CAVEAT DIRECTOR - RECENT DEVELOPMENTS AND FUTURE DIRECTIONS

INAUGURAL AUSTRALIAN WOMEN LAWYERS CONFERENCE CELEBRATING EXCELLENCE

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Introduction

Over the last few decades as women in Western democracies have begun to take their rightful role in public life they have also begun to take their seats in the boardrooms of Australian public companies. Progress has been koala-like: lots of cute photo opportunities but not much movement! Like koalas, women on boards seem an endangered species. In December 2003 and January 2004 the organization Women on Boards, funded by the Office of the Status of Women, commissioned a survey of 338 of the top 500 publicly listed Australian companies (excluding mining companies), 31 publicly listed companies not in the top 500 and 43 mainly rural companies, associations or industry bodies with boards. Women on Boards published the results of that survey in April 2004: seven per cent of all board members were women; 29 per cent of boards had one female board member; six per cent of boards had two female board members; two per cent of boards had three female board members and three per cent of boards had female chairs. Other key findings included that there was a significant trend for companies with better financial results to have female directors and that women were most likely to be on boards in the ACT (58 per cent), South Australia (37 per cent) and New South Wales (43 per cent). Women are least likely to be on boards in Queensland (27 per cent), Victoria and Tasmania (33 per cent) and Western Australia (34 per cent); the banking and finance sector (100%) and the insurance and petroleum process industries (85 per cent) were the most likely to have one or more female directors; the hotels, restaurant and leisure sectors were the least likely (nine per cent) to have a woman on their board; there was a significant trend for larger companies with more employees to have women on their boards; and, once appointed to a board, women tended to be appointed to more boards on average than men.[1]

The Australian government's Equal Opportunity for Women in the Workplace Agency (EOWA) 2006 Women in Leadership census report notes that, although women make up around 45 per cent of the labour force, at board director level there are 10 men to every woman.[2] The position is better in terms of Australian government boards: according to the Australian government's Office for Women (OFW), as at June 2004 women comprised 32.2 per cent of those represented on Australian government boards and bodies where the government has had sole responsibility for the selection and appointment process of board

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[1] Women on Boards "The vital statistics" Women on Boards website: http://www.womenonboards.org.au/pubs/a04_aicd3.htm, as at 20 September 2006.

[2] EOWA "Women's Workforce Representation - A Statistical Profile" *Australian Census of Women in Leadership*, EOWA, 2006, 17. EOWA website: http://www.eowa.gov.au/Australian_Women_In_Leadership_Census/2006_Australian_Women_In_Leadership_Census/2006__EOWA_Census_Publication.pdf.

members. As at June 2005 this number had risen marginally to 33.5 per cent.[3] EOWA's census for 2006 notes that 13.5 per cent of companies have two or more women board directors, an increase from the 2004 result of 10.2 per cent. However, across the ASX 200 there are 1,487 seats around boardroom tables, only 129 or 8.7 per cent of which are held by women, an increase from 2004 when women held 8.2 per cent or 119 board seats. It is encouraging that there has been an increase in the percentage of companies which have two or more women board directors and those which have 25 per cent or more women on their board, although this gain seems to have been offset by a decline in the percentage of companies with at least one woman on their board.[4] The percentage of women on Australian boards in 2006 (8.7 per cent) is regrettably lower than that in comparable countries such as the United States (14.7 per cent in 2005), Canada (12 per cent in 2005), South Africa (11.5 per cent in 2006), the United Kingdom (10.5 per cent in 2005) and the EU (over 10 per cent).[5]

Women lawyers have been well represented amongst the first wave of those Australian women directors. Women lawyers often choose to practise in corporate law and so regularly advise clients, both female and male, on aspects of corporate law including directors' duties. Those clients are not limited to company directors. The last few decades have shown an enormous broadening of the base of shareholders in the Australian community with the "mum and dad" shareholder phenomenon. Compulsory superannuation for all Australian workers, generally held in funds which include substantial shareholdings, has meant that most members of the community are these days ultimately affected by events such as the collapse of a major public company. The failed company's employees and other entities which have contracted for goods or services with the collapsed company are also affected. If the collapsed company is an insurance company like HIH the collapse affects policyholders throughout the nation or even internationally. Ordinary citizens may also be affected by the environmental impact of a corporation's activities. The aftershocks of events such as the financial collapse of a major public company or a serious environmental disaster caused by a company may make victims of many in the community well beyond the company's shareholders. After witnessing high-flying wealthy directors of public companies dragged through the civil and criminal courts and perhaps imprisoned, sometimes for lengthy periods, and having heard of successful major class actions, clients may ask you what redress they might have against a company or its directors who may have breached their duties. Directors may come to you for help in defending such actions.

In this paper I will refer primarily to some of the statutory duties imposed on directors and discuss some recent court decisions concerning them. I will then highlight potential future developments in the field of directors' duties, including those raised in the Corporations and Markets Advisory Committee (CAMAC) November 2005 Discussion Paper on corporate and social responsibility and the June 2006 report of the Parliamentary Joint Committee on Corporations and Financial Services.

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[3] OFW website: http://www.ofw.facs.gov.au/leadership_development/national_leadership_initiative/women_on_boards/index.htm, as at 20 September 2006.

[4] EOWA "ASX 200 Trends Over Time: Women Board Directors" *Australian Census of Women in Leadership*, EOWA, 2006, 8.

[5] See the European Commission report "Women and Men in Decision-Making" cited in EOWA "ASX 200 International Comparison: Women Board Directors" *Australian Census of Women in Leadership*, EOWA, 2006, 10.

Directors' Duties

The power to control the management of a company, its property and affairs is usually vested by the company's constitution in a board of directors.[6] This significant power provides the dishonest, lazy or incompetent director the opportunity for fraud or mismanagement of the company's assets and income. Common law and statute law have developed to protect the vulnerable who may suffer as a result, traditionally the company shareholders.

A distinction is usually drawn between the duties of executive and non-executive directors. The chief executive or managing director will usually be employed under a contract of service with an express or implied term to exercise the care and skill expected of someone in that position. The standard objective directors' duties relate more often to matters of policy, especially in respect of larger corporations. A distinction is also drawn between directors and the chairperson of the board of directors who is expected to carry the primary responsibility for selecting matters to be brought before the board, formulating policy and promoting the company.[7] Delegation by the board of directors is a regular aspect of corporate governance. If the delegation fetters the future exercise of discretions, the delegation must be authorized. The delegation must also relate to matters which in all the circumstances may properly be left to the delegate.[8] Directors are entitled to rely on management to bring to the attention of the board matters arising out of the financial and other information of the company; reliance on those to whom responsibility has been delegated will only be unreasonable where the director was aware of circumstances of such a character that no person with any degree of prudence would have had such reliance. A director cannot delegate to the point of abdication of the responsibility itself, for example, by delegating the establishment of a proper system of financial records and internal controls.[9]

Directors do not owe an independent duty to and enforceable by creditors of a company by reason of their position as directors: *Spies v The Queen*.[10] Nor are directors' duties ordinarily owed to individual shareholders even if the company holds its assets on trust for the shareholders: *Brunninghausen v Glavanics*;[11] *Southern Cross Mine Management Pty Ltd v Ensham Resources Pty Ltd*.[12]

The onus of showing that a director has not properly exercised powers or discharged duties lies on the person asserting the impropriety: *Australian Metropolitan Life Assurance Co Ltd v Ure*;[13] *Ascot Investments Pty Ltd v Harper*.[14]

Directors' statutory duties are set out in the *Corporations Act* 2001 (Cth) Chapter 2D Part 2D.1 and generally mirror those at common law. Where there is a transaction involving a potential conflict of interest particular vigilance must be applied to the duty of care.

Significantly, the term "director" is defined as including not only a person appointed to the position of director but also an alternate director or someone acting in the capacity of director regardless of the name that is given to their position. The term "director" also includes a

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6 See also s 198A *Corporations Act* 2001 (Cth).
7 See *AWA Ltd v Daniels* (1992) 7 ACSR 759.
8 See s 198D and s 190 *Corporations Act*.
9 *AWA Ltd v Daniels*, above, 789.
10 (2001) 201 CLR 603, Gaudron, McHugh, Gummow and Hayne JJ, 636 - 637.
11 (1999) 46 NSWLR 538.
12 [2004] 2 Qd R 207, 217 - 218.
13 (1923) 33 CLR 199, 206, 219.
14 (1981) 148 CLR 337, 348 - 349.

person who is not validly appointed as a director if the person acts in the position of a director or the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.[15]

Section 180 of the *Corporations Act*

Directors must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director of a corporation in the corporation's circumstances and occupied the office held by and had the same responsibilities within the corporation as the director: s 180(1). In determining whether a director has exercised reasonable care and diligence the issue is what an ordinary person with the knowledge and experience of the director would be expected to have done in the circumstances if they were acting on their own behalf. In determining whether a director has breached s 180(1) the court will have regard to the company's circumstances and the directors' positions and responsibilities within the company. In accordance with those responsibilities directors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company by familiarizing themselves with the fundamentals of the business in which the corporation is engaged; a director is under a continuing obligation to keep informed about the activities of the corporation and to monitor corporate affairs and policies by regularly attending board meetings and to maintain familiarity with the financial status of the corporation by regularly reviewing financial statements. A director will be unable to avoid liability for insolvent trading by claiming the director had not learnt to read financial statements. Nor will a director appointed because of special expertize in a limited area of the company's business be relieved of these general duties which might reasonably be expected of a director even though they are outside the particular area of expertize. Directors are entitled to rely without verification on the judgment, information and advice of management, unless reliance would be unreasonable because the exercise of ordinary care would have resulted in the directors not so relying on that advice. In determining this issue relevant factors may include whether the function that has been delegated is one that may properly be left to the delegate; the extent to which the director is put on inquiry or given facts which should have put the director on inquiry; and the relationship between the director and delegate must be such that the director honestly holds the belief that the delegate is trustworthy, competent and worthy of reliance. Knowledge that the delegate is dishonest or incompetent will ordinarily make reliance unreasonable. Further relevant considerations include the risk involved in the transaction and its nature; the extent of steps taken by the director such as inquiries made or other circumstances engendering "trust"; and whether the position of the director is executive or non-executive: *Australian Securities and Investments Commission v Adler*,[16] lately approved by the Queensland Court of Appeal in *Gold Ribbon (Accountants) Pty Ltd (in liq) v Sheers & Ors*.[17]

Gold Ribbon provides a recent example of breaches of the duty presently imposed on directors under s 180. Mr Dunn was one of a number of directors of the respondent company which was in the business of providing unsecured loans to accountants. The company made a number of improvident loans and was unable to recover the full amount of the principal of those loans from the borrowers. It brought proceedings in the Supreme Court of Queensland against a number of persons including Mr Dunn to recover the outstanding principal. The trial judge accepted the company's argument that its losses were suffered because of

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15 Section 9 *Corporations Act*.

16 (2002) 168 FLR 253, 347, Santow J.

17 [2006] QCA 335; Appeal No 5994 of 2005, 5 September 2006, [220].

Mr Dunn's failure as a director of the company under s 180 to ensure that adequate loan application assessment procedures were established and maintained by the respondent.[18] Keane JA, with whom Williams JA and Wilson J agreed on these points, found that the primary judge was entitled to find that Mr Dunn breached his duty as a director in that he demonstrated a lack of interest in the company's affairs over the relevant period through his failure to attend board meetings and the absence of his contribution to the company's lending procedures.[19] If considerations of physical separation impede the proper discharge of a director's duty to act collectively to manage the company then the director should surrender his appointment.[20] The disadvantages of physical separation may be illusory in an age of electronic communication.[21]

The term "business judgment" is defined in s 180(3) as "any decision to take or not take action in respect of a matter relevant to the business operations of the corporation."

Under s 180(2) directors who make a business judgment are taken to meet the requirements of s 180(1) and their equivalent duties at common law and in equity in respect of the judgment if it is made in good faith for a proper purpose; the directors do not have a material personal interest in the subject matter of the judgment; the directors inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and rationally believe that the judgment is in the best interests of the corporation. That belief will be rational unless it is one that no reasonable person in the director's position would hold.

Courts will be reluctant to review business judgments of directors by substituting their own judgment on the merits. As Barwick CJ, McTiernan and Kitto JJ noted in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*:[22] "Directors in whom are vested the right and the duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts."

Examples of breaches of the s 180 statutory duty despite the business judgment rule include allowing a company to enter into transactions that produced no benefit;[23] allowing a company to trade in an unreasonably risky manner contrary to industry practice;[24] allowing a notice of meeting containing multiple misleading statements to be distributed to members;[25] failing to supervise the accuracy of company financial accounts;[26] and failing to take part in active supervision of the company's management.[27] Directors of a specialized professional trustee company may owe a higher duty of care than that of the ordinary prudent person: see *Wilkinson v Feldworth Financial Services Pty Ltd*.[28]

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18 Above, [116] - [117].
19 Above, [223].
20 Above, [250].
21 Above, [251].
22 (1968) 121 CLR 483, 493.
23 *ASIC v Adler*, above.
24 *Circle Petroleum (Qld) Pty Ltd v Greenslade* (1998) 16 ACLC 1577.
25 *Australian Innovation Ltd v Petrovsky* (1996) 14 ACLC 1357.
26 *Sheahan v Verco* (2001) 79 SASR 109.
27 *Daniels v Anderson* (1995) 37 NSWLR 438; and *Gold Ribbon*, above.
28 (1998) 17 ACLC 220.

Section 181 of the *Corporations Act*

The relationship between the director and the company is fiduciary, imposing a high standard of loyalty set by equitable principles including duties to act in good faith in the best interests of the company for proper corporate purposes and to give adequate consideration to matters for decision whilst keeping discretions unfettered: *Ford's Principles of Corporations Law*.[29] These principles are reinforced by s 181 of the *Corporations Act*.

Under s 181 directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose. The section codifies the developed common law on this aspect of directors' duties. The section imposes two separate duties, the first in s 181(1)(a) and the second in s 181(1)(b).

In determining whether s 181 is breached the court must decide as a matter of law the purposes for which the power may or may not be exercised, and as a matter of fact the purpose for which the power was exercised and whether that purpose was within the category of permissible purposes.[30] As to the question of law, the size and nature of the company are relevant; directors of small companies who are also the only shareholders may well be given more extensive powers as directors than those of large publicly listed companies. The constitution of the company may be relevant as may be the type of company and its activities. In determining the question of fact, the court should give credit to the subjective opinion of the directors and their judgment as to matters of management. Where there have been dissenting directors and the majority directors do not all share the same purpose or purposes the court will have a difficult task in ascertaining the substantial purpose of the majority directors. Usually there will be a collective reason although each director's statement of the reasons may differ.[31] Where the director had multiple purposes, a merely incidental effect following from the pursuit of a permissible purpose does not negate an otherwise proper director's decision if a director is acting in good faith and in the interests of the company's financial affairs and commercial interests.[32]

The test applied by courts in determining whether there has been a breach of s 181 is objective, based on what a comparable person having the same knowledge and skill as the director would reasonably have done in the circumstances. The section is not complied with by subjective good faith or mere subjective belief that the purpose was proper if no reasonable director could have reached that conclusion: *ASIC v Adler*.[33] Because the test is objective, even honest or altruistic behaviour by directors can breach s 181 if the conduct was carried out for an improper or collateral purpose, although statements by directors about their subjective intentions or beliefs will be relevant to the objective inquiry:[34] *Permanent Building Society (in liq) v Wheeler*.[35] This principle is often condensed to the explanation that an honest lunatic is not outside the terms of s 181. Directors as fiduciaries are under an obligation not to promote the directors' personal interests by making or pursuing gain in circumstances where there is a conflict or a real or substantial possibility of conflict between their personal interests and the company's interests. In determining whether there is a

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29 H A J Ford, R P Austin and I M Ramsay *Ford's Principles of Corporations Law* Butterworths, Australia, 2000, 8.010.

30 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 835; Ford et al, above, 8.200.

31 Ford et al, above, 8.230.

32 Above, 8.240.

33 Fn 16, [738].

34 Above, [740].

35 (1994) 11 WAR 187.

possibility of conflict the test is what the reasonable person would find looking at all the relevant facts and circumstances. Mere disclosure of a conflict between interest and duty and abstaining from voting will not necessarily be sufficient to satisfy directors' fiduciary duties; directors may have an additional positive duty to take steps to protect the company's interest such as by using their power and influence to prevent the transaction. What if any action beyond disclosure directors must take will turn on the circumstances of each case but includes matters such as the degree to which the directors have been involved in the transaction and the gravity of possible outcomes for the company.[36]

A director of one company who is also a director of another company must not exercise the director's powers for the benefit or gain of the other company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent.[37] This is an area in which difficulty may arise because company law treats all companies, large or small, public or private, generally by the same set of principles.[38] What is in the interests or best interests of the company will often depend on the provisions of the company's constitution. Ordinarily directors must consider the interests of existing members of the corporation who are the proprietors of the company and who have risked their capital in the hope of commercial gain. Directors must act fairly as between different classes of members: *Mills v Mills*;[39] and *Corporations Act* Part 2F.1. But the term "best interests of the corporation" is thought by many to have a wider meaning in the modern globalized world where environmental issues may affect the very viability of the future of the planet well beyond merely maximizing short-term profits to shareholders. The *Corporations Act* specifically recognizes the interests of members in Chapter 2F which provides remedies for the conduct of the affairs of the company in a manner contrary to the interests of the members as a whole. Section 461(1)(e) provides a ground for compulsory winding up where the directors have acted in the affairs of the company in their own interests rather than in the interests of the company as a whole. It will not always be possible for directors to consult the members of the company before making a decision and the directors may not know whether members wish to take a short-term or long-term approach to the decision. Directors must balance the competing considerations of the short-term and the longer-term view, for example, in a takeover situation where the short-term view may favour acceptance of a takeover offer but the long-term benefits would seem to favour rejection of the offer,[40] or where a short-term cheaper solution would not advantage the company's long-term sustainability in terms of employee and community relations.

Recent jurisprudence suggests that, although directors owe no duty to creditors,[41] in discharging their duty to act in good faith in the interests of the company they must have regard to the interests of the company's creditors, at least where the company is nearing insolvency. Unquestionably directors have a duty to prevent insolvent trading by the company. Part 5.7B Division 3 of the *Corporations Act* exposes directors of a company which becomes insolvent to personal liability of a civil penalty and compensation if the company incurs a debt and is or then becomes insolvent and there are at the time reasonable grounds for suspecting the company's insolvency. These provisions give the liquidator the

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36 *ASIC v Adler*, above, [735].
37 *R v Byrnes* (1995) 183 CLR 501, Brennan, Deane, Toohey and Gaudron JJ, 517.
38 Ford et al, above, 8.090.
39 (1938) 60 CLR 150.
40 Ford et al, above, 8.095.
41 *Spies*, above.

opportunity to sue on behalf of all creditors rather than allowing individual creditors to take their own proceedings.

The developed jurisprudence does show some tension between those cases which emphasize the subjective requirements that directors must form a view that their conduct is in the company's interests and those which insist on an objective requirement to the director's discretion. These tensions sometimes arise as to the duty of directors in dealings between companies in a group where commercial decisions are likely to be taken having regard to group interests rather than the interests of the separate entities involved. In *Charterbridge Corporation Ltd v Lloyds Bank Ltd*[42] Pennycuick J adopted an objective formulation concluding that a director's decision benefiting the group interest to the detriment of the individual company would not be in breach of duty if an intelligent and honest person in the position of the director of the individual company could reasonably have believed that the transaction was for the benefit of the individual company. Whilst some Australian cases have followed *Charterbridge*, in *Walker v Wimborne*[43] Mason J took a different approach, stating that it was a fundamental principle in the group context that each of the companies was a separate and independent legal entity and that it was the duty of the directors to consult only the individual company's interests in deciding whether payments should be made to other companies in the group. *Ford* notes that, subject to s 187 of the *Corporations Act*,[44] although it may seem commercially unrealistic, until the law is changed so that each corporate member of the group is made liable for the debts of another corporate member, each member of a group must be treated as a separate entity.[45]

Other civil obligations under the *Corporations Act*

Section 182 of the *Corporations Act* provides that directors must not improperly use their position to gain an advantage for themselves or someone else or to cause detriment to the corporation.

Section 183 of the *Corporations Act* provides that a person who obtains information because they are or have been a director must not improperly use the information to gain an advantage for themselves or someone else or to cause detriment to the corporation. The duty continues after the person ceases to be a director.

The prohibitions imposed by s 182 and s 183, like those in s 181, arise from the fiduciary duty to prevent conflicts arising between a director's private interest and the company's interest and the obligation to act only in the best interests of the company. The concept "improperly" is assessed objectively.[46] Difficulties as described earlier will also arise here where a director acts to gain an advantage for an associated member of a company group.

Causation

If a director's improper exercise of power causes loss to the company, the director will be jointly and severally liable to compensate the company on the same basis that trustees are

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42 [1970] Ch 62, 74.

43 (1976) 137 CLR 1, 6 - 7.

44 Section 187 *Corporations Act* provides that a director of a wholly owned subsidiary is taken to act in good faith in the best interests of the subsidiary if the constitution of the subsidiary expressly authorizes the director to act in the best interests of the holding company; and the director acts in good faith in the best interests of the holding company; and the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

45 Above, 8.140.

46 *R v Byrnes*, above, 513 - 515.

personally liable to restore trust property lost in breach of trust.[47] The causation test is the "but for" test: would loss have occurred if there had been no breach of duty.[48] In *Gold Ribbon* the causation issue, which the company ultimately failed to establish, was whether on balance the improvident loans would not have been made but for the director Mr Dunn's omissions;[49] a mere increase in the chance of an application for an improvident loan being refused if Mr Dunn had performed his duty was insufficient to establish the required causal nexus between his breach of duty as a director and the company's loss.[50]

A company may also recover against a director in proceedings brought by ASIC, a liquidator or administrator under s 598 of the *Corporations Act* or in proceedings for compensation under s 1317H of the *Corporations Act* if the court concludes that the director exercised power for improper purposes constituting a contravention of s 181(1). The court has power under s 1324 of the *Corporations Act* to grant an injunction in respect of actual or threatened breaches of the law, including statutory breaches of directors' duties. ASIC or those whose interests are, have been or would be affected by the conduct in breach may apply for such an injunction.

Effect of civil breaches of directors' duties under the *Corporations Act*

Breaches of s 180, s 181, s 182 and s 183 incur a civil penalty. Following a declaration of contravention under s 1317E of the *Corporations Act*, pecuniary penalties of up to $200,000 may be awarded by the court under s 1317G. Section 1317S provides that a court may relieve a director of liability if the director can show they acted honestly having regard to all the circumstances of the case.

Under s 188(2) of the *Corporations Act* a director of a proprietary company without a secretary is liable for any contraventions of a secretary's functions under s 188(1). The offence is one of strict liability (s 188(2A)). It is a defence under s 188(3) to show that the person took all reasonable steps to ensure that the company complied with the section.

Criminal breaches of directors' duties

Under s 184(1) of the *Corporations Act* directors commit a criminal offence if they are reckless or intentionally dishonest and fail to exercise their powers and discharge their duties in good faith and in the best interests of the corporation or for a proper purpose.[51]

Under s 184(2) of the *Corporations Act* a director commits a criminal offence if they use their position dishonestly, with the intention of directly or indirectly gaining an advantage or causing detriment to the corporation, or recklessly as to whether the use may result in themselves or someone else directly or indirectly gaining an advantage or in causing detriment to the corporation.

Under s 184(3) of the *Corporations Act*, a person who obtains information because they are or have been a director commits an offence if they use the information dishonestly, with the intention of directly or indirectly gaining an advantage or causing detriment to the

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47 Ford et al, above, 8.280.

48 *Gold Ribbon*, above, [272].

49 Above, [274].

50 Above, [286] and [322] - [325]; Williams JA agreed with Keane JA on the question of causation at [113]; see also Wilson J, [338] and [342].

51 As to reliance on others' information or advice, see s 189 of the *Corporations Act*.

corporation, or recklessly as to whether the use may result in themselves or someone else directly or indirectly gaining an advantage or in causing detriment to the corporation.

The negligence necessary to establish the criminal charges under s 184 is greater than when establishing a breach of the equivalent statutory duty of care imposing civil obligations under s 180 - s 183 of the *Corporations Act*. In *Vrisakis v Australian Securities Commission*[52] Ipp J suggested that the test for breach of the duty under s 184(1) was whether the known circumstances were of such a character, so plain, so manifest and so simple of appreciation, that no person with any ordinary degree of prudence acting on his or her own behalf would have failed to take the appropriate steps. Importantly, the duties imposed on directors in s 180 - s 184 do not exclude the operation of other laws including the general law.[53]

The Future

In March 2005 our federal legislators, in response to a perceived call from community groups and others for corporations and their directors to carry out their duties looking beyond mere short-term profits for shareholders to long-term issues such as the environmental and social impacts of their corporate activities, requested that CAMAC prepare a discussion paper on directors' duties and corporate social responsibility. CAMAC published its discussion paper in November 2005. The date for receipt of submissions closed in February 2006; CAMAC received 61 submissions from community groups and associations, academics and individuals.

On 23 June 2005 the Parliamentary Joint Committee on Corporations and Financial Services also resolved to inquire into corporate responsibility and included in its reference the extent to which the current legal framework governing directors' duties encourages or discourages directors from having regard to the interests of stakeholders other than shareholders and the broader community, and whether revision to the legal framework, particularly to the *Corporations Act*, is required to enable or encourage directors of corporations to have regard to those broader interests. The committee handed down its report in June 2006.

I will turn firstly to CAMAC's Discussion Paper. It notes that companies are not obliged to go beyond compliance with the letter of the law but questions whether the adoption of business practices and internal standards that promote full compliance with the "spirit" as well as the "letter" of legal obligations may signify a better managed and more responsible company.[54]

The paper refers to the philanthropic approach to corporate social responsibility which involves companies giving to the community in financial or other ways above and beyond their primary business activities on the basis that there is some direct or indirect benefit to the company in so doing.[55] Other well recognized principles of corporate governance accept that even if corporate profit and shareholder gain are not directly enhanced by this philanthropy, a corporation in the conduct of its business may properly devote a reasonable amount of

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52 (1993) 9 WAR 395, 456.

53 See s 179 and s 185 but note the last paragraph of s 185 which provides that s 185 does not apply to the business judgment rule.

54 *Corporate Social Responsibility Discussion Paper*, 2005, 14. CAMAC website: www.camac.gov.au, as at 26 July 2006.

55 Above, 15.

resources to public welfare, humanitarian, educational and philanthropic purposes.[56] In any case the commercial approach to corporate responsibility accepts that it is likely to be in a company's own long- or short-term interests to take into account the environmental and social context in which the company operates. A well-managed company will have regard to a variety of risk factors that impinge on its operations, extending beyond financial risks to relevant social and environmental risks. The early identification and management of these non-financial risks is often integral to a company's operational efficiency, financial performance and long-term shareholder value.[57]

Another recognized approach to social responsibility is ethics-based, requiring directors to take ethical values or standards beyond the letter of the law into account in their corporate decision-making even where this may not directly enhance corporate profit or shareholder gain.[58] A variant of that concept is the altruistic approach which is based on the view that as business has access to valuable resources and the privilege of limited liability, it is part of the role of business to assist in solving social problems and advancing public welfare despite an absence of clear discernible benefit to the company in so doing.[59]

The CAMAC Discussion Paper suggests that the "stakeholders" in the corporate social responsibility and directors' duties debate include not just shareholders but others with a financial interest in the company such as financiers, suppliers and other creditors, or perhaps business partners; those involved in the company's wealth creation, for example, employees and consumers; others directly affected by a company's conduct, for example, communities adjacent to a company's operations; and pressure or lobby groups such as public interest bodies that espouse social goals relevant to the company's activities; the term could more generally include regulators, the financial markets, the media, governments and the community at large.[60] After reviewing the current law as to directors' duties[61] the CAMAC paper invites discussion on the following issues:

- whether directors, whilst still required to act for the benefit of shareholders, may also be statutorily entitled to take into account the benefit to shareholders generally as members of the community (the enlightened or elaborated shareholder benefit approach);[62]
- alternatively, should directors' duties be reformulated to permit or require directors to further the interests of non-shareholder participants such as employees, customers and suppliers even if this were to the short-term detriment of shareholders (the pluralist approach);[63]
- presently the *Corporations Act* requires that all companies other than some small proprietary companies must prepare and file with ASIC an annual report comprising a financial report and a directors' report.[64] The *Corporations Act* also requires that the annual directors' report give details of the company's performance in relation to environmental regulation where the company's operations are subject to any particular

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56 Above, 17; American Law Institute *Principles of Corporate Governance: Analysis and Recommendations* vol 1, American Law Institute Publishers, 1994, 55.

57 Above, 18 - 21.

58 Above, 25.

59 Above, 26.

60 Above, 27 - 28.

61 Above, 47 - 60.

62 Above, 69 - 71.

63 Above, 71 - 72.

64 Section 292 - s 294 *Corporations Act*.

and significant environmental regulation under a state, territory or Commonwealth law;[65]

- the ASX Corporate Governance Council in its *Principles of Good Corporate Governance and Best Practice Recommendations* suggests that listed companies establish a sound system of risk oversight and management and internal control to identify, assess, monitor and manage risk and to inform investors of material changes to the company's risk profile including material risks in financial and non-financial matters. The Australian government has asked the ASX Corporate Governance Council to consider introducing sustainability reporting into its *Principles of Good Corporate Governance and Best Practice Recommendations*;[66]
- over the last decade there has been a move towards greater disclosure by corporations of their environmental and social impact, such as the recent initiatives in the United States, the United Kingdom, South Africa, the European Union and Canada which are listed in the paper.[67]

The commercial world and the wider community anticipate CAMAC's report on Corporate Social Responsibility with great interest, especially in the light of the recent Parliamentary Joint Committee on Corporations and Financial Services report on *Corporate Responsibility: Managing Risk and Creating Value*.[68]

As noted earlier, that Committee's terms of reference included the extent to which organizational decision-makers have or should have an existing regard to the interests of stakeholders other than shareholders and the broader community, the extent to which the current legal framework governing directors' duties encourages or discourages directors from having regard to those broader interests, and whether revisions to the legal framework, particularly to the *Corporations Act*, are required to enable or encourage incorporated entities or directors to have regard to those broader interests. After reviewing the present law dealing with directors' duties under s 180 and s 181 of the *Corporations Act*, the Committee referred to the narrow view that a corporation is not a participant in the community and has no obligations to the community beyond its obligation to generate profit for its shareholders.[69] The Committee then referred to the example commonly raised in evidence before it, namely the decision of the James Hardie Group to restructure its corporate affairs so as to quarantine itself from liability for the health effects of its asbestos products. Such a decision would clearly have been in the short-term interests of its shareholders but was equally clearly contrary to the interests of external stakeholders - the employees and others affected by asbestos-related diseases through their contact with James Hardie products. The Committee's report notes:

> "James Hardie Chairwoman, Ms Meredith Hellicar has stated publicly that the company had taken a 'hard nosed' approach to its responsibilities at least in part because of concern by the Directors that the law *required* them to circumvent liability if this was in the clear interests of the company. In the *Australian Financial Review*, Ms Hellicar stated:
>
> > 'I think protection [for Directors seeking to act in the interests of stakeholders other than shareholders] would be beneficial because

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65 Section 299(1)(f) *Corporations Act*.

66 Fn 54, 84 - 86.

67 Above, 86 - 100.

68 Commonwealth of Australia, Canberra, 2006. Committee website: www.aph.gov.au/senate/committee/corporations_ctte/index.htm, as at 11 October 2006.

69 Above, 46.

> there is no doubt that the threat of a shareholder suit - even if we get majority shareholder support - a minority shareholder can still say, we don't agree, so some protection would help ... it certainly might make us feel more comfortable.'"[70]

The report refers to Professor Margaret Nowak's significant analysis of James Hardie's actions. She stated:

> "If you take Meredith Hellicar's argument that one of the things that was in the minds of the directors was that they needed to do this restructure to protect shareholder value as they saw it at that time, then I think that gave them a rather lopsided view of the way in which they should be making their decision. I would argue that that lopsided view needs to be corrected."[71]

The Committee reached the following conclusions. Directors who take the narrow interpretation are wrong and overstate the impact of s 180 and s 181 of the *Corporations Act*: current directors' duties under the *Corporations Act* were intended to provide protection for shareholders, not to create a safe harbour for corporate irresponsibility. The restrictive interpretation is relatively uncommon in corporate Australia; most directors appear ready to accept that the current directors' duties allow them some leeway for corporate responsibility and philanthropy.[72] While some directors have used that restrictive approach to defend irresponsible activities, many others have led their companies towards increased corporate responsibility without the shareholder revolts predicted by those taking the restrictive view. The most appropriate perspective for directors to take was one of enlightened self-interest; directors should act on behalf of their corporations in a socially and environmentally responsible manner at least in part because such conduct is likely to lead to the long-term growth of their enterprise.[73] The Committee rejected the proposed approach in the UK's Company Law Reform Bill 2005 because it appeared to introduce greater uncertainty into the legal expression of directors' duties.[74] The Committee also rejected the permissive approach popular in some jurisdictions in the United States which makes it clear that directors are entitled to make decisions reflecting the interests of stakeholders other than shareholders. It considered that such an approach may amount to shifting the goal posts rather than dealing with the problem, and directors who felt constrained by the *Corporations Act* may find themselves instead being constrained by whatever definition of corporate responsibility would be built into future legislation. The Committee did not consider there was any jurisprudence suggesting misinterpretation of the current provisions of the *Corporations Act* necessitating the introduction of the permissive approach.[75] The social and environmental performance of corporations is already regulated sufficiently without any need for amendment of the *Corporations Act*.[76] There was nothing in the *Corporations Act* which genuinely constrained directors who wished to contribute to the long-term development of their corporations by taking account of the interests of stakeholders other than shareholders; an effective director will realize that the well-being of the corporation comes from strategic

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70 Above, 47; Fiona Buffini "Calls to Protect Corporate Conscience" *Australian Financial Review*, 23 November 2005, 4.

71 Above, 47 - 48; Professor Margaret Nowak, Research Director, Corporate Governance and Social Responsibility Research Unit, Curtin Business School, Curtin University of Technology *Committee Hansard* 20 February 2006, 32.

72 Above, 48 - 49.

73 Above, 53.

74 Above, 55.

75 Above, 56 - 58.

76 Above, 60.

interaction with outside stakeholders in order to attract corporate advantage. More corporations and their directors should focus attention on stakeholder engagement and corporate responsibility. Any hesitation to do so does not arise from legal constraints in the *Corporations Act*, which indicates that the solution is unlikely to be legislative. The Committee concluded that "the *Corporations Act 2001* permits directors to have regard for the interests of stakeholders other than shareholders, and recommends that amendment to the directors' duties provisions within the Corporations Act is not required."[77]

The Committee recommended that investors, stakeholders and relevant business associations should encourage companies to include long-term (beyond a three to five year timeframe) and corporate responsibility performance measures as part of the remuneration packages of company directors, executive officers and managers.[78]

The Committee's Supplementary Report by Labor members also specifically referred to directors' duties[79] and recommended that there not be any alternative to the current formulation of them; if legal barriers to the consideration of legitimate environmental and social issues by directors were subsequently raised, either by judicial interpretation or in practice, this would require reconsideration by the government.[80] The Supplementary Report also recommended an amendment to the *Corporations Act* to require all public and private companies operating in Australia and above a specified size threshold to publicly disclose their top five sustainability risks and their strategies to manage such risks, such provision to be subject to an "if not, why not" flexibility mechanism modelled on that contained in the ASX Corporate Governance Council's *Principles of Good Corporate Governance*.[81]

Conclusion

All this suggests that it is likely that the community demand for high standards of corporate governance will mean that the concept of the best interests of the corporation will not be interpreted as limited to ensuring the maximum short-term profit for shareholders if that is to be done at the expense of other corporate commitments to employees, the wider community, the environment and ultimately the company's long-term sustainability. Whilst no accurate predictions can be made as to the course of jurisprudence in this developing field, the view I suggest is consistent with the plain meaning of the words imposing directors' duties in the *Corporations Act*, present jurisprudence and the view of the Parliamentary Joint Committee report to which I have referred. Interestingly, UQ Business School lecturer Mr Darren Lee's recent PhD research has found that corporate sustainability is synonymous with socially responsible investing (SRI) formally integrating economic, social and environmental concerns into investment decisions. Shareholder returns on portfolios based on SRI are no less than those of portfolios of lagging sustainability firms.[82] Furthermore, I like to think that as more and more women take their places as directors on publicly listed corporate boards, women directors will more confidently use their corporate voices to encourage corporate social responsibility in the decision-making of directors.

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77 Above, 63.
78 Above, 146.
79 Above, 181.
80 Above, 182.
81 Above, 191.
82 University of Queensland, *Research Profile 2006: Business Economics, Tourism and Law*, 13.

The recent High Court decisions of Campbells Cash and Carry Pty Limited v Fostif Pty *Limited*[83] and *Mobil Oil Australia Pty Limited v Trendlen Pty Limited*,[84] which go some way to clarifying the law in Australia relating to representative proceedings financed by litigation funders, may well result in lawyers and judges soon having a growing body of jurisprudence testing the boundaries of directors' duties, with more frequent, more innovative and more rigorous pursuit of directors who might be said to have breached their duties. The concept of civil responsibility for breach of directors' duties will remain largely as I have set out earlier in this paper, with incremental developments based on particular factual scenarios. The best interests of a corporation will usually be consistent with the best interests of the broader community. It will be in the interests of neither commerce, individual corporations nor the community if the duties imposed on directors become so onerous and unrealistic that the best women and men eschew that important role. That concern has been very recently expressed by critics of the UK's Company Law Reform Bill 2005 in that the Bill replaces shareholders' common law derivative claims against directors or former directors with a new, broader statutory procedure which applies to any breach of duty or negligence by a director or former director. It is feared the process could be abused by disgruntled employees, lobby groups, institutional investors or vulture funds. On the other hand, the court would be given a wide discretion under the Bill to summarily dismiss claims not brought in good faith and opposed by independent shareholders.[85]

William S Laufer, in his recently published book *Corporate Bodies and Guilty Minds: The Failure of Corporate Criminal Liability*,[86] offers a more cynical perspective and argues that there is scant evidence that reforms necessarily bring about lasting change in corporate behaviour.[87] He suggests that corporate regulation, especially at criminal law level, is too often a matter of game playing between prosecutors and regulators on the one hand and clever corporate counsel on the other, with

> "[s]kills and strategies for this game ... available for sale at a host of high-priced 'ethics' conferences, from a new breed of reputation and integrity management firms, from tried-and-true consulting firms, and from a legion of prosecutors-turned-defense-counsel who, better than most, know when to bluff, raise the ante, or fold ... [w]here compliance failures undermine their standing, corporate public relations offers a cure with glossy and elegant annual reports detailing social and environmental accomplishments. Corporations that want to be seen as ethical 'stewards,' but have much to hide, wash their reputations - 'greenwash' environmental violations or 'bluewash' by suggesting ethical leadership and affiliating with the United Nations or other strategic nongovernmental organizations or standards groups."[88]

No doubt, as Laufer predicts, the game will continue into the foreseeable future, despite the best efforts of many principled directors and much genuine corporate embracing of social responsibility. With litigation funding and representative actions the participants in the game may be more numerous and more diverse than in the past. The now uncontroverted acceptance of the dangers for the world of global warming means that the stakes of the game

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83 [2006] HCA 41, 30 August 2006.

84 [2006] HCA 42, 30 August 2006.

85 Daniel Lightman "Boards beware! Lawyers loom" *The Times* 12 September 2006. Times Online website: www.timesonline.co.uk, as at 28 September 2006.

86 University of Chicago Press, Chicago, 2006.

87 Above, ix.

88 Above, x.

are much higher than ever before. I am hopeful that as women are better represented in the game, the rules will be interpreted ethically and broadly and conscientiously adhered to and that women directors, women lawyers and women judges will make an increasingly significant contribution to the jurisprudence surrounding the concepts of what constitutes reasonable care and diligence for directors of corporations and the best interests of the corporation, to the benefit not only of shareholders but of the wider local, national and global community.