Alan du Mée

Proposal 1:-

Section181 and s184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation

For the purpose of Proposal 1 (and Proposals 2 and 3), should 'management' of a corporation be defined' If so, should the definition be along the lines of policy which involve decision making related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs"

Response to Proposal 1:-

Yes. The definition of Management should be extended to anyone exercising power of direction, and/or authority over any other person, within the corporation or being directed by the corporation on its behalf. This means that supervisors would no longer have a defence of being instructed to do any thing, if they knew or should reasonably have known that the thing being requested was incompetent, or illegal, or improperly authorized. This needs to be defined into Corporations Law.

Together with properly defined Whistelblower protection for all acts conducted in employment, illegal or grossly incompetent acts could no longer be made secret or covered up and many potential failures would be uncovered before they occurred.

In the Amcor price fixing case for instance, price fixing would have incurred severe penalties on anyone aware of this activity (but not necessarily involved) not coming forward, but they would also have certain protection from vilification and retribution.

All company owners, Board members, Directors, employees, contractors and service providers would have the same obligations to tell the truth and severe penalties if they do not expose incompetent or illegal acts. In return they would receive appropriate and extensive whistleblower protection from vilification and employment retribution.

This would bring Corporations Law into line with for instance Industrial Safety legislation and with certain Misleading and Deceptive Conduct aspects of Trade Practices where misleading statements (untruths) are severely dealt with.

Proposal 2:-

Subsection 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

Response to Proposal 2:-

Yes. The response to proposal 1 is equally appropriate to proposal 2.

Proposal 3:-

As a corollary of Proposal 2, s 180(2) (the business judgment rule) should be extended beyond directors and other officers of a corporal' to any other person who takes part, or is concerned, in the management of that corporation

Response to Proposal 2:-

Yes. The responses to proposals 1 and 2 are equally appropriate to proposal 3.

Proposal 4:-

Section 182 and s 184(2) (improper use of corporate position should be extended beyond directors, other officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Response to Proposal 4:-

Yes. The responses to proposals 1, 2 and 3 are equally appropriate to proposal 4.

Proposal 5:-

Section 183 and s 184(3) (improper use of corporate information} should be extended beyond past end present directors, other officers and employees of a corporation, to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

Response to Proposal 5:-

Yes. The responses to proposals 1, 2, 3 and 4 are equally appropriate to proposal 5.

Proposal 6:-

Subsection 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Response to Proposal 6:-

Yes. The responses to proposals 1, 2, 3, 4 and 5 are equally appropriate to proposal 6.

Proposal 7:-

Subsection 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company

Should the categories of persons subject to s 1309(2) (ensuing the veracity of information) be extended in the same manner as proposed for s1309(1), namely to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Response to Proposal 7:-

Yes. The responses to proposals 1, 2, 3, 4, 5 and 6 are equally appropriate to proposal 7. The 'Corporate books' definition apply to all records of the company not just financial records.

General Dishonesty proposal:-

Should there be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statutes If so, should the provision apply to:-

1. *obligations under the Corporations Act only, ar*

2. *obligations under any Commonwealth, State or Territory statutes applicable to corporations*

3. *obligations under any overseas written laws as well as Australian laws'*

Response to General Dishonesty Proposal:-

Yes for 1 and 2 above but not to 3. The law within Australia should not seek to impose additional conditions applying in overseas jurisdictions.

Related Corporations Proposal:-

Should there be a prevision to the effect that where any person who:
is a director, officer or employee of a corporation, or
takes part, or is concerned, in the management of that corporation, or

> *performs functions, or otherwise acts, far or on behalf of that corporation makes, or participates in making, a decision that is implemented in whole or part by a related corporation, that person, in addition to the duties he or she owes to the first corporation, will also owe the related corporation the duty of care and diligence (a 180(1) and good faith (a 181) in relation to that decision If this proposal is adapted, that person should have the business judgment rule defence in s 180(2) Also, where the related corporation is a wholly-owned subsidiary, that person should have the benefit of s 187.*

Response to related corporation Proposal:-

Yes in all cases.

Other behaviour question:-

Are there any forms of behaviour of individuals below board level (not otherwise dealt with in this paper) that should be prohibited, or differently regulated, under the Corporations Act.

Response to the other behaviour question:-

Yes. If we are to prevent incompetent and illegal acts within companies, it is essential that the people involved or who are on the periphery who know what is going on (potentially all employees and other service providers), are able and encouraged to tell what they know honestly, easily, quickly and without fear of recrimination. This requires whistleblower protection legislation that prohibits the naming of the people and also prohibits retribution of any kind.

It is my contention that there is a consistent and systemic failure of Governance and Management processes within many businesses and more particularly within Government Owned Corporations and in Government Departments that are the central cause of not earlier uncovering and responding to these business and administrative failures.

In all of the corporate failures in recent times many more people knew what was going on but were too afraid to act. In the FAI/HIH case a company had to fail before these acts were followed through, even though many other people inside both organisations knew what was going on.

The tendency to avoid bad news, vilify whistleblowers and to generally avoid facing issues that may reflect on their own performance is endemic in private and Government businesses.

Not only whistleblowers, but the people associated with them are often victimized and isolated. A climate of fear is thus created whereby other employees are discouraged from voicing their concerns about incompetent or illegal acts. This feudal and hierarchical approach to accountability pervades many areas of private sector and government company responsibilities.

It is therefore imperative that we also enact appropriate protection for whistleblowers (such as legislation to protect careers, income and reputation and also to remove Parliamentary privilege for naming whistleblowers or their associates), together with appropriate regulations that necessitate an independent investigation once a formal submission is made. Without such protection we cannot really expect employees to help us uncover incompetent or illegal actions. Queensland politicians have made an art form out of naming whistleblowers that discourages whistleblowing in the future.

The CLERP 9 provisions for whistleblower protection are too narrow and only focus on direct financial impacts. In most of the HIH failings, many more people knew what was going on and would have been prepared to speak out sooner, probably soon enough to prevent the failure, if they had had protection from retribution. Not having broad ranging protection for all employees to enable them to speak out about grossly incompetent or illegal acts is now long overdue.

Unless we instill a broad ranging corporate and administrative culture of transparency and open management within companies and especially Government ones, supported by legislation, and include Government departments and their agencies and insist on a consistent framework of ethical practices that include trust, honesty, integrity and accountability, we will perpetrate the very failures that have led to this discussion paper.

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Paul Martin

A. INTRODUCTION

In being tasked with investigating the collapse of insurance giant HIH, Royal Commissioner Justice Neville Owen was directed to explore whether undesirable corporate governance practices contributed to the group's failure.[1] In conducting his inquiry, Commissioner Owen examined not only the duties attaching directors, but those related to other corporate agents.

While suggesting these non-directors' duties should be functionally oriented – that is, concerned with the task performed, not the status of legal relationship between actor and company – Commissioner Owen focused on three classes of personnel, suggesting it unfortunate were they excluded from the duties' operation.[2] This paper reviews that assertion, and considers whether these groups should be so bound. It concludes that some, but not all, of the examined actors require further control.

B. THE SETTING

The non-directors' duties examined by Commissioner Owen were those contained in Part 2D.1 and s 1309 of the *Corporations Act 2001* (Cth) ('the Act').[3] Extending in some instances to an 'employee', their chief application was to an 'officer of a corporation'.[4] That phrase, defined by s 9, included directors, secretaries and persons:

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[1] See Commonwealth of Australia, HIH Royal Commission, *The Failure of HIH Insurance* (2003) vol 1, 305. Hereafter referred to as 'HIH Royal Commission'.

[2] Ibid vol 1, 121-131.

[3] See *Corporations Act 2001* (Cth) ss 180-183, 1309.

[4] The duties outlined in ss 182(1), 183(1), 184(2) and 184(3) applied to both 'employees' and 'officers', while those established by ss 180(1), 181(1) and 184(1) applied only to the latter group.

(i) who make, or participate in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or

(ii) who have the capacity to affect significantly the corporation's financial standing; or

(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act …[5]

In Commissioner Owen's belief, the range of personnel subject to these duties was inadequate – consultants and contractors,[6] 'middle' management, and personnel acting for a group company other than that by which they were (primarily) engaged[7] were, in his opinion, all likely excluded from the duties' operation.[8] That this was felt unsatisfactory flowed from the role of each in HIH's demise.

Advocating a more functionally-oriented approach, he proposed the employee-related duties instead apply to 'all persons performing functions for and on behalf of corporations'.[9] Likewise, duties intended to apply only to senior personnel should take 'being concerned or taking part in the management of the relevant entity' as their standard.[10]

In response, legislation was passed extending several duties not examined by Commissioner Owen, and s 1309, to employees.[11] As regards a functionally-

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[5] *Corporations Act 2001* (Cth) s 9.

[6] Hereafter referred to as 'consultant-contractors'.

[7] Hereafter referred to as 'group personnel'.

[8] HIH Royal Commission, above n 1, vol 1, 121-2, 126-7, 129.

[9] Ibid 126.

[10] Ibid.

[11] So as to correct perceived definitional anomalies: see *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) Schedule 9; Department of

based descriptor scepticism was expressed, 'concerned in management' singled out as 'not easily definable' and susceptible to judicial vacillation.[12] Despite this, the Corporations and Markets Advisory Committee was asked to consider whether excluding the above categories from the duties' operation was problematic.[13] A Discussion Paper will be released in June 2005.[14]

C. A THEORETICAL FRAMEWORK

Given the above, it is appropriate to examine whether the groups identified by Commissioner Owen should be unambiguously brought within the Part 2D.1 duties' scope. In this respect, the insights of Ronald Coase are useful.

Coase asserts that the firm emerges as a mechanism to minimise the burden of transaction costs.[15] Although production may be accomplished in a fully decentralised manner by way of discrete contracts between individuals, the 'search and information costs, bargaining and decision costs, policing and enforcement costs' inherent in such a method generally militate against its practice.[16]

An organiser-producer will instead prefer to enter longer-term, broadly-phrased agreements with suppliers, characterised by the surrender of (a degree of) the latter's autonomy, to the former, in exchange for specified remuneration.[17] The

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Treasury and Finance, *CLERP (Audit Reform & Corporate Disclosure) Bill – Commentary on the Draft Provisions* (2003) 139.

[12] Department of Treasury and Finance, above n 11, 141.

[13] See Corporations and Markets Advisory Committee website, <http://www.camac.gov.au>, accessed 30 March 2005.

[14] Interview with Lenny Nigro, Department of Treasury and Finance, 8 April 2005.

[15] See Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386, Ronald Coase, 'Industrial Organisation: A Proposal for Research' in Victor R. Fuchs (ed), *Policy Issues and Research Opportunities in Industrial Organisation* (1972), Ronald Coase, *The Firm, the Market and the Law* (1988).

[16] Ronald Coase, *The Firm, the Market and the Law* (1988) 6-7.

[17] Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386, 392-3.

firm surfaces as the set of such relationships under the control of a particular organiser-producer.[18]

The limit to a firm's size is reached where the cost of organising a transaction 'internally' is equal to that of conducting it through the market.[19] That is to say, as a firm expands, it becomes a less efficient device for administering transactions. A key factor in this regard is the phenomenon of agency costs.

Jensen and Meckling define agency costs as those associated with the divergence of interests between agent and principal.[20] Though the applicability of a principal-agent framework to the relationships structuring corporations has been criticised,[21] delegation of decision-making abilities remains a hallmark of the matrix of company-employee and employee-employee relations.[22]

Attendant with delegation is supervision, and it is the resources spent monitoring an agent that, amongst other factors, limits a firm's size: as the number of agents increases, so does the required level of supervision.[23] The monitoring load imposed on a firm thus shapes its internal configuration.[24]

This is the traditional rationale for imposing duties on company directors – by specifying behavioural standards and a means of redress if those standards are

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[18] Ibid 393.

[19] Coase, above n 16, 7.

[20] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 308.

[21] See, eg, Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

[22] R. P. Austin, H. A. J. Ford and I. M. Ramsay, *Company Directors: Principles of Law and Corporate Governance* (2005) 59; see also *Corporations Act 2001* (Cth) s 198D.

[23] Jensen and Meckling, above n 20, 308-9.

[24] In fact, in Jensen and Meckling's model monitoring costs are merely one element of agency costs, the others being 'bonding costs' and 'residual loss'. For discussion of these topics, not relevant to present concerns, see Michael Whincop, 'Of Fault and Default: Contractarianism as a Theory of Anglo-Australian Corporate Law' (1997) 21 *Melbourne University Law Review* 187, 191-2.

breached, agency costs are lowered and the gap between the archetype stockholder 'owners' of the company and its board is lessened, allowing the company to further expand and productive efficiency in the broader economy to increase.[25]

While such a model is oversimplified, its relevance holds where the interest in ensuring a specific result remains divorced from the ability to oversee its realisation. The extent to which a stakeholder-operative divide emerges, and to which existing behavioural controls are adequate, will thus guide our analysis of whether the Part 2D.1 duties should be extended to definitively include the three aforementioned categories of personnel.

As such, the behavioural controls applying to these actors will first be examined.

D. EXISTING BEHAVIOURAL CONTROLS

While both legal and non-legal controls are relevant to our analysis, only the former will be discussed here.[26] These arise in contract, tort and equity, and under statute.

(i) Contract

Unless inconsistent with the terms of the bargain, all contracts contain an implied duty to co-operate.[27] This exists as both a positive obligation to do all things reasonably necessary to secure its performance,[28] and a negative

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[25] See Adolphe Berle and Gardiner Means, *The Modern Corporation and Private Property* (1932); see also Adam Smith, *The Wealth of Nations* (1776) 700.

[26] For discussion of non-legal controls, see Jensen and Meckling, above n 20, and Eugene F. Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288.

[27] *Butt v McDonald* (1896) 7 QLJ 68, 70-1 (Griffith CJ).

[28] *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596, 607 (Mason J).

obligation not to impede or cause a contemplated benefit to be undermined.[29] Though not as expansive as the Part 2D.1 'good faith' and 'proper purposes' duties,[30] an overlap nevertheless exists.

Patently, consultant-contractors and middle management will normally be bound by such a term. Evidencing contractual relations between group personnel and a given company may also be possible, though corporate authority and certainty of terms issues loom as hurdles.[31]

If an employment relationship can be shown, further duties may be implied. Not only will the Part 2D.1 'use of position' and 'use of information' obligations be triggered,[32] analogous contractual duties will ordinarily be imputed as standard terms.[33] A duty of care and skill at least as broad as its sibling Part 2D.1 obligation will usually also be implied.[34]

Consonant with Coasean analysis, the touchstone for identifying such relationships has been the concept of 'control'.[35] Though now only a single indicium, the existence of 'lawful authority to command' remains, however, the

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[29] *Telstra Corporation Ltd v Australis Media Holdings Ltd* (1997) 24 ACSR 55 (McClelland CJ).

[30] See *Corporations Act 2001* (Cth) s 181.

[31] The nature of such engagement usually being largely informal and often dictated by the whims of senior management without consideration for legal niceties: see HIH Royal Commission, above n 1, vol 1, 129; see also vols 2, 3 generally.

[32] See *Corporations Act 2001* (Cth) ss 182-3.

[33] *Concut Pty Ltd v Worrell* (2001) 75 ALJR 312, 317-18 (Gleeson CJ, Gaudron and Gummow JJ), 321-2 (Kirby J). For discussion, see Breen Creighton and Andrew Stewart, *Labour Law* (4th ed, 2005) 357-64.

[34] *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555; *Williams v Printers Trade Services* (1984) 7 IR 82. Indeed, if the individual possesses a special skill identifiable by defined characteristics, such a (contractual) duty will apply regardless of employment status: see *Breen v Williams* (1996) 186 CLR 71. It may be argued the implied common law duty is broader than its statutory counterpart on account of the former's reference to 'care, skill and diligence' as compared with the latter's 'care and skill': see *Corporations Act 2001* (Cth) s 180.

[35] See Creighton and Stewart, above n 33, 284-93.

pre-eminent consideration.[36] Consultant-contractors in long-standing, immediate and loosely-defined relations with a company thus risk being classed as employees, HIH's external actuary, David Slee, a model case-in-point.[37] Group personnel and other consultant-contractors appear to be less exposed, owing to their greater autonomy.[38]

(ii) Tort

Even without an employment relationship, consultant-contractors will likely owe an identical duty of care and skill in tort, based on the standard expected of a reasonably competent individual in the consultant-contractor's profession;[39] middle management employees thus owe this duty in parallel.[40] The position of group personnel is unclear.[41]

(iii) Equity

Similar obligations arise in equity. Group personnel found to be in a fiduciary relationship with a given company[42] will owe a duty of care and skill comparable to that at common law,[43] as will consultant-contractors and middle

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[36] *R v Allan; Ex parte Australian Mutual Provident Society Ltd* (1977) 16 SASR 237, 248 (Bray CJ).

[37] On Slee, see HIH Royal Commission, above n 1**,** vol 2, 296-303.

[38] The model situation with regard to group personnel being a group executive acting with regard to a subsidiary company: see, eg, ibid vol 1, 57, vol 2, 71, vol 3, 290, 319.

[39] *Rogers v Whitaker* (1992) 175 CLR 479.

[40] *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109.

[41] In theory, a group executive will owe a tortious duty to the subsidiary company s/he is acting with regard to, however the usually ill-defined nature of her/his role with respect to that company makes it hard to identify the duty's content, as compared with more regular circumstances.

[42] Most likely under Mason J's 'undertaking' approach: see *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 96-7 (Mason J). See also the comments of Gibbs CJ in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1974-1975) 132 CLR 373 at 394.

[43] *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438.

management, if falling within a presumptive fiduciary category.[44] Whether such an obligation extends to middle management broadly, through their holding powers classically associated with senior management and the board of directors, remains unresolved.[45]

As fiduciaries, these actors owe additional duties, identical to or broader than their statutory equivalents: 'good faith' and 'proper purposes' duties mirrored in Part 2D.1, and 'no conflict' and 'no profit' duties, echoed in part by the 'use of position' and 'use of information' provisions.[46]

In fact, the 'proper purposes' duty likely extends to middle management generally,[47] also constrained, as employees, by a duty of fidelity approximating the 'use of position' and 'use of information' obligations.[48] Some consultant-contractors will accordingly also be bound. Equitable principles relating to breach of confidence further restrain all three groups.[49]

(iv) Statute

The possibility emerges that the Part 2D.1 duties already bind the studied classes. In *ASIC v Adler*,[50] Rodney Adler was found an 'officer' of wholly-owned HIH subsidiary Casualty & General Insurance Ltd ('C&G') by reason of

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[44] See *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 141 (Dawson J). An accumulation of case law leads to an argument that financial advisers may, in given circumstances, be added to this list: see, eg, *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390.

[45] See James Jackson, 'The Liability of Executive Officers Under the *Corporations Law*' (1991) 3 *Bond Law Review* 275.

[46] See Austin, Ford and Ramsay, above n 22, 227-400.

[47] Ibid 288.

[48] See Creighton and Andrews, above n 33, 359-62.

[49] See *Thomas Marshall (Exporters) Ltd v Guinle* [1978] 3 WLR 116; see also Austin, Ford and Ramsay, above n 23, 364.

[50] *Re HIH Insurance Ltd (in prov liq) and HIH Casualty and General Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler and Others (No 3)* (2002) 41 ACSR 72. Hereafter referred to as 'ASIC v Adler'.

his membership of parent HIH Insurance Ltd's ('HIH') investment committee, it being primarily responsible for group company investment decisions.[51] Given the group's business model, such decisions 'clearly' affected the whole or a substantial part of C&G's business.[52] The same result followed from Adler's HIH board membership, this providing capacity to significantly affect C&G's financial standing.[53]

Beyond implying group executives owe duties to each company they act in respect of and not merely the ultimate holding company, *ASIC v Adler*'s importance rests in its functionally-based reading of the 'officer' definition: it was the centrality of investment decisions to C&G's operations that rendered Adler, as committee member, an officer of C&G. Logically, the two external consultant committee members could also have thus been classified.

Consultant-contractors, middle management, and group personnel thus appear capable of being bound by the Part 2D.1 duties. This remains, however, a supputation.[54] It fails, moreover, to answer the question of whether these actors *should* be so bound. The case thus only contributes to our analysis – it does not resolve it.

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Though only a survey, the above neatly summarises the legal controls applying to the three groups. While each is not internally homogenous, generalisations can nevertheless be made.

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[51] *ASIC v Adler* (2002) 41 ACSR 72, 100-1 (Santow J).

[52] *ASIC v Adler* (2002) 41 ACSR 72, 100 (Santow J).

[53] *ASIC v Adler* (2002) 41 ACSR 72, 101 (Santow J).

[54] See, moreover, *Hunter Business Finance Pty Ltd v Australian Commercial & Equipment Finance Pty Ltd* [2003] NSWSC 122 (Unreported, New South Wales Supreme Court, Gzell J, 19 March 2003) [102], and the comments of Commissioner Owen: eg, HIH Royal Commission, above n 1, vol 2, 122, 256, vol 3, 32.

Middle management appear the most regulated, subject to equitable, tortious and contractual controls nearing, in combination, the content of the Part 2D.1 duties. Group personnel, though a diverse category, will often be similarly bound, the model situation a group executive, acting with regard to a subsidiary company, determined a fiduciary.[55] Even more assorted are consultant-contractors; unless in employment-like relations, a lawyer, or financial adviser resolved a fiduciary,[56] only the limited duties of co-operation, care and skill will apply.

Having charted the behavioural controls applying to each group, it is appropriate to assess their adequacy. This provokes the question: adequate for whom? If our stakeholder/operative model is to persist, the actors with an interest in our groups' behaviour – an interest the law should sanction, at least – require identification. A gap between need and ability to control will indicate a need for reform.

E. IDENTIFYING STAKEHOLDERS

All the above powers and duties are – rightly – held by or owed to the company, largely represented at law by the board of directors.[57] This may be unproblematic in smaller proprietary corporations, where agency costs are lower, but not in larger ones. As one judge has observed:

> [M]any companies today are too big to be supervised and administered by a board of directors except in relation to matters of high policy. The true oversight of the activities of such companies resides with … [s]enior management and, in the case of mammoth corporations, persons even lower down the corporate ladder … This necessarily means that, in the execution of policy, senior

[55] See n 38.

[56] See n 44.

[57] See Austin, Ford and Ramsay, above n 22, 55-137. For discussion of whom these duties might be owed to in the US, see Blair and Stout, above n 21.

> management is … exercising the powers of decision … which in less complex days used to be reserved for the board of directors.[58]

Should senior management be charged with the legal abilities currently held by the board? It is submitted not. Further to there being insufficient space within executives' day to absorb additional responsibility without acceptable cost, ensuring compliance with legal duties remains a matter of 'high policy'. The information costs associated with directorial decision-making in this context are, moreover, reduced by the equitable obligations attaching senior management.[59]

Are there others the law should empower? Creditors and shareholders are invariably mentioned, understandably; as the financiers of this mode of production, harms visited on the company are visited on them. Indeed the shareholder derivative action recognises this.[60] However their interests and the corporation's are not concentric – to so fully authorise sponsors would be to ignore the corporation's separate legal existence.

Rightly though, the above acknowledges that circumstances present where the board is unwilling and/or unable to be an effective corporate representative. It is here ASIC normally acts, representing company interests, those of shareholders and creditors, and the public more generally.[61] If considered plausible that boards could find themselves unwilling and/or unable to enforce the examined behavioural controls, there then emerge grounds for correspondingly empowering ASIC.

Such inertia appears common. Commissioner Owen's report describes advisers wrongly withholding information from company officers, subsidiary company

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[58] *AWA Ltd v Daniels t/as Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759, 832-3 (Rogers CJ).

[59] See Jackson, above n 45.

[60] For discussion, see Austin, Ford and Ramsay, above n 22, 742-69.

[61] See, eg, *Corporations Act 2001* (Cth) ss 1317E, 1317J.

directors unable to oppose group executives' decrees, and middle management employees flagrantly distorting accounting figures.[62] While not to be imputed as typical corporate behaviour, the conditions triggering these actions were, likewise, not so unusual as to suggest the HIH debacle was spectacularly unique.[63]

ASIC should be enabled to act on the three groups. As its legitimacy is ancillary, it should act only where the corporation cannot or will not. Whether to legislate this requirement or entrust ASIC with discretion is debatable, though the latter appears wiser.

F. THE ADEQUACY OF EXISTING CONTROLS

Having identified our stakeholders, we can thus assess the adequacy of the surveyed legal controls. Such analysis will reveal whether the Part 2D.1 duties, under custody of ASIC, should be extended to definitively include the three aforementioned categories of personnel.

In measuring adequacy, the company's integrity should be our lodestar – whether agency costs are so lowered as to enable it to function efficiently and profitably. Our model's flip-side also needs remembering, however: over-regulation of the three groups will stymie entrepreneurial activity, harming the company's productivity.

(i) Middle Management

It was noted middle management are heavily regulated. This stems from their role as employees, and latterly, from increasing recognition that many exercise

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[62] See, eg, HIH Royal Commission, above n 1, vol 1, 57, vol 2, 4, 7, 71, 128, 159, vol 3, 27, 30-3, 62, 290, 319, 339.

[63] Ibid vol 1, xiii-xxxix.

real corporate power. The law, in this respect, appears to lag behind other disciplines.[64]

Whether existing constraints are adequate rests on whether such personnel can, like directors and senior management, be classed fiduciaries.[65] While Welling suggests the law will proceed not by looking for the label 'senior', but by 'fixing the duty … on those ... who, as a matter of fact, exercise genuine power over … corporate destiny',[66] practice suggests acceptance will be more incremental.

Even supposing such acceptance, extension of the Part 2D.1 duties is preferable. As previously suggested, middle management are already subject to controls nearing, in combination, the Part 2D.1 duties. Given the desire to empower ASIC then, applying the statutory duties would not be a further burden.

Indeed, aligning the duties of senior and middle management makes eminent sense, given the continuity of operational responsibilities between them; ss 189 and 190 of the Act, in essence, suggest as much.[67] Comments that such a move would blur liability across management strata may be refuted – far from dictating organisational structure, reform would merely ensure those with authority can be held commensurately accountable.

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[64] B. Welling, *Corporate Law in Canada: The Governing Principles* (2nd Ed, 1992) 372.

[65] The fiduciary test being the classic measure of the ability of one person to affect the affairs of another: see, eg, *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 139-45 (Dawson J).

[66] Welling, above n 65, 375.

[67] Respectively concerned with directorial reliance upon, and delegation to, subordinates (and others), ss 189 and 190 implicitly acknowledge that real corporate power may be exercised by senior management and those below it. In interacting with the sections of the Act applying behavioural controls to senior management then, ss 189 and 190 anticipate similar regulation of 'middle' management.

(ii) Group Personnel

Owing to their diversity, the position of group personnel is less straightforward. However while potentially varied, a group executive acting with regard to a subsidiary company is, as mentioned, the usual scenario, for often inescapable reasons.[68]

As suggested, these individuals will often be classed fiduciaries. However, group executive–subsidiary company is not an established fiduciary category; being a factually-based investigation, some may not be so graded. Whether this is satisfactory turns on the group structure involved.

Where wholly-owned subsidiaries are essentially being run as divisional units, as with HIH,[69] arguments emerge for strong behavioural controls. Where ownership structure is more diffuse things are trickier – exercise of ultimate holding company power may, in certain situations, be argued less significant, given existence of countervailing forces.[70]

At first, this appears contrary to our model, separation of ownership and control classically being the justifier for behavioural regulation.[71] However the darker side of corporate groups has long been recognised – while effective risk-spreading devices, the lure of limited liability ensures their openness to abuse.[72]

Commissioner's Owen advocacy of a functional orientation surfaces as here relevant – the pertinence of ownership structure to group executive capabilities means a fiduciary test is less effective in identifying those requiring robust

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[68] See the discussion of *ASIC v Adler* above.

[69] HIH Royal Commission, above n 1, xxvi-xxvii; HIH Royal Commission, *Background Paper No 1 – Introduction and Corporate Chart* (2001).

[70] This will not be the case though, where, for example, ownership is so diffuse as to make the company's senior management the most influential actors: see Welling, above n 65, 373-5.

[71] See Berle and Means, above n 25.

[72] Simon Haddy, 'A Comparative Analysis of Director's Duties in a Range of Corporate Group Structures' (2002) 20 *Company and Securities Law Journal* 138, 139.

regulation.[73] While the proper standard remains arguable, it is submitted ability to exercise real corporate power over company affairs is apposite.[74] In this way, individuals effectively acting as directors, senior and middle management of the subsidiary would be ensnared.

As to actual controls, substance-over-form arguments posit comparable behavioural standards should apply. This is endorsed correct. The Part 2D.1 duties should hence be extended to group personnel acting as if a director, senior or middle manager of the subsidiary company. Conversely, only the duties applying to employees should cloak other, less influential group personnel.

(iii) Consultant-Contractors

Consultant-contractors are the most varied of the three groups, their range limited only by the corporation's activities. Indeed, an increasing number of these activities are being performed by them.[75] As with group personnel, this makes determining adequate, across-the-board behavioural standards difficult.

Certainly, the outsourcing of corporate functions should not be discouraged; associated efficiency gains are welcome. Consultant-contractors need differentiation according to their centrality to corporate affairs, however. This is again a question of function, and again should the eminence of the fiduciary standard, as the tightest control the law knows, be emphasised. As noted, only lawyers and, in some instances, financial advisers, are caught under current principles.

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[73] On account of equity's focus on the actor and its lesser concern for the environment in which s/he is to operate.

[74] This is in accordance with Federal Government policy: Commonwealth of Australia, *Commonwealth Submission to the HIH Royal Commission* (2002) 97.

[75] HIH Royal Commission, above n 1, vol 1, 126-7.

Whether this is adequate turns on the nature of the engagement. Where an opinion, and not advice, is given, lesser standards should apply.[76] Similarly, where the relationship is on-going, and not one-off, controls should be firmer. While ability to exercise real power over company affairs remains the relevant touchstone, the surety associated with specifying given roles is to be preferred.

Lawyers, auditors, accountants and financial advisers are those most central to company operations.[77] In their role as advice-givers, these actors require heaviest regulation; that not all are cast as fiduciaries is unwelcome. Others, like remuneration consultants, business analysts and corporate strategists should, if in longer-standing relations with a company, be correspondingly controlled. Remaining personnel should be held only to existing duties of co-operation, care and skill.

While a statutory version of fiduciary controls would be apposite, the Part 2D.1 duties have the advantage of being practically as strong, and already subject to judicial interpretation. Consistency of regulation is desirable too; these controls should thus apply to the listed professionals in the circumstances given. ASIC should also be enabled to enforce the duties of co-operation, care and skill limiting other consultant-contractors, on behalf of companies unwilling or unable.

G. CONCLUSION

It may be thought the above is an unnecessary 'clobbering' of corporate personnel with legal controls. However, while the individuals examined have not traditionally been as regulated as the reforms in this paper desire, history should not act as dogmatic restraint. Indeed, corporate governance laws have long struggled to keep pace with organisational innovation. It is submitted decentralised companies, corporate groups and outsourced personnel are today all in need of greater control.

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[76] *Pilmer and Others v The Duke Group Ltd (in liq)* (2001) 107 CLR 165.

[77] See HIH Royal Commission, above n 1, vols 2 and 3 generally.

It should be clarified that in extending the Part 2D.1 duties to the above groups, it is intended they also have the benefit of protective provisions like ss 180(2), 189 and 190 of the Act.[78] To allow otherwise would be to promote risk-averse behaviour, and as the Federal Treasurer has noted, 'the moment you legislate against risk, you legislate against the opportunity to return profit'.[79]

By advancing investor confidence stronger corporate governance standards can actually advantage jurisdictions. This in turn promotes a race to the top, leading to more sustainable business environments. In this regard, s 126(1) of the *Companies Act 1993* (NZ) should be our model.[80] Extending the Part 2D.1 duties to the suggested classes furthers this objective.

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[78] Known respectively as the business judgement, reliance and delegation rules: see *Corporations Act 2001* (Cth) ss 180, 189, 190.

[79] The Hon Peter Costello MP, 'Corporate Governance – Strengthening Conditions for Investment', Presentation to the OECD Forum, 28 April 2003, 1.

[80] See *Companies Act 1993* (NZ) s 126.

CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

26 August 2005

Mr John Kluver
Executive Director
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By mail
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Dear Mr Kluver

Corporate Duties Below Board Level
Discussion Paper

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the discussion paper *Corporate Duties Below Board Level*.

CSA is Australia's peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. In Australia, CSA has over 8,000 members and affiliates working as company secretaries, governance professionals and other officers in corporations, who advise their boards on matters of governance.

Members of CSA have a thorough working knowledge of directors' and officers' duties and the *Corporations Act 2001*.

General comments

In respect of the discussion paper, CSA comments that, in principle, it supports extending the personal duties and liabilities under the *Corporations Act* beyond directors and other officers. CSA believes there is a gap in liability below board level. The current law on the liability of senior managers not classified as officers is unclear. Any legal regime for the enforcement of corporate governance standards that does not include the acts or omissions of at least some categories of senior managers not classified as officers will not be as effective as it should be.

CSA recognises that extending these duties could bring about a better delegation of authority from the board to management. An exposure to liability based on a functional model, rather than on an employment relationship model, which extends the category of persons facing the liability into the senior management range, must produce an enhanced sense of responsibility and accountability in corporate decision making.

An extension of liability, by one method or another, along the lines proposed in the discussion paper, will enhance applied corporate governance. Risk management and compliance systems introduced by companies are likely to be more meaningfully implemented if some degree of direct liability accompanies those persons responsible for the implementation and ongoing management of them. It will also give more meaning to the law's move towards effective protection for whistleblowers.

While CSA strongly believes that directors should be responsible for the oversight of corporations, that is, they are responsible for the strategy and vision of a corporation, the HIH Insurance example illustrates the desirability of extending formal liability so that it attaches, at appropriate levels, to internal corporate functional responsibility. This is the essence of good governance, with responsibility and accountability aligned.

At the same time, it will not eliminate the other responsibility of the board to set appropriate policies and to review these regularly. Indeed, it is important that a proper delegation of authority needs to be in place so that individuals will not be liable simply because they are carrying out functions nominated by senior managers. If individuals are carrying out functions that are not authorised, however, then they should be held liable.

The issue of consent

CSA has considered the issue of consent, which was not highlighted in the discussion paper. CSA does not believe that the introduction of a consent model is necessary to achieve an extension of liability in a company. The person in whatever function they perform, by accepting a position with the company, consents to carry out that function. Therefore, it is recommended that the relevant current sections in the *Corporations Act* on consent for directors and the company secretary not be amended and that the responsibility be left to corporations to ensure that, as for other areas of legal obligations, management identifies those persons who have legal obligations and communicate to and train them to ensure that they have adequate knowledge of the law. Obtaining written acknowledgement from the person carrying out the function that they have been made aware of their obligations should be part of that process.

The concept of a senior manager possibly avoiding liability only because they have failed to sign a consent to act is unacceptable and would lead to inappropriate behaviour. The need for more stringent delegation and updating of the employee's functionality when they change jobs within the company would, rather, be a useful addition to a governance framework.

The issue of insurance

If amendments are made to the legislation extending liability in a company and to non-employees carrying out functions in the company, it is crucial that both the indemnification sections in the *Corporations Act* and perhaps other legislation, and directors' and officers' (D&O) insurance policies are reviewed to ensure these issues are aligned. For example, some D&O policies only cover officers and few, if any, would cover non-employees unless they also hold the role of director or secretary.

Recommendation 1

In principle, CSA supports extending the personal duties and liabilities under the *Corporations Act* beyond directors and other officers. CSA believes there is a gap in liability below board level. The current law on the liability of senior managers not classified as officers is unclear.

CSA recommends that the relevant current sections in the *Corporations Act* on consent for directors and the company secretary not be amended and that the responsibility be left to corporations to ensure that, as for other areas of legal obligations, management identifies those persons who have legal obligations and communicate to and train them to ensure that they have adequate knowledge of the law.

Proposals in discussion paper

Proposals 1 and 2

Should s 181 (the duty of good faith) (and its criminal consequences under s 184(1)) and s 180(1) (the duty of care and diligence) be extended beyond directors and other officers of a corporation to a wider category of persons?

Recommendation 2

CSA supports the extension of s 181 (the duty of good faith) and s 180(1) (the duty of care and diligence) to senior manager level (if those managers are not currently classified as officers), but only to those managers charged with particular responsibility (for example, mine managers, ship captains, treasury managers, a head of a significant division, or even the head of a functional department, such as a Director of Marketing) or taking part in significant decisions. It is not feasible to try to extend these liabilities to every person who "takes part in" management.

CSA believes the objective of the proposals can best be achieved by clarifying the definition of "officer".

Provisions could be inserted into the *Corporations Act* that:

(1) Combine sub-paragraphs(b)(i)&(ii) of the definition of "officer" and slightly amend it to say:

> *(b) a person:*
>
> > *(i) who makes, or substantially participates in making, decisions that significantly affect the business affairs or financial standing of the corporation;*

This is essentially the same as the proposed definition of "management" (page 24 of the discussion paper). It retains the notion of a functional test and obviates the introduction of another category of person and the need for an additional definition.

(2) For the avoidance of doubt, confirm that the officer is an officer of any corporation which is affected by the decision.

This addresses the corporate group issue (see later for further comments).

(3) Confirm that the definition of "officer" is not limited by the existence of the definition of "senior manager" (see page 12 of the discussion paper).

It is noted that the definition applies to "a person" and is not limited to employees. The definition would apply to a consultant who is engaged to perform services of the type mentioned in the definition.

Proposal 3

As a corollary of Proposal 2, should s 180(2) (the business judgment rule) be extended beyond directors and officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation?

Recommendation 3

The use of CSA's suggested solution to Proposals 1 and 2 (expanded definition of “officer”) means that the business judgment rule will automatically apply without further amendment.

However, if another solution is chosen, CSA supports the concept that the business judgment rule should be available to any person who is subject to the duty under s 180.

Proposals 4 and 5

Should ss 182 and 184(2) (improper use of corporate position) and ss 183 and 184(3) (improper use of corporate information) be extended beyond directors, other officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation?

CSA supports the concept of extending ss 182 and 183 beyond directors, officers and employees in the manner proposed.

Contracts of engagement of consultants or contractors usually specify that the consultant is an independent contractor, not an employee, and is not authorised to bind the company to contracts, and usually excludes or limits the consultant's liability to the company.

There is a distinction between two types of contract in relation to this matter:

1 One type of contract is entered into for an individual or company to provide a service as an adviser, and such an individual or company makes recommendations only. Company officers consider that advice and, after taking into account all the factors, make a decision.

2 The second type of contract consists of an individual contracting (sometimes through their company) but acting or performing functions as if they were an employee, even though their contract says they are not an employee.

CSA is comfortable that the proposed words “performs a function, or otherwise acts, for or on behalf of the corporation” captures both groups. Whatever definition is used there will be some grey situations.

CSA does not believe that ss 182 and 184 should extend only to those persons who comprise the second group, as it is important that those individuals who make improper use of corporate information be held liable.

CSA notes that there are difficulties attached to the proposal as follows:

- There will need to be a provision that consultants/contractors cannot contract out of their statutory liability and cannot be indemnified by the company in this respect.
- There may be an impact on the market for professional indemnity insurance to cover this additional area of liability for contractors.

Currently, professional indemnity or even D&O insurance in their basic form will not cover penalties. There are some D&O policies that do, but these are fairly limited. The difficulty is that the company cannot indemnify for actions taken in bad faith or not in the interests of the company, and it is reasonable to assume that in most cases a breach invoking the law in this area would prevent the company from indemnification. However, the ability of the insurance to pay in advance for legal advice and assistance for the employee/contractor needs to be retained.

Recommendation 4

CSA supports the concept of extending ss 182 and 183 beyond directors, officers and employees in the manner proposed.

Proposals 6 and 7

Should s 1309(1) (knowingly providing false or misleading information), s 1309(2) (veracity of information) and s 1307(1) (misconduct concerning corporate books) be extended beyond officers and employees of a corporation to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation?

Recommendation 5

CSA supports the amendments in these two proposals, including the amendment to s 1309(2).

Officers and employees are already covered by these sections. Extending the liability to consultants or contractors acting on behalf of the company should ensure that such persons act with due care and this in turn assists the implementation of governance frameworks within companies by those charged with such responsibilities.

Other proposals

Recommendation 6

Item 2.2.4: General dishonesty prohibition

CSA recommends that any such provision apply to the *Corporations Act* only. The discussion paper sets out the difficulties of applying any other approach.

Recommendation 7

Item 2.3: Definition of "employee"

CSA is not in favour of defining the term "employee".

The proposals for extending the various liabilities (either via a revised definition of "officer" as CSA proposes, or via the introduction of another category of person as in CAMAC's proposals) reduce the need to try to bring people within the category of "employee".

CSA notes that "employee" is currently defined in s 596AA of the *Corporations Act* in the context of employee entitlements as "a person who is or has been an employee of the company…". Attempting to define it further, or define it for other purposes, runs the risk of excluding some persons who might otherwise have been caught. What amounts to an "employee" has been the subject of many court decisions and any statutory definition will still be subject to interpretation by the courts in the circumstances of the particular case.

Recommendation 8

Item 2.4: Corporate groups: What, if any, amendments are necessary to ensure that corporate group executives are properly subject to the duties in ss 180-184?

CSA does not believe that an additional definition of the type on page 37 of the discussion paper is necessary.

CSA believes that the imposition of duties in ss 180-184 based on the performance of functions should be sufficient to cater for corporate groups.

Under the existing definition of “officer”, the “person” referred to in paragraph (b) is not required to be an employee of the corporation being affected by his/her decision. The person is an officer of the corporation merely because he/she makes or participates in a decision which affects the business or financial standing of the corporation.

This would appear to cover corporate groups because under paragraph (b) of the definition, the person will be an “officer” of the corporation which is affected by the decision. Paragraph (b) of the definition does not require any closer nexus than the fact that the corporation is affected by the decision.

Even though the existing definition of “officer” appears to be adequate in relation to corporate groups, the position would be improved by the adoption of CSA's suggested solution to Proposals 1 and 2, which involves three suggested actions to improve the definition of “officer”, including a clarifying provision, for the avoidance of doubt, that the officer is an officer of any corporation which is affected by the decision.

Item 2.5: Other behaviour

CSA has no recommendations in relation to this item.

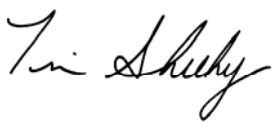
Additional comment
Recommendation 9

Section 189 of the *Corporations Act*: “Reliance on information or advice provided by others” provides a certain level of defence for directors in the limited circumstances set out in s 189(c) involving a duty under Part 2D.1 or an equivalent general law duty.

CSA is of the view that the benefit of this section should be extended to “officers” and any other persons who are exposed to the same duties as directors under Part 2D.1 or an equivalent general law duty.

Conclusion
In preparing this submission, CSA has drawn on the expertise of the members of its two internal national policy committees. We would welcome the opportunity to meet with you to discuss any of our views in greater detail. Please call me if you would like to set up a meeting. I can also arrange a meeting with our members.

Yours faithfully



Tim Sheehy
CHIEF EXECUTIVE

CAMAC Discussion Paper
Corporate Duties below Board Level

Submission from the Accounting Bodies

Proposal 1

Section 180(1) and s 184(1) (the duties of good faith and proper purpose) (Corporations Act ('CA')) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

The HIH report commented on the significant role played by middle management and considered they were unprepared to accept responsibility for their decision making. The Accounting Bodies acknowledge that many decisions within companies are made by senior managers in positions of considerable authority within the company and, in many instances, significant decisions are made by these officers without reference to the Board.

It is necessary however, to look to the definition of 'officer' within the CA. 'Officer' is defined in the CA in relation to a corporate entity, as a person who makes, or participates in making, decisions that affect the whole, or a substantial part of the business of the entity; or who has the capacity to affect significantly the entity's financial standing.

Given that definition, the Accounting Bodies consider that it is sufficient to rely on the current definition as to the people participating in a company's decision making process as they consider that the term 'officer' includes those within middle management who participate in the decision making processes. We do not support re-inclusion of a definition of 'executive officer' as the word 'executive' has connotations that place the title above the word 'officer'.

The Accounting Bodies are firmly of the view that any attempt to broaden the definition should be principles-based rather than function-based to avoid circumvention of the spirit of the legislation through job titles and job descriptions. The definition of 'employee' in Accounting Standard AASB 1028 'Employee Benefits' may provide a useful starting point:

> 'Employee means a natural person (including a director) appointed or engaged under a contract for services who is subject to the direction of an employer in respect of the manner of execution of those services, whether on a full-time, part-time, permanent, casual or temporary basis.'

Proposal 2

Subsection 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

The Accounting Bodies recognise there are two issues in this proposal.

1) The first is the issue of executive decisions being taken by people who were directors and executives of say, subsidiary companies but not the company itself.
2) The second issue arises in respect of the use of consultants who are not directors or executives, but nevertheless participate in management of the corporation concerned.

The suggestion that the duty in s180 (1) be extended to a wider class of people to include:

(i) directors, officers and employee;
(ii) others who take part or are concerned in the management of the corporation; and/or
(iii) those who perform functions or otherwise act for or on behalf of a corporation,

has some merit. The Accounting Bodies generally agree that the obligations under subsection 180(1) CA should be extended to a broader group, but not beyond the employer/employee relationship. This would be relevant to those who are directors and officers (within the CA definition) of the subsidiary company as they also have the duty, not only to the company that they direct, but to its parent.

Whilst consultants and others outside the company, who are engaged under their own set of obligations, may provide advice or make recommendations, ultimately it is the directors, officers and employees of the company that must make and implement the decisions. The Accounting Bodies therefore do not support extension of the s 180(1) duty to those who perform functions or otherwise act for or on behalf of a corporation.

The Accounting Bodies would support the use of the word ‘participate’ in respect of a person’s role within a company’s management rather than the term ‘is concerned with’, on the basis that it is more active and would require more diligence to be exercised.

Proposal 3

As a corollary of Proposal 2, s180(2) (the business judgement rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

Directors and officers must exercise a requisite degree of care and diligence at all times when making business judgements or carrying out business functions. The CA’s test of ‘sound business judgement’ currently requires directors and officers to demonstrate the same degree of care and diligence that would be required of an ordinary reasonable person holding a similar position in the same circumstance.

The Accounting Bodies agree that the ‘business judgement rule’ should be extended to all those who participate in the management of a corporation. This includes both making business judgements and carrying out other business functions.The participation in management should therefore enable the decision makers to be distinguished from those who simply carry out a function. This however, would not extend to consultants.

The Accounting Bodies consider the standards of an 'ordinary reasonable person' are not the appropriate standards. The 'reasonable person' benchmark is universally acceptable. To also use the word 'ordinary' tends to convey a lack of sophistication that would not be expected in an officer holding a participatory role in management of a corporation

Proposal 4

Section 182 and s 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Although it is acknowledged by the Accounting Bodies that this proposal would see the introduction of a functional test that may avoid the need to determine whether a particular person who satisfies the functional test is director or officer, etc of the corporation we reiterate that the Accounting Bodies are of the opinion that the extension of the sections should not go beyond the employer/employee relationship except for those who hold 'officer' positions within the company and do not fall within this definition. The only reservation held by the Accounting Bodies in not supporting an extension would be where there was improper use of their position due to fraud or negligence. If those conditions existed, the extension would be supported.

Proposal 5

Section 183 and s184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

The Accounting Bodies acknowledge that this proposal is wide ranging and applies to all past and present directors, officers and employees of a corporation, where they have had exposure to corporate information. Nevertheless, given that many matters do not come to light for a long time after the improper use may occur, we are of the opinion that responsibility should remain with those who were participating in the decision making at the time of the alleged improper use providing it is within the statute of limitations period. The proposed extension is therefore not supported by the Accounting Bodies.

Proposal 6

Subsection 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

For the same reasons outlined in Proposal 2, the Accounting Bodies do not support this proposition, as ultimately it is the directors, officers and employees of the company that must make and implement the decisions

Question 2

Should the categories of persons subject to s 1309(2) (ensuring the veracity of information) be extended in the same manner as proposed for s 1309(1), namely to any other person who performs functions, or otherwise acts, for or on behalf of that corporation?

Please see the Accounting Bodies' response to proposals 5 and 6.

Proposal 7

Subsection 1307(1) (Misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions or otherwise acts or has acted, for or on behalf of that company.

Please see the Accounting Bodies' response to the two previous proposals.

Question 3

Should there be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute?

The Accounting Bodies consider that general legal principles apply and there is no requirement to reiterate the requirement to act within the law – particularly in relation to the responsibilities that lie with officers under the CA.

Question 4

Is there any need to define the term 'employee' for the purposes of ss 182-184 or ss 1307 and 1309 if Proposals 4-7 are implemented?

The Accounting Bodies have suggested that the definition of 'employee' as set out in AASB 1028 'Employee Benefits' may be appropriate.

Question 5

Should there be a provision to the effect that where any person who:

- *Is a director, officer or employee of a corporation, or*
- *Takes part, or is concerned, in the management of that corporation, or*
- *Performs functions or otherwise acts, for or on behalf of that corporation*

makes, or participates in making, a decision that is implemented in whole or part by a related corporation, that person, in addition to the duties he or she owes the first corporation, will also owe the related corporation the duties of care and diligence (s 180(1)) and good faith (s 181) in relation to that decision? If this proposal is adopted, that person should have the business judgement rule defence in s 180(2). Also, where

the related corporation is a wholly-owned subsidiary, that person should have the benefit of s 187.

If there are one-off decisions or situations where a group of executives made commercial decisions for a corporate group, but did not at the time consider which of the subsidiaries would be used to implement the decision this is a high level decision where the same responsibilities that lie with the initial Board would flow through to the company ultimately affected by the decision.

Question 6

Are there any forms of behaviour of individuals below board level (not otherwise dealt with in this paper) that should be prohibited, or differently regulated, under the Corporations Act?

The Accounting Bodies are of the opinion that the current provisions of the CA are available to the regulators and rather than change the laws, the current CA provisions should be used more robustly. In parallel, companies themselves should reinforce their corporate governance processes to ensure there is clear direction within companies.

14 September 2005

promina

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Dear Mr Kluver,

Submission in relation to "Corporate Duties Below Board Level - Discussion Paper - May 2005" ('Paper')

INTRODUCTION

Promina Group is a leading group of insurance and financial services companies. Promina Group Limited, the ultimate holding company is listed on the ASX and the New Zealand stock exchanges.

The Paper proposes the following amendments to the Corporations Act (2001) ('**Act**') across three broad categories.

(a) Extension of sections 180(1), 181 and section 184 (1) beyond directors and officers to 'any other persons who takes part in or is concerned with the management of the corporation' and as a corollary of the proposal in relation to section 180(1), the extension of the business judgement rule to these same persons;

(b) Extension of sections 182, 183, 184(2), 184(3), 1309(1) and 1307(1) beyond directors, officers and employees to 'any person who performs or has performed functions or otherwise acts or has acted, for or on behalf of that company';

(c) Introduction of a general dishonesty provision

In accordance with the invitation for public consultation, we set out below our comments on the proposals.

COMMENTS

Proposal 1
Section 181 and s184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

Response

In our view, we believe there is no demonstrated need to broaden the obligation of the duties of good faith and proper purpose to any other person than those currently defined as 'officer' under section 9 of the Act.

We believe that extending these duties to any other person who "takes part, or is concerned, in the management of that corporation", irrespective of any definition of 'management', significantly broadens the pool of people who may potentially be liable under these sections of the Act. We believe that it is significant that there are other laws available, which impose liability on individuals below board level, such as the Insurance Act 1973. We submit that extending these duties is likely to act as a disincentive for individuals to take up managerial roles within the organisation.

In addition, the breadth of the concept of "any other person who takes part, or is concerned, in the management of the corporation could include and could impact those persons who are involved in management, but:

- have little real control or power in their managerial role to affect the organisation;
- have little or no involvement in policy making or decision making;
- have more administrative managerial roles;
- have no significant control over the outcome/impact of decision; and
- lack any significant discretion.

For the purpose of Proposal 1 (and Proposals 2 and 3) should 'management' of a corporation be defined? If so, should the definition be along the lines of 'activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporations or the conduct of its affairs?

Response

Based on our response for Proposal 1 there is no need to define management.

However, if management needed to be defined it should be synonymous with the current definition of officer under section 9 in subsections (b)(i) and (ii).

Proposal 2
Subsection 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

Response

In our view, as per our reasons in our response for Proposal 1, we believe there is no demonstrated need to broaden the obligation of the duties of care and diligence to any other person than those currently defined as 'officer' under section 9 of the Act.

Proposal 3
As a corollary of Proposal 2, section 180(2) (the business judgement rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned in the management of that corporation.

Response

Given our response to Proposal 2, there is no need to extend the business judgement rule.

Proposal 4
Section 182 and s 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation, to any other person who performs functions, or otherwise act, for or on behalf of that corporation.

Response

We support the extension of section 182 and s 184(2) beyond directors, officers and employees to any other person who performs functions, or otherwise acts for or on behalf of the corporation.

We would argue that it should be extended to persons such as contractors or consultants where they are performing functions of officers and employees (and if applicable, directors).

Proposal 5
Section 183 and s 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation,

Response

In relation to the extension of section 183 and 184(3) we make the same submission as for Proposal 4.

Proposal 6
Subsection 1309(1) (knowingly providing false and misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Response

In relation to the extension of section 1309(1) we make the same submission as for Proposal 4.

Proposal 7
Subsection 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company.

Response

In relation to the extension of section 1307(1) we make the same submission as for Proposal 4.

Should the categories of persons subject to s1309(2) (ensuring the veracity of information) be extended in the same manner as proposed for s 1309(1) namely to any other person who performs functions, or otherwise acts, for or on behalf of that corporation?

Response

In our view, if the person is performing functions which are akin to those functions carried out by the director, officer or employee then there should be no reason that those persons would not be in a position to ensure the veracity of the information which they are providing.

General Dishonesty Provision

Should there be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute? If so should the provision apply to:

- obligations under the Corporations Act only, or
- obligations under any Commonwealth, State or Territory statutes applicable to corporations
- obligations under any overseas written laws as well as Australian laws?

Response

In our view there are a number of difficulties associated with the introduction of a general dishonesty provision. One issue is that the conduct may be prohibited or dealt with under other legislation and thus cause a duplication. This may in turn impact the enforcement of the general dishonesty provision.

Another issue is that the conduct may breach "non-criminal" obligations under the legislation and therefore without a general dishonesty provision, these breaches would not otherwise have any criminal sanctions. A general dishonesty provision would not necessarily take into account the differing levels of offence and seriousness.

Is there any need to define the term 'employee' for the purposes of ss 182-184 or ss 1307 and 1309 if Proposals 4-7 are implemented.

Response

In our view the definition of employee does not need to be extended given the broad use of 'any other person' in Proposals 4 through 7.

Corporate Groups

Should there be a provision to the effect that where any person who:

- Is a director, officer or employee of a corporation, or
- Takes part, or is concerned in the management of that corporation, or
- Performs functions, or otherwise acts, for or on behalf of that corporation

makes, or participates in making, a decision that is implemented in whole or part by a related corporation, that person, in addition to the duties he or she owes to the first corporation, will also owe the related corporation, the duties of care and diligence (s180(1)) and good faith (s 181) in relation to that decision? If this proposal is adopted, that person should have the business judgement rules defence in s 180(2). Also where the related corporation is a wholly owned subsidiary, that person should have the benefit of s.187.

If this proposal is not supported, what, if any, alternative proposal should be adopted to deal with the concern raised in the HIH Report?

Response

In our view the current definition of officer is broad enough to deal with the situation in corporate groups where a general commercial decision is made for the corporate group, but without consideration of which of the subsidiaries will be used to implement the decision. Any liability is not diminished if the person is not appointed as a director of that subsidiary or if the person is employed by another company in the corporate group.

Are there any forms of behaviour of individuals below board level (not otherwise dealt with in this paper) that should be prohibited, or differently regulated under the Corporations Act?

Response

We believe that the current laws are adequate and therefore we do not believe that any other forms of behaviour should be prohibited or differently regulated.

Please do not hesitate to contact me if you have any questions about our comments above.

Yours sincerely,

Harold Bentley
Chief Financial Officer

12 August 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
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Dear Mr Kluver

CORPORATE DUTIES BELOW BOARD LEVEL

The Chamber of Commerce and Industry Western Australia (CCI) is the peak business association in Western Australia. It is the second largest organisation of its kind in Australia, representing approximately 5,000 organisations across all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance. About 80 percent of CCI members are small to medium enterprises, and members are located across all geographical regions of WA.

1. Introduction

We refer to the Corporations and Markets Advisory Committee (**CAMAC**) discussion paper of May 2005 titled "Corporate duties below board level" (**CAMAC Paper**).

The CAMAC Paper invites submissions on a number of proposals, including the possibility of extending corporate duties and liabilities under the *Corporations Act 2*001 and other legislation to additional classes of individuals below board level. The CAMAC Paper, like the HIH Royal Commission report of April 2003 titled "The Failure of HIH Insurance" (**HIH Report**), appears to adopt the view that there is a gap in liability below board level.

The purpose of this letter is to make a number of submissions in opposition to the proposed extension of corporate duties and liabilities below board level.

2. Making the "right" people accountable

2.1 Linking responsibility and accountability

In considering whether corporate duties and liabilities should be extended to additional classes of individuals below board level, it is important to be mindful of the responsibility and accountability of the individuals concerned.

CCI submits that it is unreasonable for persons below board level to be burdened with greater accountability of the kind envisioned in the CAMAC Paper, where there is a real prospect that the greater accountability would, in many cases, substantially outweigh the responsibility those persons have for the affairs of the company.

Directors and other executive officers of a corporation typically assume a large degree of responsibility and accountability for the actions they take. Significant power resides in those people. In turn, they are remunerated accordingly.

By contrast, managerial personnel in a corporation are afforded less power and responsibility in controlling the functions of the company and are given less remuneration. The accountability of this group of individuals should match their level of responsibility and power.

Decision makers should be held accountable, in appropriate cases, where they have not, for example, been duly diligent in the performance of their duties. CCI is of the view that this should begin and end with the major decision makers of the corporation, the directors and other executive officers, not those persons below board level. Those with less responsibility should be burdened with less accountability.

2.2 Access to knowledge and resources

The HIH Report strongly recommends the adoption of a "functional" test for determining whether a particular individual should be subject to corporate duties and liabilities, rather than simply restricting liability to directors and other officers. This would involve a consideration of the functions performed by an individual.

While this test appears outwardly reasonable, there is a considerable risk of injustice in its application. Directors and other officers typically have considerable resources and information at their disposal when making a decision. For this reason, they are generally able to make informed decisions, fully aware of the circumstances and operations of their organisation.

However, managers and other persons below board level often make decisions with limited resources. For example, while a manager in a large, complex organisation may have detailed knowledge of the particular division which they manage, they will often possess little information about the other aspects of the company. Managers will not always be privy to information and knowledge from all aspects of the organisation.

In the event that corporate duties and liabilities are extended to those below board level, there is a risk that managers may become inadvertently involved in a breach of duty, without their knowledge or intent. For example, a director may covertly instruct an employee to perform an action which the employee would not otherwise perform, had the employee been given all the relevant information or been in a position to investigate the circumstances on their own accord.

The legislature must be cautious not to foster a climate in which directors can inappropriately delegate responsibilities to persons below board level, and thereby pass the risk of prosecution for non-compliance to those with less information, knowledge and training. Directors and other executive officers are paid to take responsibility for making the decisions of their organisation, and the accountability for those decisions in appropriate (and in most cases already existing) circumstances should remain with the board. The extensive Commonwealth and State regimes of liability in that regard are summarised in CAMAC's other discussion paper of May 2005 titled "Personal Liability for Corporate Fault".

3. Existing mechanisms for regulating conduct below board level

In addition, and despite the findings of the HIH Report, the extension of duties and liabilities to persons below board level is unnecessary, as those persons are already subject to sufficient regulation in the form of direct and accessorial liability.

Persons below board level can be prosecuted where they are directly involved in an offence or where they have aided and abetted the commission of an offence. To this extent, mechanisms already exist for regulating the conduct of these persons.

However, the thrust of the HIH recommendations and CAMAC proposals is that persons below board level should attract further corporate duties and liabilities (i.e. duty of care and diligence, and duty of good faith and proper purpose).

Considering the responsibility of most individuals below board level (see above discussion), CCI strongly submits that the existing regulatory mechanisms are sufficient and that a further extension of duties and liabilities is unnecessary, unreasonable and unfair, and could lead to a diminution in responsibility for a corporation's actions at board level.

4. Conclusion

In summary:

(a) It is unreasonable for persons below board level to be burdened with greater accountability, especially where that greater accountability may outweigh the responsibility those persons have for the affairs of their company.

(b) Directors and other executive officers usually have considerable resources and information at their disposal, and are therefore able to make fully informed decisions. However, persons below board level often make decisions with limited resources, and with little information about the other aspects of the company.

(c) Directors and other executive officers are paid to take responsibility for making the decisions of their organisation, and the accountability for those decisions should remain with the board.

(d) The extension of corporate duties and liabilities to persons below board level is unnecessary, as those persons are already subject to sufficient regulation in the form of direct and accessorial liability.

Please contact our Mr Bill Sashegyi, Director Industry Policy on Tel: (08) 9365 7567 or e-mail sashegyi@cciwa.com if you have any questions in relation to the above.

Yours sincerely

J L Langoulant
Chief Executive

CAMAC Discussion Paper Corporate Duties Below Board Level - May 2005

Submission

Summary

Conclusions

The majority of the changes proposed in CAMAC's Discussion Paper are not in our view required to deal with the issues raised in that paper.

The proposed changes would necessarily result in a major re-positioning of the way companies currently operate and have operated for many years. There is already a substantial body of law which is designed to ensure that the senior people who control companies manage those companies in an appropriate manner and take ultimate responsibility for their activities.

Business would incur substantial time and compliance costs in accommodating the changes.

Recommendations

1. The existing duties of care and diligence (s180) and good faith (s181) should remain as is and should not be extended to a wider class of persons.
2. The prohibitions on improper use of position and information (ss184(2) & (3)) and the provision of false information (s1309(1)) and the obligation to ensure the veracity of information (s1309(2)) could be extended to employees of related corporations and, potentially, to persons who work under a contract with the company fulfilling functions which are essentially similar to those provided by an employee.
3. However, these provisions, particularly section 1309(2), should not apply to third parties who performs functions, or acts, for or on behalf of a corporation.
4. All defences available to directors who are the subject of fiduciary duties should be available to all other individuals who are subject to those duties. In this regard, we note that there appear to be oversights in the existing legislation which should be remedied. In particular:
   - Section 187 authorises directors to act in the interests of a holding company in certain situations and deems this to be acting in good faith and in the subsidiary's best interests. However, it does not apply to officers. In our view this should be amended so that officers have the same ability, being essentially a defence to a breach of fiduciary duties.
   - Section 189 provides an effective due diligence defence to directors, but not other officers, by deeming reliance on information provided by others in certain cases to be reasonable unless proved otherwise. In our view this should apply equally to other officers who are subject to fiduciary duties.
5. If the policy considerations outlined in this submission are acceptable, consideration should also be given to more clearly define the scope of those taken to "participate in" a decision. In our view, this should apply only to those who are both involved in a decision *and* can determine (alone or with others) the outcome of that decision.

Justin O'Farrell, Bob Baxt, Don Harding
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Analysis

Existing law

- The existing law already imposes fiduciary duties of care and diligence and of good faith on any person who:
  - makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
  - has the capacity to significantly affect the corporation's financial standing.
- This covers people who hold senior management positions in companies and who have the capacity to influence the decisions made by those companies. It also covers other persons who are in a position to influence the company's decisions on significant matters.
- The scope of the words "participates in" the making of decisions is unclear. It may cover persons who participate in the process leading to the decision, but it seems to us that these words would properly cover only those people who play a role in determining outcomes. It may be that this should be specifically clarified (as suggested above) if the submissions made in this paper are accepted from a policy perspective.
- Under the existing law, following the CLERP 9 amendments, any director, officer or employee may also be liable for improper conduct, including improper use of position or company information, interference with company books and providing false information to, or failing to ensure the veracity of information provided to, directors, auditors or members. These prohibitions were extended to cover employees after the occurrence of the conduct the subject of the HIH report.
- There are also general prohibitions on misleading and deceptive conduct (for example under the Trade Practices Act).

CAMAC Proposals

- The essence of the changes proposed in CAMAC's paper is to:
  - extend fiduciary duties of good faith and care and diligence to persons who may be involved in a decision but who have no capacity to determine the outcome of that decision;
  - extend the prohibitions on improper use of position and information, providing false information and, potentially, failing to ensure the veracity of information to persons who perform any functions for a company.

Fiduciary duties

- In our view, the extension of fiduciary duties to persons beyond those currently covered is not warranted.
- The governance structure of companies has been established over a long period, distinguishing between those who have the power to make decisions and those employed to assist. Recognising this, structures and practices have developed to ensure that directors and senior executives have the necessary information and protections to allow them to fulfil their functions.
- In particular, directors and senior officers currently have available to them:
  - defences such as:
    - the business judgment rule (to the extent available);
    - due diligence defences in various circumstances;
    - capacity to delegate and rely on delegates who have appropriate expertise; and
    - specific relief to allow directors to act in the best interests of the

	holding company; - access to D&O insurance; - access to all information of the company, including board papers and management reports across the full range of the company's activities; - a right to indemnity under the constitution enforceable as a contract between them and the company; - additional deeds of access and indemnity in many cases, which provide directors and officers with access to information and indemnity after they cease their position, allowing them to defend proceedings brought against them for their conduct as officeholders; - levels of remuneration commensurate with the degree of risk and responsibility assumed by them; - actual and ostensible authority to bind the company and take action on its behalf; - authority to direct employees and to determine outcomes and information flows; - board and committee meetings which provide a forum for discussion of significant issues; - access to independent legal advice and training; and - procedures for the appropriate management of conflicts, supported by a body of law. - In short, directors and officers are given responsibilities and rights commensurate with the power that they exercise.
Extension of fiduciary duties further below board level	- If it is proposed to extend fiduciary duties to people who do not hold senior positions, these individuals will be given additional responsibilities without the power to determine outcomes or the rights which protect their personal position. Alternatively, those people will need to seek such protections. - The practical consequences of this for companies would seem far reaching. The additional expense involved would appear prohibitive. - Examples of additional measures which would need to be adopted include: - training and education; - legal advice for a wider class of individuals on their fiduciary duties in given situations; - deeds of access and indemnity (as these individuals are not covered by a company's constitution); - constitutional amendments authorising the company to enter into such deeds, given that many constitutions may only authorise access and indemnity for directors and officers; - D&O insurance, assuming this is realistically obtainable; and - pressure by employees for increased remuneration proportionate to their level of risk. - More generally, companies will need to review and revise corporate structures, policies and procedures to reflect the additional regulation. - Many of the rights or protections which apply to directors and officers could not be extended to other management by actions of the company alone. For example, the protocols for managing conflicts are laid down in statute and supported by legal precedent. These do not extend, and

		cannot be readily applied to other individuals.
	-	Logically, if the duties of directors and officers are extended to other persons it would seem reasonable, from their perspective, that those persons should have a greater ability to determine outcomes and exercise power and authority. Clearly this will present significant issues for management's relationship with the directors and senior executives, who have the final authority on any decision.
	-	In our view, these changes are both onerous and unnecessary. Considerable effort has been expended already in recent years in ensuring that those with the capacity to make decisions are responsible for the implementation of proper governance procedures across their organisations.
	-	Recognising the prominence of the HIH collapse, we believe the legislature should be cautious not to "overreact" to the aberration presented by that collapse in a way which will cause extraordinary financial and other results for business generally. It should be recognised that the key persons involved in that collapse acted regardless of clear legal duties and prohibitions already imposed on them by the existing law.
Availability of defences	-	If, contrary to the above, it is thought that these duties should apply to a wider class of employees, then it is appropriate that those individuals have the same defences as currently apply to directors including the business judgment rule (as proposed by CAMAC) but also the ability to rely on due diligence (s189) and relief to allow the individual to act in the best interests of the holding company (s187). We have made specific recommendations on these above.
	-	A variety of other provisions may also require amendment.
Improper Conduct	-	The governance provisions of the Corporations Act are designed to regulate the company and its internal administration. They are not designed to regulate generally any person's dealings with a company.
	-	The prohibitions on improper use of position and information (ss184(2) & (3)) and providing false information (s1309(1)) currently apply to officers and employees.
	-	In our view it would be appropriate to extend these provisions to employees of related companies, to deal with the situation where the individuals who brief the company's board and auditors are employed by a service company.
	-	We also see some logic in applying those provisions to persons who work under a contract with the company, fulfilling functions which are essentially similar to those provided by an employee.
	-	However, we do not see a basis on which the Corporations Act should be extended to apply these provisions to any person who performs any function for a corporation (for example, sub-contractors, service providers, landlords, information providers, government agencies and regulators).
	-	There is no particular rationale for creating criminal offences relating to people's dealings with corporations which do not apply equally to dealings with natural persons, government bodies, partnerships, trusts or any other entities. It seem to us that, if such offences are thought appropriate, they should be dealt with in a broader context (for example in the Crimes Act or Trade Practices Act) so that it is the principal conduct which is relevant, not the fact that the conduct was committed in relation to a corporation, as opposed to some other type of entity.
	-	It may be that various of this conduct is already dealt with under such

		legislation, although we have not researched this point.
Obligation to ensure veracity of information	-	If, contrary to the above, it is thought that offences should extend to any person who performs a function for the company, we nevertheless would be seriously concerned if obligations to ensure veracity of information (s1309(2))were extended beyond the current position.
	-	Section 1309(2) is a positive obligation, which essentially requires individuals to warrant they have exercised due diligence in providing information to directors, auditors or members. If this is extended to any person who performs functions for a company, it would impose an enormous compliance burden on people who deal with companies. (However, it may be appropriate to extend this section to employees of other group companies, and potentially "quasi employees" in the manner outlined above.)
General prohibition on dishonesty	-	We also do not see a need for a general provision prohibiting people from acting dishonestly in connection with the company's compliance with laws. However, if such a provision is thought necessary, it should only apply to the company's compliance with the Corporations Act and not to other statutes or laws. We see no rationale for creating an offence which is specific to corporations and which does not apply if natural persons or other types of entities breach the same laws.
Corporate Groups	-	In our view there is no need for a separate provision attempting to deal with the responsibility of officers to differing entities within corporate groups.
	-	To the extent a director, officer or employee of a service company: - makes or participates in making decisions that affect the whole or a substantial part of the business of a corporation; or - has the capacity to significantly affect the corporation's financial standing, they will be an "officer" of that corporation under the existing provisions and will owe duties to that corporation.
	-	If those persons do not exercise such a role in relation to that corporation, then we see no reason why they should owe fiduciary duties to that other entity simply because they have a role or function in a related company.
	-	The directors of a corporation are entitled to delegate functions to any person, including a service company, but may not abdicate those functions. Accordingly, directors retain their obligation to manage the company and are required to supervise services provided by other group companies. This requirement already exists under current statutory and case law.
Definition of "employee"	-	We do not believe that the term "employee" needs a statutory definition. The expression has a longstanding meaning under general law and a statutory definition may cause confusion. A person may be an "officer" of a corporation and owe fiduciary duties, regardless of whether they are an employee of that corporation. As outlined above, we believe that this approach already deals with the particular issue of corporate groups.

AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS

ABN 11 008 484 197

Submission

to

Corporate and Markets Advisory Committee

on

Corporate Duties Below Board Level

26 August 2005

Introduction

The AICD supports the extension of the duties of care and diligence and good faith in the *Corporations Act* 2001 (CA) sections 180(1) and 181(1) to a person who takes part, or is concerned in, the management of a corporation.

The AICD acknowledges, indeed urges, that it is almost certainly impossible to devise a statutory definition of such personnel, or of the term 'management', that would improve upon the former definition of 'executive officer' in the CA, and, for the reasons advanced in relation to Proposal 1, urges it be reinstated as the best practicable definition of the non-director personnel intended to be covered. This would address the major concerns raised by the HIH report, and as the definition had been used since 1981 up to March 2000 there is a body of case law available to give guidance as to the meaning of these phrases. Set out in the Appendix is a short description of the development of the legislative history in this area.

In the light of those general comments, the AICD makes the following submissions on the proposals put forward in the Discussion Paper (DP).

Proposal 1

Section 181 and 184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any person who takes part, or is concerned, in the management of that corporation.

The AICD supports the extension of the duty of good faith in CA sections 181(1) and 184(1) to a person who takes part, or is concerned in, the management of a corporation. The AICD agrees with the recommendation of the HIH report that the best way of achieving the extension is to re-adopt the definitions of 'executive officer' in CA section 9 and of 'officer' in CA section 82A as in force before the commencement of the *Corporate Law Economic Reform Program Act* 1999 (CLERPA). The current definition captures a significantly narrower class of persons than the pre-CLERPA definition of 'executive officer'. To fall within the current definition the person must 'participate in making decisions that affect the whole or substantial part of the business of the corporation, or who has the capacity to affect significantly the corporation's financial standing'.

The pre-CLERPA definition of 'executive officer' was:

> 'a person, by whatever name called and whether or not a director of the body or entity, who is concerned, or takes part, in the management of the body or entity'.

That definition was first enacted in the *Companies Act* 1981 and the corresponding State and Territory Companies Codes. It was thus operative for 24 years until 30 June 2004, during which a useful body of case law on its meaning had developed, as set out in Appendix 2 to the DP.

For reasons not stated in the Explanatory Memorandum for the Bill for CLERPA, CLERPA introduced into the CA a new definition of 'officer', which incorporated – as the HIH Report noted – part, but not all, of the gloss put by Ormiston J in *Bracht* on the definition of

'executive officer'. In particular, the HIH report (as extracted on page 43 of appendix 1 of the DP) indicates:

> 'The failure to include a person 'concerned in' management, which was considered by his Honour to have had a significant effect in expanding the scope of the definition of 'executive officer' was a material omission.'

From a policy perspective, the AICD considers it appropriate that the wider class of persons who are 'concerned in' or 'take part' in the management of the corporation should be subject to the duties of good faith and proper purpose. Such examples could be full time executives in a company who are self employed but contract their services to an organisation and a people who take on a senior role in a company on an interim basis. In short, it is the function which the person fulfils that should determine whether that person will be subject to the duties.

The AICD, however, considers that it would be preferable not to include a definition of 'management' given the meaning of the word is somewhat elastic and can be appropriately interpreted by a court on the basis of the relevant facts before it. Also there is a body of case law giving guidance as to the meaning of the word and a statutory interpretation is likely to create confusion rather than clarify the meaning of the term.

Proposal 2

Sub-section 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned in the management of that corporation.

The AICD supports this proposal.

Proposal 3

As a corollary of Proposal 2, section 180(2) the business judgment rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

The AICD supports this proposal.

Proposal 4

Sections 182 and 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf that corporation.

See Proposal 5 below.

Proposal 5

Sections 183 and 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

The AICD opposes the extension of CA sections 182-184 beyond directors, officers and employees of a corporation to 'any other person who performs functions, or otherwise acts, for or on behalf of the corporation.'

The very nature of the obligation in section 182 (civil obligations) and section 184 (criminal offences) is for the person not to 'improperly use their position'. The persons to whom this obligation should properly fall are those that in fact have a 'position' with the corporation rather than simply being third party contractors. The broader approach canvassed on page 26 of the DP to extend the provision to 'any person who performs functions, or otherwise acts, for or on behalf of the corporation' may well avoid technical questions as to whether a particular individual is a director, other officer or employee, however, this would extend the reach of the provision in an inappropriate manner.

Further, the real concern that the HIH report focuses on in this respect is that certain persons may undertake activities which are very similar to those of an employee under the guise of independent contractors or consultants where 'they may be in fact be performing functions very analogous to those performed by employees'. The broader approach canvassed by the DP goes very much beyond addressing the problem identified by the HIH report in this respect. Indeed the adoption of the former definition of 'executive officer' addresses the problem identified in the HIH report. This is because the definition of 'executive officer' is a functional definition in that it applies to any person whether or not a director that is concerned in or takes part in the management of the body or entity. In this regard, the HIH report (extracted on page 46 of Appendix 1 of the DP) states as follows:

> 'In my opinion it is the performance of the relevant function that should attract the legal duty, not the precise legal relationship between the person performing that function and the relevant corporate entity. The definition which applied prior to the CLERP amendments - namely, that which embraced a person who 'is concerned, or takes part, in the management of the relevant entity' - seems appropriate.'

Persons dealing with a company falling outside the definition of director, executive officer or employee should be regulated by contract. To do otherwise would place the independent contractor or consultant with a corporation subject to the rules different from that with any other entity. Australia is a relatively small market for consulting services and the proposed extension might limit the availability of those services. Consultants are usually engaged precisely because they have gained knowledge from other companies and that is the value they add when on assignment. Invariably they are bound by confidentiality provisions as part of their contract.

More fundamentally, there is in principle no reason - except in the context of insider trading in securities - why a consultant should not take advantage of information acquired by him or her in that capacity from a corporation, except where the information is imparted to him or her on the basis of confidentiality. Disclosure of information in breach of confidentiality is generally actionable at the hands of the relevant corporation. In the absence of fraud, or theft, there is no justification for imposing penalties, civil or criminal, under the CA.

Furthermore, to extend the duty beyond officers of the company may well erode those officers' understanding of their duty to engage contractors on appropriate terms and to supervise them. It is for the officers of the company to ensure that the work done for the company is performed to standards which are in the interests of the company and that cannot, and should not be able to be, delegated. It is unreasonable to expect a contractor to have the same understanding of the 'best interest' of the company as a senior officer.

Proposal 6

Sub-section 1309(1) (knowingly provide false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

The concern outlined in the HIH report is that section 1309 at that time used the phrase 'officer of a corporation' which did not extend to employees and covered only those 'who make or participate in making decisions that affect the whole or substantial part of the business of the corporation or who have the capacity significantly to affect the corporation's financial standing'. This was a significant narrowing of the persons covered by section 1309 before those amendments became effective in March 2000 as prior to that date the definition of 'officer' set out in section 82A covered employees. As outlined in the DP, the CLERP 9 legislation enacted in 2004 has now extended 1309 to include employees. The AICD considers that the amendment of 1309 to include employees and the re-inclusion of the old definition of 'executive officer' (which includes a functional definition for those involved in management) addresses the problem identified in the HIH report and no further extension of the persons covered by section 1309 is warranted.

Proposal 7

Sub-section 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed functions, or otherwise acts or has acted, for or on behalf of that company.

The AICD does not believe that section 1307(1) should be extended to persons, other than officers and employees, who perform functions, or otherwise act, for or on behalf of a corporation. That would extend it to, for example, a storage or recycling facility to whom the relevant corporation had sent 'books'. The offence in section 1307(1) is engaging in conduct that results in concealment, destruction etc, and it is difficult to conceive of circumstances where 'books' had been destroyed by an independent contractor without an officer or employee of the corporation having engaged in conduct to that end.

General Dishonesty Provision

This proposal was put forward in the HIH Report as 'an appropriate balance between the broad ambit of operation of the law prior to March 2000 (namely the duty of honesty in the now-repealed section 232(2), which applied to all executive officers), and its unduly narrow operation now...'. If the AICD's submissions on Proposals 1 and 2 were adopted, the need for such a general honesty provision, on the Report's own reasoning, would disappear. There are, of course, in addition the several difficulties with introducing such a provision that are set out in the DP.

Need for definition of employee

The CA, and its predecessors reaching back to the UCA, have used the word 'employee' without attempting to define it, and without giving rise to any difficulty in obvious need of remedy. The AICD does not share either the view expressed in the DP that the common law tests to distinguish between a contract of service and a contract for services are either complex or imprecise, or with the implied assumption in the DP that a statutory definition would be less complex or less imprecise.

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Appendix

Because we are so accustomed to referring to the fiduciary duties owed to a corporation as directors' duties, it is easy to overlook that they apply also to non-director officers of the corporation acting in a managerial capacity. After making that point half a century ago in his *Modern Company Law*, Professor LCE Gower went on to say:

> 'This is a matter of considerable practical importance now that it is common for the management of public companies to be delegated by the board to a smaller body. At present the managers to whom the directors delegate their powers are likely themselves to be managing and other full time service directors. But the modern tendency seems to be towards to a clear distinction between the management which runs the business and the board of directors which overseas the management and lays down broad lines of policy. This may, in time, lead to the practice of delegating managerial powers to professional managers without seats on the board. In that event, certain statutory rules will need amplification but the general principles of equity are already sufficiently all-embracing to deal with most of the resulting possibilities. In the following discussion we shall refer to directors but, except where the context requires
> otherwise, what is said is equally applicable to all agents of the company; their fiduciary duties are the same but, of course, the lower one goes in the official hierarchy, the less opportunity there is for a breach of these duties.'

At the time that passage was written, neither in England or Australia did the *Companies Act* contain any provisions covering the general duties of directors and officers to their company. It was, however, only shortly afterwards that the *Companies Act* 1958 (Vic) introduced a new section 107, which from 1962 became section 124 of the *Uniform Companies Acts,* which read:

> '(1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.
> (2) An officer of a company shall not make use of any information acquired by virtue of his position as an officer to gain directly or indirectly improper advantage for himself or to cause detriment to the company.
> (3) An officer who commits a breach of any of the provisions of this section shall be –
> (a) liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach of those provisions; and
> (b) guilty of an offence against this Act.
> Penalty: Five hundred pounds.'

'Officer' was defined in UCA section 5 as including, inter alia, 'any director, secretary or employee' of a corporation.

The Explanatory Memorandum for the relevant Bill said in regard to this provision that it is new 'and so far as is known not to be found in any other legislation relating to companies in the English-speaking world.' It was 'introduced as a result of consideration of the Statute Law Revision Committee's report' on the inquiry into the affairs of Freighters Limited by an

inspector appointed pursuant to the provisions of the *Companies (Special Investigations) Act* 1940 (Vic).
The Explanatory Memorandum went on: 'It was decided to introduce this provision rather than the particular provisions suggested by the Statute Law Revision Committee as it was thought that a more general provision would be more effective. To a large extent the section 'is declaratory of the existing law, but it is believed that a restatement of the principles of the honesty and good faith that should govern directors' conduct, clearly set out in the Act, would be an effective deterrent to misconduct and will free the Courts from the technicalities of the existing law in dealing with all forms of dishonesty and impropriety of directors.'

Apart from its novelty in the context of companies legislation, the section was also notable for being the first measure in the common law world to make breach of a fiduciary duty of itself a crime, in order - as the then Victorian leader of the County Party put it - to put 'teeth' into the new section.

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Corporations and Market Advisory Committee (CAMAC)

Corporate duties below board level

Submission by

National Institute of Accountants

The National Institute of Accountants (NIA) has reviewed the Corporate and Markets Advisory Committee (CAMAC) discussion paper titled *Corporate duties below board level.* The NIA agrees with the need to discuss issues of corporate duties at all levels, however, the NIA has some concerns about some of the legislative changes proposed in the discussion paper. While corporate regulation is necessary, it is not always the answer. Legislation developed to address one problem can lead to the development of unforseen problems in the future, and therefore particular care must be exercised in recommending changes to the law. The NIA is concerned that the discussion paper does not adequately address any potential negatives from the recommended changes and does not adequately deal with alternate proposals to deal with the perceived problems.

The NIA would also suggest that the disaster that was HIH should not direct every endeavour in relation to Corporate Governance in Australia. The failure of HIH arose from a myriad of factors, often unique to the culture of that company. It is therefore not wise to undertake a review of corporate responsibility in Australia by merely doing an autopsy on HIH. Autopsies are good at determining the particular cause of one death, and while they may be educative in preventing other death's, they do not give a good understanding of the living population. Equally while we need to learn the lesson's of HIH, we should not assume all companies are infected by the same "diseases" that infested HIH or that proposals that may have helped HIH would have the same impact elsewhere.

The NIA's response to the Discussion paper will involve an analysis of the proposals, reflect on the merit of the proposals and whether alternate proposals would achieve a similar outcome without the potential negatives of the proposal. The NIA will then review the need (or potential lack there of) to make reforms to the corporate duties below the board.

Proposal 1
Section 181 and 184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any person who takes part, or is concerned, in the management of that corporation. Should 'management' of a corporation be defined? If so, should it be along the lines of "activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some bearing on the financial standing of the corporation or the conduct of its affairs"?

The rationale given for this proposal is that the current definition of 'officer' as set out in section 9 of the *Corporations Act 2001* is not as wide as the former definition of 'executive officer'. The HIH report noted that while the definition of 'officer' in section 9 was supposed to adopt the comments of Ormiston J in *Commissioner of Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728, in the opinion of the Commissioner, it "did not achieve that objective" and "the failure to include a person 'concerned in the management'…was a material omission".

The NIA does not presume to have a better understanding of the law than the Commissioner, and is of the view that if the current definition is seen by the experts to fail to embrace the breadth of he former definition, then there are good reasons to amend the legislation to bring this into effect.

It is important that the class of persons who are subject to the 'good faith' and 'proper purpose' tests include those who 'take part or are concerned in the management' of a

corporation. Responsibilities in corporations today are more broadly defused than previously, many more people can be said to be 'concerned in the management' of a corporation and the definitions of those on whom responsibilities fall need to be broad enough to encompass this.

The difficult part though will be in determining just what 'taking part or being concerned in the management of a corporation' actually means. The CAMAC proposal suggest that it should encompass "activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some bearing on the financial standing of the corporation or the conduct of its affairs".

It is important in the development of any such definition that it does not accidentally include persons who may have some minor decision making capacity but who have no real impact on the corporation itself or where those persons are limited by those above them in the discretions they have in decision making. For example, the head of a section may have the power to make a range of decisions affecting that section, however, management at the level above might impose certain restrictions or set targets and outcomes that in effect limit their ability to make decisions. Is this type of person who should now be included in the revised definition? The NIA would think not. It is important than in any changes to corporate responsibility below the board level does not lead to the situation where blame is conveniently shifted down from those responsible for leading the corporation to those who have been devolved small decision making powers.

The proposed definition includes the caveat that the person making those decisions or policies has to be in a position to have a significant bearing on the financial standing of the corporation or the conduct of its affairs. The NIA believes that this should be sufficient to avoid the concerns articulated in the paragraph above.

The NIA therefore would endorse proposal 1 and the proposed definition of being involved in the 'management' of the corporation.

Proposal 2
Subsection 180(1) (the duty of care and diligence) should be expanded beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

Proposal 3
As a corollary of proposal 2, s 180(2) (the business judgement rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

It would be incongruous to change the definition as set out in proposal 1 and not to do the same here. The test of those to whom the duties lie should be the same. The NIA also agrees that the 'business judgement rule' defence should also apply in the expanded circumstances. The NIA therefore supports the adoption of Proposal 2 and 3.

Improper use of corporate position or information

Proposal 4
Section 182 and s 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation, to any person who performs functions, or otherwise acts, for or on behalf of that corporation.

Proposal 5
Section 183 and s 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any person who performs, or has performed, functions, or otherwise acts, or has acted, for or on behalf of that corporation.

The issue that has been highlighted by the HIH report is that in most corporations now there are a range of different people employed by the corporation to work on their behalf. Not all of these are encompassed by the current terms in the relevant sections as they talk about 'directors, officers and employees', as these definitions do not include people such as contractors and consultants. Many corporations employ consultants and contractors to do a lot of work on their behalf, providing such persons with the potential to improperly use their position or knowledge.

Given the flexibility of modern corporations it does not make sense to limit the applications of section 182, 183 and 184(2) and (3), by the use of generic terms about position (such as employee) rather it would make more sense to adopt the proposals set out in the HIH report that focuses on the functionality rather than title.

Proposals 4 and 5 suggest that the above section should apply to any person performing a function or acting on behalf (or has in the past done so) from misusing their position or corporate information. The NIA supports these proposals as providing a common sense approach. This definition should be broad enough to encompass all persons regardless of their position or title.

Section 1309

Proposal 6: **Subsection 1309(1) (knowingly providing false or misleading information and subsection 1309(2) (ensuring the veracity of information) should be extended beyond officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.**

Subsection 1309(1) prohibits an officer or employee of a corporation from knowingly giving certain persons false or misleading information relating to the affairs of that corporation, while subsection 1309(2) requires that they take reasonable steps to ensure the accuracy of the information they provide to certain persons.

The CAMAC proposal is similar to the previous proposals, that being, the subsections should be extended beyond merely 'officers and employees' to also include other persons who act on behalf of or perform functions for a corporation.

The argument is again that there are many people who are not strictly employees or officers who work for or on behalf of the corporation who may be required to give information to the same people as set out in the subsections. If such persons are not included, then there is the risk that such person would be outside the law. It may

also be convenient to use such persons who are not named, so as to try and get around the requirement.

However, the definition here may be too broad. While contractors may be said to be similar to employees the issue of external consultants and external professionals complicates the situation. Lawyers, accountants and other professionals are often acting for or on behalf of a client, however, such persons have different obligations than someone who is merely engaged by a company to do some work on their behalf. This is not to say that such persons do not have an obligation to act ethically and to not provide false or misleading information (which they do, including their own professional requirements), rather it is to say we need to be careful not to include in the net of persons caught, groups that can not be said to be analogous to officers and employees. The line is not always clear.

The NIA broadly supports the proposition that all persons who are officers, employees or the like should be covered by the subsections. The NIA though believes that further regard needs to be given as to exactly who should be covered by the subsections and how best to define them without bringing in external professionals who should not be regarded in a similar vein to employees and officers of a corporations. However, such persons should also be required to act ethically, the issue is how best to define them.

Section 1307

Proposal 7: **Subsection 1307(1)(misconduct concerning corporate books) should be extended beyond past and present officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.**

The NIA believes that similar arguments as raised above for proposal 6 apply equally for proposal 7.

General Dishonesty Prohibition

Should there be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute? If so, should the provision apply to:

- **Obligations under the Corporations Act only; or**
- **Obligations under any Commonwealth, State or Territory statutes applicable to Corporations; or**
- **Obligations under any overseas written law as well as any Australian law.**

The NIA would not support a general prohibition as outlined in the CAMAC paper. It is too broad and ill defined. It would be like passing a law on all Australians to never break a law or be dishonest in their every day life. It will be impractical and could easily be misused by Corporate regulators or others to threaten employees and others with court action for very minor contraventions. If the law is already in place then that provision should be strong enough to stand on its own, if the person breaches that part of the law then they should be charged with that specific breach.

This is not say that people should not act dishonestly, which is simply a truism. It is saying that such a broad provision is unnecessary. While the paper highlights some of the potential problems if such a provision, the NIA would highlight some more:

- There is an issue of double jeopardy here, a person could be charged under numerous provisions in different acts for the same offence, this goes against the tenants of our legal system;
- It opens up the possibility of abuse, the main persons who are likely to be targeted for a breach of this sort are people who are very low on the 'rung' of corporate responsibility. Such person will not have easy access to quality legal representations and may be threatened with charges under the provisions. Such a threat, whether it is backed up by facts or not, may be enough to force such a person to act in a way that they would not otherwise;
- It places many additional people in the position of potentially breaching laws they do not even know exist. While it is fair to expect directors, officers and senior managers to understand the law they operate under, for the average employee such matters will not be a high priority. With the myriad of laws and the different types of legislation (Federal and State) it may be quite easy for them to breach a law without ever intending to;
- There would need to be a defence for lower end personnel who are acting on direct orders from senior management or the Board, the fear of losing their job is likely to be high, their understanding of what they are doing and how they may potentially be breaching may be low. To say that such person should face a similar charge to senior management is unfair and inequitable; and
- There is also the issue of proper use of the regulators resources. With limited resources the regulator should concentrate on the big issues and target those who have real authority in corporations. While such cases are difficult to prove they are the ones that need to be targeted. The regulator may find it easier to go after the 'little fish' as it will likely be cheaper and easier for them to win. Such forcing down of corporate responsibility to the lower levels and away from the real decision makers, is unwelcome and unlikely to create a good corporate culture.

The NIA can not see what good would be done by such a provision. If a person has dishonestly breached part of the law they should be charged with that breach not some 'catch all' charge. There is a great threat of abuse and misuse of such a provision and it is likely to place an unfair burden on lower level personnel that is not commensurate with their level of understanding of the law nor their ability to act independently. If abuse is happening at a lower level, it is the role of senior management to intervene and see that it does not happen. It should not be the role of the regulator to check every minor breach. The NIA also believes rather than helping to improve corporate culture in Australia, it is likely to weaken it, as focus is shifted from the big decisions to the minutiae of every decision and every person in the corporation.

The NIA believes the earlier proposals should be more than sufficient to deal with the current weaknesses in the law without the need for this general provision.

Defining 'Employee'

Is there any deed to define the term 'employee' for the purposes of ss 182-184 or ss 1307 and 1309 in Proposals 4 – 7 are implemented?

The NIA does not believe there is a need to define the term 'employee', however, if such a definition is attempted it needs to be one based on functionality and integration within the corporation rather than a list of titles, positions or strict criteria. The NIA does not believe that it will be possible to reach a consensus view on what the definition of 'employee' should be. Any definition must be able to deal with the constantly changing structure of corporations and the way they do business. A definition that may be applicable now, may not be able to deal with changes in the future.

One advantage of a definition of an employee may help in distinguishing contractors that are effectively employees from professional consultants who merely provide and advice and external services to the corporation. While such a distinction would be welcome, the issue becomes one of how do you come up with such a definition.

It is noted that even the consultation paper does not attempt to come up with a proposed definition, indicating the difficulty that is likely to arise. Given that the earlier proposals are likely to deal with the matters of current concern, it would be better to focus on those issues rather than trying to tackle something as nebulous as definition of employee. This is likely to be a more long term issue than one that can be addressed within the time frame of the discussion paper.

Corporate groups

There was concern raised in the HIH report that where there is the existence of corporate groups, decisions may be made in one company in the corporate group that affect others. It was noted that the current legislation probably does not adequately deal with this. The CAMAC paper asks whether the law needs to be changed in order to bring this about. It is the view of the NIA that if the reforms proposed in proposals 1 to 7 were adopted, then there would not be any need for further changes to the law. If they are a director or officer of one group but makes decisions that affect another, it could be said that such persons where taking part in the management of the corporation, therefore they would be caught. To try and create additional rules is likely only to complicate the matter and may cause a difference in the way the Act is applied. Therefore given the proposed changes would adequately deal with the issue, the NIA does not believe further amendments to the law will be necessary.

Other behaviour

The CAMAC paper asks whether other forms of behaviour should be dealt with. The NIA is not of the view that there is the need to add extra 'sticks', but there is the need to add 'carrots' that will also help to improve Corporate Governance. One issue that I not canvassed is that of 'whistleblower' protection. One of the biggest things that prevents corporate abuses being discovered at an earlier enough time is that often those who may be in the position to report breaches feel they can not without losing their job and potentially being ostracised in their field of work.

The NIA believes it is important to reopen the debate on how best to protect corporate 'whistleblowers'. Mechanisms should be inserted in the law that help those wishing to take such actions from potentially punitive consequences.

Potential reforms to promote 'whistleblowing' include:

- Putting in place statutory protection for people who report genuine concerns about corporate conduct;
- Setting up a statutory body where 'whistleblowers' can raise their concerns about potential misdoing at the corporate level; and/or
- Encourage training at the mid-level of corporate management of issues concerning corporate governance and the proper running of corporations. Such training should first happen when a person becomes a director or senior manager. Greater understanding of proper corporate conduct should engender good corporate culture.

Conclusion

The NIA supports the adoption of proposals 1 through to 5 as they are proposed. The NIA generally supports the principles outlined in proposals 6 and 7, however, there may be a need to have consideration on just how wide the definition should be, and the issue of how professional consultants are to be dealt with needs further consideration. The NIA though does not support the adoption of general dishonesty prohibition. The law already sets out what is prohibited and any breach should be under a specific section not some 'catch all'. There is also concern about the potential for abuse to arise out of such a requirement. The NIA also believes that it would be nearly impossible to set a definition of 'employee' that covered all potential iterations, both now and in the future.

The NIA though believes that one area that was not covered and is one of the most important in relation to promoting good corporate governance, is the adoption in the law of strong and effective mechanism that promote 'whistleblowers' and protects them when they act in good faith.

Overall though the NIA believes that corporate governance in Australia is generally in 'good hands'. There will always be examples of bad corporate governance and the law should be flexible to deal with them, however, it is not possible to catch everything. More important than legislation is ensuring that there is a good corporate governance culture. Russia has some of the heaviest penalties for breaching corporate governance provisions in the world, however, few would say it is a country known for its high level of corporate governance. A large part of this has to do with corporate culture. It does not matter what laws you put in place if the culture is one of avoidance and disrespect. HIH failed for many reasons, a large part had to do with a very poor corporate culture and excessive risk taking. HIH is not reflective of most Australian businesses and while it is important to learn lessons from it, they should not colour the view of corporate culture in Australia and dominate laws dealing with it.

Our Ref: JM:LW
Direct Line: 9926 0256

25 August 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

Re: CAMAC Discussion Paper: Corporate Duties Below Board Level

The Law Society of New South Wales congratulates the Corporations and Markets Advisory Committee (CAMAC) on its Discussion Paper addressing the complex issue of corporate duties below board level and would like to thank CAMAC for the opportunity to make this submission.

The Discussion Paper has been reviewed by the Law Society's Business Law Committee (Committee). The Committee is delighted to make a submission in relation to the Discussion Paper, and notes that the submission is not intended to address every aspect raised under the proposed amendments. Rather, it is the intention of the Committee to raise debate regarding the recommendations in general theory, and as they apply to the *Corporations Act*.

Introductory comments

At the outset, the Committee expresses the view there is need to balance the inherent time cost to business of further regulation against the suggested benefit of that regulation.

There appears to be some tension between the proposals in the Discussion Paper and the traditional approach taken by the general law, particularly equity. It is this tension that the Committee has focused on as a critical issue to address. The tension lies in the Discussion Paper's proposal that duties owed by people to the corporation should be defined by reference to the role or function they play in relation to the corporation, rather than by reference to the relationship between the person in question and the corporation.

While this proposal seems sensible initially, if someone acts as a board member or similar they should be treated as such and it is necessary to consider the legal proposition being put forward. The duties in question have always been, and continue to be, defined and imposed by reference to the nature of the relationship between the parties. This has been the case in statute, at common law, and in equity. Particularly in relation to the proposals to extend the statutory fiduciary duties to a wider class of

personnel, the Committee expresses concern over an expansion that the courts would not otherwise countenance.

The Committee also queries whether the *Corporations Act* is the appropriate vehicle for instituting wide ranging duties on employees. For example, the *Corporations Act* currently imposes certain duties (see especially ss182 and 183) on employees, the conduct of whom is appropriate for the *Corporations Act* to regulate. One of the questions that the Committee considered was whether it was appropriate for employees to owe a duty not to misuse their position or information gained by virtue of their position and whether it is necessary for the *Corporations Act* to be amended to impose such a duty.

Discussion of the recommendations

Extension of duties under sections 180 and 181:

> For the reasons expressed below, the Committee does not wholly support the proposed amendments to extend those duties imposed on directors under ss180 and 181 to 'any other person who takes part, or is concerned, in the management of the corporation'.
>
> The issues addressed in the Discussion Paper extend to the heart of the relationship that directors and senior officers have to their respective companies. The HIH Royal Commission Final Report raises a series of questions about whether the *Corporations Act* adequately reflects the commercial practicalities of managing (albeit directing) a modern corporate enterprise. Historically, the general law has taken the view that directors, by virtue of their position, are responsibly held out to be the decision makers of a corporation[1] and has dimly viewed the neglect or omission of such duties that ought to be performed.[2]
>
> The challenge, in part, before corporate Australia in this regard was in enforcing legal responsibility for the neglect of a duty that ought to have been performed on behalf of shareholders by the chairman and directors of the company. Importantly in the case of HIH, those individuals responsible for the decisions of the company were held to be accountable in the eyes of the law, and of the public. But, over the 19th and 20th centuries there appears to be a judicial reluctance to second guess business judgements made in good faith, and an explicit understanding that it is undesirable for courts to attempt to formulate general principles in this area.[3] This view was well articulated in the decision of *Dovey v Cory*, citing judicial interference to establish such principles as undesirable 'for the guidance of embarrassment of businessman in the conduct of business affairs'.[4] Today, this sentiment is well reflected in the exceptions provided by the business judgement rule under s180(2) of the Act.
>
> The issue considered under Recommendation 2 of the HIH report was whether the general duties of directors and officers under Chapter 2D of the *Corporations Act* should apply to a wider class of personnel. Justice Owen recommended that the definition to whom the duties applied should focus on 'the function performed by the relevant person – not the classification of their legal relationship to the

[1] See especially, *Salamon v Salamon & Co Ltd* [1897] AC 22, House of Lords.
[2] *Re Cardiff Savings Bank; Marquis of Bute's Case* [1892] 2 Ch 100 (Stirling J) 108. Cf *Williams v McKay* (1889) 18 A 824.
[3] Paul Redmond, *Companies and Securities Law Commentary and Materials* (3rd ed, 2000) 378.
[4] [1901] AC 477 (Lord Macnaghten) 488.

corporate entity'. The latter general law however seems to suggest the contrary, arguing that the source of duty of care and diligence lies in the relationship of a director to the company: *Daniels v Anderson*.[5] Here, Justices Clarke and Sheller state that 'we see no reason why the relationship of a director to a company should not, in accordance with the law that has been developed since *Headley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465*, satisfy the proximity test'.[6]

Although the Discussion Paper rightfully questions the extent of duties under the *Corporations Act*, the Committee does not agree with the view that such obligations be statutorily extended to 'any other person …' as it is questionable whether any other person who takes part in the management of a corporation is in fact in a position such that duties of care and diligence, as they apply to directors, ought to apply in such cases other than to 'officers'. To allow the reach of the law to extend to middle management away from company directors and officers could be interpreted as permitting the law's interference with the day-to-day conduct of business affairs.

Although *Daniels* sets down that a director's duty 'cannot simply be limited by his or her knowledge or experience, or ignorance or inaction',[7] the Committee submits that the relevant test must consider whether the individual is in a position to make decisions that have '*significant* bearing on the financial standing of the corporation or the conduct of its affairs.'[8] The Committee supports the view that a 'director should become familiar with the fundamentals of the business in which the corporation is engaged',[9] but adoption of the proposed amendments arguably provides the mechanism by which blame for corporate failure is delegated down the management chain. There are for instance, many middle managers within corporations that *do not* make decisions bearing on the financial standing of the company, and the Committee is concerned that the proposed amendments may provide for the dilution of directors' equitable duties.

In the Committee's view, extending such duties to middle management significantly waters down the necessary onus placed on directors to uphold their statutory and equitable obligations, and adoption of a 'functional' definition is arguably not in keeping with the general law. The Committee queries whether a director's fiduciary duties should be extended to middle management and whether in those circumstances company directors and middle management should both be under the same legal and equitable obligations. Perhaps a more contemporary example of these issues is highlighted by the One.Tel case,[10] and, by way of alternative example, comparison could be made with the position taken by the *US Sarbanes Oxley Act* in relation to a company's c-level executives, or 'certifying officers'.[11]

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[5] (1995) 37 NSWLR 438 (Clarke and Sheller JJA) 492 ('*Daniels*').

[6] At the risk of rekindling the fusion fallacy debate, the Committee does not place sole reliance on this reference to illicit its proceeding argument. The Committee would however like to point CAMAC to the recent decision of the Supreme Court of NSW in *ASIC v Vines* [2205] NSWSC 739, particularly to the arguments raised by Justice Austin at 1070.

[7] Per Clarke and Sheller JJA, 503.

[8] Referring to the definition of 'management' adopted in *Commissioner for Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728 (Ormiston J).

[9] *Campbell v Watson* 62 NJ Eq, 416.

[10] See especially, *Australian Securities & Investments Commission v Rich* (2003) 44 ACSR 341.

[11] The Act, for example, holds a company's c-level executives (or 'certifying officers') personally responsible for misrepresentation of financial data (see, eg, s302). These officers then become the focus of subsequent requirements such as the report by management on the company's internal control over financial reporting under s404.

Arguably, section 9 of the *Corporations Act* already embraces a functional definition of 'officer'. Accordingly, as James McConvill suggests, and the Committee agrees, 'there is simply no need to amend the law to extend to the duty of care and diligence, unless of course it is felt that there is a need to shift some responsibility from the board to middle management.'[12] As Judge Lee remarked in *Federal Deposit Insurance Corporation v Lee*, 'a director's duty to exercise due care, skill and diligence in overseeing the affairs of the bank cannot be met solely by relying on other persons … '.[13] Justice Owen does not appear to be recommending that directors' statutory duties be delegated, but the perceived risk is that if the duties are extended, this may be the adopted interpretation (albeit practical reality). For these reasons, the Committee is of the view also that the statutory provision ought to remain unchanged, but agrees that some clarification of duties is needed to accurately assess the potential impact of the reforms.

If a director is an 'essential component of corporate governance',[14] the Committee queries whether the Discussion Paper is looking to broaden the realm of corporate governance by extending duties to middle management. Justice Owen remarked in HIH, '[a]ny legal regime for the enforcement of corporate governance standards that does not extend to … at least some levels of management is unlikely to be … effective.' The Committee supports the view that it is not the role of corporate governance theorem to determine the law as it ought to be.

Extension of obligations under sections 182 and 183

For the reasons expressed below, the Committee generally supports the proposed amendments to extend the prohibitions under ss182 and 183 beyond directors, other officers and employees of a corporation to 'any other person who performs functions, or otherwise acts, for or on behalf of that corporation'.

The proposed reforms to ss182, 183 & 184 appear to 'cover the field', extending to independent contractors who do not come within the strict definition of 'employee', but the Committee agrees with the view that the 'executive officer' test may be too narrow a test to apply. Criminal provisions aside, without strict incorporation into section 9, difficulties may lie in tying responsibility to the line of office. In *ASIC v Vines*,[15] drawing on a report published by the Senate Standing Committee on Legal & Constitutional Affairs,[16] Justice Austin suggests that the statutory duties imposed on officers are an objective standard of reasonable competence. In relation to consultants and contractors, the issue then, for example, is whether and how the law applies in determining whether such employees have or could breach their statutory duty.

The importance of recognising the 'legal' role and or operational function of consultants and contractors is that they regularly perform 'acts, for or on behalf of the corporation', but responsibility for breach of duties, unless otherwise provided for under the *Corporations Act*, may better lie as a matter of employment law. The

[12] James McConvill, 'Corporate Duties: A Need for Care and Diligence', (2005) <http://www.lawyersweeklu.com.au/articles> at 11 July 2005. James McConvill is a lecturer at Deakin University Law School, and Principal of the Corporate Research Group.
[13] 770 F Supp 1281 (ND Ind 1991) 1310.
[14] *Campbell v Watson* 62 NJ Eq 443.
[15] [2003] NSWSC 1116.
[16] *Senate Standing Committee on Legal & Constitutional Affairs*, 'Company Directors' Duties: Report on the Social and Fiduciary Duties & Obligations of Company Directors', (November 1989). The Report recommended the enactment of an objective duty of care for directors.

definition of 'employee' and indeed of 'management' under the *Act* would therefore need to be revised.

Extension of obligations under sections 1309(1) and 1307

The Committee's views are in keeping with those expressed in the HIH Royal Commission Final Report that 'if an employee provides information to a director or auditor that he or she knows to be false or misleading', there is 'no reason why they should not be held to have contravened the law'. Here, the Committee points CAMAC to the recent decision of the NSW Supreme Court in *ASIC v Vines*.[17] The Committee therefore generally supports the proposed amendments to extend the prohibitions under ss1309(1) and 1307 beyond officers and employees of a corporation to 'any other person who performs functions, or otherwise acts, for or on behalf of that corporation'.

General dishonesty provision

The Committee's initial concerns with a general dishonesty prohibition is in keeping with CAMAC's, that the prohibition could lead to statutory duplication and difficulty in determining responsibility for enforcement. Otherwise, the Committee does not object with the proposed amendments to extend the current prohibitions dealing with improper use of corporate information and, providing false information, to 'any other person who performs functions, or otherwise acts, for or on behalf' of a corporation.

Further submission

The Committee thanks CAMAC for the opportunity to make this submission, and is keen to contribute to further discussion on the issues raised in the Discussion Paper.

If any further information is required in relation to this submission, please contact Laraine Walker, Executive Member of the Business Law Committee on (02) 9926 0256 or by email to lxw@lawsocnsw.asn.au. .

Yours sincerely,

John McIntyre
President

[17] [2005] NSWSC 738 (Austin J).

CPA Australia

Submission to

Corporations and Markets Advisory Committee

Review of

Corporate Duties Below Board Level

September 2005

Executive Summary

CPA Australia, the pre-eminent body representing the diverse interests of more than 105,000 finance, accounting and business advisory professionals working in the public sector, public practice, industry and commerce, academe and the not-for-profit sector, is pleased to make this submission.

More than 18,000 of our members hold company directorships, with a further 20,000 in positions of general manager and above including roles as CEO and CFO. CPA Australia is therefore well placed to provide its views on the merit and potential ramifications of CAMAC's proposals to extend current director responsibilities to individuals below board level. The comments herein are in addition to those submitted by the Legislative Review Board jointly on behalf of the accounting bodies (CPA Australia and the Institute of Chartered Accountants in Australia).

CAMAC's proposals should be considered in the context of the wider body of corporate law.

CPA Australia's submission commences with comment around the effect of s 185 of the Corporations Act (2001). This section is not considered in the Discussion Paper. Section 185's reference to the general law is significant to understanding the total scheme affecting directors' and officers' duties. It is particularly relevant to the division of corporate responsibility, identifying the nature of duties that have evolved to safeguard both corporate and shareholder interests, and to encouraging the good conduct of commerce.

Courts continue to support the notion that directors bear primary responsibility for the management of a corporation, and that this is qualified by well established understandings of reliance and delegation.

CPA Australia is of the view that failing to adequately appreciate the interaction of statute and the general law rules may lead to disharmony and uncertainty.

The law of directors' and officers' duties has evolved by way of analogy with both common law and equitable principles, nonetheless they signify defined categories of relationship and delivers a more robust basis for regulating the complexity of corporate behaviour, especially when compared to a prescriptive approach. As such the obligations that ensue from these relationships are currently attributable to clear classes of person to whom a requisite quality of performance, awareness and behaviour can be identified.

It is on this basis that CPA Australia does not support the general thrust of the Discussion Paper. A number of suggestions for targeted strengthening of the current scheme are provided for consideration by the Committee. These proposals reflect our confidence in the adequacy of the current scheme across statue and the general law.

CPA Australia's response to the individual CAMAC proposals

With respect to **proposal 1,** CPA Australia does not support the extension of the duties of good faith and proper purpose beyond those currently defined in ss 181 and 184(2). The current definition of officer contained in the Corporations Act and further developed through case law has adequate scope to include individuals who may from time to time undertake senior management decision making. We do not support the need for a third category of such individuals, and reject proposals to include those providing advisory services to the company or the board.

With regard to **proposal 2**, CPA Australia does not support the extension of the duty of care and diligence to officers of a corporation beyond those currently defined under s 180(1) as other persons involved in the management of the corporation are unlikely to meet the tests of proximity nor reasonable foreseeability of harm which underpin the duty of care. A more appropriate approach may be to explore the apportionment of tortious liability in the corporate context.

In line with its rationale for not supporting Proposal 1, CPA Australia does not support **proposal 3**. In our submission we explore the application of the statutory business judgement rule. CPA

Australia would support development of non-statutory guidance to assist the adoption of appropriate risk-management structures.

CPA Australia does not support **proposals 4 and 5** as the harms caused by, or abuses of, relationships falling outside of the scope of the current combined statutory and general law regime, given its' acknowledged breadth, are more likely to be better dealt with under more directly appropriate avenues of relief; such as contract law, civil wrong or a statutory regime other than the Corporations Act.

CPA Australia is of the view that **proposals 6 and 7** because the general law already provides the extended scope sought under s 1309(1) and 1307(1). The sections are further strengthened when considered in conjunction with s 79 (Involvement in contraventions).

Background
The interaction of statutory provisions and the general law

The CAMAC Discussion Paper does not fully consider the impact of general law on the directors' and officers' duties and hence does not make reference to s 185. However we believe it is worthwhile to consider the implications of this provision as it directs attention to the equally applicable general law.

Section 185 preserves the applicability of the general law neither lessening, impairing or detracting from the structure of rules that have emerged through precedent in the area of directors' duties.

SECTION 185 **INTERACTION OF SECTIONS 180 TO 184 WITH OTHER LAWS ETC.**

185 Sections 180 to 184:

(a) have effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation; and
(b) do not prevent the commencement of civil proceedings for a breach of a duty or in respect of a liability referred to in paragraph (a).

This section does not apply to subsections 180(2) and (3) to the extent to which they operate on the duties at common law and in equity that are equivalent to the requirements of subsection 180(1).

Section 185 has been subject to limited judicial consideration, most of which merely restate the provision's effect:

> "The statutory duties of a director are in addition to, not in derogation of, a director's duties under the general law."[1]
>
> "In other words, the statutory duties and fiduciary duties of directors exist side by side, each in aid of the other."[2]

Perhaps the most critical comment is that of Giles JA in *Adler and Anor. v ASIC*[3] where at 653 it is stated:

> " - - - the ordinary meaning of the words had primacy. Section 185 of the Act underlines that the statutory duties in ss 180-183 are additional to and stand free of a director's common law and equitable duties."

Whilst this section has respective specific interaction with ss 180 - 181 and ss 182 - 183, its presence in corporations law compels the need to consider not only the specific general law rules which inform the nature of the corresponding statutory provisions, but also the broader underlying rationale of directors' duties given rise to by separate corporate legal personality.

These considerations are relevant to understanding the character of particular duties. An appreciation of the present law as it applies to reliance and delegation is germane to the notion of with whom responsibility for management rests. It is also relevant to the definition of 'management' for the purpose of matters covered in Proposals 1 to 3. In addition, consideration of the rationale for this division of powers and the types of duty that ensue is vital in assessing whether it is appropriate to extend directors and officers duties to other 'tiers' of management or relationships as proposed in the Discussion Paper.

[1] per Palmer J in *Swannson v Pratt* (2002) 20 ACLC 1,594 at 1606.
[2] per Debelle J in *Southern Real Estate Pty Ltd v Dellow* BC200305320 at [21]
[3] (2003) 46 ACSR 504.

The division of corporate powers

Both statute and general law reinforce the principle that a corporation is a separate legal entity and that directors are responsible for the management of the company.

The corporate entity is freely capable of contracting as a principle in its own right, rather than as trustee or agent for the shareholders. In *Salomon v Salomon*[4] the doctrine is given full weight in the words of Lord Halsbury – "once the company is legally incorporated it must be treated like any other independent person with its own rights and liabilities appropriate to itself".

This separate legal personality of a corporation is further overlayed by judicial recognition given to corporate management whereby, it is only the directors who are able to exercise powers of management except in the matters specifically allotted to the company in general meeting.

Greer LJ in *John Shaw & Sons (Salford) Ltd v Shaw*[5] after reiterating the *Salomon* principle that "a company is an entity distinct alike from its shareholders and directors" goes on to say "powers of management are vested in the directors, they alone can exercise those powers." Similarly in *Alexander Ward and Co Ltd v Samyang Navigation Co Ltd* the following statement is found:

> " - - - the directors, and no one else, are responsible for the management of the company, except in matters specifically allotted to the company in general meeting. This is a term of the contract between the shareholders and the company."[6]

This division of powers is now embodied in legislation:

SECTION 198A **POWERS OF DIRECTORS (*REPLACEABLE RULE — SEE SECTION 135*)**

198A(1) **[Management of business]**

The business of a company is to be managed by or under the direction of the directors.

Note: See section 198E for special rules about the powers of directors who are the single director/shareholder of proprietary companies.

198A(2) **[Exercise of powers]**

The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting.

Nonetheless, the formal separation of shareholding and management does not infer that shareholders are at the mercy or whim of directors. In addition to contractual and tortious rights and other avenues of remedy, the law imposes fiduciary obligations which seek to "assure loyal service in the interests of the corporation, conventionally defined by the interests of shareholders."[7] The nature of these categories of duty and the rationale for the class of person upon whom the burden falls, is discussed in response to the Discussion Paper's Proposals 1 to 5.

Further insight as to why the general law has evolved to give primacy to directors, as opposed to others engaged in management, as the persons liable for duties owned to the corporation, can be deduced from the notion of the 'guiding mind of the corporation':

[4] [1897] AC 22.
[5] (1935) 2 KB 113 at 134.
[6] (1975) 1 WLR 673 at 683 per Lord Kilbrandon.
[7] B DeMott, "Shareholders as Principals", Paper presented at the University of Melbourne Harold Ford Conference – Key Developments in Corporate Law & Equity, March 2001, p 1.

> " - - - the corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its activity and directing will must consequently be sought in the person who for some purposes will be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation."[8]

Reliance and delegation

An illustration of the manner in which the general law has adapted to the complexities of the artificial corporate personality is in developments relating to reliance and delegation.

Directors have the capacity to delegate powers of management of the company in line with current commercial reality. Once responsibility is delegated, directors should be able to rely on management to manage within the scope of their authority. This does not excuse the director from responsibility as they have a positive duty of care and diligence and make inquiries in appropriate circumstances. Case law has addressed these issues and provides guidance for directors and company officers on their respective responsibilities.

The initial starting point in case law analysis of reliance and delegation is the view of Romer J expressed in *Re City Equitable Fire Insurance Co Ltd*:

> "In respect of all the duties that, having regard to the exigencies of business, - - - may properly be left to some other official, a director is, in the absence of ground for suspicion, justified in trusting that other official to perform such duties."[9]

Similarly, earlier authority recognising the necessity for directors to rely on others in the conduct of business and affairs of the company can be found in the statement of Halsbury LC in *Dovey v Cory*:

> "The life of business could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to the details of management."[10]

These themes are pivotal to the case of *AWA Ltd v Daniels*[11], in which Rogers CJ articulates a test of permissible delegation:

> "The directors rely on management to manage the corporation. The board does not expect to be informed of the details of how the corporation is managed. They would expect to be informed of anything untoward or anything for consideration by the board."[12]

And further:

> "A director is entitled to rely without verification on the judgement, information and advice of officers so entrusted."[13]

Comerford and Law's[14]comprehensive analysis of the principle espoused by Rogers CJ can be summarised as saying that where it is established that a particular matter is capable and reasonably expected of being delegated to management, "it can be assumed

[8] *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 at 713 per Viscount Haldane LC.
[9] [1925] Ch 407 at 429.
[10] [1901] AC 477 at 486.
[11] (1992) 7 ACSR 759.
[12] (1992) 7 ACSR 759 at 867.
[13] (1992) 7 ACSR 759 at 868.
[14] "Directors' Duty of Care and the Extent of 'Reasonable' Reliance and Delegation" (1998) 16 C&SLJ 103.

by directors that the matter has been attended to because it has been delegated."[15] Important qualifications on the scope of delegation are:

- the importance of the matter; and
- any intervening circumstances that would put the director on enquiry.

What might reasonably be described as the allowance of passivity in this approach has been subject to challenge. The most direct being *Daniels v Anderson*[16], on appeal from *AWA Ltd v Daniels*, in which Clarke and Sheller JJA apply a stricter, more onerous formulation of reliance. Their Honours' conclusions in this case are further analysed in the discussion of Proposal 2. Nonetheless, application of this higher standard is not free from difficulty. Comerford and Law concluding "(it) is difficult to reconcile with commercial reality: directors must delegate and must rely on others."[17]

ss 189,190 and 189D were introduced consequential to these developments:

SECTION 189 RELIANCE ON INFORMATION OR ADVICE PROVIDED BY OTHERS

(a) a director relies on information, or professional or expert advice, given or prepared by:

(i) an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or
(ii) a professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or
(iii) another director or officer in relation to matters within the director's or officer's authority; or
(iv) a committee of directors on which the director did not serve in relation to matters within the committee's authority; and
(b) the reliance was made:

(i) in good faith; and

(ii) 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; and

(c) the reasonableness of the director's reliance on the information or advice arises in proceedings brought to determine whether a director has performed a duty under this Part or an equivalent general law duty;

the director's reliance on the information or advice is taken to be reasonable unless the contrary is proved.

SECTION 190 RESPONSIBILITY FOR ACTIONS OF DELEGATE

190(1) **[Delegation by director]**

If the directors delegate a power under section 198D, a director is responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves.

190(2) **[Director not responsible in certain circumstances]**

A director is not responsible under subsection (1) if:

(a) the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by this Act and the company's constitution (if any); and
(b) the director believed:

(i) on reasonable grounds; and
(ii) in good faith; and
(iii) after making proper inquiry if the circumstances indicated the need for inquiry;

that the delegate was reliable and competent in relation to the power delegated.

SECTION 198D **DELEGATION**

198D(1) **[Delegation of powers]**

Unless the company's constitution provides otherwise, the directors of a company may delegate any of their powers to:

(a) a committee of directors; or

[15] "Directors' Duty of Care and the Extent of 'Reasonable' Reliance and Delegation" (1998) 16 C&SLJ 103 at 111.
[16] (1995) 16 ACSR 607.
[17] "Directors' Duty of Care and the Extent of 'Reasonable' Reliance and Delegation" (1998) 16 C&SLJ 103 at 112.

(b) a director; or
(c) an employee of the company; or
(d) any other person.

Note: The delegation must be recorded in the company's minute book (see section 251A).

198D(2) **[Exercise of powers]**

The delegate must exercise the powers delegated in accordance with any directions of the directors.

198D(3) **[Effect of exercise of powers]**

The exercise of the power by the delegate is as effective as if the directors had exercised it.

Section 189 sought to clarify the reasonableness of directors' reliance on information or advice provided by others within the ambit of Pt 2D.1 Duties and Powers, while s 198D directly intended to "overcome the impact of the Court of Appeal decision in the AWA case."[18]

A further issue raised by the extensive deliberations in *AWA v Daniels*, and its' appeal, is the distinction between delegation and reliance, and what might constitute unreasonable delegation, along with the latter's emphasis on a positive duty to enquire.[19] A case in which these issues were considered is *Permanent Building Society v Wheeler*[20] from which can be concluded from Ipp J's judgement that whilst delegation is not prohibited, the courts will not be sympathetic towards matters being left to management where the unique circumstances of the company dictate otherwise.[21]

The other aspect raised by *Permanent Building Society v Wheeler* is the distinction, if any, between a common law duty and an equitable obligation in terms of their respective tests for causation of loss. The CLERP Proposal for Reform Paper No 3 of 1997 noted that the initial *Daniels* decision of Rogers CJ regarded the content of tortious and equitable duties as the same. The contrasting tests in *Wheeler* are likewise applied to produce similar outcomes.[22]

The CLERP proposal does give recognition to a trend within equitable duties towards a "more objective standard for both executive and non-executive directors, particularly in relation to financial matters", and further that "it is no longer acceptable for a director to take a passive role in company affairs."[23] Recent case law reviewed below bears out the related observation made in the CLERP Proposal that "standards in all the duties are seemingly heading in the same direction."

Examination of the recent judicial consideration of s 198A and its interaction with ss 189, 190 and 198D, though limited, continues to reflect a strong adherence to the centrality of director responsibility for corporate duties and the general trend towards higher standards alluded to in the CLERP Proposal:

In *Deputy Commissioner of Taxation v Clark*[24]*;*

> "For over two decades there has been a symbiotic interaction between legislative change and judicial decision. This interaction has both clarified and intensified the

[18] R Baxt, "CLERP Explained" CCH Australia Ltd 2000 p 29.
[19] See for example *Re Property Force Consultants Pty Ltd* (1995) 13 ACLC 1051 and the line of development in insolvent trading cases both pre and post the *Daniels v Anderson* decision.
[20] (1994) 14 ACSR 109.
[21] Comerford and Law, "Directors' Duty of Care and the Extent of 'Reasonable' Reliance and Delegation" (1998) 16 C&SLJ 103 at 114.
[22] Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed., Butterworths, 2003) [8.330].
[23] Reform Paper No 3 of 1997, p 44.
[24] (2003) 45 ACSR 332 at 345 – 346 per Spigelman CJ.

> expectation that directors will participate in the management of the corporation. This expectation is reflected in s 198A of the Corporations Act - - - . This section was inserted - - - as one of the replaceable rules - - - (and) - - - has been a basal operating assumption of Australian corporation law for many decades that, subject only to express provision to the contrary, directors will participate in the management of the company. That expectation was tested in both insolvent trading cases and director's negligence cases."

In *ASIC v Rich and Ors.*[25]*;*

> "Section 198A(1) of the Corporations Act provides that the business of the company is to be managed by or under the direction of the directors. In a large business the directors must delegate their powers. However as Thomas J said in *Dairy Containers Ltd v NZI Bank Ltd* (1995) 13 ACLC 3211 at 3222:
>
> > Executives in running the day to day business of a company are exercising delegated powers. It is to be borne in mind always that they are delegated, and not original, powers and that they are therefore subject to the ultimate responsibility of the directors for the oversight of the company.
>
> The corollary is that those who have delegated their powers have a duty to exercise reasonable care and diligence to ensure that thew powers delegated are being efficiently discharged."

In *HIH Insurance Ltd (in prov liq) and HIH Casualty and General Insurance Ltd (in prov liq); ASIC v Adler and Ors.*[26]*;*

> " - - - the general law explains what the Corporations Act now requires when referring (s 190(2)) to 'reasonable grounds' in codifying the directors' responsibilities for the actions of the delegate. Thus under s 198D - - - directors may delegate - - - . Moreover, the director will be responsible for the delegates exercise of power if he or she did not believe on reasonable grounds and in good faith, after making proper inquiries if the circumstances indicate the need for it, that the delegate was reliable and competent in relation to the power delegated and would exercise the power in conformity with the duties imposed on the directors of the company by the Corporations Act: s 190(2)."

This discussion clearly shows that the courts continue to support the notion that directors bear primary responsibility for the management of a corporation, and that this is qualified by well established understandings of reliance and delegation.

In CPA Australia's view, case law in these areas appears to be an appropriate barrier to any contemplated reorientation of corporate duties to embrace a wider constituency of responsible persons or relationships. The duties which have evolved fall into defined categories, around which obligations fall to distinct classes of person who are best able to inform themselves and ensure their proper discharge.

[25] (2004) 50 ACSR 500 at 518 per White J.
[26] (2002) 41 ACSR 72 at 168 per Santow J.

Proposal 1

ss 181 and 184(2) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

CPA Australia does not support the extension of the duties of good faith and proper purpose beyond those currently defined in ss 181 and 184(2). This position is based on the view that the current definition of officer contained in the Corporations Act and further developed through case law has adequate scope to include individuals who may from time to time undertake senior management decision making. We do not support the need for a third category of such individuals, and reject proposals to include those providing advisory services to the company or the board.

The relationship between a director and a company is fiduciary. There is an association between the type of power, its related duty and the remedy for breach of that duty that has been developed in law. Any extension of a duty must also consider an extension of the power and the remedy. It is unreasonable to extend the powers of the directors to other parties. Such delegation must be on a case by case basis under the control of the directors. The law currently allows for this to occur.

It is appropriate to consider the nature of the relationships and duties contemplated here under both general law and the predecessors to s 181, particularly in relation to the type of decision to which the law is applied. Such as review reveals that the law is overwhelmingly applied to decisions within the purview of directors.

Directors owe their company an equitable duty of good faith. In *Chew v R*[27], it was stated that the duty of good faith had a number of components required of directors;

- to act honestly,
- exercise their powers in the interests of the company,
- avoid misusing their powers and
- avoiding conflicts of interest.

Thus under s 181, meeting good faith requires more than good intention and an absence of self-interest:

> "It is not to the point that a director genuinely considers his purpose to be honest if those purposes are not in the interest of the company. The director must act in a way which he conceives to be for the benefit of the company as a whole, as that concept is understood by the law."[28]

Hence, the subjective element of honesty is subservient to the actuality of whether or not the director acted in a way in which the law would regard as benefiting the company as a whole. In addition, "it is a fundamental principle governing corporate governance that the relationship between a director and the company is a fiduciary one."[29]

The nature of the fiduciary as it pertains to the director/company relationship has been subject to extensive judicial and extra-judicial analysis.

[27] (1992) 173 CLR 626.
[28] *Australian Growth Resources Corp Pty Ltd v Van Reesema & Ors* (1988) 6 ACLC 529
[29] *Fitzsimmons v R* (1997) 23 ACSR 355 at 357 per Owen J.

Directions in case law

Though dealing with an analysis of equitable compensation, the expectation as to the quality and attributes of the fiduciary relationship are reflected in the judgement of Kirby J in *Pilmer v Duke Group Ltd (in liq)*[30]*:*

> "Where fiduciary obligations exist and have been breached, equitable remedies are available both to uphold the principle of undivided loyalty which equity demands of fiduciaries and to discourage others, human nature being what it is, from falling into similar errors."[31]

and;

> "The overall purpose of the law of fiduciary obligations is to restore the beneficiary to the position it would have been in if the fiduciary had complied with its duty."[32]

and from McLachlin J in *Canson Enterprises Ltd v Boughton & Co*[33]:

> "The essence of a fiduciary relationship - - - is that one party pledges itself to act in the best interest of the other."

A close association between the nature of a specific duty and the type of remedy is likewise to be found in the long standing approach in the law's dealing with appropriation of corporate property, information and opportunity[34] and the 'account of profits' action:

> " - - - men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent. - - - they cannot retain the benefits of such contract for themselves, but must be regarded as holding it on behalf of the company."[35]

This close nexus between types of power, duty and remedy operates as an impediment to extending ss 181 (and by inference ss 182 and 183) to persons other than those already identified by statute or at general law.

Origins of s 181

J. D. Heydon in "Directors' Duties and the Company's Interest"[36] offers four formulations of duty under the preface remark: "Directors must act bona fide for the benefit of the company as a whole."[37]

The second and third of these formulations are germane to a consideration of the appropriate type of duty and relationship contemplated under s 181. Whilst recognising some ambiguity around the second formulation, that of 'benefit of the company as a whole', it is noted by Heydon that what is at its core is the balancing of interests; interests

[30] (2001) 180 ALR 249.
[31] (2001) 180 ALR 249 at 292.
[32] (2001) 180 ALR 249 at 292.
[33] [1991] 3 SCR 534 at 543 cited at (2001) 180 ALR 249 at 293.
[34] now Corporations Act ss 182 and 183.
[35] *Cook v Deeks* [1916] 1 AC 554 at 568 per Lord Buckmaster.
[36] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987.
[37] Mills v Mills (1938) 60 CLR 150 at 188 per Dixon J.

of the company as a commercial entity distinct from its corporators[38] and a regard for present and future members.[39]

An extension of s 181 will impose such duties on persons in whom the shareholders have not vested the same 'trust', and potentially create uncertainty in the conduct of a corporation's affairs.

The third formulation advanced by Heydon is that of 'for the benefit of members', which he notes as being favoured in modern statutes. [40] Significantly the statutes to which Heydon refers[41] operate as an exception with a clear dichotomy between directors duties and shareholder remedies to redress particular failures in corporate conduct. Heydon's observation that "the usual division of powers[42] within a company carries the consequence that the directors (between general meetings) - - - may lawfully make decisions contrary to the interests of the majority of shareholders"[43] is also noteworthy.

The proposed extension of s 181 appears problematic when considered in the context of this interrelationship of checks and balances which has emerged in the structure of the corporations law.

Cases dealing with the 'proper purpose' element of s 181 further illustrate these points concerning both the underlying nature of the director's fiduciary relationship and the discharge of a responsibility of a particular type that clearly rests with directors.

The line of cases in this area frequently deal with an examination of the 'proper purpose' for issuing and allotting shares as part of raising finance in the context of the presence of a possible improper or collateral motive. In *Darvall v North Sydney Brick & Tile Co Ltd & Ors*[44] Kirby P, as he then was, commences with the following remark:

> "It is a fundamental principle of company law that the directors owe a fiduciary duty to the company. The rule is one protective of the company and its shareholders. But it is also protective of the public interest which is served by integrity in the conduct of the company officers. Where issues properly before them show a breach by a director of this duty, courts should be vigilant to insist upon the thoroughgoing performance of fiduciary obligations by the director. - - - They are standards which require that directors act honestly in their dealings with their colleagues and with shareholders. As well, they require candour and full disclosure by directors where there is a risk of conflict between corporate duty and private interest."[45]

This element of disclosure was dealt with in *Fitzsimmons v R*[46] by Owen J in considering the forerunner of the current s 191[47]:

> "Each case will depend on its own facts. A director who is confronted with a possible conflict must assess his or her position. The minimum requirement be will disclosure of the interest."[48]

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[38] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 122.
[39] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 123.
[40] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 125.
[41] The forerunner to the current s 461(1)(e) 'directors have acted in the affairs of the company in their own interests' grounds for Court winding up, to which could be added the Pt 2F.1 oppressive conduct remedy and Pt 2F.1A statutory derivative action.
[42] Refer above discussion concerning s 198A.
[43] *Equity and Commercial Relationships* (edited by P.D. Finn) LBC Sydney 1987 at p 125.
[44] (1989) 15 ACLR 230.
[45] (1989) 15 ACLR 230 at 231.
[46] (1997) 23 ACSR 355.
[47] Material personal interest – director's duty to disclose

Along similar lines it is concluded in *HIH Insurance Ltd (in prov liq) and HIH Casualty and General Insurance Ltd (in prov liq); ASIC v Adler and Ors*[49]*:*

> "A director of a company (here Adler) who is a director of another company (here Adler Corp) must not exercise his or her powers for the benefit of the second company without clearly disclosing the second company's interest to the first company - - - ."

Turning to the aspect of judicial analysis of "the directors' purpose and best interest of the company", Kirby P stated that:

> "In common with other decision making, directors may have multiple purpose for reaching a particular decision. This is especially so in a collegiate body such as a board of directors. Therefore, a task of characterisation is required of the court. This task of characterisation has been assisted by the provision of a rule of thumb, suggested by the High Court, for classification of facts as they emerge in evidence. By that rule, it is necessary for the court to determine whether *but for* the alleged improper or collateral purpose, the directors would have performed the act which is impugned."[50]

This remark recognises the division of power described above which subsists between the director and the company and between the director and shareholders. Moreover, with certain powers having about them a fiduciary character the courts are recognisably proactive in enforcing vigilant performance, unlike matters which may come within the scope of 'business judgement',.

The infrequency of cases dealing with s 181 and its various precursors suggests a highly targeted basis in the application of the section which is not readily translatable to relationships outside the presently recognised scope of fiduciary duties.

This review of the law indicates that sufficient flexibility already exists in the law to ensure that officers below the level of director can be required to exercise duties of good faith and proper purpose when delegated the powers of directors. Little, apart from confusion, can be gained by a blanket extension of these duties to all persons engaged in management. Ultimate responsibility must remain with directors.

That said, CPA Australia would support efforts to enhance the consistency of definitions across the wider body of corporate law. If at some future point the current definition of officer proves inadequate, a review of this definition would be appropriate, however CPA Australia would recommend legislators ensure the definition is consistent across the wider body of corporate law, notably that the definition aligns with that included in Australian Accounting standards, such as IFRS 2 (Share-based payments).

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[48] (1997) 23 ACSR 355 at 358.
[49] (2002) 41 ASCR 72 at 233 per Santow J.
[50] (1989) 15 ACLR 230 at 248.

Proposal 2

s 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned in the management of the corporation.

CPA Australia does not support the extension of the duty of care and diligence to officers of a corporation beyond those currently defined under s 180(1) as other persons involved in the management of the corporation are unlikely to meet the tests of proximity nor reasonable foreseeability of harm which underpin the duty of care. A more appropriate approach may be to explore the apportionment of tortious liability in the corporate context.

The negligence basis of the duty of care and diligence

Justice Santow in *ASIC v Adler*[51] provides what amounts to a comprehensive summation of the various facets of the duty of care and diligence under s 180. Prominent amongst the authorities cited is *Daniels v Anderson*[52], and it is appropriate to turn to the joint judgement of Clarke and Sheller JJA in addressing Proposal 2.

Aside from the aspects of reliance and delegation discussed previously, the AWA appeal is highly significant in describing the broad sources of law (tort of negligence[53]) and precedent developments (insolvent trading) which have shaped the law's expectation as to scope and parties affected under common law obligations. This understanding is highly relevant to the limitations that might be placed on an extension of care and diligence duties and how the law might alternatively evolve to address perceived deficiencies or ills. The following remarks are made by their Honours:

> "The closeness of the relationship between the company and its directors and between the act or omission and the damage caused satisfied the requirements of the test of proximity discussed by the High Court in *Sutherland Shire Council v Heyman* (1985) 157 CLR 424. There were no policy considerations disqualifying the relationship from giving rise to a duty of care; *Gala v Preston* (1991) 172 CLR 243."[54]

and

> "The source of the duty of care at common law rests in the relationship of proximity. - - - We see no reason why the relationship of a director to a company should not, in accordance with the law as it has developed since *Hedley Byrne & Co Ltd v Heller & Partners* [1964] AC 465, not satisfy the proximity test."[55]

Subsequent to this analysis, their Honours address the evolving nature of the duty with reference to judicial attitude to insolvent trading concluding that:

> "The insolvent trading cases demonstrate that ignorance is no longer necessarily a defence to proceedings brought against a director. - - - In our opinion the

[51] (2002) 41 ACSR 72 at 166-168.
[52] (1995) 16 ACSR 607.
[53] It is noteworthy that by virtue of s 185 the right to bring civil proceedings on a basis other than s 180 is preserved, see Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed., Butterworths, 2003) [8.355].
[54] (1995) 16 ACSR 607 at 654.
[55] (1995) 16 ACSR 607 at 656.

> responsibilities of directors require that they take reasonable steps to place themselves in a position to guide and monitor the management of the company."[56]

Within the insolvent trading cases analysed, perhaps one of the more telling remarks is that of Tadgell J[57]:

> "As the complexity of commerce has gradually intensified (for better or worse) the community has of necessity come to expect more than formerly from directors whose task is to govern the affairs of companies to which large sums of money are committed by way of equity capital or loan."

Despite criticism,[58] the notion of proximity as a constraint on reasonable foreseeability[59] of harm giving rise to a duty of care remains highly relevant to understanding the duties arising from the director/shareholder relationship. Directors, vested with responsibility for management, are appointed by the shareholders. The directors are most directly in a position to foresee harm that may ensue from their negligent acts. The basis of this obligation is given further weight by their Honours' reference to a 'holding out':

> " - - - duty will vary according to the size and business of the particular company and **the skills that the director held himself or herself out to have in support of appointment to the office**."[60] (emphasis added)

Alternative approaches, such as reliance and vulnerability,[61] that have emerged to define and restrain the scope of reasonable foreseeability, more appropriately accord with the roles of directors and officers than with the extended category of persons contemplated in the Discussion Paper.

Alternative paths of development

There are elements within the further deliberations given in *Daniels v Anderson* under the headings Contributory Negligence[62] and Apportionment[63] that may present the basis for an examination of how the present care and diligence regime might be incrementally expanded to capture involvements in corporate conduct not presently covered.

Firstly on the aspect of contributory negligence, their Honours state the law as follows:

> "In the event that a court finds that a plaintiff has been guilty of contributory negligence (more accurately, causative fault) it is required to embark on a consideration of whether the plaintiff's damages should be reduced."[64]

It was further submitted in argument that the Court should make allowance for the separate negligent acts and omissions of management in the apportionment of damages. Whilst their Honours concluded that it was "not appropriate to separate the board's alleged failings from those of management",[65] it is perhaps with the background of the Discussion Paper to speculate whether the law should be more receptive of apportionment of tortious

[56] (1995) 16 ACSR 607 at 664.
[57] (1995) 16 ACSR 607 at 662; *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 126.
[58] see for example *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* [2004] HCA 16: "Proximity is not now accepted as a sole criterion for explaining when a duty of care exists at law, any more than other attempted short verbal formulae can do that job." per Kirby J at para. 148.
[59] *Donoghue v Stevenson* [1932] AC 562 at 580 per Lord Atkin.
[60] (1995) 16 ACSR 607 at 668.
[61] see for example *Perre v Apand Pty Ltd* (1991) 198 CLR 180 at 220-228 per McHugh J
[62] (1995) 16 ACSR 607 at 720.
[63] (1995) 16 ACSR 607 at 726.
[64] (1995) 16 ACSR 607 at 721.
[65] (1995) 16 ACSR 607 at 731.

liability in the corporate context. While this may be worthy of examination, existing parallels that might be drawn upon, (such as directors as joint tortfeasors for company wrongs), are a highly complex area of the law.[66]

The Discussion Paper at 2.4 poses the possibility of imputing to directors (and others) a duty owed to related corporations through which decisions are implemented. Developments in this direction, whilst potentially addressing certain aspects of the abuse of the corporate form, possibly challenge the High Court's position in *Walker v Wimborne*:

> " - - - the transaction is one which must be viewed from the standpoint of company A and judged according to criterion of the interests of that company."[67]

Moreover such development would substantially extend the existing law's recognition and treatment of conflict associated with multiple directorships.[68]

CPA Australia suggests that perhaps a more targeted avenue of development could be in relation to s 588V of Pt 5.7B which provides a basis of holding company liability for insolvent trading by subsidiaries. To this end the comments of the authors of Ford's[69] are noted as to the relatively narrow formulation of ss 588V and 588W[70] against which the ALRC originally proposed a wider reference to related corporations and the introduction of a degree of judicial discretion.

Along similar lines, the presence in the existing law of the notion of a 'de facto' director[71] may provide a further avenue of development to attribute to a corporation[72] liability for related corporate fault where a requisite level of involvement is apparent.

[66] see *Johnson Matthey (Aust) Ltd v Dascorp Pty Ltd & Ors*. (2003) 9 VR 171 at 196-203 per Redlich J.
[67] (1976) 137 CLR 1 at 6 per Mason J.
[68] see *Fitzsimmons v R* (1997) 23 ACSR 355 at 359 per Owen J and at 358 with reference to the remarks of the High Court in *R v Byrne* (1995) 183 CLR 501 at 517.
[69] Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed., Butterworths, 2003) [20.230].
[70] Recovery of compensation for loss resulting from insolvent trading
[71] see s 9 definition of director
[72] see for example *Standard Chartered Bank of Australia v Antico* (1995) 18 ACSR 1

Proposal 3

as a corollary to Proposal 2, s 180(2) (the business judgement rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation

In line with its rationale for not supporting Proposal 1, CPA Australia does not support this proposal, however detailed below are a number of observations concerning the operation of the statutory business judgement rule in terms of its covering persons other than those currently contemplated in s 180 and applicability to duties other than care and diligence.

CPA Australia would support development of non-statutory guidance to assist the adoption of appropriate risk-management structures.

Background to the introduction of s 180(2)

CLERP Proposal Paper No 3 (5.2.2) refers to the need to seek a balance between responsible risk taking, accountability to shareholders and the reluctance of courts to review bona fide business decisions. The latter point is illustrated in judicial comments such as:

> " - - - they (their Lordships) accept that it would be wrong for the court to substitute its opinion for that of management - - - . There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at."[73]

The objective in codifying this general law principle is to protect legitimate business risk type decisions from judicial scrutiny and thus challenge by shareholders. The statutory form sits appropriately in direct relationship with duties of care and diligence (by inference also skill) as these are the attributes that most directly relate to the management of the company. However when applied to ss 182 and 183 (and their criminal law counterparts in s 184) aspects of fiduciary relationship to which the courts take a far more critical approach, are being dealt with.

It is CPA Australia's view, that to allow some form of business decision based relief in these latter areas could run counter to long established notions that preclude taking corporate advantage. Nonetheless, it is suggested that there may be some scope to extend this form of 'safe haven' relief to matters potentially dealt with under s 181(1)(a)[74], particularly given some similarity in wording.

Recent judicial consideration

The objective of encouraging sound corporate governance practices is apparent in the intention that a "statutory rule would be weighted in favour of directors who make informed business decisions and would ideally encourage the active participation and involvement of directors."[75]

In *ASIC v Adler* Santow J provides a good analysis of the interaction of the s 180(2) 'base rule' and the four qualifiers (a) through (d):

[73] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 834 per Lord Wilberforce.
[74] Though not s 181(1)(b) as courts have typically dealt strictly with aspects of 'proper purpose'.
[75] CLERP Proposal for Reform: Paper No. 3 Directors' Duties and Corporate Governance p 25.

> " - - - Mr Williams simply neglected to deal with proper safeguards, with no evidence that he ever turned his mind to a judgement of what safeguards there should be. Given that the purpose of Mr Adler was to maintain or stabilise the HIH share price and of HIH to make a quick profit, Mr Williams, as a major shareholder in HIH, had a 'material personal interest' as would preclude reliance under s 180(2)(b)."[76]

A worthy avenue to promote understanding of the business judgement rule, could be through the development of a non-statutory guidance, perhaps linking description of the operation of the section with Principle 7[77] of the ASX Principles of Good Corporate Governance and Best Practice Recommendations. This could further assist to overcome the difficulty identified in the CLERP Proposal that:

> "While the current law does not prevent the adoption of appropriate risk-management structures, the worth of such structures at present is open to question given the somewhat uncertain application of the common law."[78]

[76] (2002) 41 ACSR 72 at 175, the conclusion subsequently approved by Giles JA *Adler v ASIC* (2003) 46 ACSR 504 at 615.
[77] Recognise and manage risk.
[78] CLERP Proposal for Reform: Paper No. 3 Directors' Duties and Corporate Governance p 25.

Proposal 4

ss 182 and 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Proposal 5

ss 183 and 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

CPA Australia does not support these proposals as the harms caused by, or abuses of, relationships falling outside of the scope of the current combined statutory and general law regime, given its' acknowledged breadth, are more likely to be better dealt with under more directly appropriate avenues of relief; such as contract law, civil wrong or a statutory regime other than the Corporations Act.

These two proposals can be dealt with concurrently as they interact under s 185 similarly with the general law such that "the conflict, profit and misappropriation rules may apply to the same facts which attract the statutory provisions."[79] Similarly, s 185 itself emphasises the continuing applicability of a persons duty or liability arising out of an employee relationship.

The authors of Ford [9.290] provide a short but comprehensive commentary comparing the breadth of the statutory and fiduciary based general law principles, the following passages from which are noteworthy:

> " - - - ss 182 and 183 are narrower than (the) general fiduciary duty because under that duty it is not necessary that the person who has a conflict between interest and duty has as his or her purpose causing either a detriment or loss to the company or a profit or advantage to the director."

and,

> "The statutory provisions are *wider than* the general law rules: they apply to any officer or employee, apparently including junior employees who would probably not be regarded as fiduciaries at general law."

The present regime's comprehensiveness to corporate relationships is underscored by the continuity of general law rules related to duties surviving resignation[80], the fully informed consent basis of release[81] and the absence of a need to prove the existence of a state of mind toward detriment or objective to gain an advantage.[82]

The strength of the law on the latter of these points is borne out in *ASIC v Adler* in Santow J's consideration of the Adler's accessorial liability for Williams' contraventions of ss 181 and 182:

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[79] Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed., Butterworths, 2003) [9.288].
[80] *Canadian Aero Services v O'Malley* (1973) 40 DLR (3d) 371.
[81] *Queensland Mines Ltd v Hudson* (1978) 18 ALJR 399.
[82] *R v Byrnes* (1995) 17 ACSR 551 at 559 per Brennan J.

"The manifest failure of AEUT and the fact that the HIH share price did fall despite AEUT's buying, in no way obviates the intended advantage to Mr Adler and Adler Corp. Thus to establish liability under s 182(1) it is sufficient to establish that the conduct of the director was carried out in order to gain an advantage. It is not necessary to establish that advantage was actually achieved."[83]

[83] (2002) 41 ACSR 72 at 233. Santow J analysis is subsequently approved by Gile JA in Adler v ASIC (2003) 46 ACSR 504; at 623 in relation to Williams and at 625-626 in relation to Adler.

Proposal 6

s 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

Refer below discussion with reference to s 1307(1)

Proposal 7

s 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs ,or has performed, functions, or otherwise acts or has acted ,for or on behalf of the company.

CPA Australia does not support the extension of s 1309(1) and 1307(1) as the general law already provides the extended scope sought and the amendments are unnecessary. The sections are further strengthened when considered in conjunction with s 79 (Involvement in contraventions).

Section 1307 makes it an offence to engage in conduct that results in the concealment, destruction, mutilation or falsification of any securities belonging to or books relating to the affairs of the company. Liability attaches to any officer or former officer or to any member or former member of the company, with the term 'officer' being the general purpose definition in s 9.

Section 1307 has not been widely applied nor subject to extensive judicial consideration, worthwhile comment as to its' objective and interaction with other provisions is however contained in *R v Turner (No 17)*[84]*:*

> "Insofar as s 1307(1) prohibits the concealment, mutilation, or falsification of documents; it does not impose or imply any requirement that documents be maintained or retained. However it prohibits individuals from destroying any books affecting or relating to affairs of the company. - - - It is true that both s 1306 and 1307 are concerned with company records, and it is apparent that both sections have been drawn with investigations, prosecutions, and other legal proceedings in mind. - - - In fact, s 1307 is concerned with the conduct of individuals, whereas s 1306(3) is concerned with the conduct of corporations."

This object of serving a vital adjunct to the undertaking of investigations into wider and serious misconduct is evident from Austin J's remarks in *ASIC v Rich & Ors.:*

> "Two of the issues related to bank facilities, and the specific matters that led to ASIC subsequently sending a brief to the DPP with a view to criminal charges against Mr Silberman (which were ultimately not pursued). There were three other matters, relating to One.Tel accounts (upon which a briefing note said that the "main focus" related to possible contraventions of ss 1309 and 1307), false or misleading statements in relation to securities, and continuous disclosure."[85]

[84] (2002) 10 Tas R 388 per Blow J at [28] – [29].
[85] (2005) 52 ACSR 374 at 388 – 389.

and further,

> "In the present case the search warrants were issued on the basis of reasonable ground to suspect contravention of specific criminal provisions, namely ss 999, 1311(1)(a) and 1307, the suspicion extending to events over a period of time rather than on a particular occasion. A central aspect of the suspicion was that the conduct of One.Tel and the defendants was thought to relate to false or material misleading information. The ascertainment of the range of facts would inevitably inform the investigators as to whether there was a case of breach of the statutory duty of care and diligence of directors (and probably other directors' duties) in respect of the very same facts."[86]

The nature of these proceedings indicate that s 1307 forms an important adjunct to the investigation and enforcement of the provisions of Pt 2D.1 amongst others and therefore save extension of the scope of these provisions, the present reach of s 1307 is appropriate.

It is further submitted by CPA Australia that s 1307 (along with s 1309) should be considered in conjunction with s 79 (Involvement in contraventions) from which it is suggested that the corporate law scheme is sufficiently wide to address the concerns underlying the proposal to include reference to 'any other person'; the 'engages in conduct' element of s 1307 possibly paralleling the accessorial liability effect of s 79. To this end it is worthwhile considering conclusions recently drawn by the NSW Court of Appeal in *Forge & Ors. v ASIC*[87] where it is stated under the heading 'Involvement: knowledge':

> "in *ASIC v Adler* - - - held that to be "involved" within the meaning of s 79 - - - it was necessary that the person know of "the actual events, though only the essential ones, which constitute the offence." His Honour said that that "knowledge may be inferred from the facts of exposure to the obvious, though that [did] not obviate the need for actual knowledge of the essential facts constituting the offence"."[88]

[86] (2005) 52 ACSR 374 at 429.
[87] (2004) 52 ACSR 1.
[88] (2004) 52 ACSR at 52.

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

SUBMISSION TO

CORPORATIONS AND MARKETS ADVISORY COMMITTEE

INQUIRY INTO CORPORATE DUTIES BELOW BOARD LEVEL

Introduction and Executive Summary

The Australian Securities and Investments Commission welcomes the review by CAMAC into Corporate Duties Below Board Level. ASIC considers it important that the provisions imposing duties on those who are ultimately responsible for the acts of a corporation should reflect the realities of modern commercial life.

ASIC strongly supports the adoption of a functional approach to determining which people should owe duties to the corporation. Those who take responsibility (and reap the rewards) for making decisions or taking actions on behalf of a corporation that will have significant effects upon it should owe duties to the corporation regardless of their title or employment status.

It is also important that there should not be significant opportunities for executives to avoid such responsibility through the design and use of corporate group structures.

ASIC also supports the introduction of a general prohibition on individuals acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute.

Proposals and Questions in the CAMAC discussion paper

Proposal 1. Section 181 and s184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

ASIC agrees with this proposal, but believes that it should not be implemented by amendment to the definition of "officer" because this will have consequences for many unrelated provisions in the Corporations Act.

The increasing complexity of managerial structures of corporations has led to situations where the managerial acts of people who do not fall within the current definition of "officer" in section 9 of the Corporations Act might still have a significant impact on a corporation and its stakeholders.

Sub paragraph (b)(i) of the current definition of "officer of a corporation" which refers to a person *"who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of a corporation"* is very specific and, particularly when applied in the criminal context, might enable a person to escape responsibility on the basis, for instance, that they do not make decisions that affect a *substantial* part of the business of a corporation.

Subparagraph (b)(ii) of the definition, which refers to a person *"who has the capacity to affect significantly the corporation's financial standing"* might extend the category of people, but is arguably limited to those who have a direct power in relation to decisions that may affect the corporation's finances.

The proposed formulation would encompass those "concerned in" management giving it a broader scope, which is potentially significant. This formulation does not appear in the present definition of "officer of a corporation". As noted in the discussion paper, this wording has previously appeared in the Corporations Act in the definition of "executive officer" which was repealed in 2004. In *Commissioner for Corporate Affairs (Vic) v Bracht*[1], the following meaning was given to the words "concerned in":

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[1] (1989) 14 ACLR 728

> *Advice given to management, participation in its decision-making processes, and execution of its decisions going beyond the mere carrying out of directions as an employee would suffice.*

The Court also said that involvement had to be *"more than passing, and certainly not of a kind where merely clerical or administrative acts are performed".*

The HIH report says that "middle management" in HIH played a role in the undesirable practices which occurred in that corporation. It is also ASIC's experience that middle management can sometimes be actively involved in matters which result in material damage to the corporation. This might happen even when they have no formal capacity to make financial or policy decisions, but might have made a significant contribution to the decision making process. In ASIC's view, those who accept the responsibility (and presumably the rewards) of management positions which have a potential to affect the well-being of a corporation should be subject to general duties in relation to that corporation.

Another group of people who might be caught by the proposed formulation are consultants and contractors who act more like employees and who are closely concerned in, but not actually making, significant decisions which affect the corporation. These people might not be caught by subparagraph (b)(ii) of the current definition because they are unlikely to be the formal decision makers in the corporation. Such people can be distinguished from external advisers who simply provide advice and remain at arm's length. Purely external advisers should not be caught by the provisions.

In ASIC's view, it should be made clear that a single instance of taking part or being concerned in management is sufficient to attract the duty. ASIC sees no reason why a person should escape responsibility for his or her conduct simply because it was their first foray into management or their involvement in management is irregular.

ASIC believes that the proposal should not be implemented by amending the current definition of "officer" because this would affect many provisions other than those concerned with the duties of officers. Instead, the proposal could be implemented by amending the introductory words of the relevant provisions or by the inclusion of a new definition of a term such as "a person concerned in management".

Question (Discussion Paper page 24): For the purpose of Proposal 1 (and Proposals 2 and 3) should "management" of a corporation be defined? If so, should the definition be along the lines of "activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs"?

ASIC considers that, if Proposals 1, 2 and 3 were accepted, it would be helpful for the term "management" to be defined as suggested.

Like proposal 1, the proposed definition might make it more difficult for people who have been involved in critical decisions to escape responsibility due to technical reasons.

If it is considered that the words "concerned in", as they appear in Proposals 1, 2 and 3 and as they are likely to be construed by a court, might be too uncertain, then consideration could be given to providing guidance as to what is meant by these words.

Proposal 2. ***Subsection 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.***

ASIC agrees with this proposal.

See ASIC's response to Proposal 1.

Proposal 3. As a corollary of Proposal 2, s180(2) (the business judgment rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

ASIC agrees that the group of persons to which the defence in s180(2) applies should be identical to the group to which s180(1) applies.

ASIC can see no reason why this defence should not be afforded to all those to whom s180(1) applies.

Proposal 4. ***Section 182 and 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation to any other person who performs functions or otherwise acts, for or on behalf of that corporation.***

ASIC agrees with this proposal.

Modern corporations use a range of mechanisms to retain the services of appropriate personnel. Increasingly, this has included the retention of contractors and consultants as well as employees. ASIC agrees that a functional approach should be adopted which looks at the substance of the role occupied by a person in relation to the corporation, rather than the legal formalities of the role. Where a person accepts the responsibilities and rewards of a role that is functionally similar to that of an officer or employee and abuses his or her position, that person should not be shielded by the technicalities of his or her retainer.

Proposal 5. ***Section 183 and 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any other person who performs, or has performed, functions or otherwise acts or has acted, for or on behalf of that corporation.***

ASIC agrees with this proposal.

See ASIC's response to Proposal 4.

Proposal 6. Section 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

ASIC agrees with this proposal.

There is no reason why a person retained as a contractor or consultant to the company (but who might not be considered an "employee") should be able to escape responsibility for such misconduct due to the technical aspects of their contractual arrangements. Having said that, such responsibility should not apply to the normal external adviser who merely gives advice in the ordinary course. ASIC believes that some extra element of connection to the corporation would be required in order to attract the extra responsibility.

For this reason, the application of this proposal to external professional advisers could be clarified.

Proposal 7. ***Section 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any person who performs, or has performed, functions, or otherwise acts or has acted for or on behalf of that company.***

ASIC agrees with this proposal.

ASIC's views on this proposal are similar to those for Proposal 6. Misconduct in relation to corporate books can result in the loss or falsification of vital evidence and records which might be required by ASIC or by the external administrator of a company.

Question (Discussion Paper page 29): Should the categories of persons subject to section 1309(2) (ensuring the veracity of information) be extended in the same manner as proposed for s1309(1), namely to any other person who performs functions, or otherwise acts, for or on behalf of that corporation?

ASIC considers that the categories of persons subject to s1309(2) should be so extended.

Once again, ASIC sees no reason why a person retained as a contractor or consultant to the company (but who might not be considered an "employee") should be able to escape responsibility for such misconduct due to the technical aspects of their contractual arrangements.

Question (Discussion Paper page 32): Should there be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute? If so, should the provision apply to:

- ***Obligations under the Corporations Act only, or***
- ***Obligations under any Commonwealth, State or Territory statutes applicable to corporations***
- ***Obligations under any overseas written laws as well as Australian laws?***

ASIC believes that there should be a provision which prohibits individuals from acting dishonestly in connection with the performance or satisfaction of a company's statutory obligations.

ASIC considers that a general dishonesty provision would assist in providing an enforcement response in situations where there has been a significant instance of dishonesty, but where there is a "gap" in the current Commonwealth prohibitions. Some such gaps are identified in the HIH report.

Currently, where ASIC identifies misconduct, which is not prohibited by Commonwealth laws, charges may be laid in accordance with general offence provisions under State law such as general fraud offences. The use of State charges, sometimes in combination with Commonwealth charges, in prosecutions arising out of ASIC investigations, can lead to procedural complications and will inevitably mean that there is some variation in the enforcement responses available to ASIC from State to State. In ASIC's view, this is undesirable in a national regulatory regime.

The test for "dishonesty" in the context of the provision should be clearly specified so that there is no confusion as to what the appropriate standard should be.

The Discussion Paper has raised a number of reservations about this suggestion. The first such reservation concerns the possible availability of more than one charge and the perceived risks of persons being vulnerable to double jeopardy. In ASIC's view, this reservation is misconceived. It is already often the case that a particular instance of misconduct might potentially be prohibited by a number of sections. Prosecutorial authorities routinely have to consider which of a number of possible charges is most appropriate. The Commonwealth Director of Public Prosecutions has published his approach to these decisions in the Prosecution Policy of the Commonwealth. There is a number of systemic safeguards against double jeopardy and the legal principles in relation to this are clear.

Another concern raised in the Discussion Paper is the possibility that ASIC might be responsible for administering the provision even in circumstances where the underlying statutory obligation was in legislation that ASIC did not administer. In ASIC's view, a general dishonesty provision should appear in the Criminal Code, rather than the Corporations Act. ASIC would thereby have no particular responsibility in relation to breaches occurring beyond its regulatory horizon (ie by persons who were not directors or corporations). In ASIC's view, this is the most appropriate location for a general dishonesty offence provision.

A further matter raised in the Discussion Paper is the perceived need to ensure that the penalty regime recognises that the offence will encompass less serious contraventions as well as more significant ones. There are already examples of general offence provisions, which are likely to encompass a range of behaviour of varying degrees of seriousness. Such general offences often attract fairly high maximum penalties, but in such cases the courts have a discretion to impose a lesser penalty if appropriate. The exercise of this discretion, including the consideration of relevant factors, is a day-to-day task for the judiciary. The Prosecution Policy of the Commonwealth sets out the approach that the CDPP will take in circumstances where misconduct may be covered by both a general offence provision with a high maximum penalty and a specific offence with a lower maximum penalty.

In ASIC's view, the obligations referred to by the provision should be limited to obligations under Commonwealth statutes and, if possible under the Australian Constitution, under State and Territory statutes.

Question (Discussion Paper page 34): Is there any need to define the term "employee" for the purposes of ss182-184 or ss1307 and 1309 if Proposals 4-7 are implemented.

If the proposals in the Discussion Paper were adopted, ASIC sees no immediate need for a definition of the term "employee" in the context of the duties discussed in the Discussion Paper.

ASIC prefers the functional approach advocated by the HIH Report and the Discussion Paper than an approach which is based upon the technical categorisation of a person's formal contractual arrangements. If the functional approach is adopted in these provisions, the meaning of the term "employee" is not likely to be of great significance.

Question (Discussion Paper page 37): Should there be a provision to the effect that where any person who:

- ***Is a director, officer or employee of a corporation, or***
- ***Takes part, or is concerned in the management of that corporation, or***

- ***Performs functions, or otherwise acts, for or on behalf of that corporation***

makes, or participates in making, a decision that is implemented in whole or part by a related corporation, that person, in addition to the duties he or she owes to the first corporation, will also owe the related corporation the duties of care and diligence (s180(1)) and good faith (s181) in relation to that decision? If this proposal is adopted, that person would have the business judgment rule defence in s180(2). Also where the related corporation is a wholly-owned subsidiary, that person should have the benefit of s187.

If this proposal is not supported, what, if any, alternative proposal should be adopted to deal with the concern raised in the HIH report.

ASIC considers that there should be reform to address the situation where a general commercial decision is made with respect to a corporate group without considering which of the subsidiaries will be used to implement that decision.

In ASIC's view the law must recognise the reality of the increasing use of intricate corporate group structures and the tendency of executives to make decisions for these groups as a whole, rather than on a company-by-company basis.

Where several executives make a decision in the interests of a corporate group as a whole that, for instance, a particular transaction should occur, but do not address their minds to the question of which corporation in the group should be a party to this transaction, it might be difficult to establish that the executives are officers of the particular company which ultimately takes part in the transaction. This might require the prosecution (or ASIC in civil proceedings) to establish that the executives are officers of a corporation, that they might not even be aware of and certainly may not have consciously considered at the time that the decision was made. Even the proposed broader scope of the directors' duties provisions set out in Proposals 1 and 2 might not encompass this situation.

ASIC is aware of matters where such decisions have had a significant effect on the company that has become the vehicle for their implementation. ASIC believes that those who make such decisions should owe appropriate duties to that company. ASIC would support a proposal that the decision makers should be deemed to owe duties under s180(1) and 181 in those circumstances.

In the context of corporate groups, the current and proposed future scope of the directors' duties provisions will result in situations where a person owes a duty to more than one company. In many such cases, this will not necessarily pose a significant issue because the interests of the group as a whole and the companies in the group will be aligned. In cases where there is a divergence between the interests of the group and the potential interests of individual companies that might be called upon to implement decisions, ASIC considers it appropriate for the executives making the decisions to deal with that misalignment of interests to avoid a conflict.

Again, ASIC sees no reason why the business judgment rule in s180(2) should not apply to the same categories of people who are covered by s180(1).

Question (Discussion Paper page 38): Are there any forms of behaviour of individuals below board level (not otherwise dealt with in this paper) that should be prohibited, or differently regulated, under the Act?

Currently, ASIC is not aware of any additional forms of behaviour that need to be addressed.

27 September 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Sir

CORPORATE DUTIES BELOW BOARD LEVEL - SUBMISSIONS

The Commercial Law Association of Australia Limited has a proud tradition within law and business spanning over 40 years. The Association provides an opportunity for lawyers and those involved within finance and commerce to network, and lobby government on issues of mutual concern. The Association also aims to improve the flow of information, promote high professional ethical standards, and increase the dissemination of information on corporate law issues.

We refer to the Corporations and Markets Advisory Committee's Discussion Paper entitled Corporate Duties Below Board Level dated May 2005.

We have had the opportunity to review submissions made on the Discussion Paper by the Australian Institute of Company Directors, as published on their web-site.

We support their submissions, with the following further observations.

- ***Directors ultimately responsible*** – it is clear that in most companies that the Directors are, by their Constitution or the applicable replaceable rule (s 198A(1), *Corporations Act*), mandated to manage the business under their direction. This mandate, and the attendant obligations that go with this mandate, has the corollary that the business structure and operations of the company in which a director holds office are, and are to be, a creature of director determination. It is they that institute, guide and monitor this structure and operations, and no amount of delegation may result in an abdication of their clear all-company encompassing responsibilities in this area. Cries from directors that they are not across what management is doing are generally not good enough.

- ***Effect on Directors' and Officers' insurance policies and cost*** – it would be disappointing if any extension of the duties and liabilities of officers, as that term may be defined or redefined, were to lead to an

increase in the costs and complexities for companies to secure adequate insurance cover.

- ***Interaction with employment law duties*** – the provisions of the Corporations Act, and its recent predecessors, pertaining to the duties of directors and officers has in many respects developed with greater focus on directors, as traditionally understood, than on employees who fall within the definition of officers. We submit that CAMAC very closely consider the employment law aspects of their proposals, as they may finally be drawn. An important example of how the law relating to directors as fiduciaries and employment law may collide is the duty of a director not to fetter his or her discretion. This duty is to be contrasted with the duty of an employee of fidelity, an element of which is the duty of an employee to take at least lawful direction. The duty to at least take lawful direction means that an employee does not have an unfettered discretion to decide matters for himself or herself. This collision becomes all the more apparent and of practical consequence where traditional directors' duties extend below Board level.

- ***Business judgment rule amendment*** – currently the business judgment rule, set out in s 180 of the *Corporations Act*, has a top down, director focus. We submit that for officers at below Board level it must necessarily be part of their business judgment, and in measuring their possible personal liability as an officer, that they have may have received a binding lawful direction as an employee.

- ***Effect on concept of limited liability of company; liquidation and voluntary administration issues*** – as has been seen in the recent Federal Court decisions in *Concept Sports* and *Sons of Gwalia*, disappointed shareholders are becoming, including through litigation funding, more adept at finding alternative avenues in seeking redress against companies, directors and officers where the assets of a company may be exhausted for whatever reason.

  We submit that the extension of personal liability for directors and officers, in a way that is not generally co-terminous with the available assets of the company, of itself weakens the strength of properly cast limits on recovery for limited liability companies, and the facility for companies in circumstances of insolvency or near insolvency to either be resurrected, through the voluntary administration and deed of company arrangement processes, or brought to an orderly end through the liquidation process.

In considering any extensions of the liability for directors and officers, we suggest that CAMAC consider too the impact of any such extensions in these areas.

We trust that these submissions are of assistance in your deliberations.

Should you wish us to expand upon any of them, please do not hesitate to contact the writer.

Yours faithfully

Daren Armstrong
Secretary – Legislative Review Taskforce

Law Council
OF AUSTRALIA

John Kluver
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Corporations and Markets Advisory Committee
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Dear Mr Kluver,

CAMAC discussion paper *Corporate duties below board level.*

The following is a submission from the Corporations Committee ("the Committee") of the Business Law Section of the Law Council of Australia. Please note that these comments have been considered by the Executive of the Business Law Section. However, owing to time constraints, they have not been considered by the Council of the Law Council of Australia.

If you would like to discuss this submission, please contact the Chairman of the Corporations Committee, John Keeves on (08) 8239 7119.

Yours faithfully,

Peter Webb.
Secretary-General
7 October 2005

Summary

The Corporations Committee of the Business Law Section of the Law Council does not support the general extension of the duties of care and diligence and good faith in the *Corporations Act* 2001[1] to persons who take part, or are concerned in, the management of a corporation. If, however, the field of operation of officers duties and liability is to be varied then there is a need to generally review the related provisions for example, the business judgement rule, the delegation and reasonable reliance principles.

The Committee is concerned that the CAMAC proposals might not deliver the policy outcome the provisions seek and could be better dealt within alternative approaches.[2] Primarily, if there is a need to regulate specific executive or consultant activities they should be regulated through the relevant specific provisions of the Corporations Act, for example accounts, or other specific pieces of legislation.

Proposals

Proposal 1

Should Section 181 and its criminal consequences under 184(1)(the duties of good faith an proper purpose) be extended beyond directors and other officers of a corporation to any person who takes part, or is concerned, in the management of that corporation.

Whilst it makes sense to impose duties of a fiduciary nature with penal consequences on directors and officers (and in limited circumstances employees), the Committee questions whether these duties ought to be extended to a wider class of persons within the corporation.

The primary responsibility for the corporation's operation should (and in practical terms does) rest with the directors and senior management.

The discussion paper is unclear why CAMAC believes that the new definition of *officer*, in the Corporations Act is inadequate.[3] Commissioner

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[1] Sections 180(1) and 181(1).

[2] This approach is also consistent with the approach taken by the Business Council of Australia in BCA's Business Regulation Action Plan for Future Prosperity 23 May 2005 available at http://www.pageup.com.au/platform/editor/v4.0/downloadFile.asp?p=%98%8C%5BSb%87it%8DV%81%8Bwglj%B0%8B%B0%94%A0%BB%B6%A7%9C%9E%D0%A6%BF%BB%B2%A6%BC%BD%C5%A4%BA%8D%9B%A4%8C%9C%CA%CC%C7%CA%91%B7&f=Business_Regulation_Action_Plan_For_Future_ProsperityFINAL.pdf

[3] The definitions of executive officer in s 9 and of officer in s 82A were substantial altered in the commencement of the *Corporate Law Economic Reform Program Act* 1999. Section 9 now defines an *officer of a corporation to mean:*

(a) a director or secretary of the corporation; or

(b) a person:

(i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or

(ii) who has the capacity to affect significantly the corporation's financial standing; or

Owen seems to have preferred a return to the earlier definition whereby the term 'executive officer' was included in the definition, but the basis of the criticism is not precisely articulated, other than the general principle that casting the net more widely would better achieve the general objectives of the Corporations Act. It is not clear to the Committee that this general principle necessarily follows – although in any particular case it might make it somewhat easier to prosecute (including by way of civil penalty proceedings) persons who might be regarded as morally blameworthy. The key policy question is whether a wider net will result in better corporate performance or fewer (or less damaging) corporate failures. In Committee's view, this is the analysis that should be undertaken before instituting a policy change in this area of corporate law. That said, if there is evidence of anomalies resulting from previous law reform, as a matter of fundamental principle, any such anomaly should be addressed.

The Committee notes that the Corporations Act currently defines "officer"[4] as a person who can affect a substantial part of the business of the corporation or has the capacity to significantly affect the corporation's financial standing. This functional definition should be satisfactory to ensure that managers at the higher levels are responsible for their actions, and it is these persons who should have the primary responsibility and liability for the management of the corporation.

Rather than necessarily extending the class of individuals that might be subject to the Corporations Act in a general way, it might be better to focus on who ought to fall within the definition of officer and how and why they should be regulated.

The Committee notes that in the recent *ASIC v Vines*[5] Austin J applied the then applicable definition of who had management responsibilities under company law (although in that case the court was dealing with the pre-2000 definition of "officer incorporating the term "executive officer").

As you will recall, in this case three former executives of GIO were found to have breached their duties as executive officers during AMP's takeover bid for the company by failing to act with reasonable care in the preparation of a profit forecast.

In *Vines* the Court the found the areas where the law pre-2000 was unclear were around:

First: whether "management" can be said to occur where the activity is confined to a segment of the company's overall business (such as

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(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation); or ...

[4] Section 9.
[5] [2005] NSWSC 738

production, sales or trading) – a position specifically addressed by paragraph (b)(i) of the current definition of officer.

Secondly, whether "management" may occur amongst those corporate officers who are not directors and do not report directly to the board – a matter that seems to have been at least implicitly excluded as an issue under the current definition.

In doing so, the Court broadly interpreted who was defined as officer under the Corporations Act His Honour preferring the wider *Bracht* test over the narrower insolvent trading cases definition.[6]

His honour said:

> *In my view Ormiston J's decision in Bracht should be followed with respect to the statutory directors' and officers' duties in s 232, in preference to Burchett J's approach in Holpitt. In this statutory context, the purpose of the definition of "executive officer" is to identify, amongst those who work for the corporation, that group whose responsibilities are significant enough to justify the imposition of special statutory duties. It would be very odd if, say, the national sales manager of a major listed corporation, whose dishonesty or disloyalty or negligence could cause very substantial harm to the corporation, were not an "executive officer" subject to the statutory duties because his or her responsibilities were limited to the sales segment of the business, in circumstances where the statutory duty clearly applies to the company secretary. In Holpitt, Burchett J was concerned that the potential unfairness of making a company executive responsible for debts which he or she had no role in incurring. The problem does not arise in the present context, where the issue is intrinsically confined to assessing the proper discharge of the executive's own responsibilities in his or her position in the corporation.*[7]

In *Vines*, the Court examined the extent of activity required to attract the old definition i.e. being "concerned in" or "taking part in" management. The Court supported a view "taking part in" connotes active participation short of ultimate control, although it had to be more than the administrative carrying out of the orders of others. The idea of being "concerned" in management was held to have a wider operation, connoting participation at a variety of levels and at differing intensities, some of which "may be relatively modest." [8] In *Vines* the Court found that:

> *In my opinion it is plain in the present case that Mr Vines took part in, and was concerned in, the management of GIO Australia Holdings through his roles as chief financial officer and the*

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[6] *Commissioner for Corporate Affairs v Bracht* (1989) 7 ACLC 40 see also *Forge v ASIC* [2004] 52 ACSR 1.
[7] At paragraph 1049.
[8] At paragraph 1054.

> *executive officer with principal responsibility for the takeover defence process in the financial aspects of the Part B statement. Mr Fox took part in, and was concerned in, the management of GIO Insurance by virtue of his position as executive director of the company as from 5 November 1998, and Mr Robertson did likewise up to 5 November 1998. Mr Robertson continued to take part in, and be concerned in, the management and GIO Insurance after that date because of his attention to his special responsibilities in respect of the profit forecast. By virtue of the same activities, Mr Fox and Mr Robertson were concerned in, and took part in, the management of GIO Australia Holdings.*

It is noted that it is possible that Messrs Fox and Robertson might not have been found to have been officers of the holding company under the current "officer" definition and if this were correct such a conclusion might provide some basis for considering that the 2000 amendment to the "officer" definition should be re-examined. However, an analysis of *Vines* suggests that the same result might have been achieved under the new definition. At paragraph 1054 Austin J cited with approval a passage from *Bracht* (at 832) suggesting to take part or be concerned in management, a person would need to be *involved in* the decision making processes of the corporation. At paragraph 1041 Austin J cited further passages from *Bracht* (at 830) suggesting the relevant activities must related to the whole or a substantial part of the business of the corporation or have a significant bearing on the financial standing of the corporation. It is noteworthy how these requirements echo the language of the existing (post-2000) "officer" definition. One might be able to infer that the same finding – that Messrs Fox and Robertson were "officers" - may have been available under either the old or the new definition. If this is correct, then a return to the old definition might be of limited effect from a policy perspective, at least if *Vines* is used as an example. It may well be the case that the failure to include a specific reference to "concerned in management" in the new definition did not affect the scope of operation because (on the *Bracht* analysis) to be "concerned in management" would require participation in decision making affecting the whole or a substantial part of the business, or significantly affect the financial standing of the company.

As noted by Commissioner Owen, the new "officer" definition appears to have been intended to be a codification of case law surrounding the old "executive officer" definition (see for example the comments in Ford, Austin and Ramsay, *An Introduction to the CLERP Act 1999*, Butterworths, 2000, at paragraph 2.5 – also referring to *Bracht*).

Moreover, in our submission, it has not been established that the policy reasons for amending the "officer" definition in 2000 – part of the carefully considered CLERP corporate governance package – are no longer relevant, and that casting a wider net (if that would be the effect of returning to the old language – or simply seeking to widen the net) has been justified on sound and carefully considered policy grounds. In any

event, any review of the officer definitions should at least involve a reconciliation of the officer, employee, executive officer and senior manager definitions. Clearly, there is a need to return to the explanation behind the change from the previous definition of 'officer' beyond the inconsistency problem in s 82A.

Proposal 2

Should s 180(1) (the duty of care and diligence) be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned in the management of that corporation.

See above comments, which the Committee thinks apply equally to the duty of care and diligence.

Proposal 3

If Proposal 2 is adopted, should s 180(2)(the business judgment rule) be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

The Committee considers that if the definition of officer were to be extended, then it would follow that the application of business judgment rule should be extended accordingly.

Additionally, the Committee suggests that s 189 and other similar provisions should be reviewed if any such amendment is proposed, to ensure that the reliance and delegation rules respond appropriately to a wider "officer" definition (noting, for example that section 189 is limited to "directors").

Proposal 4

Should s 182 and 184(2) (in proper use of corporate position) be extended beyond directors, other officers and employees of the corporation, to any person who performed as functions, or otherwise acts, for or on behalf that corporation.

It is difficult to argue in favour for applying "position" rules to consultants and contractors who do not hold a "position" as such. It is not clear to the Committee what that would mean from a practical perspective. A provision of this nature is likely to be broad and far reaching, with a significant likelihood of unintended consequences. A clear policy

foundation for this proposal should be articulated, and the limits of the new "functional" doctrine would need to be very carefully thought through.

Proposal 5

Should s 183 and 184(3) (improper use of corporate information) be extended beyond past and present directors, other officers and employees of a corporation, to any person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

The Corporations Committee has some concern about the extension of sections 182 – 184 beyond directors, officers and employees of a corporation to "any other person who performs functions, or otherwise acts, for or on behalf of the corporation."

Applying the provisions to any person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation may appear superficially attractive but given that consultants and contractors regularly perform many 'acts, for or on behalf of the corporation', such a proposal is likely to have unforeseen and unintended consequences.

However, it is difficult to argue against applying "information" rules to consultants and contractors. Generally this would be quite consistent with an ordinary part of the terms of a consultant's contract of engagement.

Proposal 6

Subsection 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts for or on behalf of a corporation.

The Committee supports the extension of this "information" rule as proposed.

However, the proposal ought to be limited to s 1309(1) and not be extended to s 1309(2): an independent contractor could not readily, or at least without incurring considerable cost, take reasonable steps to ensure that any particular information was not false or misleading.

Proposal 7

Sub-section 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions or otherwise acts or has acted, for or on behalf of that company.

The Committee supports the extension of s 1307(1) to persons, other than officers and employees, who perform functions, or otherwise act, for or on behalf of a corporation.

There is no policy reason to limit the field of application of this type of provision, and the keeping of accurate records is fundamental to good governance and administration. There is no basis for differentiating between persons on the basis of their legal character but in relation to this provision a functional test should apply and any one who has the capacity to falsify books (regardless of character) should be regulated.

General dishonesty provision

The discussion paper also considers whether there should be a general provision in the Corporations Act, as the HIH Report recommended, prohibiting individuals from acting dishonestly in connection with any statutory obligation imposed on the corporation.

The Committee notes that he US Sarbanes-Oxley Act holds a company's officers personally responsible for misrepresentation of financial data, but in doing so focuses on the role of the 'c-level' executive i.e. "principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions"[9] These "certifying officers" have then become the focus of subsequent requirements such as the report by management on the company's internal control over financial reporting under section 404.

In contrast to the US position, the breadth of the suggested class of people subjected to these more general 'corporate duties' may have become too wide. The Committee believes it may be better to focus on some specific functional individuals having specific duties in connection with specific roles for example, financial reporting.

The Committee agrees with the position stated in the paper that this is an area usually dealt with in the other legislation and to include such a provision in the Corporations Act might raise the possibility of multiple offences for single transgressions, mismatched defences and inconsistent treatment of offenders.

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[9] Sarbanes-Oxley Act of 2002 s 302.

In the Committee's submission, offences on the part of officers or employees relating to specific statutory obligations should be dealt with in the particular legislation concerned. This would allow the policy issues related to the particular legislation to be taken into account when determining the nature and extent of liability. Moreover, the responsibility for enforcement should rest with the individual regulator in question, rather than placing a further level of regulator responsibility on the shoulders of ASIC – with possibility that the blurring of lines of responsibility will lead to less effective regulation.

That said, it is hard to disagree with the proposition that all persons ought to act honestly when acting on behalf of a company – the question is whether that ought to be a statutory obligation under the Corporations Act with potentially serious penalties for breach.

Corporate groups

The Committee notes that the discussion paper also briefly looks at whether there are problems with the application of the current provisions relating to officers in corporate groups.

It is one thing to say that officers should act with care and diligence,[10] in good faith in the best interests of the company as a whole and for a proper purpose.[11] It is another thing to say that officers must act in the interests of the corporation of which they are an officer, in the context of corporate groups.

The Committee is concerned that sometimes it is not realistic to judge officers on the basis that each corporation in a group should be treated as having its own interest even when they are wholly-owned subsidiaries. The Committee believes that the current state of the law is not satisfactory. It is an unrealistic requirement to criticise every decision in which an officer fails to consider the interests of the separate entity, especially when the decision is taken in the interests of the group as a whole and for the benefit of the shareholders of the holding company, often the only external shareholder in the chain of corporations that make up the group.

The ongoing dilemmas for officers in corporate groups would not be made any easier by extending the duties in care and diligence and good faith and proper purpose to 'any other person who takes part, or is concerned, in the management of the corporation'. The Committee submits that there remains a need for real reform based around the reality that in most cases corporate groups are a unitary economic enterprise functioning to further

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[10] Section 180.
[11] Section 181.

the interests of the group as a whole, or those of its dominant corporate body.[12]

The Committee support calls for reform to permit wholly-owned corporate groups to choose whether to be consolidated or non-consolidated. Such a change would allow groups and their officers to be regulated by single enterprise principles where it was appropriate.[13]

That said, in the absence of such reform, the Committee recognises that in the event of corporate failure, it would be inappropriate for a person who in fact was undertaking a function on behalf of one member of a corporate group to escape responsibility for clear wrong doing (where there is no issue of intra-group interests involved) merely because he or she was not an employee of the particular group company concerned. The Committee notes that the existing "officer" definition is at present "functional" at least in so far as it would respond in such circumstances – and it is highly probable that a senior executive of a holding company who was involved in the management of a subsidiary in a sufficiently senior capacity would be found to be an officer under the current definition.

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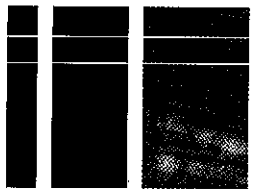
[12] Corporate Groups Final Report (May 2000) pg 22.

[13] Under this proposal, directors of the ultimate holding company of a wholly-owned corporate group could choose to adopt the consolidated corporate group structure. For groups that "opt in", a term such as "consolidated corporate group company" would have to be included on all public documents of the group companies, indicating to outsiders the status of that group.
These corporate groups would be regulated by single enterprise principles in the following manner:
- the Corporations Act would treat the corporate group as one legal structure
- officers of group companies could act in the overall group interest without reference to the interests of their particular group companies
- the holding company and each group company would, subject to any contrary agreement, be collectively liable for the contractual debts of all group companies,
- group companies could merge merely at the discretion of the directors of the holding company;
- ASIC would be given the power to provide appropriate relief from accounting and any other residual separate entity requirements.

See Corporate Groups Final Report (May 2000) pg 32.



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26 October 2005

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
Level 16, 60 Margaret Street
SYDNEY NSW 2000
Email: john.kluver@camac.gov.au

Dear Mr Kluver

This submission is made on behalf of the Insurance Council of Australia in response to the Corporations and Markets Advisory Committee's (CAMAC) discussion paper on *Corporate Duties Below Board Level.*

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. ICA membership represents more than 90 percent of total premium income written by private sector general insurers. ICA appreciates the opportunity to provide a response on these issues and welcomes continued consultation on these issues as they are under review.

While individual ICA members have made separate submissions, this letter touches on specific issues common to ICA members, primarily those involving regulatory consistency and the need for a considered approach.

Corporate Duties Below Board Level

While ICA supports the 2003 HIH Royal Commission Report findings, it has concerns about CAMAC's view on how to implement these recommendations. For example, the proposed extension of the definition of "officer" to an indeterminate class of people has the potential to create greater uncertainty across levels of management. It is also likely that the lack of clarity in the definition could lead to a broad judicial interpretation which could expose unintended persons in areas of middle management and below to increased liability.

ICA does not believe that this was the Royal Commission's intention. The 2003 HIH Report focused on ensuring that a "functional" definition of personnel applied. It did not, however, indicate an intention to shift responsibility away from the Board and Directors and on to management. ICA is concerned that these reforms have the potential to develop a culture which would encourage the shifting of responsibility (both up and down the chain) and further encourage both officers and management to act in a manner which is compliance centred and risk averse.

Corporations are already regulated by a range of legislation with which management is required to abide in such areas as occupational health and safety, insurance, prudential regulation, and trade practices. These regulations impose responsibility and subsequently liability on these individuals. This legislation is becoming well established and understood, and is operating effectively. As such, ICA does not believe that this is an area that is in need of greater regulatory oversight.

Any decision to extend the definition of officer needs to be undertaken after due consideration of the intended outcomes including clearly identifying which groups of people are to be captured by these changes. In addition, any decision to include consultants and contractors must be done cautiously and should contemplate the unintended consequences that it may have on contractors, external consultants, and external advisors. Any change should be limited to such persons that are specifically performing the functions of officers.

Potential Insurance Issues

The extension of liability could have yet unquantified impacts both on Directors & Officers (D&O) and Professional Indemnity Insurance (PI) cover. For managers that are captured in this broader definition, greater liability will mean that they will have to seek out D&O and/or PI insurance to offset their personal risk. By extending the level of management exposed to risk, there is potential that D&O and PI insurance premiums will be forced to rise in order to cover this extended pool of risk.

Members have indicated that risks based on work done for companies by external contractors, consultants and advisors are not covered by traditional D&O insurance. Specifically, companies would have to broaden the definition of "management" in their policies to include these external groups. Extending the definition of management has the potential to have claims brought against a corporation for any historic wrongful act committed by any of their past contractors or consultants. This has the potential to add significant unquantifiable exposure to insurers. For example, as part of writing a policy, an insurer would have to collect information on all past contractors and consultants of the corporation in order to quantify the additional exposure involved. This would have the potential to increase the risk and subsequently the pricing of D&O policies.

Regulatory Environment

There is already growing evidence that the complexity of the regulatory environment has created a compliance mentality within corporations. Business decisions are being taken with compliance as a major factor. This need to further focus on compliance as the dominating concern, even at the middle management level, will continue to make companies more risk averse, stifle innovation and creativity.

ICA encourages CAMAC to have their reforms reflect the spirit of the Prime Minister's Taskforce to examine the reduction of red tape, and strongly believes that any changes should be implemented in a manner that keeps regulatory cost for companies to a minimum.

We would welcome an opportunity to discuss these matters further once you have had a chance to consider our comments.

Yours sincerely

Alan Mason
Executive Director

AUSTRALIAN **B**ANKERS' **A**SSOCIATION INC.

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11 November 2005

Mr John Kluver
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john.kluver@camac.gov.au

Dear Mr Kluver,

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments to the Corporations and Markets Advisory Committee (CAMAC) discussion paper *Corporate duties below Board level*.

1. General observations

The discussion paper considers the extent to which officers (excluding directors), employees and other individuals are subject to personal duties and liabilities under the *Corporations Act 2001*. The discussion paper generally corresponds with the recommendations in the HIH Royal Commission report *The Failure of HIH Insurance* (April 2003) (HIH Report).

The ABA recognises that there are a number of matters that the HIH Report attempts to address as part of the recommendations, including:

- Clarifying the duties of managers without shifting responsibility from the Board;
- Taking account of structures of large companies where decisions may be collective and/or without reference to the Board;
- Clarifying the responsibilities of consultants who perform corporate functions; and
- Ensuring that corporate governance standards apply throughout the company.

However, the ABA is concerned that the proposals in the discussion paper may adversely impact on the sound, efficient and effective decision-making of companies. Furthermore, it is not clear as to whether the concerns held by some with the recent cases of corporate malfeasance have arisen due to inherent deficiencies with the law.

Firstly, the ABA is concerned by the proposal that statutory duties and obligations of directors and officers of a company under the *Corporations Act 2001* should be extended to others involved in the management of the corporation. A dilution of primary duties is likely to confuse management roles within the company particularly as directors, other officers and other employees would share responsibility for the same matters. This would be detrimental to the company, its shareholders, creditors, employees and other stakeholders.

The extension of liability beyond directors and officers to other managers or employees could have a substantial impact on the efficiency and effectiveness of business and compliance programs. If there is uncertainty regarding the liability of companies and individuals within the company, it is likely that companies would have difficulty in implementing adequate risk management procedures and insurance for potential liabilities. Directors' and officers' (D&O) and professional indemnity (PI) insurance would need to be extended to cover more complex and uncertain liabilities; thereby generating unnecessary compliance costs.

Secondly, the ABA is concerned by the proposal to introduce a statutory obligation to prohibit individuals from acting dishonestly in connection with the performance of their duties. Individuals should, and are required to act honestly according to a number of Federal, State and Territory statutes, including the Corporations Act (which provides that directors and officers commit an offence if they are intentionally dishonest). Therefore, the ABA believes that if a prohibition is introduced that it should be restricted to conduct in connection with the company's obligations under the Corporations Act.

2. Specific comments on proposals for law reform

2.1 Proposals 1, 2 and 3: Extend the duties of care and diligence, good faith, and proper purpose

Sections 180(1) and 181(1) of the Corporations Act currently apply only to directors and officers of a corporation. The definition of an 'officer' applies to those who make or participate in making decisions that affect the whole or a substantial part of the business of the corporation, or who have the capacity to significantly affect the company's financial standing[1].

[1] Section 9, Corporations Act

The discussion paper proposes to extend these duties to any other person who is concerned, or takes part in the management of the company. Therefore, the extended application of these duties would apply to middle management, employees, consultants, advisers and independent contractors. It could also cover directors and officers of related corporations in appropriate circumstances; however, arguably senior executives would already be captured by the definition.

The main issue raised by the HIH Report is ensuring that companies make sound decisions, and those individuals that make the decisions are accountable for them. However, the proposal in the discussion paper, in practice, may unduly impact on the ability of companies to make sound, efficient and effective decisions.

The ABA recognises that an individual who has a significant contribution to the decisions of the company, that have a real impact on the interests of the company, should have a duty to act in good faith, with care and diligence and for a proper purpose. However, the ABA has a number of concerns with the proposal to extend the statutory duties to a wider class of individuals within the company.

Firstly, the extension of these duties to a wider class of individuals may cause inefficient and overly cautious decision-making, or alternatively, a lack of decision-making, as managers and employees seek to shift responsibility, or debate who should accept responsibility for decisions and conduct. This cannot be good for the company, its shareholders, employees and other stakeholders. The ABA believes only decision-making which has a substantial impact on the company should be subject to good faith, care and diligence and proper purpose duties.

Secondly, contemplating extending the duty to act in good faith, with care and diligence and for a proper purpose to a wider class of individuals presents a challenge in how the proposal can be applied to those with genuine managerial responsibilities. The ABA considers that the current definition of an 'officer' as contained in the Corporations Act already ensures that managers that hold senior positions are responsible for their actions. Amending the definition to include individuals who "take part in" management, is too broad and would likely capture a wider class of individuals than is reasonably intended. The ABA does not support reintroducing the pre-CLERP definition of 'executive officer'.

The ABA also notes that since the HIH Report was released, there have been a number of shifts in the regulation of corporates, in particular Australian Prudential Regulation Authority (APRA) regulated entities. In June 2005, after a period of consultation, APRA released its draft *Fit and Proper* and *Corporate Governance Standards* and guidance notes for APRA-regulated entities, including authorised deposit-taking institutions (ADIs), general insurance and life insurance institutions.

The ABA recognises that the policy intention of the draft standards is to ensure that APRA-regulated entities exercise sound judgment and act prudently in their decision-making and apply corporate governance standards throughout the company. As this is consistent with the general policy intention contemplated in the proposal, the ABA believes that it would be useful for APRA to finalise its prudential standard prior to the Government giving further consideration as to whether it is necessary to extend any statutory duties as contained in the Corporations Act. The ABA has previously expressed concern with the potential for overlap, duplication or inconsistent obligations between the *Banking Act 1959* and the Corporations Act; and thereby the unnecessary legal, operational and administrative costs that would result.

If the statutory duties of directors, officers and other employees are varied in the Corporations Act, then there will be a need to consider amending the "business judgement rule" accordingly. Section 180(2) of the Corporations Act provides that a director or other officer of a corporation who makes a business judgement is taken to meet the requirements of care and diligence if they make the decision in good faith; do not have a personal interest; reasonably inform themselves about the subject matter; and believe the decision is in the best interests of the company. The business judgement rule operates in relation to the duties in section 180(1) and the equivalent duties in common law.

Furthermore, if the statutory duties of directors, officers and other employees are varied, then there will also be a need to consider access and availability to insurance policies, such as directors' and officers' (D&O), to ensure that any extension of legislative obligations is aligned with adequate insurance coverage. It is important for all employees to have certainty regarding their rights and responsibilities.

Finally, assignment of greater and wider responsibility within the company will impact directly on remuneration, as employees' accountabilities under the law are increased. Companies are already responding to increased workload and duties associated with the new corporate governance requirements and extended responsibilities by lifting fees for directors[2]. Wages pressure will have an effect on shareholders, the employment market and the wider economy.

2.2 Proposals 4 and 5: Extend the prohibition on improper use of position or information

Sections 182(1), 183(1), 184(2) and 184(3) of the Corporations Act prohibit directors, company secretaries, other officers and employees of a corporation from using their position, or company information, to gain an advantage for themselves, or someone else, or to cause detriment to the corporation.

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[2] Kitney, D, Buffini, F and Hooper, N (2005). *Shareholders urged to lift directors' fees*. Australian Financial Review. 7 November 2005.

The discussion paper proposes to extend these prohibitions to any other individuals who perform corporate functions, or otherwise act, for or on behalf of the corporation, such as consultants, advisers, contractors or other suppliers of services.

The main issue raised by the HIH Report is regarding individuals that may undertake activities that are similar to those of an employee of the company. However, the proposal in the discussion paper, in practice, would extend further than the problem identified by the HIH Report.

The ABA recognises that all employees should not use their position or company information in an improper manner. However, the ABA is concerned with the proposal to extend the prohibition to individuals that do not hold a "position" within the company. Such a provision is likely to be broad and therefore is likely to generate substantial unintended consequences. It seems illogical to create a criminal offence for external consultants and agents in respect of their dealings with corporations which would not apply to their non-corporate clients.

Furthermore, an extension of the duties to consultants, advisers, contractors and agents may result in directors and other officers being uncertain as to their responsibilities in terms of engaging specialised services. It is also unreasonable to assume that a consultant, adviser, contractor or agent would, in all circumstances, understand what is in the best interests of a company, if indeed this is how the extension of prohibitions is to apply.

A contract of engagement or employment is likely to contain provisions that relate to the improper use of position or information, such as confidential clauses. Notwithstanding, the ABA suggests that if a prohibition was to be introduced, that it would be more appropriate for this conduct to be prohibited under criminal or trade practices legislation.

2.3 Proposals 6 and 7: Extend offences concerning falsification of books and provision of false or misleading information

Under section 1307(1) of the Corporations Act, it is an offence for an officer or employee of a company to conceal, destroy, or falsify books relating to the affairs of the company. Under section 1309(1) of the Corporations Act, it is an offence for an officer or employee of the company to knowingly make available or give false or misleading information to the Board, auditors, shareholders or debenture holders.

The discussion paper proposes to extend these offences to any individual who performs functions, or otherwise acts, for or on behalf of the company. Information could include a company's accounts, capital raising documents (such as prospectuses and product disclosure statements), or any other information to be disclosed by the company according to its continuous disclosure obligations.

The ABA believes that maintaining accurate records of a company is essential for good corporate governance. Therefore, the ABA supports extending the application of the offences to individuals that have the capacity to falsify a company's books. However, to require any individual who performs functions for or on behalf of the company to take reasonable steps in relation to all information would be impractical.

2.4 Acting dishonestly

The discussion paper considers whether to introduce a statutory obligation to prohibit individuals from acting dishonestly in connection with the performance of their duties to the company.

The ABA believes that all individuals should act honestly when acting on behalf of a company. Indeed, clause 2.2 the Code of Banking Practice provides that: "We will act fairly and reasonably towards you in a consistent and ethical manner."

Under Chapter 2D of the Corporations Act, directors and officers must act in good faith, with care and diligence, for a proper purpose and in the best interest of the company. To act dishonestly must be considered not to be acting in good faith and it is difficult to conceive on public policy grounds that dishonesty could be legitimised as being in the best interests of the company.

In addition to the statutory provision relating to directors and officers of companies, under section 912A of the Corporations Act, financial services providers are obliged to act "efficiently, honestly and fairly".

The ABA considers that there are various Federal, State and Territory statutes that contain provisions regarding 'honesty', including the Corporations Act. Therefore, the ABA is concerned that introducing a general prohibition would be too broad and is likely to have substantial unintended consequences, such as duplication, overlap or inconsistencies with other legislative obligations. Firstly, liability for dishonesty in respect of other legislation is more appropriately dealt with in the specific legislation. Secondly, the inclusion of a general provision in the Corporations Act that applies to all legislation may lead to multiple offences and inconsistent defences.

The ABA notes that in the United States, section 404 of the Sarbanes-Oxley Act holds a company's officers accountable for 'misrepresentation'. In this instance, the obligation is limited to the Chief Executive Officer and Chief Financial Officer and in relation to financial information.

The ABA supports in principle a prohibition against dishonest conduct for all individuals acting on behalf of a company; however, the ABA is concerned with the proposal and therefore believes that a prohibition should be restricted to conduct in connection with the company's obligations under the Corporations Act. Statutory prohibitions against dishonesty in respect of other conduct is best dealt with in the specific legislation that regulates that conduct.

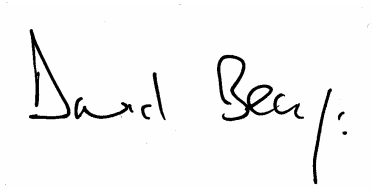
2.5 Corporate groups

The discussion paper contemplates whether legislative amendments are required to apply to corporate group executives either making one-off decisions regarding a particular corporate group or making general commercial decisions for the corporate group, but without considering which of the subsidiaries would be used to implement the decision.

The ABA does not believe that a person who makes or participates in making a decision that is implemented in whole or part by a related corporation, should hold specific duties not only to the first corporation, but also to the related corporation. Any such provision would necessarily be complex and confusing. Furthermore, the ABA considers that the definition of an 'officer' as contained in the Corporations Act would necessarily apply to a senior executive of a holding company who was involved in the management of a subsidiary.

The ABA would be happy to discuss any of the issues raised in this letter with you further. Please contact me or the ABA's Director, Corporate & Consumer Policy, Diane Tate on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely



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David Bell