# CORPORATE GOVERNANCE - IS THIS THE ANSWER TO CORPORATE FAILURES?

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*The financial collapse of a number of very large companies overseas and in Australia in recent years has led to increased calls for stronger corporate governance rules to improve the rights of shareholders. Corporate governance, whilst a critical and important development in our corporate law, if over-relied on can in fact lead to unnecessary tensions and conflict with the rules of the common law and the Corporations Act 2001 (Cth), with potentially dire consequences for company directors and officers. Our courts should be prepared to provide a more sensitive and sensible interpretation of the law to overcome the too ready reliance on tortuous and lengthy legislative over-reaction or soft non-binding rules which may confuse rather than assist the regulatory regime.*

## I INTRODUCTION

Corporate governance issues have attracted unprecedented levels of interest in Australia in recent times. The collapses of companies such as HIH, One.Tel and Ansett Airlines (amongst others in Australia), and Enron and WorldCom in the United States, have sharpened demands from the public to increase the accountability of company directors and executives when major organisations fail financially. In addition, some of these cases and other company reports have illustrated that directors and executives have been paid huge salaries and other forms of remuneration at a time when the relevant company is suffering financially or is in financial difficulty.

One response has been to increase the role of corporate governance. Another has been some quick legislation or broader reforms such as proposed by the CLERP (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) (referred to as the '*Bill*' or the '*CLERP 9 Bill*'). The results have been that corporations and their officers have been introduced to a complex matrix of governance requirements which interact with each other and with community expectations in varied and potentially contradictory ways.

These developments commenced in a sense with the *Criminal Code Act 1995* (Cth) (the '*Criminal Code*')[1] which, in essence, was passed before the recent corporate collapses but only came into law later. The next set of crises arose because of the inability of companies to meet the payments due to employees

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1 This Code only became effective in December 2001, even though enacted in 1995.

when the companies collapsed. This raised very interesting questions of whether directors owed duties to employees (there is a specific statutory provision in the UK which raises this is as a critical factor that directors must take into account).[2] Although there is no such duty in Australia in the *Corporations Act 2001 (Cth)* ('*Corporations Act*'), the Government enacted the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth) in 2001. This legislation raised a series of issues, some of which are considered in a paper that I presented to the annual conference of the Banking and Financial Services Law Association on 6 June 2002, parts of which I have revised and incorporated into this article. The issues raised were again highlighted by the HIH/One.Tel disasters;[3] apart from the corporate governance questions thrown up by these collapses, more specific questions surrounding payments to certain employees and the payments of bonuses to directors have led to further legislative initiatives.[4]

It was felt, however, that merely enacting black letter law legislation to deal with these issues was an inadequate approach to the relevant problem even though in the United States the Sarbanes-Oxley legislation highlighted such an approach. The development of a culture of compliance, and the need to ensure that directors and their companies were reflecting on the broader responsibilities that those organisations owed to the community (as well as to employees) in a number of different senses, have been instrumental in much of the current push. This is illustrated in part by the Australian Stock Exchange ('ASX') introducing what are in essence semi-binding amendments[5] to their listing rules entitled *Principles of Good Corporate Governance and Best Practice Recommendations* ('ASX Guidelines').[6] Even that initiative was regarded as inadequate by some politicians. The federal Government has been under constant pressure to enact additional legislation. This was foreshadowed, following the collapses of HIH and other companies, in the CLERP 9 Discussion Draft[7] which has now been converted into the Bill referred to earlier. It is expected this legislation, which was tabled in the Commonwealth Parliament on 04 December 2003, will be passed by the federal Government in the first half of 2004.

There is little doubt that the main method of ensuring compliance with rules, whether we want to call it corporate governance or rules of the law, is via the common law and the *Corporations Act*. This legislation provides the framework against which the Australian Securities and Investments Commission ('ASIC') and, in the context of listed companies, the ASX, are working with the Director

2 See *Companies Act 1985* (UK) s 309(1).

3 See also Celia Hammond, 'Insolvent Companies and Employees: The Government's Year 2000 Solutions' (2000) 8 *Insolvency Law Journal* 86 and note also the very interesting examination of these issues by J Hill, 'At the Frontiers of Labour Law and Corporate Law: Enterprise Bargaining, Corporations and Employees' (1995) 23 *Federal Law Review* 204.

4 *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth).

5 The Listing Rules are intended to be binding both contractually and through the operation of s 793C, and to a lesser extent, s 1101B of the *Corporations Act 2001* (Cth).

6 These Guidelines were introduced by an amendment to the Listing Rules to take effect from 31 March 2003.

7 Corporate Disclosure - Strengthening the financial reporting framework containing proposed amendments to the Corporations Act.

of Public Prosecutions ('DPP') in appropriate cases. to ensure that companies comply with the relevant rules.

The 'story' of enforcement of the provisions in the *Corporations Act*, which carry modest penalties for breach,[8] has been an uneven one on the part of both ASIC and the DPP. The ASX has adopted an almost non-interventionist role in dealing with the failure of companies to comply with its Listing Rules; it has quite responsibly referred relevant matters to ASIC to pursue individual cases. The early history of enforcement by ASIC has in part been affected by the difficulty that ASIC had previously experienced in pursuing directors and officers for breaches of the relevant statute where it had relied on criminal sanctions. With the introduction of a civil penalty regime into the *Corporations Act* in 1993, ASIC has, in a sense, been far more active and successful in pursuing directors and others who have breached the legislation with some high profile examples in recent years. But even this area of regulation has been the subject of concern because of the reluctance of some courts to treat relevant cases as governed by the criminal rules of pleading and evidence.[9] Despite these 'setbacks', ASIC has boasted a number of successful prosecutions involving the directors of the HIH organisation,[10] and this has been coupled with some recent high profile insider trading cases - *R v Hannes*[11] and *R v Rivkin*.[12]

Other decisions from time to time have seen the courts relying more heavily on a black letter law approach to the interpretation of the statutes and the rules of evidence. This in turn has influenced the more frequent reliance on self-regulation highlighted by the ASX Guidelines and now by a number of initiatives in the context of the *CLERP 9 Bill*. In this article, I will also discuss some of these difficulties before reviewing other problems thrown up by the increasing reliance on corporate governance and self-regulation best illustrated by the rules of corporate governance which have been receiving the most recent attention.

## II A CONTRAST IN JUDICIAL INTERPRETATION - TWO HIGH PROFILE CASES

To illustrate the frustration that can sometimes arise in pursuing high profile litigation through the courts where the regulator needs to rely on the evaluation of the specific statutes, I discuss two recent cases: *Whitlam v ASIC*[13] in the New South Wales Court of Appeal and *Macleod v R*[14] in the High Court of Australia.

The *Whitlam* case concerned a high profile New South Wales organisation (a company limited by guarantee), about which I will be commenting further in this

8 The *CLERP 9 Bill* will increase penalties to a maximum of $1 million for companies.
9 See Middleton, 'The difficulties of applying civil evidence and procedural rules in ASIC's civil penalty proceedings under the Corporations Act' (2003) 21 *Company and Securities Law Journal* 505.
10 *ASIC v Adler & Ors* (2002) 168 FLR 253.
11 (2002) 173 FLR 1.
12 (2003) 198 ALR 400.
13 (2003) ACLC 1259 ('*Whitlam*').
14 (2003) 197 ALR 333 ('*Macleod*').

article in a different context. In this case, ASIC was seeking to ensure that the Chairman of Directors (Whitlam), amongst others, carry out his obligations in relation to the voting of certain proxies at a meeting of the company. The interpretation of certain provisions of the *Corporations Act* by the New South Wales Court of Appeal has resulted in some criticism of the black letter law approach of the Court to the provisions of the *Corporations Act* (although an appeal is pending in the High Court of Australia).

In the second case, *Macleod*, the High Court appeared to adopt a softer and more proactive approach in interpreting what was, in effect, a criminal statute.

### A *The Whitlam* Case

At first instance in *ASIC v Whitlam & Ors*,[15] Gzell J of the New South Wales Supreme Court held that Nick Whitlam, the Chairman of the National Roads and Motorists' Association ('NRMA') had been in breach of certain duties in relation to the exercise of proxies that were given to him in relation to a general meeting held on 28 October 1998. As noted earlier, the NRMA is a very high profile organisation with a history of highly publicised disputes involving corporate governance issues. Indeed, in other cases dealing with the allegation that directors had leaked confidential discussions and papers involving directors' meetings to the public through the Sydney Morning Herald, the allegations led to some high profile litigation in the New South Wales Supreme Court and Court of Appeal in two cases.[16] Any request for proxies to be given to a director (or more specifically, a Chairman of Directors) in such an organisation in particular, would have been widely anticipated by members of the NRMA, as requested, and would have been observed by the directors or the relevant person.

However, ASIC, in its statement of claim, alleged that Whitlam had failed to sign a poll paper with respect to some 3,973 proxy votes directing him to vote against a particular resolution which concerned remuneration of directors. On the basis of legal advice received at the time of the relevant meeting, the returning officer of the meeting refused to count the votes, with the effect that the amendments to the articles were initially passed. However, later, as a result of further advice, the votes were counted and on the recount the resolution was defeated. This meant that, in effect, the wishes of those members who had wanted the resolution defeated were, in fact, 'granted'.

ASIC alleged that Whitlam had deliberately failed to sign the proxy paper in respect of these votes and that he was in breach of s 250A of the *Corporations Law* (now the *Corporations Act*). This section requires the person given the proxy to vote in the way directed by the member/shareholder. ASIC also alleged that Whitlam had breached s 232(4), 232(2) and 232(6) of the *Corporations Law*[17] - namely that he had not acted honestly, that he had acted without appropriate care

[15] (2002) 42 ACSR 407.

[16] *NRMA v Geeson* (2001) 39 ACSR 401 (affirmed on appeal in (2001) 40 ACSR 1) and *NRMA v Fairfax* [2002] NSWSC 563 (Unreported Macready M, 26 June 2002), these cases are discussed below in section III.

[17] The equivalent to ss 180, 181 and 182 of the *Corporations Act*.

and diligence, and that he had made improper use of his position as a director. As noted earlier, Gzell J held that Whitlam had committed a number of breaches of the *Corporations Law*. In the first place, he held that Whitlam, by failing to sign the poll paper, had acted in a deliberate and pre-meditated way which was in breach of s 250A of the *Corporations Law* (which is a mini code regulating the way in which proxies are to be voted). He also ruled that the behaviour constituted breaches of directors' duties under the relevant provisions of the *Corporations Law* referred to above. As a result of these findings, Gzell J at a later hearing, disqualified Whitlam from being a director for a number of years. Whitlam appealed, and the New South Wales Court of Appeal reversed those rulings.[18]

In effect, the Court of Appeal held that whilst Whitlam may have behaved in a strange fashion (and I shall return to the comments of the Court on this issue shortly) he was in fact not guilty of a breach of his duty to act as a director in dealing with the proxies. In the Court's view, there was inadequate evidence to support a finding that Whitlam had breached the *Corporations Law* and that therefore the disqualification and the orders made by the Court in relation to penalty were reversed.

The decision of the New South Wales Court of Appeal has caused an enormous reaction in the general community. The *Australian Financial Review* in its editorial on 15 July 2003 suggested that the decision 'defies common sense, and is out of step with modern understandings about corporate governance and duties of directors and chairmen'.

The concerns that the community has with issues of corporate governance and related matters (matters to which I will return shortly) suggest that such an interpretation is unacceptable. However, although the *Australian Financial Review* agreed that the decision may not have been wrong in a strict sense on the law (because of some of the issues I will discuss below) it felt that the case, or the law underpinning it, needed review - a result that will not now occur, at least in relation to this matter, as ASIC has withdrawn its appeal to the High Court.

When a person who is the chairperson/director of a company seeks proxies, on behalf of the company, in relation to a meeting that is to be held, should the law impose on that person additional obligations which relate to his or her position as a director, or indeed as the chairperson (assuming that this might carry with it additional duties to that of a normal director)? Or is the Court of Appeal correct in suggesting that the only obligation on the person is that of an agent exercising the duties of an agent in the normal course?

The duties of an agent are of course (in a sense) quite different from that of a director. It had been argued by Whitlam that simply because a person became a chairperson of a company or a meeting, did not mean that in carrying out those duties that person was obliged to behave as though he or she were a director of a company. Gzell J at first instance, whilst acknowledging that the duties of a chair

[18] (2003) 46 ACSR 1.

of a meeting might be different from the duties owed by a director of the company, noted:

> That does not mean, however, that the duties of a chairman are mutually exclusive or that a breach of the *Corporations Law* section 250A [now section 250A of the *Corporations Act*] cannot also constitute a breach of [the relevant provisions of the *Corporations Act*].

His Honour held that there were no decisions he could find that obliged him to reach a contrary decision.[19]

Gzell J later noted that a director of a company did not cease to be a director simply because he or she chairs a meeting of the company and that indeed it was important that the director who was the chairman continued to observe all of the obligations cast upon that person.

The Court of Appeal, in evaluating the relevant issues, reached a different conclusion to Gzell J on this issue - that is, whether Whitlam owed duties as a director in carrying out his role as a proxy holder. The Court noted:

> The primary judge was correct to say that a director did not cease to be a director because he or she chairs a meeting of members; and indeed the circumstances that a director is acting as chairman or in any other role does not necessarily mean that he or she is not at the same time exercising a director's powers or discharging a director's duties. But he or she might not be doing so: not everything a director does that affects his or her company is an exercise of a director's powers or a discharge of (or even governed by) a director's duties.[20]

It was also suggested by the Court that Gzell J was wrong in concluding that a director who had been appointed a proxy to vote was acting as a director. In the Court of Appeal's view, the fiduciary duties that a chairman owed were not to the company but to the individual member appointing the director. It added these words:

> In addition, the director is subject to statutory requirements, such as those of s 250A that we have considered, but only in his or her capacity as proxy, not as a director. Further, these duties and requirements are not duties owed to the company: the fiduciary duties are owed to the particular member who appointed the director as proxy, and the statutory requirements do not appear to give rise to any duty owed to any legal entity other than that member and/or the State.[21]

Furthermore, the Court highlighted the potential conflict that might arise by suggesting that where a member directed the proxy to a person, who happened also to be a director, to vote in a way that the director might believe was not in the best interests of the company, the director would be obliged to vote in the way in which the proxy directed that person. In doing so, the Court of Appeal added

19 See (2002) 42 ACSR 407, [147].
20 (2003) 46 ACSR 1, [150].
21 Ibid [152].

that the director in such a case would not normally be in breach of the director's duties to the company.[22]

Indeed, one could analyse the Court of Appeal's discussion on the basis that the director was merely acting in an administrative capacity. Furthermore, the duty of a shareholder (or a representative of a shareholder) to consider decisions affecting the company is governed by a very different set of rules to those which govern the role of a director. A shareholder can be selfish in considering his or her own interests ahead of those of the company in appropriate circumstances. Accordingly, a person who is appointed as the representative of that shareholder could also take into account those selfish considerations ahead of the interests of the company.

Had ASIC pleaded its case differently, a different result might well have been reached by the Court of Appeal. In this context, the Court noted:

> The court raised ... the possibility that [Whitlam owed a duty] as a director to the company to make an appropriate contribution to the proper running of the annual general meeting, and in particular to the carrying out of voting procedures, and a duty not to subvert those procedures; and that a deliberate attempt to subvert those procedures would be a breach of that duty as a director. Viewed in that way, while [Whitlam] certainly had a duty as a fiduciary to the proxy givers to act in accordance with their directions, he may also possibly have had a duty to the company, in so far as he was a director having some control over the voting procedures, not to subvert those procedures. If so, both duties would have required him to vote as directed.[23]

This high profile case then was considered in a different context by the Court of Appeal. It recognised that it was dealing with a very unusual organisation - a company like the NRMA (which I have noted earlier had been the subject of other judicial comments from the New South Wales Courts) where, in some respects, some judges feel the director would not only be serving the company in carrying out his or her duties but perhaps also occupying a public position. In any event, the Court of Appeal added these interesting comments:

> When a director does so, particularly where the company has held out to members that a director will act as their proxy, it could be argued that the director then has the dual role of agent for the particular members and director serving the company. In those cases where a member gives no direction how to vote, it may be the case that the director must cast a vote bona fide in the interest of the company, so that there would be no difficulty in seeing this as an exercise of the director's duty. Where the member does give a direction of how to vote, the director's duty as agent for the member would generally require that this direction be followed, even if the director does not think it in the interests of the company; but it could possibly be argued that this does not mean that the casting of a vote is not a discharge of a director's duties, because

22 Ibid [153].
23 Ibid [160].

> the director has a duty to serve the company by acting faithfully as proxy (so that the company fulfils what it has held out to members), which displaces any duty as director to consider how the vote itself would affect the interests of the company.[24]

Having tantalisingly raised this particular question, the Court did not answer it. In my view, the decision of the New South Wales Court of Appeal is a strange one. It highlights the interactions in the statutory interpretation that I alluded to earlier. It also highlights the need for ASIC, or indeed, any litigant, to be very careful in how they approach a particular case or a particular prosecution. It properly, in my view, reflects the position that if a penalty provision of the statute is being pleaded, it is appropriate for the relevant tribunal to ensure that the basic elements of the breach have been established by the prosecutor. If, on the other hand, we are dealing with a civil penalty for a damages action, whilst the onus may not be quite so high, a similar obligation is, in my view, imposed on the regulator or the plaintiff to make sure that the relevant crucial elements are established. Does this mean, however, that every 't' has to be crossed and every 'i' dotted? To a certain extent, this question was reflected (but not necessarily answered) by certain comments made in conclusion of the case by the Court of Appeal where it noted:

> The result is not entirely satisfactory. On the one hand, we are not able to find that [Whitlam] did not deliberately fail to sign the poll papers. On the other hand, the effect of dismissing the proceedings is to rule out the possibility that the [defendant] ... will be subject to being precluded from being a director of a corporation or corporations; and this could be considered as not being in the public interest in circumstances where the question of whether or not the failure to sign was deliberate has not been properly determined.[25]

As I have suggested earlier, the decision is an unsatisfactory one in many respects. The interpretation of statutory provisions of this kind can, in extreme circumstances, lead to over-regulation with amendments being promulgated for legislation which are probably unnecessary. Whilst I sympathise with the proposal that a person should not be unduly dealt with by the law unless the statutory provision under which that person is to be charged is clearly identified and pleaded, the intended legislative provisions may need to be considered more sensitively by courts when the aims of the legislation appear to have been frustrated by a technical and narrow interpretation. If the facts suggest that the major elements of the prohibition or breach have been established by the regulator (or by the civil plaintiff in the claim for damages), it is counterproductive if a court appears to bend over backwards to find a technical basis for avoiding a common sense or a policy interpretation of the statute.

[24] Ibid [161].
[25] Ibid [170].

### B *The Macleod Case*

The facts of *Macleod*[26] are fairly straightforward and need not occupy much time. In essence, certain charges were brought against Macleod, who was the person responsible for establishing three different companies: TrainEx Pty Ltd; Starlight Film Studios Limited; and Communications Entertainment Network Limited. Macleod was a director of the companies at all relevant times, save for a brief period when he was only their secretary. He was in fact the only shareholder in one of the companies, TrainEx. A scheme was promoted by TrainEx, which appeared to be the lead company, and several thousand investors contributed to that scheme. In due course, however, the companies, which were initially established to make movies, either lost the relevant funds or, as was alleged by the Crown, the funds were misappropriated by Macleod. It brought proceedings against him under s 173 of the *Crimes Act 1900* (NSW). The relevant provisions of this section are:

> whosoever, being a director ... or member of any body corporate ... fraudulently takes, or applies, for his own use or benefit, or for any use or purpose other than the use or purpose of such body corporate ... or fraudulently destroys any of the property of such body corporate ... shall be liable.

The Crown alleged that more than $2 million of the monies invested in the company (totalling over $6 million) had been applied by Macleod for his own benefit. Whilst investors were furnished with certain income statements (creating an illusion that films were being made and profits were being generated), the fact of the matter was that Macleod was expropriating the property for himself.

In a jury trial, Macleod was convicted of fraudulently applying company property. The New South Wales Court of Criminal Appeal upheld the conviction. On appeal to the High Court, Macleod argued that a director of a company cannot be guilty of fraudulent application of a company's property if:

(1) he is the controller of the company; or
(2) he consents to the transfer of the property.

In doing so, Macleod relied heavily on a decision of the Victorian Court of Criminal Appeal in *R v Roffel*.[27] Although the statute being considered in *Roffel* was different to the New South Wales statute, it led to quite an extraordinary result in my view.[28]

In three separate judgments (Gleeson CJ, Gummow and Hayne JJ; McHugh J and Callinan J), the High Court dismissed the appeal. In doing so, some of the judges distinguished *Roffel* while others simply stated that it was incorrectly decided. Each of the judgments recognised that a company was a separate legal entity from its founders, shareholders, etc (embracing the standard judicial authority in

[26] (2003) 197 ALR 333.
[27] [1985] VR 511 ('*Roffel*').
[28] See Bob Baxt, 'Company law - stealing from one's own company - House of Lords disapproves of Victorian Full Court decision' (1993) 67 *Australian Law Journal* 696.

*Salomon v Salomon & Co*)[29] and should therefore be distinguished from the persons who are involved in the company. In these circumstances, the question is, as put by McHugh J, can a person be

> guilty of fraudulently applying property contrary to section 173 [of the Crimes Act] if that person is the controlling mind of and the only person beneficially interested in the company.[30]

McHugh J believed that a person could be convicted, even though that person was the controlling mind and the sole shareholder of the company.[31] Obviously, important questions as to the meaning of the word 'fraudulently' and other issues arose in this case, but in the context of the approach taken to the duties in the Act, the questions put by both McHugh and Callinan JJ are important.

McHugh J answered the fundamental question in the following words:

> In [*Salomon's case*] the House of Lords unequivocally ruled that even if a company is in essence a one-person business, no question of agency or trusteeship arises between the company and its controller. The company has the legal and beneficial title to its property. While legislative restriction on fraudulent trading by agents, trustees and directors in property entrusted to them for a particular purpose pre-dates the emergence of the separate legal entity concept, the current provision must be read in light of the dichotomy between the company and those who are its shareholders.[32]

These words may be trite in some respects, but it is surprising that they were not applied in that sense by the Full Court of the Supreme Court of Victoria in *Roffel*. He then noted that even where the shares of the company are closely held, the interests of the company are not synonymous with the intentions of those persons who are in control:

> Even if all the shareholders are officers of the company and consent to the taking of the company's property, one or all of them can be guilty of an offence or offences against section 173 of the [*Crimes Act*].[33]

He ruled that *Roffel*, which had been relied on by Macleod, had been wrongly decided and favoured the decision of the dissenting judge in that case, Brooking J. In my note in the Australian Law Journal referred to earlier, I highlighted the fact that the decision might have been correct on a strict legal interpretation but not one that I favoured. Fortunately, the judges in this case have now recognised that such a strict legal interpretation is inappropriate.

Callinan J, in his separate judgment, made these rather interesting observations about the nature of a company and its officers and shareholders:

29 [1897] AC 22.
30 (2003) 197 ALR 333, 346.
31 But of course, similar questions can be asked in relation to misusing one's position or power in breach of ss 182 and 183 of the *Corporations Act*.
32 (2003) 197 ALR 333, 348.
33 Ibid.

> A director or officer acting in breach of his obligations under statute law relating to companies, or in breach of its [constitution], by using the money of a company for his own purposes is no more the voice or the amanuensis of the company, as between himself and the company, than a thief who gains access to its treasury and steals money from it, or a forger who forges a company cheque in his own favour.[34]

The interpretation must surely be one that would be applied in dealing with ss 182 and 183, even though they are not criminal provisions, although criminal prosecutions can be brought in relation to these provisions in appropriate circumstances.

Justice Callinan also made one other interesting comment which shows how difficult it is for criminal provisions to be interpreted:

> Although the appellant was not charged with defrauding the investors, the way in which the money was raised from, and was held and applied for their benefit by the company, necessarily meant that the effect of the appellant's dealings [with the relevant property] could not be divorced from an assessment of the appellant's state of mind, and the nature of his conduct in dealing as he did with the money [to which the company had title]. In this matter, as will often be the case, a dishonest state of mind in respect of one aspect of an offence ... will inevitably colour another element ... It does happen from time to time that the conduct of an accused might constitute more than one offence, or that it might render him criminally liable for a different offence, or in addition to the one with which he has been charged. In these circumstances, the prosecution may, in general, choose which charge or charges should be laid. The possibility of a formulation of a charge different from the one with which the accused is charged, does not mean that facts and circumstances of greater, or more direct relevance to the uncharged offence, are irrelevant to the charge of defence.[35]

When we deal with criminal sanctions, and the courts are forced to assess language according to the dense drafting techniques that are sometimes adopted, we can often reach results that create disbelief and incredulity in the community. Such was the response to the decision in *Roffel*. Nevertheless, that is the nature of our common law system and the nature of the interpretation of our legislation so that decisions like *Macleod* are to be welcomed as an indication that the courts will, in appropriate circumstances, review these matters in a more progressive or proactive manner.

The chance that the courts will not do so, or that we will get results such as those in the *Whitlam* case which, whilst technically supportable, raise commercial and other incredulity, means that there will be more and more reluctance to rely on the criminal sanctions in statutes. It is therefore surprising, in this context, to see an organisation such as the Australian Competition and Consumer Commission

[34] Ibid 359.
[35] Ibid 362.

championing criminal sanctions as opposed to civil sanctions in relation to the *Trade Practices Act 1974* (Cth) - even though the absence of criminal sanctions in relation to cartel behaviour, etc is not something that should be supported.

ASIC, and other regulators, are now pursuing with greater vigour breaches of the law that raise significant matters of community interest. Decisions such as the High Court decision in *Macleod's* case may well encourage litigation based on the criminal rather than civil sanctions.

The so-called black letter law approach to statutory interpretation which dominated the regulation of corporations in the 1980s and 1990s has of course had a number of other repercussions. Rather than adopt a more generalised approach to legislation that was illustrated by the original *Trade Practices Act 1974* (Cth), and by other commercial legislation such as the *Partnership Act* and similar legislation, there has been a penchant for tortuous and precise legislative drafting in the corporations law area equivalent to the approach adopted to the *Income Tax Assessment Act 1936* (Cth) (as amended) following the spate of unsuccessful cases brought under the old s 260 (now pt IVA of the taxation legislation). It is not my intention to go into the pros and cons of black letter law drafting in this article. I have hopefully illustrated that courts can, with a degree of flexibility, adopt a more pro-active approach to the legislative interpretation with positive results for the community. If courts continue to adopt a strict black letter law approach to legislation, especially corporate legislation, then the almost fatal consequences for the regulation of Australian corporate life may be a feature of future development.

## III SHOULD THERE BE MORE REGULATION OR SELF-REGULATION? PRINCIPLES OF CORPORATE GOVERNANCE OR BLACK LETTER LAW?

The extraordinary corporate collapses referred to earlier, led in part to a strident reaction in many parts of the world with perhaps the most amazing reaction being in the United States of America where the Sarbanes-Oxley legislation was enacted. In many respects, it adopted the most prescriptive black letter law approach to corporate regulation seen in the United States for many years. The Australian government has been more cautious in responding to the collapses that have occurred here. After commissioning Professor Ian Ramsay of the University of Melbourne[36] to undertake a report on issues of accounting and auditing practice, the government awaited the balanced and, in my view, responsible report of the Royal Commission into the collapse of HIH ('Owen Report').[37] Now, the *CLERP 9 Bill* continues with what is basically a more constrained approach by government in dealing with concerns relating to insolvent trading, continuous disclosure and other matters of relevance.

[36] Ian Ramsay, *'Disclosure of Fees and Charges in Managed Investments: Review of Current Australian Requirements and Options for Reform'* released 25 September 2002.

[37] The Hon Justice Owen: *'Australia. HIH Royal Commission: The failure of HIH Insurance'* released 4 April 2003.

The most difficult matter the Australian Government has had to face has been the extraordinary pressure that has been placed on it, and on those involved in the management of corporations, in relation to disclosure of executive salaries. The passion that this issue has generated in the form of debate is nothing short of remarkable in my view.

The *CLERP 9 Bill* has dealt with this issue in a number of very interesting ways. Apart from continuing to require more responsible and detailed disclosure in relation to the financial affairs of the company, there have also regrettably been some further initiatives taken in this legislation reflecting political and other pressures. The decision to vest non-binding powers on shareholders on matters relating to executive salaries is an exercise in popular vote catching in my view. More troubling is the decision to vest some rather extraordinary powers on ASIC to issue 'infringement notices' (including the imposition of fines) for breaches of the continuous disclosure regime. This power, the so-called fining power, is an example of inadequate evaluation of the basic problems in this area. It is very disappointing and frustrating that the recommendations of the Australian Law Reform Commission ('ALRC') in its Report No 95, *Principled Regulation: Civil and Administrative Penalties in Australian Federal Regulation* (March 2003), have not even been considered, let alone discussed, in dealing with this issue.[38]

This reaction, together with a growing tendency to rely on self-regulation and community criticism to influence the more effective and responsible management of companies, whilst it may work in some circumstances and may appear laudable on its face, will not achieve the desired result. In fact, these forces may result in these initiatives backfiring. Apart from the fact that the Government is placing more and more responsibility on ASIC (and to a certain extent on the ASX) there is inadequate evidence, in my view, that the Government has devoted the appropriate resources to the regulators to deal with these relevant issues.

I will return briefly to the *CLERP 9* initiative, the so-called fining power, later. But in this part of the article I want to discuss the very interesting problem resulting from reliance on rules of corporate governance which are underpinned by the highlighting of social responsibility on the part of directors. This trend can place directors in an extraordinary position of conflict. The issues are best illustrated by the recent decisions in the NRMA cases which I have mentioned briefly earlier.[39]

It is important, in considering these cases, to remember that the duty of company directors is owed to the company - the members as a whole (or the hypothetical shareholder or member) rather than particular interest groups. Suggestions made in earlier cases that duties might be owed to creditors have almost certainly been

[38] See below n 82 for further comments on this issue.

[39] *NRMA Limited v Geeson & Ors* (2001) 40 ACSR 1 (affirming [2001] NSWSC 832) (*'Geeson'*) and the later unusual decision of Master Macready in *NRMA v John Fairfax* (2002 NSWCA 563 (Unreported, Macready M, 26 June 2002)) to which I referred briefly earlier in this article (collectively *'NRMA cases'*).

dispelled as a result of the High Court of Australia decision in *Spies v R.*[40] I shall also return to comment briefly on that decision and the implications for litigation involving company directors later. It is appropriate at this point to provide you with a brief background to the *NRMA cases* (much of this is taken from my unpublished paper referred to earlier).

### A *The Geeson Case*

In *Geeson*,[41] the NRMA sought an injunction restraining the four defendants (Stewart Geeson, Anne Keating, Jane Singleton (who were directors of the company) and John Fairfax Publications) from publishing or otherwise disclosing information in relation to an NRMA board meeting on 17 September 2001. During this board meeting, the President of NRMA (Nick Whitlam) sought an undertaking from the board members not to disclose certain information which the NRMA regarded as confidential.

The three defendant board members declined to provide that undertaking. NRMA applied to the Supreme Court of New South Wales for an injunction preventing the disclosure of all board papers or other papers read during the board meeting by the three directors.

At first instance, Bryson J refused the NRMA application. He held that by declining to give an undertaking the directors were not, in the circumstances, threatening to communicate such information. While his Honour found that there were reasonable grounds to believe that Ms Keating would disclose part of the discussions relating to occupation of the chair at the meeting, it appeared that the NRMA Directors Code of Conduct (the '*Code*') allowed Ms Keating to do so. Therefore, in his Honour's view, there was no proper ground on which she could be restrained. It would not be in breach of her general law fiduciary duties, nor would she be in breach of ss 182 and 183 of the *Corporations Act*. Furthermore, Bryson J found that there was no proper ground for restraining a third party from publishing information disclosed to it by a director in compliance with the *Code*.[42]

In discussing the NRMA's application for an injunction, his Honour also made several comments in relation to the nature of the NRMA as a company limited by guarantee, and the need for its directors as such to take into account public interest issues in carrying out their obligations. In particular, noting that the membership of the NRMA was large, his Honour made this rather colourful statement which I regard as legally dangerous:

> ... [NRMA's] activities are so *pervasive* that it does not seem too much to say that the NRMA is part of the *general organisation of society in New South Wales*. In my view interests of NRMA as a whole would be positively served by making public, for the information of members and others, events and

40 (2000) 201 CLR 603.
41 (2001) 40 ACSR 1.
42 In his judgment, Bryson J discussed the general principles in relation to the law on confidential information and considered in particular the requirement of detriment in the disclosure of confidential information, finding that it was necessary in this case to show detriment. He also held that protection given by the law of confidential information is not given on a blanket basis.

> circumstances at a board meeting ... The *readiness of media to report such things is a reflection of real, well-based and widespread interest and concern in the community.*[43]

The NRMA applied for leave to appeal Bryson J's judgment. Its application was dismissed by the Court of Appeal. The judgment was handed down by Ipp AJA (Mason P and Giles JA concurring). The Court of Appeal also reflected on the nature of the NRMA. The view of Ipp AJA was that it was in the interests of a very large mutual association for members to be fully informed, and that sometimes the only way of doing this was through the press. His Honour held that there was also insufficient evidence to suggest that the information, the subject of possible dissemination, was confidential. In reaching this view, he also relied on the constitutional freedom of communication:

> ... in light of the extent to which the affairs of the applicant are of direct and immediate concern to the members of the public, it is arguable that considerations analogous to those involving *freedom of communication* in relation to public affairs apply.[44]

The facts of *Geeson* may well have given the judges the opportunity to dismiss the application for an injunction. I will not be discussing the merits of their Honours' decisions except in dealing with specific legal issues which are relevant to the thesis that I favour - that the duty of non-disclosure overrides any so-called public duty.

Let me turn next to the fascinating proceedings involving the unwillingness of journalists to disclose to the Court the source of their information in relation to proceedings of the board meetings of the NRMA.

### B *NRMA v John Fairfax*

In *NRMA v John Fairfax*,[45] NRMA brought an application under pt 3, r 1 of the *Supreme Court Rules 1970* (NSW) for the production of documents and examination of journalists involved in the publication of articles which disclosed information that arose during two NRMA board meetings. The matters related to the directors' expense policy and to NRMA's election advertising policy. NRMA wished to obtain the identity of the sources from which the journalists obtained their information on these matters. NRMA argued that it required this information in order to obtain an injunction against the director from leaking information in the future.

Master Macready ordered that the defendants produce documents and reveal their sources. His Honour concluded that publication in the media of information showing a conflict arising between members of the board would harm NRMA's reputation which he agreed was important for its affairs and would also damage 'the perceived value of the brand'.

[43] (2002) 20 ACLC 111, [35] (emphasis added).
[44] (2001) 40 ACSR 1, [48] (emphasis added).
[45] [2002] NSWSC 563 (Unreported, Macready J, 26 June 2002) (*'NRMA 3'*).

In discussing the nature of the NRMA, Master Macready held that the NRMA was not an organisation which was of such political importance that required the Court to suggest that issues relating to the freedom of political communication may override the policy underpinnings of company law which prohibited the disclosure of information that was sensitive to the board. In his view, the matters disclosed were not matters relating to political discussions.

His Honour found that the potential for further harm, resulting from disclosures of board discussion, was serious. It outweighed the possible harm which in his view might be caused to the reputation of journalists and their ability to obtain information if they were forced to disclose their sources. The fact that the disclosure of information was contrary to the NRMA Code was an important consideration. His Honour stated that:

> the plaintiff is a very large organisation fulfilling an important role in this State. We are not here concerned some local organisation whose members are at loggerheads. Many of the subjects discussed by the board are extremely confidential and serious harm could result from disclosure.[46]

### C *Disclosure By Directors - A Conflict In Policies*

The invitation to directors to consider public interest matters could, in appropriate cases, cause extraordinary concern for many of our larger public companies. If the New South Wales Court of Appeal was correct in allowing the directors of the NRMA to 'spill the beans' to the public at large through the media, what does this do with the obligation imposed on the directors of a company both at common law and by virtue of ss 182 and 183 of the *Corporations Act*? These two sections respectively require directors not to make improper use of their position to gain advantage for the relevant director or to cause detriment to the company (s 182), and not to make improper use of the information to gain an advantage for the director or to cause detriment to the company (see s 183). In particular, the director's duty of confidentiality has been the subject of a series of cases which are worth discussing briefly in this context where they highlight the impossible position in which a director may find himself or herself if he is required to 'spill the beans', as it were, to the public in dealing with matters that come to the company's board because these are so-called matters in the public interest.

I shall deal briefly with four cases: *Bennetts v Board of Fire Commissioners of NSW*;[47] *Molomby v Whitehead*;[48] *Harkness v Commonwealth Bank of Australia*;[49] and finally, *Endresz v Whitehouse*.[50]

#### 1 *The Bennetts Case*

In *Bennetts*,[51] the board in charge of the organisation was constituted by statute

46 Ibid [169].
47 (1967) 87 WN (Pt 1) (NSW) 307 ('*Bennetts*').
48 (1985) 7 FCR 541 ('*Molomby*').
49 (1993) 32 NSWLR 543 ('*Harkness*').
50 [1998] 3 VR 461 ('*Endresz*').
51 (1967) 87 WN (Pt 1) (NSW) 307.

and comprised a President and four other members, each elected by a separate constituency. One of the members was elected by the members of the Fire Brigade Employees' Union ('the Union'). The board had to consider, on the basis of the recommendation of a finance committee of the relevant organisation and after receipt of counsel's advice, whether to appeal an Industrial Commission decision relating to the Union's application for a new award. When the board met to receive and consider this recommendation, Bennetts, who had been elected by the permanent firemen to the board, sought a copy of counsel's advice. The chairman agreed to supply the advice but only if Bennetts provided an undertaking not to disclose its contents to the Union. Bennetts refused to give this undertaking.

The main question Street J in the New South Wales Supreme Court had to consider was what was Bennetts' right to view the advice received from counsel. The right to view the advice was affected because Bennetts had declared his intention to disclose the details of the advice to the Union.[52]

In answering this question, Street J acknowledged Bennetts' bona fides in recognising that he was subject to conflicting loyalties, and that he owed the higher duty to the persons appointing him. Justice Street concluded, however, that notwithstanding these bona fides, the principle governing this issue was the *overriding* duty of Bennetts to the board and that that duty could not be compromised in any degree whatsoever.[53]

As exemplified by *Bennetts*, in considering the duty of confidentiality, consideration of directors' rights to gain access to company information necessarily arises. In this case, counsel for the defendants, with whom Street J agreed, denied that a board member has an absolute right to inspect a document that is clearly confidential, and contended that the right to inspect was a right essentially and fundamentally linked to the execution of a duty cast upon a board member.[54] Hence, Bennetts' declaration of his intended disclosure of the confidential legal opinion to the Union resulted in him being denied access to the confidential legal opinion.

Street J, in delivering his judgment, referred with approval to various observations made in *Edman v Ross*.[55] This was a case concerning the common law right of directors of a company to inspect and take copies of documents. In the judgment, delivered by a different member of the famous Street family, it was noted:

> The right to inspect documents and, if necessary, to take copies of them is essential to the proper performance of director's duties, and, though I am not

[52] *Ford's Principles of Corporations Law* [9.430] states that Bennetts is an example of a case of actual conflict between duty and a wrongly perceived extraneous duty. Reinforcing the principle that a director owes a duty to the company first and foremost, Ford notes Street J's comment that: '... a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the board exists.'

[53] (1967) 87 WN (Pt 1) 307, 312.

[54] Ibid.

[55] (1922) 22 SR (NSW) 351.

> prepared to say that the Court might not restrain him in the exercise of this right if satisfied affirmatively that his intention was to abuse the confidence reposed in him and materially to injure the company, it is true, nevertheless, that its exercise is, generally speaking, not a matter of discretion with the court and that he cannot be called upon to furnish his reasons before being allowed to exercise it. In the absence of clear proof to the contrary the Court must assume he will exercise it to the benefit of his company.[56]

*Bennetts* makes it clear that the right to access company information will be denied if directors intend to breach their duty in disclosing confidential information they have had access to. But there will always be difficulty in showing that directors are not acting with the appropriate bona fides in seeking the relevant information. The onus will be on those who wish to prevent access in most cases. This particular matter is discussed by Beaumont J in the next case.

### 2 *The Molomby Case*

In *Molomby*,[57] Beaumont J in the Federal Court of Australia had to consider a director's right to access relevant corporate information where that director was in effect representing a particular 'interest' group in the organisation.

Molomby was a law graduate and a barrister, and at the time he brought this case, a director of the Australian Broadcasting Corporation ('the ABC'). He was appointed to the board on the nomination of the Minister, in consequence of an election held by the staff of the ABC. Molomby sought access to ABC corporate documents relating to claims for legal fees and other matters. Whitehead, the managing director of the ABC at the time, denied Molomby access to these documents. Accordingly, Molomby, in seeking access to the relevant corporate documents, asserted that Whitehead had committed an error of law, arguing that as an incident of his office as director he had a prima facie right or power to see the corporate documents and that no reason existed in his case for displacing that prima facie right.[58]

Molomby was successful in his action, with Beaumont J holding that, prima facie, Molomby was entitled to the information relating to the management and affairs of the ABC. As a director of the ABC, Molomby enjoyed prima facie access to corporate material, to assist him in the proper execution of his fiduciary obligation to advance the interests of the ABC. No initial burden of proof rested upon Molomby to show any particular reason for, or utility in, the grant of access.[59] The evidentiary burden rested upon the ABC to show why his right of

[56] Ibid 361.
[57] (1985) 7 FCR 541.
[58] Note, by couching his argument in these terms, Molomby acknowledged that there may be occasions where a director's right of access will be denied.
[59] It should also be noted that Beaumont J stated that even if Molomby had to make out a case for access, the matters which he was questioning were relevant to the affairs and management of the ABC especially from his standpoint as a lawyer and he therefore would have been granted access.

access to information should be restricted, or even denied.[60]

Whilst Beaumont J identified a general rule that a director of a company has the right or power to inspect corporate material to advance the interests of the relevant company, he also noted that there were some exceptions to the general rule.[61] Two relevant exceptions highlighted by him were that access may be limited:

- if the director is not a member of the relevant committee dealing with a particular matter;[62] or
- if evidence illustrates that the director's aim was not to fulfil the proper execution of appropriate fiduciary obligations, but rather, to pursue conduct which might be to the detriment of the company.

In my view, the judgment of Beaumont J in *Molomby* is consistent with Street J's judgment in Bennetts. In *Molomby*, there was no evidence that Molomby was pursuing information other than in the discharge of his fiduciary duty. In *Bennetts*, the aim of the director was to elevate the interest of his appointor above that of the board - he intended to disclose the contents of an important confidential legal opinion, disclosure of which would cause harm to the Fire Commissioners of NSW.

### 3 *The Harkness Case*

In my view, *Harkness*[63] is the most important of the three cases which form the key authorities in the area. It most closely deals with a commercial situation and contains very useful comments by the judge on how the relevant principles should be evaluated.

Spedley Securities Limited ('Spedley') operated in the short term money market. The State Bank of Victoria, of which the Commonwealth Bank of Australia Limited (the 'Bank') became owner, provided a bill facility to Spedley for $4 million. The Bank received bills maturing on 6 December 1988 to the value of $4 million. Later Spedley went into liquidation and the liquidator claimed the $4 million as a preference. The Bank argued that the payment was received in good faith and in the ordinary course of business. Austroclear Pty Ltd ('Austroclear') cleared transactions in the short term money market by requiring payment from the participating banks (setting out their net position) at the end of each day. Each of the banks (including the Bank) had appointed representatives to the disputes committee of Austroclear. The committee dealt with situations where a

60 In this context, Beaumont J endorsed the comments of Street CJ in *Edman v Ross* (1922) 22 SR (NSW) 351. Justice Beaumont also considered the comments of Slade J in *Conway v Petronius Clothing Co Ltd* [1978] 1 WLR 72; that a director's right of inspection could be rendered more or less nugatory, at least for many months, if it could be shown the director's actions were to injure the company or for other improper motives. But in this instance, the facts did not require him to rule against the director.

61 (1985) 63 ALR 282, 292. See also *Ford's Principles of Corporations Law* [10.380] where he states that *Edman v Ross* (1922) 22 SR (NSW) 351 is the Australian authority recognising that the Court will grant the right to inspect only to such an extent as is necessary for the particular occasion.

62 *Birmingham City District Council v O* [1983] 1 AC 578.

63 (1993) 32 NSWLR 543.

participating bank refused to clear its position. Condron was the Bank's representative and as a member of the committee, obtained knowledge of an incident on 9 November 1988 in which Spedley's obligation in respect of the sum of over $880,000 was not met. Condron mentioned this incident to other officers of the Bank. It was argued that the Bank had become aware of this fact, thus it had lost the protection available to it under the relevant insolvency rules. In effect, the Bank knew that the payment was a preference.

Counsel for the liquidator argued that Condron should be assumed to have passed on the information to the Bank because, as a representative on the board of another entity, the knowledge of that nominee should be attributed to the appointer. In this context, Young J had to consider the nature of the duty of confidence owed by Condron.

Whilst acknowledging the general application of this rule, Young J noted that there could be situations where by consent of both companies, a nominee director could be requested to report back to the company appointing that director. But this was not the situation which applied as a rule of thumb.[64]

In his Honour's view, the *Bennetts* case provided the relevant principle, although that decision did refer to confidential proceedings of the board. After reviewing a series of cases including *Bennetts* and *Molomby*, Young J concluded:

> Whilst ordinarily there will be a duty to communicate knowledge received, where a director is functioning within another corporate organisation and information comes to the director in the course of that work with the other organisation, his duty of confidentiality to that other organisation will subsume any duty he might otherwise owe to the company which appointed him to that organisation. The use of the word 'representative' does not take the matter any further. Whether a person is elected by a special interest group, considered to be a representative of one group or another group, or a nominee director, does not alter the fact that the person owes the duty of confidence to the board to which he or she has been appointed.[65]

This statement by Young J not only reinforces that directors owe a duty of confidentiality to the company on whose board they sit, but that this duty of confidentiality subsumes any duties they may owe to the company that appointed them as director.[66]

In relation to obligations relating to confidential information, Young J made certain other relevant observations which are particularly pertinent to the NRMA situation:

> There is sometimes difficulty in classifying what is confidential and what is not, and indeed different board members may have different views on

64 Ibid 551.

65 Ibid 555.

66 *Ford's Principles of Corporations Law* [9.050] supports this view by stating that any duty to the appointor is subject to the duty of confidentiality to the company of which the person is a director, citing *Harkness*.

> *borderline* items. It is quite clear that a resolution unanimously supporting the public utterance of the chairman [of the board] could not be confidential. On the other hand, a resolution authorising the general manager to negotiate for the purchase of another company would obviously be confidential. In between are situations where judgment is called for. Some board members may consider that selective leaking of information and gaining reaction may be for the benefit of the company but this is always a dangerous attitude to adopt. The *safest course to take is to obtain approval from the board by resolution to the communication of any information outside the board so that the director knows where he or she stands.* Sometimes, however, it does not occur to a director to ask for such approval until well after the meeting has concluded. What is confidential is not to be found merely by looking to see whether someone has marked 'confidential' against an item. The obligation of directors is to keep secret any matter which is discussed, the communication of which might detrimentally affect the company; indeed, even the issuing of information as to who voted in what way on a particular resolution may detrimentally affect the working of a company if it is breezed abroad. The duties of a person whether a director or an executive who serves on a committee of an organisation will be much the same.[67]

Young J added that if directors were to obtain information which was important to the affairs of the company, there would be a duty both to communicate the information to the company and also to receive it.[68] However, whilst ordinarily there was a duty to communicate knowledge received, where directors were functioning within another corporate organisation and information comes to them in the course of that work with the other organisation, their duty of confidentiality to that other organisation would subsume any duty they might otherwise owe to the company which appointed them to that organisation.[69]

### 4 *The Endresz Case*

One other interesting case dealing with this issue is *Endresz*.[70] In this case, the Full Court of the Victorian Supreme Court accepted the reasoning in *Harkness*. The appellant, Endresz, was found guilty by a magistrate of eight charges contrary to the *Companies (Acquisition of Shares) (Vic) Code*. The offences arose out of Endresz's activities whilst acting on his own behalf and on behalf of a company controlled by him (CTC Nominees Pty Ltd ('CTC')) in obtaining control of a mining company (Emu Hill Gold Mines NL ('Emu Hill')).

Various issues were raised on appeal, including whether representations made by Endresz to the ASX contained a statement that was false or misleading in a material particular and was likely to have the effect of maintaining or stabilising the market price of securities, namely shares in Emu Hill. Endresz's contention was that the answers given by him in the letter to the ASX were given by him as

67 (1993) 32 NSWLR 543, 552-3 (emphasis added).
68 Ibid 555, citing Justice Von Doussa in *Beach Petroleum NL v Johnson* (1993) 115 ALR 411, 566.
69 Ibid 553.
70 [1998] 3 VR 461.

chairman of the board of directors of Emu Hill and not in his capacity as director of CTC, and that the duty of confidentiality which he owed to CTC precluded him from being required to answer a letter to Emu Hill on the basis of any knowledge which he had gained purely as an officer of CTC.

Ormiston J, who delivered the judgment of the Full Court, acknowledged the correctness of the judgment of Young J in *Harkness*. He noted that Young J referred to the principle as being that 'the obligation of directors is to keep secret any matter which is discussed, the communication of which might detrimentally affect the company'.[71] Ormiston J also referred to academic commentary on the issue, *Ford's Principles of Corporations Law*,[72] where it is stated:

> A distinction has to be drawn between the case where the director is a controller of two companies and where the director is only one of several directors of two companies. In the former case each company will know what the other knows because they have the same directing mind and will: attribution of the director's knowledge to each company does not depend on the existence of duty but on the director being identified with each company as its directing mind and will.[73]

The authors appear to have regarded the question of *duty* not to disclose as paramount in regard to this situation. Where a director is only one of several directors on a board, that person's knowledge will not be imputed to the company or companies the director represents unless the facts clearly require such a conclusion.

## 5 *Some Conclusions On The Cases*

Hopefully, this discussion illustrates the extraordinary position that directors may find themselves in if we impose so-called rules of corporate governance that create almost a moral or community obligation on the directors which may clash with their duties at law, with the regulator being unable to provide any kind of guidance to the director in the event the director breaches the common law or statutory duty.

If directors breach their statutory duty, then very significant implications may arise, in my view. In particular, I refer to the ability of shareholders to sue directors for breaches of the law. Whilst the courts can, in appropriate cases, forgive directors for breaches of their general law duties to act honestly and in good faith (by virtue of s 1318 of the *Corporations Act*) and, more particularly, statutory duties (by virtue of s 1317S of the *Corporations Act*), unless the directors obtain forgiveness from the court, an action on the part of the shareholders, who might be encouraged to act pursuant to the corporate governance regime that is set in place, may be effective. Let me deal with this issue briefly.

71 Ibid 482.
72 *Ford's Principles of Corporations Law* [16.220].
73 [1998] 3 VR 461, 482.

## IV HOW FAR CAN SHAREHOLDERS OVERRIDE DIRECTORS' DUTIES UNDER THE LAW?

With the continuous push for shareholder involvement (eg non-binding votes on executive remuneration packages contained in the *CLERP 9 Bill*) and the calls for greater reliance on corporate responsibility, directors may at times well seek some kind of blanket protection from appropriate sources, including shareholders, for those actions which might cut across the more traditional activities of directors. Seeking forgiveness from the court is of course both expensive and time consuming and, on the basis of the success rate in cases that have been decided recently, quite problematic.

It is well accepted that members of a company can in certain circumstances forgive the breaches of duty of a director so as to override the potential implications of the common law in relation to the actions of the director. Furthermore, the company's constitution can modify the fiduciary duties owed by directors at common law. This was most clearly spelt out in the High Court decision of *Whitehouse and Anor v Carlton Hotel Pty Ltd.*[74]

In addition, certain statutory innovations may provide some relief for directors who are required to act on behalf of a group enterprise rather than individual companies. Section 187 of the *Corporations Act* was modelled on s 131 of the *New Zealand Companies Act*. However, in New Zealand, the modification of the duties of directors extends beyond the scenario of a wholly owned subsidiary (which s 187 covers) to that of partly owned subsidiaries and, indeed, even joint venture companies. The conditions that directors must satisfy in each case are quite similar. It is interesting to note that so far the Australian government has not accepted the recommendations of what was the Companies and Securities Advisory Committee (now known as Corporations and Markets Advisory Committee) in its final report on corporate groups.

Certainly Jacobs J, in *Levin v Clark*[75] and *Re Broadcasting Station 2GB Pty Ltd*,[76] was attracted to the approach of companies permitting directors to take into account the interests of another company - in one case a lender; in another case a major shareholder in carrying out their obligations in relation to the specific company. That view has been supported by other courts but in this article it is not appropriate to deal with these issues in any detail. The High Court has also provided some comfort in such a scenario. In *Whitehouse*, the Court accepted the proposition that the articles of association or, indeed, a separate document or agreement

> may be formed so that they expressly or impliedly authorise the exercise of the power [in that case the allotment of unissued shares] for what would otherwise be a vitiating purpose.[77]

[74] (1987) 162 CLR 285 ('*Whitehouse*'). See also *Japan Abrasive Materials Pty Ltd v Australian Fused Materials* (1998) 16 ACLC 1172.
[75] [1962] NSWR 686.
[76] [1964-1965] NSWR 1648.
[77] (1987) 162 CLR 285, [6].

Although in that case, the High Court found that the relevant clause did not have that effect, the fact that it was considered, and that the High Court made its decision based on the wording of the relevant clause, suggests that a properly worded clause may 'authorise' conduct that would otherwise be a breach of the director's duty.

Indeed, this decision appears to have influenced the reasoning of the judges in the *NRMA cases*. Justice Bryson ultimately took the view (affirmed on appeal) that the Code could be relied upon by directors as 'authority' for actions that might in other circumstances possibly amount to a breach of the fiduciary or statutory duties owed to the company. This view, however, is not discussed in any detail by the Appeal Court. I believe that this kind of analysis can lead to an incorrect assessment of such a code and to a claim of 'indemnity' of director's actions.

Two recent cases have discussed the possibility of shareholders, in a general meeting or through the adoption of a clause in a constitution or some similar act, overriding a breach of statutory duties. In *Pascoe Limited (in liquidation) v Lucas*,[78] Debelle J suggested that even statutory breaches of duty could be forgiven by shareholders. Justice Santow, however, in the earlier decision of *Miller v Miller & Miller*,[79] rejected the approach that was later taken by Debelle J. Whilst his Honour did not refer to any authority for his statements, he noted that ratification can never be a blanket indemnification or exception of the duties of directors on a prospective basis. In his Honour's view, ratification could not cure a breach of statutory duty (such as that imposed by s 180 and following sections) especially those which impose criminal liability. As Santow J noted in that case, the most that ratification of a document of this kind can do is

> remove from the scope of technical dishonesty such actions as issuing shares for a purpose which is not a proper one, in the sense of not being for the benefit of the company as a whole.[80]

In view of the fact that s 1324 of the *Corporations Act* permits any person whose interests are affected to seek remedies in relation to breaches of statutory duties, the view of Santow J is, in my opinion, the better one. The impact of s 1324 of the *Corporations Act*, to my mind, creates a significant hurdle for persons who suggest that they can escape the wrath of dissatisfied shareholders or others. Until there is a decision of a higher court suggesting the contrary, that is the view that I believe would hold sway.

My opinion is supported further by the existence in the legislation of specific statutory provisions which empower the court to forgive directors for breaches of the several penalty provisions contained now in s 180 and following sections. Sections 1318 and 1317S of the *Corporations Act* (s 1317S was formerly s 1317JA) provide clear examples of how the directors should seek to avoid liability in circumstances of these kinds. Consequently, in the event of conflict,

[78] (1998) 16 ACLC 1247.
[79] (1995) 16 ACSR 73.
[80] Ibid 89.

directors cannot rely on the constitution or any of the kinds of agreement that existed in some of the cases discussed.

## V SOME SPECIAL IMPLICATIONS OF THE CLERP 9 BILL

The *CLERP 9 Bill* contains a number of very interesting initiatives which will, without doubt, shift the balance of 'regulation' in the area of company law from the traditional court enforcement approach to one of commercial and moral persuasion. ASIC will be vested with quite extraordinary powers to, in effect, fine companies which do not comply with the continuous disclosure provisions of the *Corporations Act*. This so-called fining power already exists in the *Corporations Act* in relation to minor 'breaches'.[81] Whether the legislation will work in Australia is very unclear. Despite the fact that companies will not be deemed to have breached the legislation as a result of the payment of a fine pursuant to this new set of proposals, the prospect of negative publicity being utilised by ASIC in order to highlight its success in bringing about stricter compliance with the disclosure regime poses a very real concern for the way in which our law should be administered. The enormous pressure that can be placed on companies (and indirectly on their officers) by the imposition of the so-called fines without ASIC having to prove its case before an independent body causes me a great deal of concern. I do not understand the necessity for this new fining power which was the subject of very significant criticism by the ALRC in its report on administrative law and related remedies in this area.[82] The main argument for the utilisation of this penalty regime, rather than requiring ASIC to utilise the courts in the usual fashion in seeking compliance with the law or seeking undertakings under the *Corporations Act*, is that the court processes are just too time consuming, costly and slow, and that these so-called 'minor breaches' of the law that are being targeted are more effectively dealt with through such a form of self-regulation.

The criticisms of the Discussion Paper of CLERP 9 by the ALRC were quite significant, as I have indicated earlier. In any event, ASIC has not produced the evidence to support its assertions that it cannot obtain appropriate relief from the courts. Indeed, only on 27 November, 2003, ASIC obtained what it regarded as a satisfactory court settlement of its claim against Southcorp Limited for alleged breaches of the continuous disclosure regime. If in fact our courts are not working effectively, or the rules are inadequate (which may well be the case, as I have averted to as a possibility earlier), then let us go about amending those rules so that the system can work more effectively. Regrettably, we often engage in legislation by popular support (or to win elections) in various areas of our law.

If this power is retained (as seems likely for political reasons) it will be a rallying call for other regulators to seek similar powers and for ASIC and other regulators

[81] See, eg, *Corporations Act 2001* (Cth) s 1313.

[82] ALRC Report 95 '*Principled Regulation: Civil and Administrative Penalties in Australian Federal Regulation*' March 2003; in particular, see ch 12 in pt C and ch 31 in pt F.

in the future to utilise the short-cut route of obtaining more powers rather than arguing the case in an appropriate fashion.

I have earlier averted to the fact that the Listing Rules of the ASX are, in effect, a 'law'. The corporate governance principles that the ASX introduced in essence may have the force of law by virtue of the provisions of the *Corporations Act* referred to earlier.

In this regard, ASIC, the licensee, or certain others, including a 'person aggrieved' can make an application to the court to compel compliance with Listing Rules.

New Listing Rule 4.10 adopts the 'if not, why not' approach: where a company has declined to comply with ASX Guidelines, it must disclose the manner in which it has not complied, and the reason for its failure to comply. The ASX has described the increase in corporate accountability represented by the adoption of the ASX Guidelines as 'a major evolution in corporate governance practice in Australia'.[83]

The effect of this evolutionary change may be broader than anticipated. Interestingly, it would appear that any 'person aggrieved' can challenge a company's failure to explain its compliance with ASX Guidelines. The breadth of standing conferred by this term remains of some controversy. The definition of the expression 'person aggrieved' offers scope for third parties other than shareholders to challenge the failure on the part of the relevant company, and indeed the directors, in complying with these ASX Guidelines. Legislation (in particular s 793C) was amended to ensure that a person aggrieved extended to shareholders. But the willingness of certain courts to interpret the expression such as 'person aggrieved' or the similar expression used in s 1324 of the *Corporations Act* - a person whose interests are affected in an exhaustive fashion - will no doubt lead to the potential for bodies such as the Australian Shareholders Association or indeed others to question a soft approach by, say, the ASX, or ASIC which also has the power to enforce the Listing Rules, in dealing with the failure of a company to comply with the ASX Guidelines.

I have written previously[84] on the potential scope for the predecessor to s 1324 of the *Corporations Act* (ie s 574 of the then Companies Codes) to give third parties the right to bring directors and others who are made responsible for specific duties under the *Corporations Act* to account. The arguments first espoused by me have now been taken up by others who have also been surprised at how slowly the use of the remedies under s 1324 has developed. It is unnecessary to delve into this issue in this article.

[83] K Hamilton, 'Principles of Good Corporate Governance and Best Practice Recommendations' *ASX Corporate Governance Council* March 2003, foreword.

[84] See Bob Baxt 'Will section 574 of the Companies Code please stand up!...' (1989) 7 *Company and Securities Law Journal* 288. See in particular also Hargovan, 'Directors' Duties to Creditors in Australia after Spies v Queen...' (2003) 21 *Company and Securities Law Journal* and the further references listed in that article. Whilst my article written in 1989 was the first to raise this particular issue directly, Hargovan, and others referred to in that article, have now enriched the debate in relation to this issue.

## VI CONCLUSION

Whilst it is important for issues of corporate governance to be progressed in whatever way that is reasonable, I am concerned that the current state of development in our law is such that we are abandoning the responsibility of assessing legal rules to see if they work effectively and then amending those that can be amended to ensure that they do work effectively, and are instead relying on the so-called 'light-handed approach' of self-regulation. Unfortunately, self-regulation involves more and more reliance on the ability of regulators to act on their own volition. Regulators are not responsible to the electorate (although they are arguably responsible to the Parliament through various committees). I find the process of regulating the regulators through the parliamentary committee process inadequate and inappropriate, especially in the context of issues of such importance. We have in our current legislation a number of important laws that have been enacted to protect the interests of shareholders and investors generally. These laws should be pursued through the courts in appropriate cases by the regulators. If those cases are run and lost (such as the *Whitlam* case) it may be appropriate in those circumstances for the legislation to be amended. It is not appropriate, in my view, for regulators to be vested with new powers such as the fining power referred to earlier, nor for there to be increasing reliance on so-called 'self-regulation' in the hope that we will see compliance with the law. Too often we are driven in seeking changes to our law by media speculation and comment which is often both inaccurate and highly politicised. We have a Law Reform Commission which is apparently treated with such disdain by the Government that it does not even respond to its reports (as noted earlier). This is clearly both inadequate and inappropriate.

Australia has a reasonably sound record in relation to the enforcement of its corporations laws. There have been few cases in which the courts have highlighted inadequacies in the legislation dealing with directors duties. Recent successes by ASIC in this area to which I referred earlier are clear evidence of this success, although there are some problems at the edges which I have also referred to earlier. Those are the issues that need to be addressed. By widening the range of matters to be considered through codes of conduct and other forms of self-regulation which are not regarded as the responsibility of any particular body or organisation or simply the need to prevent further problems in the future and the proliferation of greater legislative change which, I believe, will prove to be both unnecessary and very costly.