

CAMAC Discussion Paper Corporate Duties Below Board Level - May 2005

Submission

Summary

Conclusions

The majority of the changes proposed in CAMAC's Discussion Paper are not in our view required to deal with the issues raised in that paper.

The proposed changes would necessarily result in a major re-positioning of the way companies currently operate and have operated for many years. There is already a substantial body of law which is designed to ensure that the senior people who control companies manage those companies in an appropriate manner and take ultimate responsibility for their activities.

Business would incur substantial time and compliance costs in accommodating the changes.

Recommendations

1. The existing duties of care and diligence (s180) and good faith (s181) should remain as is and should not be extended to a wider class of persons.
 2. The prohibitions on improper use of position and information (ss184(2) & (3)) and the provision of false information (s1309(1)) and the obligation to ensure the veracity of information (s1309(2)) could be extended to employees of related corporations and, potentially, to persons who work under a contract with the company fulfilling functions which are essentially similar to those provided by an employee.
 3. However, these provisions, particularly section 1309(2), should not apply to third parties who performs functions, or acts, for or on behalf of a corporation.
 4. All defences available to directors who are the subject of fiduciary duties should be available to all other individuals who are subject to those duties. In this regard, we note that there appear to be oversights in the existing legislation which should be remedied. In particular:
 - Section 187 authorises directors to act in the interests of a holding company in certain situations and deems this to be acting in good faith and in the subsidiary's best interests. However, it does not apply to officers. In our view this should be amended so that officers have the same ability, being essentially a defence to a breach of fiduciary duties.
 - Section 189 provides an effective due diligence defence to directors, but not other officers, by deeming reliance on information provided by others in certain cases to be reasonable unless proved otherwise. In our view this should apply equally to other officers who are subject to fiduciary duties.
 5. If the policy considerations outlined in this submission are acceptable, consideration should also be given to more clearly define the scope of those taken to "participate in" a decision. In our view, this should apply only to those who are both involved in a decision *and* can determine (alone or with others) the outcome of that decision.
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Analysis

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| Existing law | <ul style="list-style-type: none"> - The existing law already imposes fiduciary duties of care and diligence and of good faith on any person who: <ul style="list-style-type: none"> - makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or - has the capacity to significantly affect the corporation's financial standing. - This covers people who hold senior management positions in companies and who have the capacity to influence the decisions made by those companies. It also covers other persons who are in a position to influence the company's decisions on significant matters. - The scope of the words "participates in" the making of decisions is unclear. It may cover persons who participate in the process leading to the decision, but it seems to us that these words would properly cover only those people who play a role in determining outcomes. It may be that this should be specifically clarified (as suggested above) if the submissions made in this paper are accepted from a policy perspective. - Under the existing law, following the CLERP 9 amendments, any director, officer or employee may also be liable for improper conduct, including improper use of position or company information, interference with company books and providing false information to, or failing to ensure the veracity of information provided to, directors, auditors or members. These prohibitions were extended to cover employees after the occurrence of the conduct the subject of the HIH report. - There are also general prohibitions on misleading and deceptive conduct (for example under the Trade Practices Act). |
| CAMAC Proposals | <ul style="list-style-type: none"> - The essence of the changes proposed in CAMAC's paper is to: <ul style="list-style-type: none"> - extend fiduciary duties of good faith and care and diligence to persons who may be involved in a decision but who have no capacity to determine the outcome of that decision; - extend the prohibitions on improper use of position and information, providing false information and, potentially, failing to ensure the veracity of information to persons who perform any functions for a company. |
| Fiduciary duties | <ul style="list-style-type: none"> - In our view, the extension of fiduciary duties to persons beyond those currently covered is not warranted. - The governance structure of companies has been established over a long period, distinguishing between those who have the power to make decisions and those employed to assist. Recognising this, structures and practices have developed to ensure that directors and senior executives have the necessary information and protections to allow them to fulfil their functions. - In particular, directors and senior officers currently have available to them: <ul style="list-style-type: none"> - defences such as: <ul style="list-style-type: none"> • the business judgment rule (to the extent available); • due diligence defences in various circumstances; • capacity to delegate and rely on delegates who have appropriate expertise; and • specific relief to allow directors to act in the best interests of the |

holding company;

- access to D&O insurance;
 - access to all information of the company, including board papers and management reports across the full range of the company's activities;
 - a right to indemnity under the constitution enforceable as a contract between them and the company;
 - additional deeds of access and indemnity in many cases, which provide directors and officers with access to information and indemnity after they cease their position, allowing them to defend proceedings brought against them for their conduct as officeholders;
 - levels of remuneration commensurate with the degree of risk and responsibility assumed by them;
 - actual and ostensible authority to bind the company and take action on its behalf;
 - authority to direct employees and to determine outcomes and information flows;
 - board and committee meetings which provide a forum for discussion of significant issues;
 - access to independent legal advice and training; and
 - procedures for the appropriate management of conflicts, supported by a body of law.
- In short, directors and officers are given responsibilities and rights commensurate with the power that they exercise.

Extension of fiduciary duties further below board level

- If it is proposed to extend fiduciary duties to people who do not hold senior positions, these individuals will be given additional responsibilities without the power to determine outcomes or the rights which protect their personal position. Alternatively, those people will need to seek such protections.
 - The practical consequences of this for companies would seem far reaching. The additional expense involved would appear prohibitive.
 - Examples of additional measures which would need to be adopted include:
 - training and education;
 - legal advice for a wider class of individuals on their fiduciary duties in given situations;
 - deeds of access and indemnity (as these individuals are not covered by a company's constitution);
 - constitutional amendments authorising the company to enter into such deeds, given that many constitutions may only authorise access and indemnity for directors and officers;
 - D&O insurance, assuming this is realistically obtainable; and
 - pressure by employees for increased remuneration proportionate to their level of risk.
 - More generally, companies will need to review and revise corporate structures, policies and procedures to reflect the additional regulation.
 - Many of the rights or protections which apply to directors and officers could not be extended to other management by actions of the company alone. For example, the protocols for managing conflicts are laid down in statute and supported by legal precedent. These do not extend, and
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cannot be readily applied to other individuals.

- Logically, if the duties of directors and officers are extended to other persons it would seem reasonable, from their perspective, that those persons should have a greater ability to determine outcomes and exercise power and authority. Clearly this will present significant issues for management's relationship with the directors and senior executives, who have the final authority on any decision.
- In our view, these changes are both onerous and unnecessary. Considerable effort has been expended already in recent years in ensuring that those with the capacity to make decisions are responsible for the implementation of proper governance procedures across their organisations.
- Recognising the prominence of the HIH collapse, we believe the legislature should be cautious not to "overreact" to the aberration presented by that collapse in a way which will cause extraordinary financial and other results for business generally. It should be recognised that the key persons involved in that collapse acted regardless of clear legal duties and prohibitions already imposed on them by the existing law.

Availability of defences

- If, contrary to the above, it is thought that these duties should apply to a wider class of employees, then it is appropriate that those individuals have the same defences as currently apply to directors including the business judgment rule (as proposed by CAMAC) but also the ability to rely on due diligence (s189) and relief to allow the individual to act in the best interests of the holding company (s187). We have made specific recommendations on these above.
- A variety of other provisions may also require amendment.

Improper Conduct

- The governance provisions of the Corporations Act are designed to regulate the company and its internal administration. They are not designed to regulate generally any person's dealings with a company.
 - The prohibitions on improper use of position and information (ss184(2) & (3)) and providing false information (s1309(1)) currently apply to officers and employees.
 - In our view it would be appropriate to extend these provisions to employees of related companies, to deal with the situation where the individuals who brief the company's board and auditors are employed by a service company.
 - We also see some logic in applying those provisions to persons who work under a contract with the company, fulfilling functions which are essentially similar to those provided by an employee.
 - However, we do not see a basis on which the Corporations Act should be extended to apply these provisions to any person who performs any function for a corporation (for example, sub-contractors, service providers, landlords, information providers, government agencies and regulators).
 - There is no particular rationale for creating criminal offences relating to people's dealings with corporations which do not apply equally to dealings with natural persons, government bodies, partnerships, trusts or any other entities. It seem to us that, if such offences are thought appropriate, they should be dealt with in a broader context (for example in the Crimes Act or Trade Practices Act) so that it is the principal conduct which is relevant, not the fact that the conduct was committed in relation to a corporation, as opposed to some other type of entity.
 - It may be that various of this conduct is already dealt with under such
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| | | legislation, although we have not researched this point. |
| Obligation to ensure veracity of information | - | If, contrary to the above, it is thought that offences should extend to any person who performs a function for the company, we nevertheless would be seriously concerned if obligations to ensure veracity of information (s1309(2)) were extended beyond the current position. |
| | - | Section 1309(2) is a positive obligation, which essentially requires individuals to warrant they have exercised due diligence in providing information to directors, auditors or members. If this is extended to any person who performs functions for a company, it would impose an enormous compliance burden on people who deal with companies. (However, it may be appropriate to extend this section to employees of other group companies, and potentially “quasi employees” in the manner outlined above.) |
| General prohibition on dishonesty | - | We also do not see a need for a general provision prohibiting people from acting dishonestly in connection with the company’s compliance with laws. However, if such a provision is thought necessary, it should only apply to the company’s compliance with the Corporations Act and not to other statutes or laws. We see no rationale for creating an offence which is specific to corporations and which does not apply if natural persons or other types of entities breach the same laws. |
| Corporate Groups | - | In our view there is no need for a separate provision attempting to deal with the responsibility of officers to differing entities within corporate groups. |
| | - | To the extent a director, officer or employee of a service company: <ul style="list-style-type: none"> - makes or participates in making decisions that affect the whole or a substantial part of the business of a corporation; or - has the capacity to significantly affect the corporation’s financial standing, they will be an “officer” of that corporation under the existing provisions and will owe duties to that corporation. |
| | - | If those persons do not exercise such a role in relation to that corporation, then we see no reason why they should owe fiduciary duties to that other entity simply because they have a role or function in a related company. |
| | - | The directors of a corporation are entitled to delegate functions to any person, including a service company, but may not abdicate those functions. Accordingly, directors retain their obligation to manage the company and are required to supervise services provided by other group companies. This requirement already exists under current statutory and case law. |
| Definition of “employee” | - | We do not believe that the term “employee” needs a statutory definition. The expression has a longstanding meaning under general law and a statutory definition may cause confusion. A person may be an “officer” of a corporation and owe fiduciary duties, regardless of whether they are an employee of that corporation. As outlined above, we believe that this approach already deals with the particular issue of corporate groups. |