Book Review

By Rosemary O'Grady

There is great debate, a phoney war, underway about the tension which exists between the spirit of the laws of management of other people's money and the black letter.

According to Mr Justice Chernov in his lengthily-entitled *The Role of Corporate Governance Practices in the Development of Legal Principles Relating to Directors*, although corporate governance practices do have a "common underlying basis, namely, to do the right thing ...." there is a "conflict" inherent in the exercise of business judgement.

"... The legal principles seek to resolve the conflict between the recognition of the business judgment rule on the one hand, and on the other, the need to ensure that business judgment is exercised properly (as distinct from correctly)."

Ask not, Bernard, how a principle conducts a search, nor seek for the distinction between "properly" and "correctly", which is about as significant as the number of angels who can dance on the head of a pin.

As a teacher of corporate law, however, seeking to instil in students new to the subject an understanding of the "right thing", I usually start with a history of the nature of the beast, from which right conduct and an appreciation of it emerges painlessly.

In the law on directors' duties there have been some startling recent examples of corporate neglect and wrongdoing.

When the management of companies became so complex it could scarcely be conveyed accurately to a board of non-executive directors, the obvious appeal of professional management assuming ownership of the company became apparent. Financial deregulation and the value of bonus payments or share-issues made to directors in the 1980s meant that such executive dreams were realisable for the first time, through leveraged or management buy-outs. In brief, corporate governance is the tension or struggle which exists between the ownership of a company and its management.

Ian Ramsay introduces the topic and the "mechanisms" which "play a role in corporate governance": the duties of directors and officers, board structure, auditors, institutional investors – the market "heavies", takeovers, disclosure, markets, capital, labour, executive remuneration, shareholdings by staff, ownership concentration, financial policy – levels of debt, voting and shareholding litigation, regulators.

Corporate Governance and the Duties of Company Directors

edited by Professor Alan Ramsay

Centre for Corporate Law and Securities Regulation

He raises the issue of board structure and corporate performance, a subject recently addressed publicly and interestingly by Ken Jarrett, a former Harlin director of Elders-IXL, and refers to the literature on board composition and share price. There is no significant correlation – a finding which suggests that, at least in Australia, such studies should take into account the limited pool of directorial talent, and, perhaps, that there should be comparative studies undertaken at times of normal trading by contrast with share price fluctuation at times of, say, a management buy-out.

Chief Justice Norman Veasy writes an overview of US attitudes to directors' duties, drawing the useful, one would have thought obvious, distinction between "enterprise" and "ownership" issues in decision-making.

Illustrating the frustration felt by many corporate practitioners in seeking to apportion liability for corporate loss, Chernov J quotes Rogers CJ in the Commercial Division in NSW:

"... unproductive expenditure on legal costs, a reduction in the amount available to creditors, a windfall for some, and an unfair loss to others. Fairness or equity seems to have little role to play." (*Qunitex ... v Schroders...* (1990) 3 ACSR 267).

Equity is what goes out the window when powerful interests demand that legislators open the door on black letter law. Yet, if the idea of the corporation was grounded in any principle at all – and it was, it was in the idea of equity and benefit to all participants.

Michael Kirby J refers us to Wilberforce LJ whose Holdsworth lecture *Law and Economics* demonstrates how developments since the nineteenth century have led inevitable to the (unsatisfied) demand for change in legal thinking about companies. The greatest of these changes, says Kirby J, is globalization, and the international impact of shifting economic and financial resources.

Corporate labour policies are another of Kirby J's concerns, the Australian economy being necessarily linked now to the impact of international conglomerate decisions; and "privatisation: and the shift of formerly governmental functions to the market place which are now displaced by contractual ones on a playing field which almost nobody ever believed was going to be level from the outset.

"Simplification" of laws seems barely adequate in the face of demands that law be seen to be less "out of touch with modern commercial practice", but Kirby J points to the high level of inconsistency in judicial as well as legislative attitudes to corporate practice and the need for a more sophisticated approach to regional issues and comparative law, without loss of understanding of the essence of corporation: risk-taking and entrepreneurship.

Western Australian Chief Justice Davis Malcolm writes with characteristic clarity of *Directors' Duties: The Governing Principles*.

This good historical view extracts the non-interference principle, the commercial reality principle, the non-prescriptive principle, and appeals for legislative development which preserves the law's "flexibility and ability to adapt to circumstances."

A dashing account of relevant case law follows, with a survey of separate directors' duties, which so often give rise to difficulty in the minds of the ethically-unschooled and leave open the door to the incomprehensibly-vexed question of

continued on page 19

Book Review

Corporate Governance and the Duties of Company Directors
ed. Alan Ramsay

continued from page 18

fiduciary relationships.

Most interestingly, Malcolm CJ addresses himself to the judicial balancing act involved in deciding between "foreseeable risk of harm against the potential benefits that could reasonably be expected to accrue to the company ..." a formulation of Ipp J's in *Vrisakis v ASC* (1993) 11 ACSR 162. He concludes optimistically about judicial approaches and adaptability, ending with *dicta* typical of his style: "The temptation to lay down detailed general rules or principles has been strenuously avoided. This is an approach which should continue to be followed."

Professor John Farrar of Bond University writes of directors' duties of care in Australia and New Zealand, pointing to the wide discretion allowed NZ directors exercising business judgment, a trend no doubt partially accounting for Auckland's current commercial surge.

Associate Professor Bob Baxt points to the shift this decade to greater judicial scrutiny of decisions made by directors pursuant to duties to exercise care and diligence – a "swing of the pendulum." He then examines the issues in the *AWA* case (1992) 10 ACLC 933, and its appeals. The story of the consequences of Andrew Koval's apparently unrestricted forex dealings and the subsequent attempt to recover from auditors is already a legend in Australian corporate law and not to be missed. Baxt, too, cites Ipp J's *Vrisakis* judgment and provides a nice summary of conflict of interest, referring to the *Marcus Clark* case.

In conclusion, while Malcolm CJ and Rogers CJ resist a statutory business judgment rule, Baxt suggests the time has come for reassessment.

Michael J Whincop of Griffith University discusses statutory duties of honesty and propriety and concludes "the present formulations of the duties of propriety have been demonstrated to be misspecified from doctrinal and analytical perspectives ...", a view with which most students would probably agree. But his attitude to fiduciary duties presumes a freedom of shareholder activity which, at least within the markets as currently constituted in Australia, is perhaps romantic.

Justice E W Thomas of New Zealand discusses nominee directors and fiduciary obligations and elaborates on the Privy Council's 1991 decision in the *Kuwait-Asia Bank* case on the liability of parent companies for acts of employee directors, emphasising the need for corporations law both to maintain "fundamental canons of the common law" and to accord with commercial reality.

Robyn Carroll of UWA discusses "shadow directors" and corporate third party liability. She, too, after an interesting case review, addresses the relevance of fiduciary duties imposed on directors, and the underlying equitable foundation of such duties.

Professor Paul Redmond of UNSW addresses the need fora statutory business judgment rule, concluding, after a review of costs and benefits, that such a rule is "unnecessary and undesirable when the general law presently accords a respect bordering upon deference for directors' business judgments and the financial obstacles to shareholder suits are so formidable and their incidence so rare." This is a view most shareholders would probably take too.

Finally, Alan Cameron AM deliberates from the perspective of the ASC on enforcement and the role of the courts, an unconventional piece which concludes with a suggestion , one couldn't call it a plea, for revival of the sentence-indication system in corporate litigation.

To sum up: no laughs, a few good ideas, some insights.

-Rosemary O'Grady