

THE ALBATROSS AROUND THE NECK OF COMPANY DIRECTORS

A JOURNEY THROUGH CASE LAW, LEGISLATION AND CORPORATE GOVERNANCE

LISA BARNES

Corporate governance is not a new concept. In fact the popularity of the subject area has generated much academic debate and research particularly in the last 15 years with the large- scale international corporate collapses of the early 2000s and the recent global financial crisis. The object of this research is to demonstrate the nature of the current climate of corporate governance in an Australian context through case law and legislation. It does not prescribe a ‘one-size-fits-all’ corporate governance solution, in fact this research clearly demonstrates that corporate governance can be linked to compliance with *Corporations Act 2001* in particular directors’ duties. Australian case law has demonstrated the continuing need for clarification of the legislation but this research acknowledges it also adds to the increasing burden already bestowed upon company directors.

INTRODUCTION

In Australia the current *Corporations Act 2001* is the main legislative requirement that all company directors and officers must comply with, and like the Albatross hung over the neck of the Ancient Mariner in Coleridge's 1798 poem, it is a burden to all company directors. It has undergone many changes with the corporate collapses of the early 2000s and the subsequent Corporate Law Economic Reform Programs (CLERP) and the global financial crisis, as well as the continuing need for case law clarification. The Australian Securities Exchange (ASX) and its recommended corporate governance principles of 2010 has further placed a compliance burden on Directors particularly for listed companies under listing rule 4.10. The combination of directors' duties under the *Corporations Act 2001* and the ASX Corporate Governance recommendations (2010) has further forced directors to consider who is on the Board, and how, as a team, they ensure they both comply with company law and corporate governance recommendations.

This paper demonstrates the most significant case law evolving to shape the current Australian corporate laws. It then attempts to link directors' duties as imposed by that law (*Corporations Act 2001*) and the Australian Securities Exchange corporate governance recommendations (2010) that listed companies must comply with, in order to answer the following research problem.

Does the current Corporations Act 2001 for directors' duties, align with the ASX (2010) corporate governance principles?

This leads to the following research questions being posed:

RQ1: What are the relevant pieces of legislation that relate specifically to directors' duties in Australia?

RQ2: What current case law has involved the issue of directors' duties in Australia?

RQ3: Can we align the 'directors' duties legislation' (Corporations Act 2001) to that of the ASX Corporate Governance Recommendations (2010)?

1.2 CORPORATIONS ACT 2001

As shown by the following table, the role of the court system is important in the formulation of case law to clarify current legislation such as the *Corporations Act 2001*.

The *Corporations Act* codifies the duties imposed upon directors. These may be categorised broadly into statutory duties, common law duties and equitable fiduciary duties.

Relevant sections of the Act are summarised in Table 2.

Table 1. Role of Courts in Clarifying Corporations Act 2001

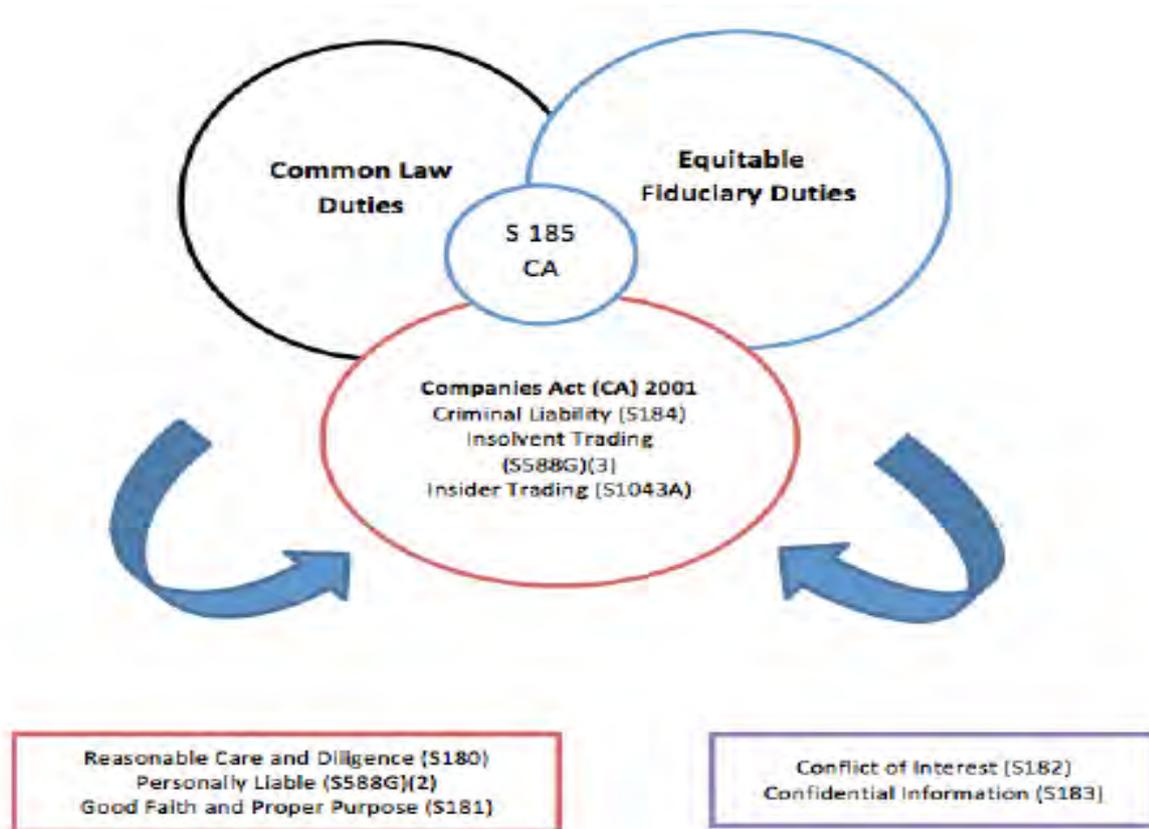
Year	Number of Registered Companies (ASIC Annual Reports)	Number of Cases Reported Under Halsbury Classification of Category 120 of LexisNexis ACL Reporter
2010	1,778,933	175
2009	1,719,825	110
2008	1,668,610	284
2007	1,572,054	324
2006	1,411,421	441
2005	1,362,962	386
2000	1,173,709	252

Under the *Corporations Act 2001*, directors' duties are classified as common law duties, such as reasonable care and diligence (s 180) as well as good faith and proper purpose (s 181). Breaches of these can result in a director being personally liable (s 588G). There are also equitable fiduciary duties; these duties include clauses on conflict of interest (s 182) and the use of confidential information (s 183). Under the *Corporations Act 2001*, directors can also have criminal liability (s 184) for acts such as insolvent trading (s 588G) and insider trading (s 1043A). It is easier to see the combination of these duties and the criminal or civil penalties for breaches as shown in Figure 1.

Table 2. Current Laws In Relation to Directors

Corporations Act 2001	Common Law Duties	Equitable Fiduciary Duties
Criminal Liability (s 184)	Reasonable Care and Diligence (s 180)	Conflict of Interest (s 182)
Insolvent Trading (s 588G)(3)	Personally Liable (s 588G)(2)	Confidential Information (s 183)
Insider Trading (s 1043A)	Good Faith and Proper Purpose (s 181)	

Figure 1: Directors' Duties



The Commonwealth government recognises that all of these laws place a heavy burden on directors, and has encouraged the Council of Australian Governments (COAG) to review these in light of state legislation. Nicholson and Underhill (2012) discuss the “Personal Liability for Corporate Fault Reform Bill” that imposes personal liability on company officers for offences committed by corporations. The reforms came from the 2009 Council of Australian Governments (COAG) which intends to harmonise corporate wrongs with personal criminal liability. This has been replaced by the *Miscellaneous Acts Amendment (Directors’ Liability) Act No. 2, 2011* (NSW) (‘2011 Act’) and was subsequently replaced by the *Miscellaneous Acts Amendment (Directors’ Liability) Act 2012* (NSW) (‘2012 Act’), which commenced on 11 January 2013.

1.3 Current Australian Case Law for Directors’ Duties

Table 3 lists the most commonly referred to case law from 1991 to 2012 in relation to breaches of directors’ duties. It states the year of the case, its name, the directors’ duty in question and the specific section of the legislation it refers to. The cases listed have helped shape the current performance of directors in Australian Boardrooms as there are implications for directors both personally and professionally, be they on a for-profit or a voluntary not-for-profit board. All directors duties then are the same on ALL directors whatever the entity, with both civil and criminal liabilities imposed on Directors.

Bryans (2011) discusses the James Hardie case in relation to non-executive breaches of care and diligence in relation

to ASX announcements that were misleading and failing to request a copy of the announcement. In the Centro case for example, Giordano stated (2011) that the directors failed to exercise their statutory duty of care and diligence in approving inaccurate accounts (s 180(1)), statutory duty of care and diligence, (s 344(1)) (reasonable steps to comply with financial reporting duties) and s 601FD(3) in the failure of classifying \$1.75 million USD as non-current when in fact they were short-term liabilities. In 2010, Heath in discussing the *ASIC v Rich* cases (2009) stated that directors are not responsible for unforeseeable risks, and a mistake or judgment of error does not automatically invoke s 180(1) breaches. However, Directors still needed to understand company financial statements, a responsibility that could not be avoided. As Table 3 has shown, case law in Australia continues to be active in particular to directors’ duties, and clarification of *Corporations Act 2001*.

1.4 Corporate Governance in Australia

Corporate Governance is not a new concept, in fact the concept (although not in its present form) dates back to 18000BC when bartering traders agreed to the Code of Hammurabi, the basic rules of business transactions.

Table 3. Recent Case Law on Directors' Duties

Year	Case Name	Finding/Description	Breach of Law Companies Act 2001
1991	<i>Commonwealth Bank of Australia v Friedrich</i> 5 ACSR 115; 9 ACLC 946	S588G(2) director found to be personally liable for debts incurred by the company, as the loan was fraudulent and he should not have signed annual reports with assets listed that the business did not own.	Insolvent Trading s 588G (3) Personally Liable s 588G(2)
1992	<i>AWA Ltd v Daniels t/as Deloitte Haskins and Sells</i> 7 ACSR 759	Problems with delegated authority and incorrect procedures for reporting to a company board. An equal duty of care for both executive and non-executive directors. That all should be familiar with the business of the company.	Reasonable Care and Due Diligence s 180
1995	<i>Gambotto v WCP</i> 182 CLR 432; 127 ALR 4147	Minority shareholder case where a proposed amendment to the constitution and subsequent compulsory acquisition was invalid. To avoid administration and taxation costs was not a proper purpose.	Minority Shareholder Rights s 136
1995	<i>R v Byrnes and Hopwood</i> (1995) 183 CLR 501; (1995) 130 ALR 529	Court found that officers could still be in breach of duties even when they thought it would benefit the company, but for an improper purpose.	Good Faith and Proper Purpose s 181
2001	<i>R v Firms</i> 51 NSWLR 548; 38 ACSR 223	Held that it is was insider trading under s 1034A as the information was publicly available even if no one had observed it.	Insider Trading s 1034A
2003	<i>ASIC v Southcorp Wines</i> 203 ALR 627; 22 ACLC 1	Contravened continuous disclosure rules by communicating to analysts before notifying ASIC s 674(2)	Confidential Information s 183
2003	<i>ASIC v Rich</i> 44ACSR 341; 21 ACLC 450 - One. Tel	Non-executive chair failed to act with proper care and diligence; it also deals with the business judgement rule.	Good Faith and Proper Purpose s 181
2003	<i>R v Rivkin</i> 198 ALR 400; 45 ACSR 366	Insider trading held s 1043A as information that was material and not publicly available was used to buy shares. Court imposed detention and a fine.	Insider Trading s 1043A
2003/2004	<i>ASIC v Plymin</i> 46 ACSR 126; 21 ACLC 700. <i>Elliott v ASIC</i> 10 VR 369; 205 ALR 594.	Breach of statutory duty to prevent insolvent trading. S 588G requires individual directors to take reasonable steps to prevent a company from incurring a debt. Banned from being a director and fined \$25,000 and \$15,000 respectively.	Insolvent Trading s 588G(3)

Table 3. (Con't)

Year	Case Name	Finding/Description	Breach of Law Companies Act 2001
2005	<i>ASIC v Vizard</i> 145 FCR 57; 219 ALR 714	Insider trading breach s 183, in that information obtained as a director that was not publicly available was used for their own purposes to purchase shares in other companies (even though they made losses). Fined \$400,000 and disqualified from being a director for 10 years	Insider Trading s 1043A
2007	<i>Vines v ASIC</i> 55 ACSR 617; 23 ACLC 1387 - GIO	Chief Financial Officer (CFO) duties of care and diligence, s180 negligence, and lack of due diligence in forecasting made public.	Reasonable Care and Diligence s 180
2008	<i>The Bell Group Ltd (in liquidation) v Westpac Banking Corporation (No 9)</i> [2008] WASC 239	Directors' duties to consider the interests of creditors in a restructure for corporate debts. Banks were also found to assist in the directors' breach of duties and were fined.	Reasonable Care and Diligence s 180
2008	<i>ASIC v Narain</i> [2008] FCAFC 120	Misleading information regarding chemicals and claims it could stop spread of disease that was not backed up by medical advice. Managing director was held personally liable for making the statements.	Personal Liability s 588G(2) Reasonable Care and Diligence s 180
2009	<i>Jubilee Mines NL v Riley</i> 253 ALR 673; 69 ACSR 659	Continuous disclosure should be balanced with no misleading or deceptive conduct. Principle of 'when in doubt disclose' should be considered carefully as company should not also mislead the market with incomplete information.	Reasonable Care and Due Diligence s 180
2011	<i>ASIC v Healy</i> 2011 FCA 717 (Centro)	S180(1) directors' breach as inaccurate financial accounts were approved.	Reasonable Care and Due Diligence s 180
2011/2012	<i>ASIC v Fortescue Metals Group Ltd</i> FCAFC 19	Held FMG and Managing Director Andrew Forrest breach of continuous disclosure for engaging in misleading or deceptive conduct concerning ASX releases and investor briefings in relation to signing of framework agreements with Chinese companies. FMG had stated that the agreements were legally binding, when they were not. Overturned on appeal in 2012.	Reasonable care and diligence s 180

Table 4. Timeline of International Corporate Governance Guidelines

Date of Issue	Document Name	Event (If Any)
1800 BC	Code of Hammurabi	
1991	Bosch Committee – Corporate Practices and Conduct (reissued in 1995)	To prevent such collapses from the 1980s such as Bondcorp and Quintex
1992	Cadbury Committee Report (UK)	Maxwell Insurance and Polly Peck Collapses
1993	Hilmer Report (Australia)	Following from Bosch Committee reports
1995	Vienot Report (France)	
1995	Toronto Stock Exchange recommendations on Canadian Board practices (Canada)	
1996	Report on Corporate Governance in Hong Kong (HK)	
1997	King Report (South Africa)	
1997	Netherlands Report (Netherlands)	
1998	Hampel Report (UK)	Following from Cadbury Committee
1998	Olivencia Report (Spain)	
1999	OECD Principles of Corporate Governance	For non-corporate entities such as universities
2001	Ramsay Report (Australia)	Hilmer Report, Collapses of HIH and OneTel
2002	Sarbanes Oxley Act 2002 (US)	From collapses of Enron and WorldCom
2003	Combined Code on Corporate Governance (UK)	From Hampel Report findings
2003	ASX Good Corporate Governance and Best Practice	From OECD guidelines and Ramsay Report
2003	AS 8000 - 2003 Standards (Australia)	
2004	Clerp 9 Act 2004 (Australia)	From Ramsay Report
2004	Corporate Governance in New Zealand Principles and Guidelines (NZ)	
2010	Corporate Governance Principles & Recommendations with 2010 Amendments (ASX)	From review after the Global Financial Crisis
2012	UK Corporate Governance Code	

Particularly after the corporate collapse era of 2000s, and the global financial crisis, many countries have adopted some form of governance code such as that of the Corporate Governance Council of Australia, with their Best Practice Recommendations for listed companies on the Australian Securities Exchange (2010). These principles are recommendations only and are based on the ‘if not why not’ explanation by companies. They are not a one-size-fits all governance regime. Although these are recommendations only, for listed companies in Australia, listing rule 4.10 dictates that companies must address each of these governance initiatives, and explain if they have not adopted the recommendation (if not why not).

In particular for listing companies in Australia it is important to attempt to link the Corporate Governance recommendations by the ASX 2010 to that of their *Corporations Act 2001* Directors’ Duties obligations as shown in Table 5.

It is interesting to see that all eight corporate governance recommendations by the ASX (2010) can be aligned with a specific piece of legislation in relation to directors’ duties by the *Corporations Act 2001*.

Table 5. ASX Recommendations (2010) and CA (2001)

ASX CG Principle	<i>Corporations Act 2001</i>
Principle 1 <i>Lay solid foundations for management and oversight</i>	Reasonable Care and Diligence s 180 Good Faith and Proper Purpose s 181
Principle 2 <i>Structure the Board to add value</i>	Good Faith and Proper Purpose s 181 Personally Liable s 588G(2)
Principle 3 <i>Promote ethical and responsible decision-making</i>	Reasonable Care and Diligence s 180 Criminal Liability s 184
Principle 4 <i>Safeguard integrity in financial reporting</i>	Reasonable Care and Diligence s 180 Criminal Liability s 184
Principle 5 <i>Make timely and balanced disclosure</i>	Conflict of Interest s 182 Confidential Information s 183 Reasonable Care and Diligence s 180
Principle 6 <i>Respect the rights of shareholders</i>	Insolvent Trading s 588G (3) Insider Trading s 1043A Good Faith and Proper Purpose s 181
Principle 7 <i>Recognise and manage risk</i>	Insolvent Trading s 588G (3), Insider Trading s 1043A, Good Faith and Proper Purpose s 181, Reasonable Care and Due Diligence s 180, Conflict of Interest s 182, Confidential Information s 183
Principle 8 <i>Remunerate fairly and responsibly</i>	Reasonable Care and Diligence s 180

1.4 Discussion and Conclusion

RQ1: What are the relevant pieces of legislation that relate specifically to directors' duties in Australia?

We can see that the main areas for Directors Duties in the *Corporations Act 2001* are:

- Reasonable Care and Diligence (s 180)
- Good Faith and Proper Purpose (s 181)
- Conflict of Interest (s 182)
- Use of Confidential Information (s 183)
- Insolvent Trading (s 588G) (3)
- Insider Trading (s 1043A)

Breaches of these can potentially make directors personally liable (s 588G) (2) and could result in criminal liability (s 184). Directors should also be aware of the Business Judgment Rule, s 180(2) which states that officers of a company are compliant with s 180(1) if they made a judgement in good faith for a proper purpose, they do not have any material personal interest, they inform themselves about the subject matter to a reasonable level and they rationally believe that the judgement is for the best interests of the corporation.

RQ2: What current case law has involved the issue of directors' duties in Australia?

As shown by Table 3, case law is still a significant determinate to clarify the current *Corporations Act 2001*, and will continue to be. For example, as recently as 2012, the case of *ASIC v Fortescue Metals Group Ltd* FCAFC 19 held that Fortescue Metals Group (FMG) and Managing Director Andrew Forrest were not in breach of continuous disclosure for engaging in misleading or deceptive conduct concerning ASX releases and investor briefings in relation to signing of framework agreements with Chinese companies. FMG had stated that the agreements were legally binding, when in fact they were not. Case law will continue to be active in Australia to make sure that directors are aware of their duties and that breaches will be investigated by ASIC in the court system.

RQ3: Can we align the Directors Duties Legislation (Corporations Act 2001) to that of the ASX Corporate Governance Principles (2010)?

In fact, all eight ASX (2010) corporate governance recommendations can be aligned to the legislation stated in the answer to research question 1, showing that directors' duties in the legislation can be a compliment in relation to the applicability of corporate governance regimes, and visa versa.

To answer then the research problem of whether the current *Corporations Act 2001* for directors' duties align with the ASX 2010 corporate governance principles, it can be seen then that they do in fact relate to each other, although some corporate governance mechanisms can and do share several pieces of legislation specifically related to directors duties, however they are not in complete isolation of each other. Directors of all entities in all sectors (for-profit and not-for-profit) should then be clearly aware of their duties as imposed on them by *Corporations Act 2001* and aware of their obligations under listing rule 4.10 for Corporate Governance for listed companies on the ASX. They should also be aware of current or pending case law decisions in relation to the carrying out of their duties as directors.

Directors' duties then are imposed on all Directors of all entities with serious consequences for breaches both on a civil or criminal basis. This research has shown that corporate governance may mean different things to different entities, but the *Corporations Act 2001* is applied to ALL directors of ALL entities and is part of corporate governance compliance (ASX 2010). Adams (2004) describes corporate governance as being not unlike a beauty and a beast, and that Directors who wish to do 'good' involve at least due diligence, compliance and corporate governance. All these recommendations, however, only add more to the burden already held by Directors both paid and voluntary. Like the rhyme of the Ancient Mariner (Coleridge 1798), case law, legislation, recommendations, etc. are not unlike the description of the mariners on the boat at sea, surrounded by the sea water, when the mariner is thirsty,

*Water, water, everywhere,
And all the boards did shrink;
Water, water, everywhere,
Nor any drop to drink.*

Directors of all Boards then, need to be vigilant, aware of their obligations, fully informed and ethical in all decisions they make for and on behalf of their boards. The last thing they would want to see is their company in the courts, and their decision questioned by a judge.

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A U T H O R P R O F I L E

Dr Lisa Barnes' area of research is in business studies, particularly in Accounting, Corporate Governance and Social Responsibility. She has published 8 book chapters, 18 refereed journal articles, presented papers at 27 conferences (7 international), and published 2 books. She is currently the external engagement officer for the Newcastle Business School, Newcastle University, and has formed strong relationships with local business. Email: Lisa.Barnes@newcastle.edu.au