CPA Australia

Submission to

Corporations and Markets Advisory Committee

Review of

Corporate Duties Below Board Level

September 2005

Executive Summary

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

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

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

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

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

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

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

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

CPA Australia's response to the individual CAMAC proposals

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

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

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

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

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

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

Background
The interaction of statutory provisions and the general law

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

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

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

185 Sections 180 to 184:

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

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

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

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

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

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

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

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

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

The division of corporate powers

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

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

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

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

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

This division of powers is now embodied in legislation:

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

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

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

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

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

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

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

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

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

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

Reliance and delegation

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

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

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

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

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

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

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

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

And further:

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

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

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

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

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

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

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

SECTION 189 RELIANCE ON INFORMATION OR ADVICE PROVIDED BY OTHERS

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

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

(i) in good faith; and

(ii) after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation; and

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

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

SECTION 190 RESPONSIBILITY FOR ACTIONS OF DELEGATE

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

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

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

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

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

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

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

SECTION 198D **DELEGATION**

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

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

(a) a committee of directors; or

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Proposal 1

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

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

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

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

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

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

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

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

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

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

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

Directions in case law

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

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

and;

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

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

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

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

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

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

Origins of s 181

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

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

---

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

Proposal 2

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

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

The negligence basis of the duty of care and diligence

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

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

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

and

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

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

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

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

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

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

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

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

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

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

Alternative paths of development

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

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

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

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

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

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

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

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

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

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

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

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

Proposal 3

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

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

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

Background to the introduction of s 180(2)

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

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

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

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

Recent judicial consideration

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

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

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

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

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

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

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

Proposal 4

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

Proposal 5

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

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

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

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

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

and,

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

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

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

---

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

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

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

Proposal 6

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

Refer below discussion with reference to s 1307(1)

Proposal 7

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

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

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

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

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

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

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

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

and further,

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

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

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

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

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