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ASIC V LINDBERG (2012)

Director's Duty of Care and Act with Diligence – Case Analysis



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1.0 Introduction

A sound regulatory environment is essential for economic prosperity and growth in the long term. Without a strong corporate regulatory environment and governance principles the corporate environment and industries in the economy cannot thrive (Hertog, 1999). Corporations Act 2001 is the backbone of Australian corporate laws and provides the foundation for the regulation of corporate sector in Australia. Australian Securities and Investment Commission (ASIC) plays the role of corporate, financial markets and services regulator with the aim to promote investor confidence through transparent and fair dealing in the markets (ASIC, 2016).

The foundations of Australian corporate law lie in the common law. The duty of directors of a company as understood under the common laws and general principles have undergone numerous changes over time to suit the standard of care required by the directors in the prevailing commercial environment. The fast changing dynamic business and technological environment of the 21st century demands directors and key executives and other management personnel of the corporations to be more proactive and efficient in setting strategic direction as well as making informed decisions for the business concern. This has led to the codification of the common law understanding of directors' duty of care into legislation in various states including Australia.

ASIC v Lindberg (2012) is one case law where the Supreme Court of Victoria under the judge Robson J. have provided further guidance on the duty of care and diligence of directors and key officers of the companies as laid under the Corporations Act 2001 (Cth). The judgment of the court also provides some vital principles for imposing pecuniary and disqualification penalties subsequent to the breach of aforementioned duties (MinterEllison.com, 2012). This paper highlights some of the key issues and involved in this case along with the facts identified and agreed to by the parties to the lawsuit, provides a brief explanation of the legal principles and statute relevant to the case, discusses the legal arguments raised by the parties, and finally discusses the basis of judgment pronounced by the court.

2.0 Issues and Facts involved in the case

The lawsuit relates to the very popular events concerning the Australian Wheat Board's (AWB) alleged contravention of the UN resolutions relating to prohibition of sale and trade of

commodities to Iraq except those that are necessary on humanitarian grounds such as food and water. Sanctions were also put in place denying Iraqi regime access to currency. AWB was the supplier of wheat to Iraq under the UN treaties.

2.1 Alleged Contraventions

Two specific issues were involved based on which AWB was alleged to have contravened the UN resolutions of that time. This includes:

1. AWB used to pay a 10% “trucking fee” to an intermediary company they provided the Iraqi government access to some hard currency. The terms of the agreement also resulted in a violation of the UN treaties which required the payment out of proceeds from the sale of Iraqi oil only for specified purposes.
2. The second allegation was in respect of the contract AWB made with a third party for the recovery of \$8 million debt for wheat shipments to Iraq. This was done by mutually agreeing on a price hike of the supply of wheat to Iraq. This again resulted in the violation of UN terms as mentioned above (ASIC v Lindberg, 2012).

When the matter was discovered, investigations were started that included an external investigation by the Independent Inquiry Commission (ICC) of UN, and an internal inquiry instituted by AWB’s board under the name of *Project Rose*.

When several facts were revealed from the inquiries and investigations, the ASIC brought legal proceedings against the managing director of AWB – Andrew Lindberg, and the CFO of the company – Paul Ingleby, in separate prosecutions (MinterEllison.com, 2012).

2.2 Agreement between ASIC and defendant Lindberg

The facts relating to the contravention were agreed between ASIC and Mr.. Lindberg and the resulting pecuniary penalty and the cessation of the office of director by Lindberg was also agreed by both the parties. As per the declarations to be made it was agreed by both the parties that Mr.. Lindberg failed to fulfill the following fiduciary and other duties acting in his capacity as the managing director of AWB.

1. Ascertain through inquiries and otherwise whether the recovery of debts amounting to \$8 million by increasing the price of the wheat to be supplied tantamount to violation of the UN resolutions.

2. Failed to account for the information under Project Rose investigation that can be obtained by interviewing the former employees of the AWB. Only current employees were interviewed on the basis of documents in the possession of the company.
3. Failed to communicate to the relevant Group board and the members of the company that the debt has been recovered through price hike agreement and that the amounts under the contract with the third party were wrongly described as “commission and success fee”.
4. Delays in informing the AWB board that the funds were channeled to the Iraqi government through the intermediary company through trucking fee (ASIC v Lindberg, 2012).

All other allegations on Mr.. Lindberg were dropped by ASIC on condition that Mr.. Lindberg agreed on the abovementioned contraventions of UN resolutions and the resulting non-compliance of duties under the Corporations Act 2001. It was also agreed among the parties that none of the allegations involved dishonesty, fraudulent intent or moral turpitude (MinterEllison.com, 2012).

3.0 Relevant Laws and Principles relating to the case

3.1 Duty of Care and Acting Diligently – Section 180(1)

By not being able to fulfill his duties as described above, Mr.. Lindberg had contravened the provisions of Section 180(1) of the Corporations Act, 1990 which reads as follows.

“A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- a) were a director or officer of a corporation in the corporation's circumstances; and
- b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer” (Section 180(1) of the Corporations Act 2001).

As per the general rule, directors of the company are liable for damages resulting from any negligence in the performance of the duties they are entrusted with. However, what constitutes negligence and how it will be calculated is rather subjective and construed based on the judgment of the various courts for same subject matters (Adams, 2001).

In *Norman v Theodore Goddard* (1992), the court described the principles that should be considered while deciding whether the director acted with care and diligence, as considering whether the care is such that would be exercised by a reasonably diligent person having:

- a) Skills, experience and general knowledge expected of a person in that position and acting in that capacity, and
- b) Skills, experience, and general knowledge that the director in contravention has.

In exercising the duty of skill, a director is required to exercise that degree of skill which can be expected of a person having his level of expertise and experience. This is often referred to as “ordinary prudence” and is a subjective test (Tomasic, Bottomley, and McQueen, 2002). For example, in *ASIC v Healey* (2011) it was held that the directors did not demonstrate their duty of care by failing to notice issues in the financial reporting and results published to shareholders.

As per section 181 of the Corporations Act 2001, a director is also required to act in good faith and for a proper purpose in the best interest of the company and its shareholders when exercising powers and discharging their obligations as defined in the Act. Sections 182 and 183 are not applicable in this case as both ASIC and the Board of AWB have agreed that Mr. Lindberg did not use his position and influence to gain unfair advantage for himself with a fraudulent intent.

3.2 The Minimum Standard of Care as per Common Law

Another leading case that addressed the duty of care is *ASIV v Adler* (2002). The judge Santow J. offered a detailed explanation of duty of care that can serve as a foundational basis for determining whether Lindberg acted with diligence and care. These include, but are not limited to the following.

- Duty to act with skill and diligence,
- Duty that is, at a minimum, equivalent to that of an ordinarily prudent person,
- Duty that is commensurate with the expertise, skill, and diligence of any director holding office in the company
- Standard of care that requires a director to be well informed in respect of all state of business affairs of the company
- Any delegation should fulfill the abovementioned duties at a minimum

- Acting with and all decisions should be based on rationale and in the best interest of the company and its members (ASIC v Adler, 2002).

3.3 The Business Judgment Defense

If a director can prove the above considerations and that the business decision taken by him was in good faith and as per the information available with the Board at that time, and there is no negligence on this part; then Section 180(2) afford the only defense of the *Business Judgment Rule* by virtue of which no liability would be later imposed on the director if company faces any loss. It is also held in ASIC v Rich that the burden of proof to demonstrate the Business Judgement Rule lies on the director. The judgment given in the case of ASIC v Lindberg elaborates on this exception as well.

4.0 Legal Implications and Arguments of the parties to case

4.1 Role of the Court and ASIC

Since agreement between ASIC and Lindbergh was reached, a declaration of contravention of civil penalty provision under section 180(1) was made by ASIC under section 1317E of the Corporations Act 2001. Under the agreement, ASIC banned Lindberg from holding the office in management position 14 September 2014, and also imposed a monetary penalty of \$100,000. However, the Court needs to be satisfied with it, in order to impose pecuniary (which may extend to a maximum of \$200,000) and disqualification penalty on Lindberg as per section 1317G of the Act. For this, the Court needs to be satisfied that the disqualification and pecuniary penalty are justified and the director in default is not aggrieved by the said decision.

Based on the agreed statement of facts between the parties, and taking into account the evidence presented and its own considerations, the Court may enhance or reduce the penalty and make its own judgments as deemed necessary. However, the Court will respect and give due consideration to the agreement reached among the parties (ASIC v Maxwell, 2006).

4.2 Arguments of Mr. Lindberg

It was held and noted by the honorable judge that:

- Mr. Lindberg was concerned about the issues of the company.

- He sought internal and external advice at times relating to the ongoing issues including the ones relating to the contravention of the UN resolution.
- He described his inactions as “mistakes” rather than negligence (ASIC v Lindberg).

4.3 Arguments of ASIC

- In this case, the reputational risks that surrounded the agreements with the intermediary company and modifying the contracts to supply wheat as per UN resolutions risked the company’s operations and potential loss of goodwill. Therefore, Lindberg as MD of the company should have played a more active role. This converts the mere mistake into negligence on his part.
- In relation to investigations under Project Rose, Mr. Lindberg needed to be on high alert and consider investigations from all perspectives.
- At several times Lindbergh relied on senior and other managing staff of the company as he was preoccupied with other business work. So he failed to give proper attention to this matter of great significance (ASIC v Lindberg).
- Lindberg should have formed his own opinion regarding the events rather than relying on his staff (MinterEllison.com, 2012).

5.0 Conclusion and Judgment of the Court

Judge emphasized the importance of ensuring proper standards of care and diligence are exercised by the board of directors. Failing it may cause a loss to shareholders, creditors and other stakeholders of the company. Judge Robson J. also held that section 180(1) “not seek to punish the mere making of mistakes or errors of judgment” (Paragraph 72 of the Judgment). However, the business judgment defense is not available to Lindberg as his inactions did not amount to decisions as per section 180(1) “to take or not take action in respect of a matter relevant to the business operations of the corporation”

Taking advice from the experts and other members of the staff does not fall within taking due care and acting diligently. A managing director of the company should be able and ready to play an active (not passive) role in the management of all affairs of the company, even when they are duly and diligently working on other areas of business. As to when can a director rely on

information from others and experts, the guidance is lacking and shall be a subject of future lawsuits in on this subject matter.

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