hold honorary directors to account and does that standard accord with community expectations and values?

#### E *Directors' Duties: What Is the Situation for Honorary Directors?*

While the case was not pleaded, and hence the decision not based, on the footing of a breach of directors' duties,<sup>33</sup> the implications in this field are many and significant. Issues relating to directors' duties will frequently be invoked in the context of insolvent trading cases where, such as the instant case, the directors claim ignorance of the company's financial floundering.<sup>34</sup> The findings of fact which led Tadgell J to conclude liability under the provisions relating to insolvent trading therefore, could equally apply to cases directly involving a director's duty of care and diligence.

The current expression of this duty is found in CA s 180(1). It establishes an objective test; the standard being 'a reasonable person ... if they were a director ... of a corporation in the corporation's circumstances'. In relation to the directors' duty of care and diligence, Tadgell J stated:

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<sup>30</sup> Ibid 198.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid 199.

<sup>33</sup> Ibid 197.

<sup>34</sup> Boros and Duns, above n 20, 164.

There is nothing in the Code to suggest that the standard to be expected of a part-time non-executive director of a company not for profit is different from the standard expected of any other director of a profit-making company: both are required ... to exercise a reasonable degree of care and diligence in the exercise of their powers and the discharge of their duties. Notwithstanding that, conduct that will be held to involve a departure from the required standard of reasonableness will vary infinitely from case to case according to the circumstances.<sup>35</sup>

The “one size fits all” approach to corporate regulation has been criticised by many for not recognising the stark differences in running different sorts of entities. One commentator argues that the case ‘highlights the inherent problems of having a single regulatory system for all companies’<sup>36</sup> without reference to their size, their views to making a profit and type of incorporation. Another adverts to the challenges facing directors of such companies:

[T]here is little respite to apathetic or inactive, though honest, non-executive directors of companies who do not diligently make themselves aware of their obligations under the [law], comply with those obligations and more particularly keep themselves informed in relation to the general financial state of affairs of the company.<sup>37</sup>

Fears existed that such a stringent standard expected of non-executive, honorary directors would result in mass resignations of those unwilling to expose themselves to liability or unable to afford or find appropriate insurance.<sup>38</sup>

Today, determinations of whether a director has breached the statutory duty of care and diligence ‘will take into account the company’s

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<sup>35</sup> *Friedrich’s Case* (1991) 5 ACSR 115, 197.

<sup>36</sup> Sievers, above n 2, 342.

<sup>37</sup> Stephanie Long, ‘Case Note: *Commonwealth Bank of Australia v John Friedrich, Maxwell Walter Eise & Ors*’ (1991) *Queensland Law Society Journal* 347, 350.

<sup>38</sup> Sievers, above n 2, 343.

circumstances and the [director]'s position and responsibilities within the company.'<sup>39</sup>

In determining whether the duty to prevent insolvent trading has been breached, similar considerations can be entered.<sup>40</sup> A reasonable director of a company is one who is able to generally appreciate the company's accounts and auditor's reports; it seems there is no excuse for ignorance in this matter, whether a remunerated chief executive officer or an honorary, non-executive director.<sup>41</sup> Nevertheless, the question of whether the duty has been discharged will depend upon 'the type of company, the size and nature of its enterprise, the provisions of its constitution, the composition of its board and the distribution of work between the board and other officers.'<sup>42</sup>

In his obiter comments, Tadgell J seemed to invite a greater consideration of the nature and personal circumstances of the defendant director, which seems to have been taken up to some degree by reforms from the legislature, evidenced in the current legislation. Those reforms are at best conservative and likely to do little to assuage the fears that honorary, non-executive directors are too harshly dealt with by company law.<sup>43</sup>

*Friedrich's Case* reflects on a regulatory regime which afforded very little consideration of the exigencies under which non-executive, honorary directors work. Some reforms have attempted to address this situation, but it possibly falls short of community expectations regarding how those honorary directors of not-for-profit entities should be held to account. A separate regulatory regime for such corporate entities is a reform worthy of investigation.

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<sup>39</sup> LexisNexis Australia, *Ford's Principles of Corporation Law* (at 62) [8.305]; Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998 (Cth) para 6.75.

<sup>40</sup> Boros and Duns, above n 20, 51.

<sup>41</sup> LexisNexis Australia, above n 39, [20.130].

<sup>42</sup> *Friedrich's Case* (1991) 5 ACSR 115, 125, quoting *Byrne v Baker* [1964] VR 443, 450.

<sup>43</sup> See Sievers, above n 2.

I thought that it was worthwhile to traverse in some detail the facts and judgment in *Friedrich's Case*. It is a good exposition of the position of voluntary non-executive directors.

*Friedrich's Case* was one which turned on its facts, as invariably all cases do. However, the actions of the directors might be thought reprehensible with the advantage of hindsight, which is too often blessed with 20/20 vision. It would be surprising if a case similar to *Friedrich's* arose now. There is now an increased awareness of the duties of directors generally and especially with respect to insolvent trading, since some recent spectacular corporate collapses both here and abroad.<sup>44</sup>

Remember that this was a case about insolvent trading and not general directors' duties. It does, however, serve as a salutary lesson for us all.

Let us now look at the role of the Chair.

The Chair of your school Board is there to do a particular job, that is, to manage the business of board meetings. The Chair should ensure that decisions are actually made on agenda items, where necessary. Importantly, the Chair should make sure that all members of the Board who wish to have had a proper opportunity to contribute to the discussion before a vote is taken. The primary job of the chair is to provide leadership for the Board and be on good terms with the school principal. Moreover, the Chair must ensure that a proper process is followed in all the Board deliberations.

It is important to remember that while the Chair's formal authority may be set out in the constituent documents that mandate the formation of the Board, the real power comes from the relationship that the Chair forges with each member of the Board; in the result, it is the members of the Board who have elected the Chair and on whom any hopes for re-election rest.

In addition to all of these tasks, the Chair is expected to do the work of an ordinary director as well. Remember the hapless Mr Eise of the National Safety Council. Little if anything is recorded of his style as

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<sup>44</sup> Some of the more infamous corporate collapses/scandals of our time have included such corporations/personages as Alan Bond, Christopher Skase, One.Tel, HIH Insurance, WorldCom and Enron.

Chair, except to the extent that he and the other directors were completely caught in the charismatic personality of the CEO, John Friedrich.

In his report on the collapse of former insurance company HIH, Owen J noted that the Chair has higher standards and duties imposed by law, because of its unique position.<sup>45</sup>

#### THE ROLE OF A BOARD MEMBER

In this part I will talk about the general expectations of a board member of a school board. The remarks apply equally to a board member of an incorporated school board under the CA or an *Associations Incorporation Act* or those serving as members of a school board formed informally.

Keep in mind that these expectations apply equally to the Chair.

Elizabeth Jameson describes a director's duty as 'reading and considering ... Board papers and actively participating in meetings and getting to know the finances and operations of an organisation sufficiently to make well informed decisions.'<sup>46</sup>

All directors owe fiduciary duties to the company. All Board members are required to discharge their duties and powers with reasonable care and diligence to the same degree that a reasonable person would exercise those same duties and power. Section 180(1) of the CA codifies that common law duty. Additionally, the director must act in good faith, honesty and to the best of his or her ability. The directors must comply with a reasonable standard of care in the discharge of that duty.<sup>47</sup> The courts have considered the position where a director may not have any relevant qualifications and have made no allowances to the standard of care which would take into account any lack of qualifications.<sup>48</sup> The

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<sup>45</sup> Commonwealth, The HIH Royal Commission, *The Report* (2003) para 6.2.1. The Royal Commission was presided over by Justice Neville Owen of the Court of Appeal of the Supreme Court of Western Australia.

<sup>46</sup> Fishel, above n 1, 116.

<sup>47</sup> *Daniels (t/as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR 438.

<sup>48</sup> *Gamble v Hoffman* (1997) 24 ACSR 369.

courts have also said that a director must be familiar with the company's operations including its financial status.<sup>49</sup> Directors appointed for their special skills or experience are required to keep themselves informed about all areas of the company operations.<sup>50</sup>

They are also required to exercise their duties in good faith and for the benefit of the company.<sup>51</sup>

The position of a volunteer, non-executive director, to the extent that the duties owed by that director to the company were unclear, has been clarified in *Friedrich's Case*<sup>52</sup> where the Court said:

the stage has been reached when a director is expected to be capable of understanding his company's affairs to the extent of actually reaching a reasonably informed opinion of its financial capacity.<sup>53</sup>

There is some hope for the diligent board member in the so-called 'safe harbour provisions'.

The courts recognise that they ought not to interfere in the operation of boards unless there is a good reason to do so.<sup>54</sup> The business judgment rule allows directors to take reasonable risks in their stewardship of the company, as long as the judgment to take that risk was exercised in good faith and not for any irrelevant purpose.<sup>55</sup>

To come within the provisions of the statutory business judgment rule, Board members would have to show that they considered the questionable transaction and considered it, on rational grounds,<sup>56</sup> to be

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<sup>49</sup> See *AWA Ltd v Daniels (t/as Deloitte Haskins & Sells)* (1992) 7 ACSR 759, 821 and following pages ('AWA Case').

<sup>50</sup> *Re Property Force Consultants Pty Ltd* [1997] 1 Qd R 300.

<sup>51</sup> *Corporations Act 2001* (Cth) s 181.

<sup>52</sup> *Friedrich's Case* (1991) 5 ACSR 115.

<sup>53</sup> *Ibid* 126.

<sup>54</sup> *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 NSWLR 68.

<sup>55</sup> *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483, 493.

<sup>56</sup> *Corporations Act 2001* (Cth) s 180(2)(d).

in the best interests of the school. They would also have had to make that judgment in good faith<sup>57</sup> after informing themselves about the subject matter of the transaction to the extent that they reasonably believed to be appropriate.<sup>58</sup> Further, they would need to show that they had no material interest in the transaction.<sup>59</sup>

Section 189 of the CA allows, in certain circumstances, directors to rely on the skill and judgment of others in making decisions. The advice has to be professional or expert<sup>60</sup> and given by a director within that director's authority.<sup>61</sup> Moreover, the reliance must be made in good faith and after making an independent assessment of the advice.<sup>62</sup>

A word briefly on the position of a Board member with particular skills.

A Board member with expertise or special skills owes at least identical duties, both statutory and common law, to those owed by other Board members just discussed.

However, as an expert in, say, financial matters, the Board member has a higher duty than normal in the area of financial matters.<sup>63</sup> They would be expected to make use of their expertise in the interests of the company.<sup>64</sup>

It does not appear that either the common law or statutory business judgment rule would be available by way of defence, because of the expert knowledge in financial matters.

## INSOLVENT TRADING

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<sup>57</sup> *Corporations Act 2001* (Cth) s 180(2)(a).

<sup>58</sup> *Corporations Act 2001* (Cth) s 180(2)(c).

<sup>59</sup> *Corporations Act 2001* (Cth) s 180(2)(b).

<sup>60</sup> *Corporations Act 2001* (Cth) s 189(a).

<sup>61</sup> *Corporations Act 2001* (Cth) s 189(a)(iii).

<sup>62</sup> *Corporations Act 2001* (Cth) s 189(b).

<sup>63</sup> *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers* [2006] QCA 335.

<sup>64</sup> *Ibid.*

I have not dealt with this issue in any great detail; rather I rely on the exposition in *Friedrich's Case* to set the scene. Needless to say, insolvent trading is an absolute 'no no' and severe penalties attach. Properly discharging one's duty of care and diligence will almost always simultaneously discharge the duty to prevent insolvent trading.

As has been clearly set out above, it is a duty of a member of a Board to read AND UNDERSTAND the financial statements provided. If you are unclear about anything, ask and keep asking questions until you get the answers that you need in order to discharge your duty.

A word now on the role of the Church.

As well as all of these rules, members of the school board of a Lutheran School have to assimilate the guidelines laid down by the Church into the operation of the school board. The Church is a legitimate stakeholder in Lutheran schools.

#### CONCLUSION

In drawing it all together, as I said at the beginning, it is all quite simple. The question posed which needs to be addressed is: 'What do Board members need to know to discharge their duties?'

There are a number of regimes applicable in Australia and the relevant regime depends on the type of legal entity that your Board is formed under. At the peak, there is the *CA* that has codified the common law directors' duties and added some further obligations. The *Associations Incorporation Acts* apply some obligations on the part of committee members that, in essence, represent the common law position. If you fall outside of these two regimes, then, at a bare minimum, the common law duties will apply. If you aim to comply with the highest standard then little should go wrong for you.

Read your meeting papers, ask questions, participate fully, be aware of conflicts and read and understand the financials!

Some more practical issues. Be prepared to invest the time required in your role as a school board member. The school can help you here – make sure papers are provided to you well ahead of the meeting and

with plenty of time to reads them and consider the decisions you have been asked to make.

If you do not understand something or are in any way unclear ask questions, ask again and again until you get the answers you need. Remember Mr Eise, he didn't start asking questions even after it was way too late and he paid the price.

Make sure that you are allowed to make a contribution at the board meeting if you want. The job of the Chair is to let you have your say.

Pay attention to the financials. Insist on regular reports if they are not provided. Again ask questions for clarification purposes.

Avoid undeclared conflicts of interest. If you think you might be in a conflict of interest situation discuss it with the Chair and if necessary announce it at a meeting, ensure it is minuted and act in accordance with common sense and the law.