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Directors' liability for approving financial statements containing blatant incorrect items: Lessons from Australia for all directors in all jurisdictions

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and

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1 Introduction

It is well-known that the ultimate responsibility for approving a company's financial statements or accounts is that of the board of directors and this is provided for in section 414 of the UK Companies Act 2006. In addition, there are several other provisions in the UK Companies Act 2006 that require board approval of reports prepared to insure good corporate governance, for instance the directors' report,[1] the corporate governance report[2] and the remuneration report[3]. These reports are of a non-technical nature and directors would normally understand them easily, which would usually make signing off on them not too problematic. However, what is more problematic is signing off on the financial statements or accounts. It has never been determined exactly which steps directors should take to familiarise themselves with the financial statements or accounts of a company before approving them. Or, to put it differently, when will they be liable for a breach of their duty of care and diligence if it is later discovered that the financial statements they approved contained blatant mistakes? To what degree must directors be knowledgeable enough to pick up such mistakes? To what degree must directors inform themselves of the financial statements to make an informed decision before approving them? In addition, to what extent can directors rely on the advice of others, for instance the company's auditors, the company's audit committee, the company's Chief Executive Officer (CEO) and the company's Chief Financial Officer (CFO) before approving a company's financial statements?

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[1] S 419 of the UK Companies Act 2006.

[2] S 419A of the UK Companies Act 2006.

[3] S 422 of the UK Companies Act 2006.

Some of these interesting issues were dealt with in a recent Australian case, the case of *ASIC v Healey*, also generally called the Centro case, referring to the collection of companies associated with the Centro property development group that started doing business in Queensland, but expanded rapidly and later on got involved in international business activities, especially in the USA. In fact there are two reported cases of importance for purposes of the current discussion, namely the case of 27 July 2011 (hereafter referred to as *Healey v ASIC* (27 July 2011))[4] and the case of 31 August 2011 (hereafter referred to as *ASIC v Healey* (31 July 2011)[5]. In *Healey v ASIC* (27 July 2011), the Australian Federal Court of Appeal held that directors and an officer of a company were liable for a breach of their duty of care and diligence by not picking up that the company's financial statements incorrectly classified a large amount of current liabilities as non-current liabilities. In *ASIC v Healey* (31 August 2011), the Court dealt with the sanctions against the directors, in particular whether they should be relieved from liability; whether they should be disqualified from being directors; and whether the Court should impose pecuniary or civil penalties against them.

The Centro case is of particular importance for directors in all modern company law jurisdictions, as the statutory provisions or the common law duty of care, skill and diligence applicable to directors are broadly the same in most jurisdictions. In addition, common law principles or statutory provisions protecting directors when they rely on the advice or information provided by others are basically the same in most modern company law jurisdictions. The general principle is that directors must inform themselves of the advice or information provided by others. They must then develop informed opinions, but if there are no reasonable grounds to suspect that the advice or information was incorrect or misleading, they will be protected against liability. There is no general expectation that directors must scrutinise each and every piece of advice or information in great detail in an attempt to detect mistakes or to find out whether or not the advice or information is misleading. Reasonable reliance on advice or information provided by others is essential for a board to fulfil its role, functions and responsibilities. In fact, it is essential that, especially in large public companies, the board should be able to rely on the advice and information of others as the board's task is

[4] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 (27 July 2011) available at <http://www.austlii.edu.au/au/cases/cth/FCA/2011/717.html>. We refer to the paragraph numbers of this case.

[5] *Australian Securities and Investments Commissions v Healey* (No 2) [2011] FCA 1003 (31 August 2011) available <http://www.austlii.edu.au/au/cases/cth/FCA/2011/1003.html>. We refer to the paragraph numbers of this case under the part dealing with the "Reasons for the Judgment".

to direct, govern, guide, monitor, oversee, supervise and comply, not to manage the business of the company.[6] In Australia section 180(1) of the Australian *Corporations Act 2001 (Cth)* deals with directors' duty of care and diligence, while section 189 contains the underlying rules when directors can rely on advice and information provided by others.

In this article, we first deal with the initial reaction that followed the decision of Justice Middleton in *Healey v ASIC* (27 July 2011). We then deal with the legal case against the directors and the facts of the case before we analyse the case. Our discussion of *Healey v ASIC* (31 August 2011) is focussed on the sanctions imposed against the directors. We conclude our article by drawing the attention to some lessons that can be learnt from the Centro case. These lessons are applicable universally to the directors of all modern company law systems.

2 Background and context

The initial agitation among Australian directors arising from *ASIC v Healey* (27 July 2011) was reminiscent of the agitation that followed the decision in *AWA Ltd v Daniels*[7] nearly 20 years ago and its subsequent appeal in *Daniels v Anderson*[8] in 1995.[9] *Daniels v Anderson* in particular caused anxiety among Australian directors because the duty of care of directors was held to be no different to the duty of care at common law that applies to all people under such a duty. Thus it was held in *Daniels v Anderson* that ordinary negligence (not gross negligence or recklessness) was enough to hold directors liable for a breach of their duty of care. Also, the traditional approach that subjective elements like the knowledge and experience of a particular director should be considered in determining a breach of a director's duty of care, was held to be inappropriate. It was held that whether or not a director breached his or her duty should be determined objectively, measuring the conduct of a director against the conduct of a reasonable person in a similar situation.[10]

[6] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) 77-81.

[7] *AWA Ltd v Daniels* (1992) 7 ACSR 759.

[8] *Daniels v Anderson* (1995) 37 NSWLR 438.

[9] For discussion of this "historical agitation" from the two Daniels cases and their impact on directors' duties see J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) 142 and 242.

[10] See J. J. du Plessis, "A comparison of directors' duty of care, skill and diligence in South Africa and in Australia" [2010] *Acta Juridica* 263 at 270-275.

After *Daniels v Anderson* there was considerable uncertainty as to when directors could rely on the advice provided by others and also whether Australian directors were protected by a "business judgment rule" comparable to the American "business judgment rule". As a result of these concerns a few prominent statutory provisions were added to the Australian *Corporations Act 2001 (Cth)*. First, statutory provisions were added to confirm that directors could delegate powers to others,[11] but they remain responsible for the exercise of that power.[12] However, they will not be liable if there were no reasonable grounds to suspect that the delegate exercised the delegated power improperly and that the director believed on reasonable grounds and in good faith that the delegate was reliable and competent.[13] Second, a statutory provision was added to clarify when directors could rely on the information or advice provided by others.[14] Finally, a safe-harbour rule, called the "business judgment rule", was added to the Australian corporations legislation as another attempt to protect directors from liability for a breach of their duty of care and diligence.[15]

3 The significance of the Centro case

The Centro decision had some important implications for directors and corporate governance in general [16] and reinforced that good corporate governance requires more than just policies and systems but also needs directors to be attentive to their responsibilities and to play an active rather than passive role when performing their duties.[17]

The decision reaffirmed the responsibilities of directors that had been outlined in legislation and previous cases.[18] As Firth noted, it clarified where the boundary is rather than set a new one, even though the decision may be "sobering" for some directors. [19] With regard the

[11] S 198D(1) of the Australian *Corporations Act 2001 (Cth)* – hereafter abbreviated as ACA in the footnotes.

[12] S 190(1) of the ACA.

[13] S 190(2) of the ACA.

[14] S 189 of the ACA.

[15] S 180(2) of the ACA.

[16] For example, see *ASIC v Healey* (27 July 2011) para 14 where Justice Middleton described directors as being "an essential component of corporate governance … placed at the apex of the structure of direction and management of a company".

[17] *ASIC v Healey* (27 July 2011) paras 16-22.

[18] See for example *AWA Ltd v Daniels* (1992) 7 ACSR 759; *Daniels v Anderson* (1995) 37 NSWLR 438 and *ASIC v Rich* [2003] NSWSC 85.

[19] See B. Frith, "Centro ruling reminds directors where their responsibilities lie", *The Australian*, <http://www.theaustralian.com.au/business/opinion/centro-ruling-reminds-directors-where-their-responsibilities-lie/story-e6frg9kx-1226083776840> at 20 July 2011.

specific issues of the case, many directors will be relieved that the decision may not be as far reaching as implied by some of the sensational media headlines about the case. As will be seen below, the case was decided on a very particular set of facts and this will limit the application of the legal principles that could be extracted from the case to similar or comparable factual situations because of the doctrine of precedent. In addition, the subsequent case where the focus was on the appropriate sanctions against the directors, namely the case of *ASIC v Healey* (31 August 2011), is seen by some as illustrating that under similar circumstances directors can expect neither to be disqualified for long periods of time nor have hefty civil penalties imposed against them – see discussion below.

The key message all directors, not only Australian directors, should take from the Centro case is that they must be active participants and "apply an enquiring mind"[20] to form their own opinions to meet their common law and statutory obligations as directors.[21] Anything less could compromise the company's corporate governance processes, with detrimental effects on shareholders and other stakeholders.[22]

The impact of the Centro ruling has largely focussed on non-executive directors as it involved directors' reliance on information provided by others, suggesting that they are not involved in the day-to-day management of the company. However, two of the defendants in the case were officers, namely Andrew Scott (Chief Executive Officer (CEO), but he was also a director) and Romano Nenna (Chief Financial Officer (CFO)).[23]

4 Background and facts of the case

The Australian Securities and Investments Commission (ASIC) has wide powers under the Australian *Corporations Act 2001 (Cth)* to institute civil actions against directors and officers for a breach of any of a large number of statutory duties contained in the Australian *Corporations Act 2001 (Cth)*.[24] ASIC used these powers to institute civil actions against

[20] *ASIC v Healey* (27 July 2011) para 20.

[21] This does not mean that they must act independently at all times and cannot rely on others in some circumstances. See *ASIC v Healey* (27 July 2011) para 129.

[22] *ASIC v Healey* (27 July 2011) para 4.

[23] The ruling would also apply to other categories of directors such as nominee directors, alternate directors, de facto directors and shadow directors as these directors are also more likely to be non-executive directors. P. Hanrahan, I. Ramsay and G. Stapledon, *Commercial Applications of Company Law* (13th ed, 2010), paras 9-240 to 9-270.

[24] The so-called "Civil Penalty Provisions" are listed in s 1317E of the ACA.

seven directors and an officer (the CFO) of Centro Property Ltd, the holding company of a group of companies that primarily developed and invested in shopping centres, but was also involved in retailing.

The facts, simplified for current purposes, were that the 2007 consolidated financial statements[25] of the Centro Group failed to disclose significant matters: for Centro's property arm they failed to disclose some AUD1.5 billion of short-term liabilities by classifying them as non-current liabilities and they failed to disclose guarantees of short-term liabilities of USD1.75 billion; while for Centro's retail arm they failed to disclose AUD500 million in liabilities classified as non-current. In short, current liabilities of almost AUD4 billion were in fact not disclosed as such in Centro's financial statements, which obscured the picture regarding the actual financial position of the Centro Group to a considerable degree.[26] When these errors were discovered in January 2008 and announced in February 2008 the Centro Group collapsed.

5 ASIC's case against the directors of the Centro Group and the outcome of the case

ASIC's case against the directors and officer of Centro was based on a breach of three provisions of the Australian *Corporations Act 2001 (Cth)*:

- A breach of directors' and officers' duty of care and diligence (s 180(1) of the Australian *Corporations Act 2001 (Cth)*);
- A breach of the directors' and officers' statutory duties in relation to taking reasonable steps to ensure the financial statements are prepared in accordance with the provisions of the Australian *Corporations Act 2001 (Cth)* (s 344(1)); and
- A breach of directors' and officers' duty to take all steps that a reasonable person would take, if such a person was in the directors' or officers' position, to ensure compliance with the Australian *Corporations Act 2001 (Cth)* (s 601FD(3)).

[25] The term "financial statements" is used in a wide sense in this article, including the notes to the financial statements and the required financial report, for instance the Directors' Report.

[26] F. Giordano, "Financial reporting duties of directors – ten corporate governance lessons from Centro for non-executive directors of listed public companies" (2011) 63 *Keeping good companies* 390 at 393 estimates that there would have been "a net asset deficiency of $1.93 billion if [Centro] had included the misclassified short-term liabilities" in its financial statements.

Justice Middleton held that ASIC was successful in proving[27] that the directors and officer breached these statutory duties. Justice Middleton summarised his judgment by observing that "the directors failed to take all reasonable steps required of them, and acted in the performance of their duties as directors without exercising the degree of care and diligence the law requires of them".[28]

6 Justice Middleton's judgment

The first part of the 27 July 2011 judgment contains a convenient summary of the case and some general explanations and clarifications regarding the decision. The second part of the judgment refers to the relevant statutory provisions and accounting standards, in particular the requirement that the financial statements of a company must reflect a "true and fair" view of the company's financial position. As far as classification of a liability as current and non-current is concerned, the Australian Accounting Standards Board ('AASB') Rule 101 was relevant. At all times during the relevant period for the financial statements, AASB 101 provided that an entity was required to classify a liability as current in its financial reports when:

(a) it expected to settle the liability in its normal operating cycle; or

(b) it held the liability primarily for the purposes of trading; or

(c) the liability was due to be settled within twelve months after the end of the reporting period; or

(d) the entity did not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period,

and all other liabilities were required to be classified as non-current.

Thus, there could be no doubt that all the liabilities mentioned above were current liabilities, but were not classified as such in the financial statements.

It is significant to note that on 6 September 2007 the board approved the financial statements and the directors' declaration of approval (required under s 295(4) of the Australian

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[27] It is beyond the scope of this article, but note the application of the unique burden of proof standard, called the "Briginshaw standard" see *ASIC v Healey* (27 July 2011) paras 99-103.

[28] *ASIC v Healey* (27 July 2011) para 8.

Corporations Act 2001 (Cth)) of the financial statements was signed properly. This declaration included, inter alia, that in the directors' opinion, the financial statements complied with Accounting Standards, the Australian *Corporations Act 2001 (Cth*), Regulations and other mandatory professional reporting requirements. Also, the declaration specifically stated that the financial statements represent "a true and fair view of the company's and consolidated entity's financial position as at 30 June 2007 and of its performance as represented by the results of their operations, changes in equity and their cash flows, for the financial year ended on that date".[29] The declaration of solvency, namely that there were reasonable grounds to believe that the relevant companies in the Group would be able to pay its debts as and when they become due and payable, was also included in the declaration. As mentioned above, when it was discovered that almost AUD4 billion current liabilities were not classified as such, the Centro Group collapsed and by then it became obvious that the 2007 financial reports of the Centro Group contained material misstatements.

Though not a central issue of this case, it was in dispute whether a declaration by the CEO and the CFO (required under s 295A of the Australian *Corporations Act 2001 (Cth)*) was in fact made and whether it was made available to the board. This declaration is one the CEO and CFO must personally sign to attest that financial records have been properly maintained; that the financial statements (and notes to the financial statements) comply with the accounting standards; and that the financial statements (and notes to financial statements) give a true and fair view of the company's or group's financial position. It should be noted that this declaration is in addition to the declaration made by the board of directors and is aimed at directing the CEO and CFO's attention specifically to these issues and to make sure that the board is also aware of the fact that these two important officers of the company have considered these matters and that they have made a formal declaration in this regard.

It is also noteworthy that Justice Middleton specifically mentioned the issue of corporate governance and the board structure and board committees of the Centro Group.[30] During the relevant period, there was in force a written Board Charter that applied to the directors and officer against which ASIC instituted the civil action. The Board Charter, inter alia, expected the board to monitor the company's financial position and business results (including the audit process) to understand at all times the health of the company; to ensure regulatory

[29] *ASIC v Healey* (27 July 2011) 60(a)(ii).

[30] *ASIC v Healey* (27 July 2011) et seq.

compliance and maintaining adequate risk management processes; and to ensure a high level of transparency reporting to security holders and compliance with the highest ethical standards. Thus, it was difficult for the directors or officer to deny that they were not aware of their actual responsibilities.

There was also a Board Audit and Risk Management Committee that fulfilled its functions under a Board Charter. This Board Charter made it clear that it was expected of this committee, inter alia, to assist the board in discharging its responsibilities with respect to the financial statements, financial report and annual report; to oversee the preparation of financial statements and reports; and to oversee financial controls and systems. The normal procedures for this committee's audit responsibility included determining the reliability and integrity of accounting policies and financial reporting and disclosure practices; and monitoring compliance with applicable accounting standards and other requirements relating to the preparation and presentation of financial results.[31] At all times during the relevant period the auditor of each for the Centro Group and associated entities was PricewaterhouseCoopers ('PwC'). These corporate governance issues are mentioned as an illustration of the fact that there were no indications that the Centro Group's corporate governance systems were deficient, which is confirmed by looking at the Centro Group Webpage.[32]

7 Importance of the case

7.1 Who was affected?

The failure to correctly classify the liabilities as current rather than non-current and the failure to disclose the short-term guarantees exposes a core tenet of corporate governance, namely that "financial objectives are expressed to be the driving factor underpinning contemporary corporate governance regulation".[33]

Good corporate governance is of significant importance for protecting shareholders rights, assisting them to make prudent investment decisions and maintaining their confidence in

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[31] *ASIC v Healey* (27 July 2011) para 34.

[32] Centro Properties Group, Corporate Governance webpage, <http://www.centro.com.au/Investment+Products/Centro+Properties+Group/Corporate+Governance.htm> accessed at 29 August 2011.

[33] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 159.

companies. The Centro decision reinforces this and the directors' failure had detrimental impacts on financial outcomes, investment, shareholders and confidence in Centro.

Similar to *ASIC v Rich*,[34] Centro's actions meant that the company's true financial position was not revealed. If Centro had correctly classified its current liabilities, they would have exceeded the company's current assets[35] raising significant concerns for investors.[36] When these deficiencies came to light, Centro's share price crashed[37] and it faced action for misleading investors.[38]

While Centro was one of the first Australian companies to suffer under what became known as the Global Financial Crisis (GFC),[39] the actions (and inactions) of Centro's directors were contrary to their statutory duties and obligations. Therefore, Justice Middleton's ruling would not have differed at a different time or if the GFC had not occurred.

7.2 Prudent corporate processes – necessary but not sufficient condition

The Centro decision reinforced that directors are a focal point of corporate governance for companies.[40] It would be easy to speculate that Centro's corporate governance processes must have been lacking, which contributed to the failures perpetuated by the directors. Centro

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[34] *ASIC v Rich* [2003] NSWSC 85.

[35] Giordano estimates that there would have been "a net asset deficiency of $1.93 billion if [Centro] had included the misclassified short-term liabilities" – see F. Giordano, "Financial reporting duties of directors – ten corporate governance lessons from Centro for non-executive directors of listed public companies" (2011) 63 *Keeping good companies* 390 at 393. Also, when considering the advice of the expert witness Mr. Lonergan, Justice Middleton noted that "[i]t is normal commercial practice for current assets to exceed current liabilities. Unless this is so, there is a serious risk that the entity may not be able to meet its debts as and when they fall due". *ASIC v Healey* (27 July 2011) para 473.

[36] These concerns would have been amplified if the guarantees had also been revealed.

[37] From $10 in May 2007 (a few months before the erroneous financial statements were published in the company's annual report) to $0.037 in early September 2011. P. Ryan, "ASIC pursues Centro directors for 'misleading' investors", *ABC News*, <http://www.abc.net.au/news/2009-10-21/asic-pursues-centro-directors-for-misleading/1111850> at 1 August 2011 and Australian Stock Exchange webpage for Centro Properties Group, <http://www.asx.com.au/asx/research/companyInfo.do?by=asxCode&asxCode=CNP> at 4 September 2011.

[38] P. Ryan, "ASIC pursues Centro directors for 'misleading' investors", *ABC News*, <http://www.abc.net.au/news/2009-10-21/asic-pursues-centro-directors-for-misleading/1111850> at 1 August 2011.

[39] P. Ryan, "ASIC pursues Centro directors for 'misleading' investors", *ABC News*, <http://www.abc.net.au/news/2009-10-21/asic-pursues-centro-directors-for-misleading/1111850> at 1 August 2011.

[40] See *ASIC v Healey* (27 July 2011) para 14.

has a range of corporate governance documents on its website[41] and states that these “charters and policies … ensure that the Group complies with the ASX Corporate Governance Council Recommendations”.[42]

The fact that these documents exist currently does not mean that they existed prior to the events that caused ASIC to take Centro to court. It may be possible that Centro prepared the documents and sharpened its corporate governance focus as a result of the deficiencies revealed by the case. However, Justice Middleton specifically mentioned the corporate governance of the Centro Group but did not describe it as lacking or deficient in any way.[43]

Implementing and maintaining appropriate corporate governance processes and systems is essential for a company to demonstrate its corporate governance credentials but this may come to nothing if they are not applied consistently throughout all levels of the company.[44] The personal and human aspect is critical for these (or in fact any) processes and systems to be effective. Directors cannot be “fast asleep”[45] as it may undo “all the systems and processes the [Centro] board put in place to guard against errors”.[46]

This was a key theme of Justice Middleton’s finding that directors are “not relieved of the duty to *pay attention* to the company’s affairs which might reasonably be expected to attract inquiry”[47] nor should they be “just “*going through the motions*” or [putting] sole reliance on

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[41] See for example Centro Properties Group, Corporate Governance webpage, <http://www.centro.com.au/Investment+Products/Centro+Properties+Group/Corporate+Governance.htm> at 1 August 2011; Centro Properties Group, Corporate Governance webpage, <http://www.centroinvestor.com.au/overview/corporate-governance> at 1 August 2011; and Centro Retail Trust, Corporate Governance webpage, <http://www.centro.com.au/Investment+Products/Centro+Retail+Trust/Corporate+Governance.htm> at 1 August 2011.

[42] Centro Properties Group, Corporate Governance webpage, <http://www.centro.com.au/Investment+Products/Centro+Properties+Group/Corporate+Governance.htm> at 1 August 2011.

[43] *ASIC v Healey* (27 July 2011) paras 30 et seq and 291 et seq.

[44] See the final paragraph in the article by the Chartered Secretaries Australia. Chartered Secretaries Australia, “Centro case – asking the dumb questions”, <http://www.csaust.com/Content/NavigationMenu/TechnicalResources/Governance_information/Otherreports/Australian_informati.htm> at 1 August 2011.

[45] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 146.

[46] L. Wood, “Boards watching the Centro case”, *The Sydney Morning Herald*, <http://www.smh.com.au/action/printArticle?id=2456842> at 20 July 2011.

[47] *ASIC v Healey* (27 July 2011) para 18, emphasis added.

others, no matter how competent or trustworthy they may appear to be".[48] Therefore, while prudent corporate governance processes and systems are essential for a company, they will only be truly effective if they are complemented by the diligent attention and application by a company's directors and other officers.

7.3 Benefit of independent directors

It can be argued that Centro employed prudent corporate governance practices by appointing independent directors. However, the existence of independent directors is no guarantee that corporate governance failures will not occur. If a company has a potential exposure because its independent (and other) directors are "fast asleep",[49] they need to be woken to improve the company's corporate governance effectiveness and it is possible that the Centro decision may be what is needed to wake them up.

The benefits of independent directors will be optimised if these directors are active participants in the governance of the company[50] (including keeping themselves informed about the company's operations and performance,[51] as well as being aware of their own obligations as directors) and they are supported by the company through prudent corporate governance practices.

7.4 Impact on the role, duties, responsibilities and potential liabilities of directors

As noted above, the Centro decision is of significant importance for (in particular non-executive) directors in respect of their duties and obligations[52] even though the consensus view is that "the [Centro] decision does not redefine existing law"[53] and simply "clarified the

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[48] *ASIC v Healey* (27 July 2011) para 174, emphasis added.

[49] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 146.

[50] *ASIC v Healey* (27 July 2011) paras 16-22.

[51] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 268.

[52] See for example S. Lannin, "ASIC targets Centro directors", *ABC News*, <http://www.abc.net.au/news/2009-10-21/asic-targets-centro-directors/1112248> at 1 August 2011; J.J. du Plessis, *Centro, Fortescue actions all part of a high stakes game for ASIC* (2011) The Conversation <http://theconversation.edu.au/centro-fortescue-actions-all-part-of-a-high-stakes-game-for-asic-1414> at 1 August 2011; I. Ramsay, "Will Centro's mistakes prompt action across the board?" (2011) The Conversation <http://theconversation.edu.au/will-centros-mistakes-prompt-action-across-the-board-2048> at 1 August 2011; and University of Western Sydney, "Centro ruling puts onus on directors", (Press Release, 28 June 2011), <http://pubapps.uws.edu.au/news/index.php?act=view&story_id=2999> at 1 August 2011 14.

[53] Arnold Bloch Leibler Arnold Bloch Leibler, "Case note – The Centro decision: *ASIC v Healey*", Arnold Bloch Leibler <http://www.abl.com.au/default.asp?p=4,5,7> at 1 August 2011.

duties of directors".[54] For example, the minimum requirements of diligence for directors under section 180(1) of the *Corporations Act 2001* were outlined clearly in *ASIC v Rich*[55] and were not expressed any differently in the Centro decision. What has come as an apparent surprise to the Centro directors and others, however, is that they have a requirement "to make further inquiries into matters revealed by [the company's financial statement and board papers] where it is appropriate to do so".[56]

There appears to have been a (possibly explicit and unanimous) expectation by Centro's non-executive directors that they could rely entirely on the company's management and auditors. This expectation may seem reasonable when considering the distinction between the roles of a company's executives (responsible for the management of the company) and its directors (responsible for its direction).[57] However, the Centro case illustrates that mere inaction, not even reading or studying the financial statements and not forming an independent view on them, exposes directors to liability for a breach of their duty of care and diligence.

The fundamental and basic mistake that the non-executive directors in particular made was not to bring an inquisitive mind to the board meeting where the financial statements were approved. They should have asked fundamental questions and sought specific assurances of correctness after they had informed themselves, as far as practicable possible within the limits of their own knowledge and experience, of the correctness of the financial statements. The fact that they did not specifically ask about the CEO and CFO's signed declaration of correctness of the financial statements as required under s 295A of the Australian *Corporations Act 2001 (Cth)*, is in itself an indication of the fact that they did not fulfil their duty of care and diligence.

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[54] R. Austin and C. Reynolds, *All reasonable steps to be in a position to guide and monitor – the impact of the Centro decision* (2011) Minter Ellison <http://www.minterellison.com/public/connect/Internet/Home/Legal%2BInsights/Alerts/NA-All%2Breasonable%2Bsteps/> at 1 August 2011.

[55] *ASIC v Rich* [2003] NSWSC 85. These requirements or standards are discussed in J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 274.

[56] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 274.

[57] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 77-83.

One can, however, not help to feel some sympathy for the non-executive directors who acted "honestly" as Justice Middleton pointed out pertinently.[58] It is not difficult to imagine that the non-executive directors trusted and relied on the expertise of the auditors (PriceWaterhouseCoopers), their Board Audit and Risk Management Committee, their CEO and their CFO. That seemed to have been a mistake and this particular aspect of the case, in particular in light of the reliance-section (s 189 of the Australian *Corporations Act 2001 (Cth)*) will probably remain one of the most controversial aspects of the Centro case. It should be noted that the directors specifically pleaded reliance on s 189 of the Australian *Corporations Act 2001 (Cth)*, but Justice Middleton does not even refer to the section once. It means that the practical application and usefulness of this section is all but clear.

One may interpret Justice Middleton's judgment as meaning that s 189 of the Australian *Corporations Act 2001 (Cth)* only applies if the director has made "an *independent* assessment of the information or advice, having regard to the *director's knowledge of the corporation* …". However, that section also provides that "the complexity of the structure and the operations of the corporation"[59] must also be taken into consideration and there is no doubt that the structure of the Centro Group was hugely complex and the operations of the Group were vast, with highly complex international financial involvement and investment, especially from the USA. In fact, the structure and operations of the Group was so complex that the professional auditors, the qualified audit committee, the CFO and the CEO did not pick up the blatant mistake of the wrong classification of current liabilities as long term liabilities, a mistake that is now seen in hindsight as an Accounting 101 mistake.

The facts and the application of the law to these facts at times seem not to match if one focuses on the role and the responsibilities of the professional auditors, the qualified audit committee, the CFO and the CEO in comparison with the role and the responsibilities of non-executive directors. The unfortunate consolation is that this is probably only reflected in the fact that the non-executive directors got off very "lightly" as will be seen later. The reality is, however, that they were held to be in breach of their duties and that reality will stand unless the directors appeal, which is highly unlikely. It is highly unlikely as they would not like to run the risk of a counter appeal by ASIC against the lenient sanctions the court imposed.

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[58] *ASIC v Healey* (27 July 2011) para 8; *ASIC v Healey* (31 August 2011) para 13.

[59] Section 189(b)(ii) of the ACA, emphasis added.

An important moral of this story is that “a director, whilst not an auditor, should still have [and apply] a questioning mind”[60] and that is consistent with the requirement that they take any reasonable and appropriate actions required to direct and govern the company, including keeping themselves current about the company’s operations and activities.[61]

Non-executive directors in particular should not passively accept information and advice given to them without applying an independent enquiring mind, as they have a statutory obligation to form an independent opinion where a company’s financial statements are concerned,[62] rather than acknowledging someone else’s opinion.[63] This means that they cannot simply expect that the company’s management and auditors did the right thing but must apply their own (not insubstantial) knowledge of the company, ask questions and form their own opinion.[64]

Centro’s directors were found to have breached their duty of care and diligence because they did not take “all reasonable steps required of them”[65] to perform their duties as directors as they failed to form an independent opinion of the financial statements presented to them.[66] This did not mean that the directors were dishonest and Justice Middleton considered them to be “conscientious people”.[67] Nonetheless, it was in fact held that they abrogated their duties as directors.

7.5 Was the business judgement rule applicable?

As mentioned above, s 180(2) of the Australian *Corporations Act 2001 (Cth)* contains a business judgement rule that provides some protection for directors in the case of business

[60] *ASIC v Healey* (27 July 2011) para 17.

[61] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 268.

[62] Section 295(4)(c) of the ACA requires directors to make a declaration “in the directors’ opinion”.

[63] See F. Giordano, “Financial reporting duties of directors – ten corporate governance lessons from Centro for non-executive directors of listed public companies” (2011) 63 *Keeping good companies* 390 at 393 and *ASIC v Healey* (27 July 2011) para 20.

[64] See F. Giordano, “Financial reporting duties of directors – ten corporate governance lessons from Centro for non-executive directors of listed public companies” (2011) 63 *Keeping good companies* 390 at 393; *ASIC v Healey* (27 July 2011) paras 521 and 572.

[65] *ASIC v Healey* (27 July 2011) para 8.

[66] Chartered Secretaries Australia. Chartered Secretaries Australia, “Centro case – asking the dumb questions”, <http://www.csaust.com/Content/NavigationMenu/TechnicalResources/Governance_information/Otherreports/Australian_informati.htm> at 1 August 2011.

[67] *ASIC v Healey* (27 July 2011) para 8.

decisions that appeared to be sound at the time they were made but subsequently turn out to have been flawed or sub-optimal.[68] A "business judgment" is defined in s 180(3) of the Australian *Corporations Act 2001 (Cth)* as "any decision to take or not to take action in respect of a matter relevant to the business operations of the corporation". Does the approval of financial statements and reports constitute a business decision? It is submitted that it is not, because the approval of financial statements of the company is a statutory requirement rather than a discretionary business judgment. Thus, the protection of directors would lie in the reliance provision contained in s 189 of the Australian *Corporations Act 2001 (Cth)*. However, even if this argument is not accepted it should be pointed out there are four different requirements before the business judgment rule would protect a director, namely that a director or other officer of a corporation is only protected if they:

(a) make the judgment in good faith for a proper purpose; and

(b) do not have a material personal interest in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best interests of the corporation.

The Centro directors would not have been able to rely on the business judgement rule as the third and fourth limbs were clearly not met. As outlined above, they did not "inform themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate"[69] as Justice Middleton did not believe the directors took "all reasonable steps required of them"[70].

It is also questionable whether the court would have considered the Centro's directors' failure to apply their "independent enquiring minds" to be a "judgement" that would be captured under the business judgement rule.

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[68] See for example P. Latimer, *Australian Business Law* (28th ed, 2009) at 666.

[69] Section 180(2)(c) of the ACA.

[70] *ASIC v Healey* (27 July 2011) para 8.

7.6 Knowledge of the company

A key point against the Centro directors was the fact that they should have known that the financial statements were inaccurate, which is similar to the allegations made by ASIC in *ASIC v Rich*.[71]

Firstly, the current liabilities arose shortly before the 30 June 2007 reporting date, so the directors should have been aware of their existence so soon afterwards at the 6 September 2007 board meeting. Secondly, the classification of liabilities into current and non-current is a fundamental accounting concept that experienced directors should have been aware of. Further, the notes to the financial statements included an explanation of the definition of borrowings classified as current liabilities.[72] Finally, the guarantees were provided after the 30 June 2007 reporting date but before the 6 September 2007 board meeting, so they should have been current in the minds of the directors.[73]

7.7 The buck stops at the board

Could directors absolve themselves from their duties through delegation and reliance on others? The answer is clearly "no" as directors are only permitted to delegate their powers, but not to abrogate their duties and responsibilities. That is why there are specific pre-requisites before a director can rely on the protection of s 189 of the Australian *Corporations Act 2001 (Cth)*. Section 189 provides, inter alia, that the director's reliance on the information or advice is taken to be reasonable (unless the contrary is proved), only when the reliance was made in good faith; and after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation. It could be argued that the Centro decision put responsibility where it belongs – on directors so that they "seriously consider such matters and take appropriate action… and [are] not just "going through the motions" or [relying] on others, no matter how competent or trustworthy they may appear to be".[74] However, as was

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[71] J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (2nd ed, 2011) at 273.

[72] *ASIC v Healey* (27 July 2011) para 54(c).

[73] This was the basis for Justice Middleton's comments that the "significant matters not disclosed were well known to the directors, or if not well known to them, were matters that should have been well known to them". *ASIC v Healey* (27 July 2011) para 11. See also F. Giordano, "Financial reporting duties of directors – ten corporate governance lessons from Centro for non-executive directors of listed public companies" (2011) 63 *Keeping good companies* 390 at 392.

[74] *ASIC v Healey* (27 July 2011) para 174.

pointed out above, there are no certainties as to where the borders are drawn, especially when the complexity of the structure and operations of the corporation will and should also be taken into consideration in addition to the other aspects mentioned.

7.8 Volume of information

Part of the defence of the Centro directors related to the amount of information that they received with their board packs which resulted, in some cases, to some directors not reading all the information provided to them. Justice Middleton stated firmly that the volume of papers provided to a board "is within the power of the Board to control".[75]

There is a trade-off that arises from this statement. By minimising the information they receive, the board may be delegating more to the executive management of the company for which they are still responsible. Nevertheless, the message to boards is clear – they cannot rely on the volume of information as an excuse for lack of knowledge on an issue. If necessary, the board should request to defer decisions if there is insufficient time or information to make an informed decision. This is, however, sometimes easier said than done in a dynamic business environment where decisions are almost always made on the run.

7.9 Version control

The Centro directors also stated that there was some degree of confusion about which version of the financial statements they were considering. Again, this is something that a board should able to control, even though a document prepared under tight timeframes (such as end of year financial statements) may have a number of versions produced in a short period. The board should ensure that management provides them with as few versions as possible; preferably only a single, final version.[76]

[75] *ASIC v Healey* (27 July 2011) para 298.

[76] This contrasts to the Audit Committee where members may see a numbers of versions of the financial statements in a short period due to requests for changes and amendments. However, the Audit Committee should have strict protocols in place to address this issue.

8 Penalties imposed: The Centro decision of 31 August 2011[77]

8.1 Background

In the decision of 27 June 2011 the Court handed down its decision and reasons for the liability of the directors ("liability judgment"). In the decision of 31 August 2011 the question of penalties and applications for relief from liability made by the defendants were considered.

It was widely reported that the media thought the directors and officer got off "lightly". Justice Middleton held that there was no need for any civil penalty or any period of disqualification for any of the six non-executive directors. This is remarkable as ASIC suggested civil penalties of between AUD30,000 and AUD60,000, . together with disqualification periods of between six months and 18 months. As far as the CEO (Andrew Scott) is concerned, Justice Middleton also imposed no period of disqualification, but ordered him to pay a pecuniary penalty of AUD30,000. This is remarkable as ASIC suggested a 3-year period of disqualification and a AUD100,000 pecuniary penalty. The CFO (Romano Nenna) was disqualified for two years, but no pecuniary penalty was imposed. In his case, he admitted to the breaches of his duties, but ASIC suggested, similar to its suggestion for the CEO, a 3-year period of disqualification and a AUD100,000 pecuniary penalty. Justice Middleton also held that the defendants share the costs of ASIC for bringing the proceedings against them. In this regard it is highly likely that the directors' and officers' Directors and Officers Insurance (D&O Insurance) would cover all these costs, meaning that in fact the directors would not deplete their own wealth to pay these costs.

8.2 Court's power to grant relief from liability for breaches of duties

Similar to section 1157(1) of the UK Companies Act 2006, sections 1317S and 1318 of the Australian *Corporations Act 2001 (Cth)* provide that there are situations where a Court can relieve a director from liability after the Court has found that a director acted negligently or in breach of his or her duties. In determining whether or not to make this order, sections 1317S(1) and 1318(1) provide that this relief could be given if a person who has been held to have acted negligently or breached a duty "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". All the non-executive directors asked the Court for this relief. However, Justice Middleton denied such relief even though it was held that the non-

[77] *ASIC v Healey* (31 August 2011).

executive directors acted "honestly".[78] Thus, the relief was denied based on the fact that Justice Middleton was not of the opinion that the non-executive directors "ought fairly to be excused", which is the second value-judgment (after the value judgment of "honesty") the Court must make under sections 1317S(1) and 1318 of the Australian *Corporations Act 2001 (Cth)*.

It is worthwhile to point out that there is some confusion created by what Justice Middleton said concerning when the applicants[79] would be considered to have "acted honestly", which is a requirement for relief under sections 1317S(1) and 1318 of the Australian *Corporations Act 2001 (Cth)*. Justice Middleton seems to use quite a restrictive interpretation of the word "honestly" in sections 1317S(1) and 1318(1). In fact, he read in some additional words into these sections by stating that to be entitled to the relief, "the court must be *positively satisfied* that the applicant has acted honestly" and that "[a] mere absence of dishonesty will not satisfy the requirements of the provisions".[80] This seems to be quite an artificial way of looking at the sections. Is Justice Middleton saying that there are degrees of "honesty"? Mere honesty at the lower end of the scale and then a high level of honesty at the other end of the scale? Must a Court look at the facts of a case and determine whether it is "negatively satisfied" that the applicant acted honestly (is that when they acted dishonestly?); whether a Court is "merely satisfied" that the applicant acted honestly (which was what Justice Middleton held was how the Centro non-executive directors acted); or whether a Court is "positively convinced" that the applicant acted honestly. It is submitted that the only consideration is whether, objectively, the applicant acted honestly or not. Once this is determined the relief is either denied or the Court moves on to determine whether "the person ought fairly to be excused", which is a value judgment the Court needs to make, "having regard to all the circumstances of the case, including those connected with the person's appointment".[81]

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[78] *ASIC v Healey* (27 July 2011) para 8; *ASIC v Healey* (31 August 2011) paras 13 and 88.

[79] The defendants applied for relief and are, therefore, called the applicants for purpose of their application under ss 1317S and 1318 of the ACA.

[80] *ASIC v Healey* (31 August 2011) para 87, emphasis added.

[81] See ss 1317S(1) and 1318 of the ACA.

8.3 Relief from liability primarily aimed at non-executive directors

As far as the second limb of the liability relief provisions are concerned, it is perhaps a good time to be reminded exactly why that was added to the UK Company Law Legislation, which was later adopted in Australia. The general prohibition of companies to exempt directors from liability by way of very wide exemption clauses in companies' Articles of Association caused concerns in the UK after the cases of *In re City Equitable Fire Insurance Company Limited*[82] and *In re Brazilian Rubber Plantations and Estates Limited.*[83] This concern was expressed clearly in the Greene Report of 1926.[84] As a result of the recommendations of the Greene Committee, statutory provisions were added to prohibit such wide forms of exemption in companies' Articles of Association. However, there was a concern that people who were appointed to the board for their special skills and not involved in the day-to-day business of the company, what we now call a typical non-executive director, would not take up positions in boards if there was not some form of additional protection for them. It was, therefore, recommended that section 279 of the *Companies (Consolidation) Act 1908 (UK)* be amended

> "…by adding a provision to the effect that in determining whether a director ought to be excused the Court shall take into consideration all the circumstances relating to his appointment. Such a provision would meet the case of a director who has been appointed because of his special knowledge or for a special purpose and not to direct the business of the company generally."[85]

It is common knowledge that community expectations of directors, including expectations of non-executive directors, have changed considerably since 1926. However, it is perhaps time that we interpret sections comparable to section 1157(1) of the UK Companies Act 2006 and sections 1317S and 1318 of the Australian *Corporations Act 2001 (Cth)* in their historical context and not shy away from the actual aim or purpose the legislature had in mind when these provisions were enacted. In fact the relief-provision was aimed at providing a particular form of relief *for non-executive directors*. It is submitted that because of this historical

[82] [1925] Ch 407.

[83] [1911] 1 Ch 425.

[84] Greene Report, *Report of the Company Law Amendment Committee* (Cmd 2657/1925-26) HMSO London (1926) at 19-20 paras 46-47.

[85] Greene Report, *Report of the Company Law Amendment Committee* (Cmd 2657/1925-26) HMSO London (1926) at 21 para 21.

context Courts should take this into consideration when non-executive directors apply for relief. It should not be forgotten that the intention of the legislature with the relief-provision was definitely to draw a clear distinction between the unique position of non-executive directors compared to that of executive directors.

8.4 Specific reasons for not relieving the non-executive directors from liability

Justice Middleton provided specific reasons for not allowing relief from liability from any of the directors, not imposing any civil penalties or disqualification periods on any of the directors, but imposing a civil penalty of AUD30,000 on the CEO and a disqualification period of 2 years on the CFO. He mentioned that very much at the forefront of his consideration was the issue of general deterrence. In his view the orders went far enough to indicate the Court's disapproval of the actions of each of the defendants, and to satisfy the requirements of the principle of general deterrence. Any additional penalties were considered unnecessary to facilitate the future adherence to high standards. He then explains as follows:[86]

> What the Court has attempted to do is to recognise the seriousness of the contraventions, but at the same time take into account the circumstances in which the contraventions occurred, the overall conduct of the defendants, and the impact of the penalties imposed on these particular defendants. These factors militate very strongly against more excessive penalties. To achieve this balance is in the public interest; to impose greater penalties in the circumstances of this proceeding would not bring about a greater benefit for society or the corporate world, and would otherwise be unfair and inappropriate.
>
> It goes without saying that in the measurement of punishment, the quantity of punishment in the context of general deterrence can never be absolutely determined by any standard or invariable rule: in the end, the measurement is reached by considering what appears to be the best to prevent future contraventions.

We think it is very unlikely that ASIC will appeal Justice Middleton's decision. The reason being that ASIC originally asked for only short periods of disqualification and relatively small amounts of civil penalties.

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[86] *ASIC v Healey* (31 August 2011) para 6-7.

8.5 Did the Centro non-executive directors practically get off scot free?

With respect to the penalties handed down in the Centro case, it has been described that Justice Middleton took a "Goldilocks position – not too hot, not too cold"[87] which elicited a range of responses. The disparate reactions to the penalties imposed on the Centro directors and officers were not surprising as they simply reflected the observer's point of view. Shareholder advocates thought that the court had "let down the entire community"[88] and that the CEO's AUD30,000 fine was "quite paltry"[89], while the CEO noted that he suffered other detriments such as a loss of reputation and being unemployable and that the court penalties actually "vindicated" him. [90] These observers largely missed the point as Justice Middleton's focus was on sending an appropriate message that would deter others rather than punishing the Centro defendants[91] and he considered ASIC's requests for harsher penalties to be "unnecessary and excessive" to achieve his objective of deterring others "from making the same mistake". [92]

A key learning from the Centro case is not seen in relation to the quantum of the penalties imposed but from Justice Middleton's message which reinforced the "irreducible requirement of directors to ... take all reasonable steps to be in a position to guide and monitor".[93] This was not a new message but simply confirmed (by further clarifying) what is considered to be acceptable in terms of directors' obligations.

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[87] L. Wood, *Judge settles on Goldilocks option, not too hot and not too cold* (2011) Brisbane Times <http://www.brisbanetimes.com.au/business/judge-settles-on-goldilocks-option-not-too-hot-and-not-too-cold-20110831-1jm3w.html> at 4 September 2011.

[88] R. Gluyas, "What's the point? Investors slam Centro cop-out", *The Australian* (Sydney), 1 September 2011 <http://www.theaustralian.com.au/business/companies/whats-the-point-investors-slam-centro-cop-out/story-fn91v9q3-1226126810360> at 4 September 2011.

[89] ABC, "Centro directors hear convictions", *Lateline Business,* 31 August 2011, <http://www.abc.net.au/lateline/business/items/201108/s3307141.htm?> at 4 September 2011.

[90] S. Lannin, "Centro boss fined for breach of corporate law" *ABC News,* 31 August 2011 <http://www.abc.net.au/news/2011-08-31/centro-boss-fined-for-breach-of-corporate-law/2864618> at 4 September 2011.

[91] *ASIC v Healey* (31 August 2011) para 6.

[92] S. Danckert "ASIC loses bid to ban Centro directors", *The Australian* (Sydney), 1 September 2011 <http://www.theaustralian.com.au/business/asic-loses-bid-to-ban-centro-directors/story-e6frg8zx-1226126821631?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+TheAustralianProperty+%28The+Australian+%7C+Property%29> at 4 September 2011.

[93] *ASIC v Healey* (27 July 2011) para 16.

9 Lessons and conclusions

The first and probably most important lesson from the Centro case is that directors need to be vigilant at all times and cannot blindly rely on information received from others – they must, at least to a certain extent, evaluate and consider information themselves and they should, at times, rely on independent advice to get a second opinion if they are not satisfied with the advice or information received from management.

As noted earlier, the key message that directors should take from this case is that they must be active and engaged participants in their role, applying themselves diligently and with an enquiring mind, so they can form their own opinions to meet their common law and statutory obligations as directors. They can rely on others in certain circumstances but they cannot delegate the responsibility for their own decisions and are required to ask questions to ensure they make an informed decision. However, there may be situations where they have an obligation to seek further advice on complex or risky areas even though they have already received (and are not dissatisfied with) a first opinion on an issue.

Directors must acknowledge that these are the ways in which shareholders expect directors to act and such practices are also in accordance with the high community expectations for directors and officers to fulfil their duties. Further, these actions would probably also assist to protect directors and officers against liability.

The Centro case clarified the importance of the CEO and CFO declaration provided under s 295A of the Australian *Corporations Act 2001 (Cth)* both in relation to the obligations of these officers as well as to the ability for (particularly non-executive) directors to rely on such a declaration. We are certain that Australian directors will make sure that they get the declaration under s 295A from the CEO and the CFO before they approve the financial statements under s 295 of the Australian *Corporations Act 2001 (Cth)*.

A salient lesson from the case was that the directors were found to have acted honestly but this did not excuse them from liability. Similarly, while it may seem reasonable for directors to rely on the advice received from the independent auditor, the Board Audit and Risk Management Committee, the CEO and the CFO, they must also take "all reasonable steps required of them",[94] which includes bringing to bear an enquiring mind.

[94] *ASIC v Healey* (27 July 2011) para 8.

One further lesson from the case is the need for directors to be cognisant of their common law and statutory duties and obligations. This may require potential directors to undertake appropriate training prior to joining a board, or require new directors be provided with a suitable induction program when they join a board or for existing directors to be supported with ongoing directorial development. While this development could be initiated by either the company or an individual director, it would be incumbent upon the director to ensure they have the requisite skills, including the skills to understand and analyse financial statements, to perform their role.

In addition, Justice Middleton's choice of words when discussing the issue of relief under sections 1317S and 1318 of the Australian *Corporations Act 2001 (Cth)* may raise some uncertainty regarding future application of these sections as he considered that "the court must be *positively satisfied* that the applicant has acted honestly" rather than "an absence of dishonesty". [95] It is not clear that the court should require anything beyond simply being satisfied that the applicant acted honestly – the degree of satisfaction should not be relevant in relation to these sections. We would not be surprised if this comment were to be tested in future.

Finally, it is likely that ASIC would be satisfied with the outcome of the Centro case as it provided clear and unequivocal signals to directors, even though Justice Middleton considered ASIC's requested penalties to be too harsh. While the case did not provide any clarity on the application of s 189 of the Australian *Corporations Act 2001 (Cth)*, it is reasonably certain that all Australian directors got a wake-up call that there could potentially be serious consequences if they do not make "informed decisions". We also think that all boards of all public companies will have hard and serious discussions with their auditors, their audit committees, their CEOs and their CFOs. We predict that Australian boards will take particular care in future to ensure that they get actual assurances from those they rely on for advice and information. To this end, we believe that ASIC would be satisfied that the greater good of good corporate governance was served.

[95] *ASIC v Healey* (31 August 2011) para 87, emphasis added.