New Developments in Directors' Duties — The Victorian Stance on Financial Competence

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INTRODUCTION

Until recently, it could unequivocally be stated that in Australia 'the law does not yet require competence from company directors as a matter of law'.[1] It has long been considered counter-productive to impose unduly restrictive entrance barriers to directorships. Further, the notion of the corporation as a self-governing constituency suggested that shareholders could select what directors they chose and bear the consequences.[2] Accordingly, standards of care, skill and diligence owed by directors have been based on subjective individual criteria, leading to low overall standards. Even if the assumptions relating to shareholder consent were valid, the creditors of badly managed corporations might be in a different position. Creditors whose claims are based on tortious liabilities are clearly non-consenting parties. Indeed, the notion of informed consent to corporate governance is unconvincing in many modern commercial contexts.[3] The traditional approach has been widely viewed as out of step with modern commercial and social needs, and possibly inconsistent with existing statutory duties relating to accounts and financial statements. Reform has been recommended, but no legislative action has been taken.

The general duties of directors (and other officers) are laid down in s232 of the Corporations Law. The Corporations Law s592 does not specifically relate to the duties of directors. Rather, it imposes liability on the directors and officers of corporations that incur debts when there is no reasonable ground to expect solvency. It can be argued that in recent Victorian constructions of this provision, the courts have taken the initiative. On the basis of an integrated reading of statutory requirements and policy goals, they have, for the first time, expressly articulated a financial competence requirement in Australian company law. That is a positive development in general, but the particular defendants could be seen as victims of an abrupt judicial change in direction. If more is to be expected of company directors, corresponding adjustments aimed at the protection of vulnerable persons are necessary.

[1] *Dwyer* v *NCSC* (No 2) (1989) 7 ACLC 743 at 748 *per* Young J.

[2] See, for example, *Turquand* v *Marshall* (1869) LR 4 Ch App 376 at 386, where Lord Hatherley LC remarked of the defendant directors 'however ridiculous and absurd their conduct might seem, it was the misfortune of the company that they chose such unwise directors...' In similar vein, Dankwerts J in *Pavlides* v *Jensen* [1956] 1 Ch 565 indicated that a company must bear with 'a set of amiable lunatics' at 570.

[3] Nevertheless, that view has had adherents. In *Salamon* v *Salamon & Co* [1897] AC 22 Lord Macnaghton observed that '[t]he unsecured creditors of A Salamon and Company, Limited... have only themselves to blame for their misfortunes. They trusted the company... but they had full notice that they were no longer dealing with an individual...' at 53.

In the current era of pervasive and spectacular corporate insolvency, creditors are eager to identify new or more effective avenues of recourse in order to recoup their claims. The current Australian law of insolvency, predicated on nineteenth century legislative patterns, has predictably proved inadequate in many important respects. Fundamental reform of significant aspects of both personal and corporate insolvency law was advocated by the Australian Law Reform General Insolvency Inquiry (the Harmer Report).[4] Although the Final Report was published in December 1988, no action has yet been taken.[4a] Some aspects of the recommended reform may now be considered somewhat dated.

CURRENT DEFICIENCIES OF s592

Accordingly, corporate creditors must operate on the basis of existing legislation. Consistent with the historical pattern of company law, the courts have demonstrated a prompter concern for creditors' rights than the legislature. In particular this article will examine the impact of recent judicial construction of the Corporations Law s592 [Companies (Victoria) Code s556] on creditors' claims and on the development of the general standard of skill and care required of company directors. Section 592, while reflecting a concern for creditors, has significant inadequacies and, until recently, was considered relatively ineffectual. Creditors have encountered difficulty in obtaining access to records and information in order to demonstrate circumstances of insolvency.[5] Further, it has been held that a liquidator has no standing to bring proceedings.[6] As the section applies only to companies defined in s589, which are being wound up, investigated, in receivership, under official management or other circumstances of insolvency, a creditor's action may be dismissed on the basis that it has been brought prematurely.[7] The Harmer Report recommended that the section be eliminated in its present form and replaced with a totally restructured provision, imposing a positive duty on directors to prevent insolvent trading.[8] Further rationalising amendments, such as the introduction of presumptions of insolvency, *locus standi* for the liquidator and decriminalisation were also recommended.[9]

[4] The Australian Law Reform Commission General Insolvency Inquiry Report No. 45.

[4a] At the time of going to press the unveiling of a draft bill incorporating proposed insolvency law reforms for public comment was announced.

[5] Harmer Report paras 290, 297.

[6] *Ross McConnel Kitchen & Co Pty Ltd (in liq)* v *Ross & Ors* (1985) 3 ACLC 326.

[7] *DM Drainage & Construction Pty Ltd* v *Lewis* (1989) 7 ACLC 74.

[8] Harmer Report 126–144.

[9] Ibid.

THE DIRECTOR'S DUTY OF SKILL AND CARE

Prior to recent Victorian developments, the predominant Australian judicial interpretation of s592 (formerly s556) was consistent with the traditionally benign view that company directors, particularly if non-executive, were not required, as a matter of law, to be competent. There was no requirement that they actively institute a system effectively to inform themselves of the company's affairs, possess the capacity to interpret basic financial data or pay consistent attention to the affairs of the company. The twentieth century witnessed the introduction of a growing number of statutory duties related to the judgement of financial affairs and the conduct of company meetings.[10] There have been corresponding calls for higher levels of competence, albeit isolated.[11] Nevertheless, those developments have uneasily co-existed with the Dickensian figure of the Marquis of Bute,[12] who, sublimely indifferent to the affairs of the insolvent bank over which he nominally presided, not only had no knowledge of irregularities, but also had no recollection, at the time of its collapse, of his 40 year connection with it as President. Similarly, Sir Arthur Aylmer 'absolutely ignorant of business', H W Tugwell 'seventy-five years of age and very deaf'[13] and the defendant of *Re Denham and Co*, 'a country gentleman not a skilled accountant'[14] were merely the comic personifications of a real and long-lived principle of company law. In relation to skill and care, directors were to be judged by reference to an individual standard derived from their own particular background, skills and capacities. The applicable standard thus curiously applied an objective enquiry of reasonableness to an individually-tailored, fundamentally subjective standard of capacity and experience. As such, it was not entirely a parody to claim that '[the courts] . . . ask of a director that he do only as much as one might fairly expect of someone as stupid and incompetent as the director happens to be . . .[15]

The early cases influential in the elaboration of directors' standards emanated from a nineteenth century socio-economic milieu of laissez-faire policy, reverence for hierarchy and toleration of high-born but inactive figure-heads on boards. Further, as directors during this formative period of company law were typically unpaid, and did not enter service contracts subject to the common law, the principles governing their duties developed wholly in equity. Consequently, they corresponded to the individual, subjective criteria already developed by Chancery in relation to trustees.[16] Rather than imposing a uniform professional standard on directors, the law recognised that they did

[10] See the provisions listed on pp: 10–11 below.
[11] For example, Menzies, D in 'Company Directors' (1959) 33 ALJ 156.
[12] In *Re Cardiff Savings Bank; Marquis of Bute's Case* [1892] 2 Ch 100.
[13] In *Re, Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425, 427.
[14] (1883) 25 Ch D 752.
[15] R W Parsons, 'The Director's Duty of Good Faith' (1967) 5 MULR 395 at 395.
[16] R R Pennington, *Director's Personal Liability* (London, BSP Professional Books, 1989) Ch 5.

not constitute a clearly demarcated, unified professional category.[17] In relation to standards of skill and care, the appropriate enquiry, applied on a case by case basis, was whether the director in question had fallen below the expectations raised by his own capacities, whatever they might be. This approach resulted in a number of paradoxes and bemusing distinctions discreditable to the law. A director's exposure to legal liability increased according to competence and capacity, providing little legal incentive to develop and apply professional expertise. Distinctions were drawn between a failure to attend meetings at all, which was excusable, and a failure to attend to duties which arose at meetings, which was not.[18] Implicitly, cases such as *Re Cardiff Savings Bank: the Marquis of Bute's Case*[19] suggested that a cultivation of self-induced ignorance was the best insurance against liability.

Consistent with the mild traditional construction, in *Re City Equitable Fire Insurance Co Ltd*[20] a case comparable in several respects to the recently decided *Commonwealth Bank of Australia* v *Friedrich and Ors*,[21] Romer J enunciated his classical three-fold statement of the company director's duty of care. In that case, the liquidator sought to render the directors of a large insurance company liable for a shortfall on winding up, due to their alleged negligence in relation to losses sustained by the company through investments, loans, and the payment of dividends out of capital. The directors, who were not figureheads, but rather 'as active . . . as circumstances would reasonably permit'[22] were conceded to have behaved honestly throughout. However, largely due to the fraud of one director, a person of high reputation and implicity trusted, his co-directors had permitted a number of improvident or improper transactions. Romer J acknowledged that the scope of a director's duty would depend on an indeterminate number of possible variables, including the nature of the relevant company, the particular function assigned, and the provisions of the company's articles. He recognised that the law gave no 'very clear answer' to the precise degree of skill and diligence required, due to the inherent problem of determining negligence when the duty itself was relatively ambulatory.[23] Nevertheless, Romer J considered that decided authority had established three general propositions, viz:

'(1.) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience . . .[24]

(2.) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the

[17] See Cooney Report. The approach is also illustrated by the remarks of Learned Hand J in *Barnes* v *Andrews* 298 Fed 614 at 618 (1924) and the observations of Neville J in *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.
[18] In *Re Cardiff Savings Bank: The Marquis of Butes Case* [1892] 2 Ch 100, 109.
[19] Supra.
[20] [1925] Ch 407.
[21] (1991) 9 ACLC 946.
[22] [1925] Ch 407, 444.
[23] Id 427.
[24] Id 428.

board upon which he happens to be placed. He is not, however, bound to attend all such meetings . . .[25]

(3.) In respect of all duties that . . . may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.'[26]

Applying the relevant standards, Romer J considered certain directors prima facie liable for negligence in relation to some transactions. However, as the negligence was not wilful, they ultimately escaped liability due to the operation of a wide exemption clause in the articles. Such blanket exemptions were subsequently precluded by provisions corresponding to the current Corporations Law s241 (Companies (Victoria) Code s237).

THE COONEY REPORT 1989 — SENATE STANDING COMMITTEE ON CONSTITUTIONAL AND LEGAL AFFAIRS — COMPANY DIRECTORS' DUTIES

The reluctance to erect rigid entry barriers to directorships, the recognition of the immense variety in scale and nature of corporate enterprise,[27] and the abiding fear of inhibiting characteristically risky commercial activity by an overzealous judicial second-guessing of good faith management decisions,[28] have continued to inhibit the implementation of an objective duty of skill, care and diligence for directors. Nevertheless, the Cooney Report, while noting the problems, recommended that current community expectations justified the adoption of an objective duty of care.[29] The Report further suggested that the 'business judgement rule' evolved by American courts should be introduced.[30] The business judgement rule functions as a 'safe-harbour' for directors who exercise business judgement in good faith, provided that certain conditions have been met. They include an absence of conflict of interest, an exercise of active discretion, the pursuit of reasonable steps to gain information, and the exercise of reasonable care in the circumstances, with reference, *inter alia*, to (a) any special skill, knowledge or acumen possessed by the director, and (b) the degree of risk involved.[31]

The Cooney Report also considered the current position on attendance at meetings unsatisfactory and recommended the enactment of a provision

[25] Id 429.
[26] Ibid.
[27] Noted by Romer J in *Re City Equitable*, supra at 426 where he observed: 'The position of a director of a company carrying on a small retail business is very different from that of a director of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of a director of one insurance company may differ from those of a director of another.'
[28] Exemplified by Lord Eldon's famous dictum that a court could not manage 'every playhouse and brew-house in the country.' *Carlin* v. *Drury* 1812, V & B 154; 35 ER 61.
[29] Cooney Report 29.
[30] Id 31.
[31] Id 30; See also Company and Securities Law Review Committee 'Company Directors and Officers — Indemnification Relief and Insurance' Discussion Paper No9 April 1989 para 112.

requiring attendance at board meetings in the absence of reasonable excuse.[32] It was likewise critical of the current toleration of inactive 'status' directors.[33] In relation to delegation, the Report recommended a specific formulation to limit the extent of permissible reliance on others, in contrast to the currently ill-defined boundaries.[34]

The Cooney Report recognised that existing statutory additions and reformulations have proved inadequate to accommodate company law to modern commercial practice and social need. Indeed, while the formulation of the general duty of care in the Corporations Law s232 (formerly s229) may have been intended to impose an objective and higher standard, reductive judicial interpretation has preserved the subjective common law standard, construing the provision as a codification of Romer J's principles. In *Byrne* v *Baker*[35] the Full Court of the Supreme Court of Victoria adopted that approach. Interestingly, there is no reference to skill in the Corporations Law s232, so the statutory standard may actually be weaker. As the Corporations Law s232(11) provides that the section takes effect 'in addition to, and not in derogation of, any rule of law relating to duty or liability' the common law skill requirement nevertheless survives.

In addition, a number of provisions have imposed additional statutory duties upon directors, particularly in relation to accounts, audit, financial statements, and meetings. They include:

> Corporations Law ss292–298, ss301–303 [Companies (Victoria) Code s269 (1) (2) (3) (4) (5) (8) (9) (10A) (11)].
> Corporations Law s304–5 [Companies (Victoria) Code s270 (1) and (2)].
> Corporations Law s316 [Companies (Victoria) Code s275].
> Corporations Law s315 [Companies (Victoria) Code s274].

However, despite the implicit suggestion that such provisions demand an elementary level of financial competence, at least, until recently, there was little judicial recognition that a competence requirement had evolved in Australian law. Accordingly, in the 1989 decision of *Dwyer* v *NCSC* (No2)[36], Young J., dealing with an appeal against disqualification by a director who had been 'completely ignorant of basic skills and morality' observed that:

> 'the law does not yet require competence from company directors as a matter of law'[37]

IMPACT OF RECENT DEVELOPMENTS

It would seem, however, that as a result of recent Victorian construction of the Corporations Law s592 (Companies (Victoria) Code s556) a competence

32 Report 31.
33 Ibid.
34 Id 33–36.
35 [1964] VR 443.
36 (1989) 7 ACLC 743.
37 Id 745, 748

requirement, particularly, in relation to financial affairs, has, for the first time, been expressly recognised in Australian company law, albeit indirectly. The Victorian decisions depart from the predominant New South Wales approach to the provision. Although the decisions have the status of obiter dicta in relation to the general duty under the Corporations Law s232, both Ormiston J in *Statewide Tobacco Services Ltd* v *Morley*[38] and Tadgell J in *Commonwealth Bank of Australia* v *Friedrich and Ors*[39] emphasised the need to construe the provisions on directors' duties as a coherent integrated code. The desirability of such an approach is evident, and it is likely that the reasoning of the Corporations Law s592 decisions will exert an impact on the construction of the Corporations Law s232. Accordingly, at least some aspects of recommended reform may be anticipated by a judicial determination to upgrade standards in accordance with policy and community needs, by, *inter alia*, a new recognition of the implications of existing requirements imposed on directors by the Corporations Law. An increasing severity is discernible in the pattern of Victorian decision-making. While the survival of the traditional subjective criteria was, to some extent, still entertained by Ormiston J in *Statewide Tobacco Services Ltd* v *Morley*, the judgement of Tadgell J further narrows their scope. Further, a correspondingly narrow construction of the exculpatory provision contained in the Corporations Law s1318 [Companies (Victoria) Code s535] in relation to s592 (previously s556) is likely to preclude an ultimate escape from liability pursuant to s592.

The imposition of higher standards is a positive development. However, to the extent that the recent Victoria decisions represent an unpredictable departure from previous construction, the individual defendants may be seen as the victims of law in transition. Further, if it be accepted that more is now required of directors, it is regrettable that no adjustments have simultaneously occurred in order to protect potential victims, such as passive individuals overborne by manipulative family members, and financially incompetent persons who naively assume office in non-profit organisations.

Possible prophylactic measures might include:

(a) the provisions of explicit advice on directors' duties, together with warnings on liability for breach, at the point when people take office as directors.

Currently, there is no established procedure designed to inform intending directors of their duties and potential liablity.

(b) the encouragement of non-profit organisations to incorporate under Associations Incorporation legislation, rather than under the Corporations Law.

The current position of committee members who manage incorporated associations is unclear. It has been suggested that they would owe common law and equitable duties analogous to those of company direc-

[38] (1990) 8 ACLC 827.
[39] (1991) 9 ACLC 946.

tors.[40] Even if that were established, the managers of such associations would not be exposed to the full complement of statutory duties established by the Corporations Law; nor would they be vulnerable to liability pursuant to s592, and to potential criminal sanctions.

(c) the abolition of the company limited by guarantee, provided that uniform state Associations Incorporation legislation is achieved.

(d) if the company limited by guarantee is retained, the introduction of a more flexible standard for directors of non-profit organisations. In *Commonwealth Bank of Australia* v *Friedrich & Ors* Tadgell J noted that at present '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'.[41]

LIABILITY OF COMPANY DIRECTORS TO CREDITORS

Where a company proves assetless on insolvency, or where it has made dispositions of property which cannot be recovered through the antecedent transactions provisions of the Corporations Law, a possible avenue of recovery for creditors may lie in an action against the directors or officers of the debtor company. Generally, such recovery is precluded as a consequence of the fundmental doctrine of separate legal entity, which establishes that a company is a legal person distinct from its human controllers and equity-holders.[42] Nevertheless, there are several possible means whereby directors can be rendered liable to creditors. They include:

1. liability pursuant to Corporations Law s567(5) where a voidable preference has had the effect of freeing a director or officer from liability under a guarantee or otherwise.
2. sales and dispositions to a company by directors and their associates at an over-value, or sales and dispositions by a company to directors and their associates at an under-value. [Corporations Law s567(1) and (2).]
3. liability pursuant to Corporations Law s233 — [liability of director of a trustee company where no right of full indemnity out of the assets of the trust exists.]
4. liability pursuant to Corporations Law s232. Such liability might typically arise in either of two broad ways:
   a. A director may breach his or her duty by entering into a transaction not actuated by a purpose bona fide for the good of the company as a whole. In addition to obvious fraud, this category of breach would also comprehend transactions, which although honestly intended and

[40] K L Fletcher, *Non-Profit Associations*, (Sydney, Law Book Company Limited, 1986) at 289.

[41] (1991) 9 ACLC 946 at 1,011.

[42] *Salamon* v *Salamon & Co* [1897] AC 22.

within power, were actuated by reasons ulterior or extraneous to that power. The courts have again been zealous on behalf of creditors in this area. Case law has established that, at least at a certain stage of financial difficulty, the interests of the company as a whole may comprehend the interest of creditors.[43] Some commentators would view the notion of a duty owed to creditors as inherently at odds with the essential nature of a director's duty.[44] Further, there is significant imprecision in defining the degree of financial difficulty required to activate the duty.[45] Moreover, it is not clear whether a creditor could or should have standing to bring an action pursuant to the Corporations Law s232.[46]

b. A director may breach his or her duty by failing to exercise the requisite degree of care and diligence in the management of the company's affairs, or by entering into improvident transactions. In consequence, the director would become liable for the loss occasioned. As discussed above, as the applicable standard of care has long been predicated on individual capacities, there have been few successful actions for negligence.

c. liability pursuant to Corporations Law s592 (previously Companies (Victoria) Code s556)

THE CORPORATIONS LAW s592 [COMPANIES (VICTORIA) CODE s556)]

The Corporations Law s592 provides:

(1) Where:

(a) a company has incurred a debt;

(b) immediately before the time when the debt was incurred;

(i) there were reasonable grounds to expect that the company will not be able to pay all its debts as and when they become due: or

(ii) . . .

(c) the company was at the time when the debt was incurred, or becomes at a later time, a company to which this section applies; any person who was a director of the company, or took part in the management of the company at the time when the debt was in-

[43] *Walker* v *Wimborne* (1976) 137 CLR 1; *Kinsela* v *Russell Kinsela Pty Ltd (in liq)* (1986) 4 ACLC 215; *Jeffree* v *NCSC* (1989) 7 ACLC 556: see also H A J Ford, 'Directions in the Law of Directors', *Developments in Corporations Law Conference*, University of Melbourne 20 July, 1991, Paper, 5–7.

[44] See I A Renard, Commentary to J D Heydon, *Directors' Duties and the Company's Interests* in P D Finn (ed) *Equity and Commercial Relationships* (Sydney, Law Book Company Limited, 1987) 120, 140.

[45] *Nicholson & Ors* v *Permakraft (NZ) Ltd (in liq)* (1985) ACLC 453.

[46] Companies and Securities Law Review Committee, Report No12 November 1990 'Enforcement of the Duties of Directors and Officers of a Company by Means of a Statutory Derivative Action'.

curred contravenes this subsection and the company and that person ... are jointly and severally liable for the payment of the debt:

(2) In any proceedings against a person under subsection (1), it is a defence if it is proved:
  (a) that the debt was incurred without the person's express or implied authority or consent; or
  (b) that at the time when the debt was incurred, the person did not have reasonable cause to expect:
    (i) that the company would not be able to pay all its debts as and when they became due; or
    (ii) that, if the company incurred that debt, it would not be able to pay all its debts as and when they became due.

Section 592, as Tadgell J observed in *Commonwealth Bank of Australia* v *Friedrich and Ors*, is in identical terms to the previous s556, save that the penalties are now given in Schedule 3.

Section 556 was itself based upon earlier provisions to similar effect, viz s303(3) and subsequently ss374A to 374G of the Uniform Companies Acts. In *Shapowloff* v *Dunn*[47] the High Court propounded a test of 'a blending of subjective and objective considerations.[48] However, the relevant provisions were in different terms and imposed liability on an officer who was 'knowingly a party'. It was therefore uncertain to what extent subjective considerations survived in the context of s556.

NEW SOUTH WALES CONSTRUCTION OF s556

In *3M Australia Ltd* v *Kemish*[49], Foster J noted the 'clear change in legislative policy introduced in s556(1). The net of liability, both criminal and civil, is cast far more widely than in the earlier section.'[50] His Honour observed that in establishing the offence, it was no longer necessary for the plaintiff to show that the defendant was knowingly a party to the incurring of the debt. The question whether there were reasonable grounds to expect that the company could not pay its debts pursuant to s556(1)(b)(1) was to be determined objectively, 'according to the standard of a director or manager of ordinary competence. ... No elements personal to the defendant are involved at all'.[51]

Nevertheless, Foster J considered that subjective elements individual to the defendant survived in relation to the defences established in s556(2). Although there were objective reasonable grounds sufficient to establish the offence, a defendant might be able to rely on the fact that *he* did not have reasonable cause to expect that the company was insolvent. In Foster J's opinion, the relevant negative could be established 'by proof that significant

[47] (1980–1981) 148 CLR 72 per Wilson J at 85.
[48] Ibid.
[49] (1986) 4 ACLC 185.
[50] Id 190.
[51] Id 191.

information . . . was in fact unknown . . . to the defendant'.[52] But what if that ignorance were itself the result of substandard conduct? The illustrative reasons for ignorance advanced by Foster J in *3M* v *Kemish* are generally non-blameworthy. For example, it is stated that 'Such ignorance on his part might arise from the fact that his managerial post did not bring him in contact with such knowledge. Again, it might be that his managerial post in the company did not carry with it any intrinsic responsibility for the evaluation of the financial position of the company. Other fact situations can be imagined'.[53]

While it would seem that a director, as distinct from other company officers, would never be able to claim, in view of specific statutory obligations, that his or her position did *not* carry intrinsic responsibility for corporate financial evaluation, at a later point in the judgement, Foster J was more ambivalent. He contemplated that a defendant might have no 'cause to expect' insolvency, not only due to ignorance of grounds, but also because the director 'although being aware of them, was unable to interpret their significance'[54]. His Honour further observed that:

> 'The next step is to inquire whether this ignorance or failure properly to interpret the "grounds" was objectively "reasonable". In determining this latter question, regard must necessarily be paid, inter alia, to the actual position occupied by the defendant in the company, the range of responsibilities properly attached to it, the degree to which it properly fell upon him to take steps to acquaint himself with the facts going to make up the "grounds" established under subsec(1) or to acquire the expertise necessary to interpret them correctly. Quite clearly, considerations relating to the actual position of the defendant are involved . . . and could include, for instance, his state of health . . . or absence overseas at the relevant time.'[55]

Applying those tests, Foster J found the defendant liable. While in full financial control of the company, he had allowed it to incur debts when it was clear that necessary creditor tolerance and a vital loan were unavailable. Further, having regard to his standard of expertise in accounting, the defendant was unable to rely on the defences.

In *Metal Manufactures Ltd* v *Lewis*[56], Hodgson J found that a 'passive' female director, who had been actively excluded from participation in the company's affairs by her husband, and who may not have realised she was a director other than for 'signing purposes', could not rely on the defence under ss556(2)(b). His Honour indicated that when ignorance was relied on in this context, regard might be had to illness or absence, but not 'to a person's complete ignorance of his duties as a director of a company and his complete neglect of such duties'.[57]

[52] Ibid.
[53] Ibid.
[54] Id 192.
[55] Ibid.
[56] (1986) 4 ACLC 739.
[57] Id 749

Nevertheless, Hodgson J found that the defendant could rely on s556(2)(a), in that the relevant debt was incurred without her express or implied authority or consent. In this context, he found that the defendant's husband had simply assumed that authority to act for the company and, as 'neither he nor she ever regarded her authority or consent as being called for, ... her inactivity did not communicate authority or consent to him: it was merely acquiescence'. Further, any general consent to the husband acting as 'the personification of the company could not amount to authority to engage in criminal conduct.'[58] His Honour accordingly concluded that inactivity on the part of an ordinary director would not necessarily amount to authority or consent. Factors relevant to the determination would include: whether the person incurring the debt was accustomed to act in accordance with the defendant's advice, or was otherwise subject to his influence or persuasion; the steps reasonably available to the defendant to prevent the incurring of the debt; and the duration and extent of the defendant's actual or constructive knowledge of the insolvency of the company.[59]

In conclusion, on Hodgson J's reasoning, although a totally inactive, ignorant and incompetent director could not avail herself of the defence pursuant to s556(2)(b), the independent alternative defence under s556(2)(a) *would* frequently be available, particularly in the context of a patriarchal 'one man' family company where a wife's directorship was assumed merely to comply with formal requirements. While the judgement is implicitly sensitive to the vulnerability of women within certain family structures, the consequence is that family property owned by the controller's wife would be beyond the reach of creditors, although she had been an ostensible participant in management.

On appeal to the Full Court of the Supreme Court of NSW,[60] the result was affirmed by the majority, albeit on different grounds. Mahoney J noted that the husband occupied the office of managing director, and accordingly, his authority did not derive from the consent of other directors, but from the fact of appointment to that office. Consequently, he could incur debts without their consent or authority, and even in the face of dissent. The managing director's authority would continue until it was duly terminated or restricted, but there was no available evidence to suggest that the female defendant had the power to do so.[61] McHugh JA stated that the relevant authority or consent related to the very debt, rather than debts generally.[62] Moreover, he considered that 'authority' implies a correlative power to prevent. Although consent, as an alternative, did not require such correlative power to prevent, signification of approval or consent was required.[63] However, a director's consent to appointment to office did not constitute consent or authority to each individual debt incurred by the appointee. Rather 'each debt is author-

[58] Id 753.
[59] Id 754.
[60] *Metal Manufactures Ltd* v *Lewis* (1988) 6 ACLC 725.
[61] Id 733.
[62] Id. 735
[63] Id 736.

ised by the general authority which the general manager has, not by the vote of each director who appointed him to his position.'[64] Accordingly, the defendant 'had no power to prevent him [her husband] from exercising his authority to contract the debt. She knew nothing about it.'[65]

Kirby J strongly dissented, asserting that the over-all legislative scheme signified raised levels of responsibility for directors. He stated that 'The time has passed when directors and other officers can simply surrender their duties to the public and those with whom the corporations deals by washing their hands, with impunity, leaving it to one director or a cadre of directors or to a general manager to discharge their responsibilities for them.'[66] His Honour considered that the legislative scheme would be thwarted by a judicial gloss derived from 'judicial remarks upon other statutes or . . . the law of agency.'[67] Accordingly, Kirby J concluded that the defendant had given her implied authority and consent to the incurring of the debt. The fact that the managing director had arrogated authority was irrelevant. The defendant 'must have known (or must be taken by the statute to have known) that opting out of concern in the company's affairs would mean . . . that the company . . . would have to incur debts which would thereupon be incurred by her husband . . . with her implied acquiescence, authority and consent.'[68]

Kirby J advocated a purposive approach to statutory construction. In that context, he identified the dual purpose of s556 as (a) to provide a means of redress to creditors and (b) to instil in directors a concern to take particular care in incurring debts during times of insolvency and economic difficulty.[69] He asserted that the scheme of the section should not be frustrated by the device of 'donning the blinkers of indifference to, and assuming the bridle of neglect of, the interest in the company's affairs.'[70]

RECENT VICTORIAN APPROACH TO s556

Despite the arguments urged by Kirby J, in the subsequent Victorian decision of *Heide Pty Ltd t/a Farmhouse Smallgoods* v *Lester*[71], O'Bryan J expressly adopted the reasoning of McHugh JA as 'plainly correct'[72] but distinguished *Lewis's* case on the facts. Although *Heide* again involved a defendant female director who allegedly took no part in corporate management, she was actively engaged as a receptionist/secretary, opened the mail, 'fobbed off' creditors and connived to eliminate a substantial company overdraft.[73] Although the female defendant did not authorise the incurring of the relevant

64 Ibid.
65 Ibid.
66 Id 728.
67 Ibid.
68 Id 730.
69 Id 727–8.
70 Id 730–1.
71 (1990) 8 ACLC 958.
72 Id 962.
73 Id 961.

debts, she knew of the ordering system in place and could not establish the absence of implied consent. Moreover, from the date of a crucial meeting, in which she was made aware of the company's deteriorating position, the defendant had no reasonable cause not to expect insolvency. She was thus unable to rely on the defences established in s556(1)(a) and(b).[74]

Statewide Tobacco Services Ltd v *Morley*[75]

In *Statewide Tobacco Services Ltd* v *Morley* handed down only a few days after *Heide,* Ormiston J distinguished the majority judgements of *Lewis,* while acknowledging 'striking similarities to the present case.'[76] *Statewide Tobacco Services Ltd* v *Morley* again involved an inactive female director who had never taken any part in the day to day running of the business, and was told 'remarkably little about its activities'.[77] The business was run first by the defendant's husband and subsequently by her son.

In relation to the defence under s556(2)(a), Ormiston J noted the generally limited nature of an individual director's authority, so that 'one would therefore look normally to some act of the board.'[78] Nevertheless, if it were held that individual directors, due to their own restricted authority, could not ordinarily authorise the incurring of debts 'the section would be meaningless in that every director could say that he was not the principal and thus every debt was incurred with the authority of the company, not himself.'[79] Accordingly, his Honour held that in the context of the section 'the authority in question is that which is conferred by the act of one or more directors, whether participating in the grant of the company's authority as a member of the board of directors or in his role as managing or executive director.'[80] Ormiston J was critical of McHugh JA's importation of constructions of the word 'authorise' from intellectual property contexts to that of s556. He rejected the proposition that authority must necessarily imply a concomitant power to restrain. An ordinary director would rarely have such power, and, if able to rely on that circumstance, would never be liable, even if aware that the company was trading while insolvent. Consequently, '[t]he section would have little practical purpose'.[81]

His Honour considered that where a director 'is unable to persuade his fellow directors to withdraw that authority when the company is insolvent, he should seek to have the company wound up or resign'.[82] In sum, Ormiston J. concluded that where an individual director participated in conferring a general or usual authority to an executive director or other relevant officer, he would be unable to reply on the defence in s556(2)(a). While critical of much

[74] Id 968.
[75] 1990 8 ACLC 827.
[76] Id 840.
[77] Id. 829.
[78] Id. 834.
[79] Id. 837.
[80] Ibid.
[81] Id 840.
[82] Ibid

of the reasoning on authority by the majority in *Lewis's Case,* he distinguished *Lewis* on the ground that there, the husband was managing director, but there was no evidence that the defendant wife had participated in his appointment.

Further, his Honour expressly dissented from the view expressed by Hodgson J and McHugh JA that the relevant authority must be confined to a particular debt.[83] Accordingly, he concluded that the informal general agreement that the defendant's son should manage the company on her behalf was a sufficient authorisation for the purposes of s556(2)(a).

In relation to the defence under s556(2)(b) Ormiston J adopted the reasoning of Hodgson J. in *Lewis's case,* concurring with the view that its language was sufficiently different from prior equivalent provisions as to make the reasoning of the High Court in *Shapowloff* v *Dunn* generally inapplicable. In the context of s556(2)(b), Ormiston J. held that:

> 'the issue is directed to what the director might reasonably know and understand of the company's general financial position at the relevant time. In the light of the various duties now imposed upon the directors, it would not appear unreasonable that they should apply their minds to the overall position of the company. In other words, a defendant is not entitled to say that he or she was told a minimal number of facts about the company's financial affairs but chose to ignore the possibility of other facts, or at least failed to enquire further as to other relevant facts. What is reasonable, therefore is related in part to the extent of the enquiries that the director has made and should have made about the company's solvency. A director should not in those circumstances be entitled to hide behind ignorance . . . which is of his own making or . . . has been contributed to by his own failure to make further necessary enquiries'.[84]

That approach is consistent with his Honour's view that:

> '[T]he present s556 is to be interpreted in the light of the more stringent obligations now placed on directors . . . [T]here can be little doubt that a more rigorous approach should now be taken by the courts in the light of the . . . remedies . . . and of other legislative changes.'[85]

In particular, Ormiston J drew attention to the obligations pursuant to s269 of the Code [Corporations Law s292–303] and concluded that a director must have 'sufficient knowledge and understanding of the company's affairs and its financial records to permit the opinion of solvency to be formed.'[86] Specifically, he noted that 'even in a small company a director should ask for and receive figures, albeit of a basic kind, on a more or less regular basis.'[87] His Honour also considered that while short-term failure to obtain the necessary information from executives or others might on occasion be reasonable, a director 'cannot rest on that ignorance'.[88]

83 Id 842.
84 Id 846–7.
85 Id 832.
86 Ibid
87 Id 847
88 Ibid.

Nevertheless, Ormiston J somewhat ambivalently preserved some elements of the traditional cases. He observed that directors' duties 'do not as yet involve any degree of competence, only a reasonable degree of diligence and honesty.'[89] His Honour defined diligence as requiring an obligation to try to understand the company's financial affairs. However, at certain points, diligence might shade off into competence.

Ormiston J expressly refrained from providing a catalogue of the kinds of information and degrees of understanding required. He stated that 'directors are not required to have omniscience'[90] and reiterated that part-time positions and delegation remain permissible. While his Honour expressed confidence that even directors of 'modest talent' might continue to avoid liability, at one point in his judgement, he specifically recognised that he had consciously diverged from the tenor of previous construction. He observed:

> 'I have been concerned that this conclusion may result in too rigorous an application of the provisions of the section. It does impose obligations which some directors may be surprised to discover and which would be contrary to the impression they had formed . . . [However] if liability under sec. 556 had been enforced in the manner suggested from the time the Code came into effect, some of the more disastrous liquidations of recent years would not have occurred.'[91]

Commonwealth Bank of Australia v *Friedrich & Ors [The National Safety Council Case]*[92]

Ormiston J left alive some possibility of subjective considerations, considered a 'competence' requirement not established and stated the duty in terms that a director must *try* to understand a company's financial affairs. The remarks of Tadgell J, in the recent decision of *Commonwealth Bank of Australia* v *Friedrich and Ors*, while generally consistent, subtly extend the statement of duty. They reduce the scope for subjective criteria and the possible avenues of escape from liability. It can be argued that his Honour expressly articulated a duty of financial competence, rather than mere diligent attempts at it.

Agreeing that s556 must be construed in the light of the integrated obligations of directors under companies legislation, Tadgell J pointed out that, due to the intensified complexity of commerce, more exacting demands and standards of capability were now expected of directors.

> 'In particular, 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. Moreover, he is under a statutory obligation to express such an opinion annually. I think it follows that he is required by law to be capable of keeping abreast of

[89] Ibid.
[90] Ibid.
[91] Id 843.
[92] (1991) 9 ACLC 946.

the company's affairs, and sufficiently abreast of them to act appropriately if there are reasonable grounds to expect [insolvency]'.[93]

The facts of *Commonwealth Bank of Australia* v *Friedrich* attracted much publicity. The National Safety Council, a venerable company limited by guarantee, collapsed in 1989, with a deficiency of assets in the order of $258 million. The company's directors, frequently nominees of members (such as Victorian Employers' Federation, Department of Conservation etc) were all non-executive. None had demonstrated financial expertise, although one was 'better-versed' than others. None was insured. All gave their time on a voluntary basis — other than for out-of-pocket expenses, no payments were received. Following liquidation, the State Bank of Victoria, a major creditor, sought to recover approximately $100 million from the directors. All but one defendant, the President, Mr Eise, settled during the course of the litigation.

The collapse of the NSC, though complex, was based entirely on the elaborate fraud of its chief executive, a charismatic and influential figure. Broadly, from 1985 on, his fraudulent technique depended on the raising of false invoices against customers for non-existent services, and false invoices for illusory containerized safety equipment ostensibly purchased from other sources. The income and assets of the company were thus inflated on a massive scale. Loan finance was procured on the basis of this fraud, and treated as the product of cash sales. Accordingly, '[t]he company's major source of funds ... was from fraudulent borrowings from banks and other financiers'.[94]

The Board's control over loan approval was strikingly lax, and recorded in the vaguest terms, although multi-million dollar sums were involved. Board agendas and accounts were provided irregularly and typically *at* meetings, rather than in advance. 'Management accounts ... were generally unhelpful in form and misleading in substance [so that] the Board had no useful accounts at all ...'[95] While at some periods, accounts were provided more regularly, they were of an 'unrevealing nature'.[96] Ultimately, a more financially aware director joined the Board, and, in response to his complaints, accounts temporarily improved. For the period ending 30 June 1986, delays, cancellations and inadequate statements were forthcoming. Despite the dearth of meaningful financial information, in 1987 the directors adopted the accounts, which were supplied without due time to digest them. The accounts were accepted by the general meeting, although no auditor's certificate or notes were attached. Further, a qualified auditor's report was not disclosed to the general meeting, nor, apparently, to the directors themselves. Tadgell J remarked 'Most, if not all, of these statutory requirements [viz s269 etc] were breached in relation to the 1986 accounts and the annual general meeting'.[97] As such, 'it must be said, however, that if there had been compliance with the

[93] Id 956.
[94] Id 970
[95] Id 973.
[96] Id 972.
[97] Id 977.

fundamental provisions of the Code in relation to the accounts, including the sending of copies of accounts and associated reports and statements to members before the meeting, this litigation would probably not have arisen'.[98]

The situation further deteriorated. Immediately prior to the 1988 annual general meeting, two directors, including the defendant Eise, simply signed a bundle of documents produced by Friedrich at the last moment, without considering them. Queries were met with lies, and, although no one had read the accounts or reports, they were adopted. The auditor's report, which Friedrich waved briefly at the meeting, was in fact trenchantly qualified. It revealed, *inter alia*, that the value of contract debtors and work in progress, and the very existence of the claimed $60 million containerised equipment, could not be confirmed. Again, no director learned of the qualified auditor's report until later.

In Tadgell J's terms,

> 'by proposing and supporting a motion that accounts . . . and an auditor's report they had never seen be received, approved and adopted, the directors of the time . . . most seriously misled the annual general meeting . . .. The truth was that the whole of the company's financial affairs was then out of the control of the directors and they were never to regain it.'[99]

The directors did not subsequently take steps to obtain copies of the accounts, so that obvious discrepancies with details already supplied were not queried. In May, 1988, 'whether or not the directors understood at the meeting that they had authorised what the minute set out' a finance facility with the State Bank of Victoria for approximately $80 million was authorised.[100] The supposed security for the facility, viz debtors' liabilities and containerized equipment, did not exist; nor did the State Bank 'make any useful investigation to ascertain the existence or value [of the property] over which it assumed it held security.'[101] Subsequently, the overdraft facility was increased without any authorisation. Relevant State Bank staff had implicit confidence in the fraudulent chief executive.

By late 1987, the relationship between Eise and Friedrich had deteriorated. Tadgell J found that there were reasonable grounds to expect insolvency by May 1988, when the State Bank's loan facility was approved. The Board had persistently failed to comply with the requirements of the Code in relation to accounts and annual general meetings. The directors had sighted only sketchy accounts. Given the requirements of the Code, the auditor's report should have been furnished to the directors and laid before the annual general meeting. Accordingly, Tadgell J remarked that 'It is difficult, although perhaps possible, to imagine that a director properly doing his job would not have known . . . [the contents by February 1988'.[102] If, however, he did not, 'he would, if properly doing his job, and using no more than common sense, have

98 Id 979.
99 Id 982.
100 Id 985.
101 Id 986.
102 Id 1000.

called for and considered both the accounts and the report within a relatively short time'.[103] The relevant facts would then have been discovered, and the director, thus put on enquiry, would have found that the company's solvency probably depended on assets which had not been verified. As such, 'a person properly seeking to perform the duties of a non-executive director' would have reasonable grounds to expect insolvency.[104] The supposed inability to verify claimed debtors and equipment persisted for 11 months, but their non-existence was ultimately promptly and simply ascertained. Further, Tadgell J rejected the claim that Eise had no suspicions of the chief executive prior to March 1989.

Defence under Companies (Victoria) Code s556 (2)(b) [Corporations Law s592 (2)(b)

The defendant's attempt to rely on the defence under s556(2)(b) failed. While conceding that Eise was an active director, deceived by a fraudster who had also taken in creditors and accountants, Tadgell J underlined the persistent breaches of the Code and the failure to take reasonable steps that were available to obtain proper financial information. Lacking such information, Eise nevertheless signed reports and statements. He was not entitled to rely on the fact that he had not read those reports.[105] His Honour emphasised that the very strength of the plaintiff's proof pursuant to s556(1) made it difficult to rely on the defence under s556(2)(b). While it was true that the accountants engaged in late 1988 did not suspect insolvency for a further three months, their initial brief was not an insolvency investigation, and their short acquaintance with the company's affairs could be contrasted with Eise's long-standing connection. Tadgell J observed that 'a director does not prove that he did not have reasonable cause to expect etc ... by calling evidence that expert advisers had not advised him by that time that insolvency was proved to their satisfaction'.[106]

Application of Corporations Law s1318 (formerly s535) to Corporations Law s592 (formerly s556)

It is clear that the incurring of debts in the context of insolvency can give rise to liability under both the general provisions of the Corporations Law s232 and the more particular provisions of s592. However, a creditor may not have standing in a s232 action. The relationship between the two distinct sources of liability is not fully resolved. Judges such as Kirby, Tadgell and Ormiston JJ have urged that the provisions of the Corporations Law relating to directors be construed as an integrated code. On the basis of that approach, it would seem that the identical conduct capable of exculpation in an action under

103 Id 1,001.
104 Id 1,002.
105 Id 1,005.
106 Ibid.

s232 should likewise be capable of exculpation in an action under s592. On the other hand, there have been judicial indications that liability under each section should be treated as entirely distinct. In *Coates* v *Hardwick*[107] Cosgrove J of the Supreme Court of Tasmania held that even if a breach of duty under s232(1) were established, that would not justify depriving a defendant of the potential defences available under s592. The predominant view appears to be that although s592 imposes a liability in the circumstances set out in the section, it does not impose a duty as such. The liability is not based on an act or omission, a wrong which is a tort or breach of contract, or a misfeasance or breach of trust. That approach to s592(1) was adopted by the Full Court of the Federal Court in *Official Trustee in Bankruptcy* v *CS & G Handby Pty Ltd*[108] in which it was held that the statutory liability under s592(1) was a liquidated claim capable of proof in bankruptcy. It was also endorsed by Giles J in *CCA Systems Pty Ltd* v *Communications and Peripherals (Australia) Pty Ltd*.[109] In consequence, there are grounds for the view that, in some senses, s592 constitutes 'a code within a code' which stands alone within the Corporations Law. Consistent with that view, there are indications that s1318, the general exculpatory provision, may not be available in relation to liability under s592(1), although it might be available if the liability arose under s232 in relation to identical conduct.

In *3M Australia Pty Ltd* v *Kemish*,[110] Foster J considered it unnecessary to determine whether the exculpatory provision was applicable to proceedings under s556(1), as the defendant's conduct could not entitle him to relief in any event.[111] In *Commonwealth Bank of Australia* v *Friedrich*, Tadgell J again left open the question of its application.[112]

The Corporations Law s1318 (formerly s535) provides:

> 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 ... 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 ... the court may relieve the person either wholly or partly from liability on such terms as the court thinks fit.

In *Lawson* v *Mitchell*[113] the Full Court of the Supreme Court of Victoria had considered the earlier equivalent provision, which was not expressly limited to civil liability and contained a requirement that the defendant act both honestly and reasonably. Young CJ and Newton J discussed the legislative history of the section. They considered that the principal purpose of the section had been to relieve directors from civil liability for loss caused to the

[107] (1988) 6 ACLC 266.
[108] (1989) 7 ACLC 1,070.
[109] (1989) 7 ACLC 1,080.
[110] (1986) 4 ACLC 185.
[111] Id 200.
[112] (1991) 9 ACLC 946, 1010–11.
[113] (1975) ACLC 40–200.

company by neglect or breach of fiduciary duty. Further, it seemed likely that the wider phrase 'negligence, default, breach of trust or breach of duty' was introduced as an ameliorating response to the equivalent of the Corporations Law s241 (Companies (Victoria) Code s237) which avoided certain indemnities. Accordingly, Young CJ and Newton J concluded that the predecessor of s535 did not apply to criminal offences. As a result of the decision, the section was subsequently specifically limited to civil liability. However, they left undetermined the question whether the section could apply to civil actions brought not by the company or its liquidator, but 'by somebody else such as a shareholder or debenture holder seeking personal relief for himself'.[114]

If s535 were not available in proceedings brought by shareholders, it is even less likely to be available in actions by creditors whether under s232 (if that is possible) or s592(1). Further, in *Commonwealth Bank of Australia* v *Friedrich*, it was argued that its application was precluded by the terms of s556(1), as the liability under that section does not require any default or breach of duty. Rather, it depends simply on the defendant's position in the company in the given circumstances. Tadgell J appeared to accept that proposition — he observed 'I have difficulty in seeing that s556 imposes by its terms a liability for an act or omission in contravention of the Code or for the breach of any duty imposed by the Code or otherwise'.[115] In this context, he found relevant the interpretation of analogous English provisions in *Customs and Excise Commissioners* v *Hedon Alpha Ltd Ors*[116] and *in Re Produce Marketing Consortium Ltd (in liq)*[117]. His Honour was likewise attracted to the argument that the provision of specific defences in s556(2) ruled out the application of the generalised defence under s535. On the issue of whether the s535 defence could properly be available against third parties and creditors, Tadgell J considered that overseas authorities which precluded its application were arbitrarily reasoned. He noted that the question had been left open in *Lawson* v *Mitchell* and concluded that 'It would be odd, but nevertheless possible, that s535 was intended to be available as a defence to a civil claim under s556(1) but not a defence to a criminal proceeding under that subsection'.[118] In sum, while the tenor of his observations did not encourage the view that s535 may be available in relation to s556 proceedings, Tadgell J expressly refrained from closing off the possibility.

Factors Relevant to Courts Discretion Under s535

Tadgell J considered that even if s535 did apply, the defendant's conduct did not justify his exculpation. It was pointed out that the defendant served in a part-time honorary capacity for community service. Further, the plaintiff creditor, although better placed to investigate, had been equally deceived.

114 Id 28, 207.
115 (1991) 9 ACLC 946 at 1007.
116 [1981] QB 818.
117 [1989] 1 WLR 745.
118 (1991) 9 ACLC 946 at 1010.

While noting that the Code itself makes no distinction between executive and part-time or paid and honorary directors, his Honour agreed that all the factors cited were legitimate factors to take into account in the context of s535. He observed:

> 'I should think it right that the courts should use the jurisdiction conferred by s535 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 ... able people should not be deterred from offering their voluntary services for want of appropriate protection'.[119]

Nevertheless, a director could not make out a case under s535 by arguing that he had relied on the creditor bank. 'The notion that a director of a company should be entitled to rely on a lender not to make an imprudent loan to the company of which he is a director seems to me to involve an inversion of reality'.[120] Further, Eise's persistent and flagrant breaches of his obligations under the Code, in particular, his false representation of having studied accounts, had shown a want of 'honest resolve' which would have exposed the fraud. Such conduct, if not itself dishonest, at least involved 'the utmost folly'.[121] The defendant's serious compromising of his duty had facilitated the massive fraud, and disentitled him to relief under s535.

CONCLUSION

In conclusion, although the relationship between ss232 and 592 of the Corporations Law is not fully resolved, Victorian construction of the latter provision demonstrates a determination to impose upgraded levels of vigilance and financial standards on company directors. While at this stage, the Victorian approach to s592 is isolated,[122] it would seem to reflect aspirations for reform and community expectations in an era of increasing insolvency. It is likely to influence judicial interpretation of company directors' general duty of care and diligence, and may herald the establishment of a requirement of financial competence. Such a requirement would represent a departure from a traditional tenet of company law, with wide-reaching implications for the commercial community.

[119] Id 1012.
[120] Ibid.
[121] Ibid.
[122] In *Group Four Industries Pty Ltd* v *Brosnan* (1991) 9 ACLC 1181 Duggan J of the Supreme Court of South Australia expressly declined to follow the judgement of Ormiston J in *Statewide Tobacco Service Limited* v *Morley*. Duggan J held that a female company director whose husband had 'assumed complete defacto control' (1189) could rely on the defence under s 556(2)(a) and (b). His Honour stressed that 'the existence of a severe penal sanction' supported a narrower interpretation (1190).