Corporations and Market Advisory Committee (CAMAC)

Corporate duties below board level

Submission by

National Institute of Accountants

The National Institute of Accountants (NIA) has reviewed the Corporate and Markets Advisory Committee (CAMAC) discussion paper titled *Corporate duties below board level.* The NIA agrees with the need to discuss issues of corporate duties at all levels, however, the NIA has some concerns about some of the legislative changes proposed in the discussion paper. While corporate regulation is necessary, it is not always the answer. Legislation developed to address one problem can lead to the development of unforseen problems in the future, and therefore particular care must be exercised in recommending changes to the law. The NIA is concerned that the discussion paper does not adequately address any potential negatives from the recommended changes and does not adequately deal with alternate proposals to deal with the perceived problems.

The NIA would also suggest that the disaster that was HIH should not direct every endeavour in relation to Corporate Governance in Australia. The failure of HIH arose from a myriad of factors, often unique to the culture of that company. It is therefore not wise to undertake a review of corporate responsibility in Australia by merely doing an autopsy on HIH. Autopsies are good at determining the particular cause of one death, and while they may be educative in preventing other death's, they do not give a good understanding of the living population. Equally while we need to learn the lesson's of HIH, we should not assume all companies are infected by the same "diseases" that infested HIH or that proposals that may have helped HIH would have the same impact elsewhere.

The NIA's response to the Discussion paper will involve an analysis of the proposals, reflect on the merit of the proposals and whether alternate proposals would achieve a similar outcome without the potential negatives of the proposal. The NIA will then review the need (or potential lack there of) to make reforms to the corporate duties below the board.

Proposal 1
Section 181 and 184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any person who takes part, or is concerned, in the management of that corporation. Should 'management' of a corporation be defined? If so, should it be along the lines of "activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some bearing on the financial standing of the corporation or the conduct of its affairs"?

The rationale given for this proposal is that the current definition of 'officer' as set out in section 9 of the *Corporations Act 2001* is not as wide as the former definition of 'executive officer'. The HIH report noted that while the definition of 'officer' in section 9 was supposed to adopt the comments of Ormiston J in *Commissioner of Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728, in the opinion of the Commissioner, it "did not achieve that objective" and "the failure to include a person 'concerned in the management'…was a material omission".

The NIA does not presume to have a better understanding of the law than the Commissioner, and is of the view that if the current definition is seen by the experts to fail to embrace the breadth of he former definition, then there are good reasons to amend the legislation to bring this into effect.

It is important that the class of persons who are subject to the 'good faith' and 'proper purpose' tests include those who 'take part or are concerned in the management' of a

corporation. Responsibilities in corporations today are more broadly defused than previously, many more people can be said to be 'concerned in the management' of a corporation and the definitions of those on whom responsibilities fall need to be broad enough to encompass this.

The difficult part though will be in determining just what 'taking part or being concerned in the management of a corporation' actually means. The CAMAC proposal suggest that it should encompass "activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some bearing on the financial standing of the corporation or the conduct of its affairs".

It is important in the development of any such definition that it does not accidentally include persons who may have some minor decision making capacity but who have no real impact on the corporation itself or where those persons are limited by those above them in the discretions they have in decision making. For example, the head of a section may have the power to make a range of decisions affecting that section, however, management at the level above might impose certain restrictions or set targets and outcomes that in effect limit their ability to make decisions. Is this type of person who should now be included in the revised definition? The NIA would think not. It is important than in any changes to corporate responsibility below the board level does not lead to the situation where blame is conveniently shifted down from those responsible for leading the corporation to those who have been devolved small decision making powers.

The proposed definition includes the caveat that the person making those decisions or policies has to be in a position to have a significant bearing on the financial standing of the corporation or the conduct of its affairs. The NIA believes that this should be sufficient to avoid the concerns articulated in the paragraph above.

The NIA therefore would endorse proposal 1 and the proposed definition of being involved in the 'management' of the corporation.

Proposal 2
Subsection 180(1) (the duty of care and diligence) should be expanded beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

Proposal 3
As a corollary of 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.

It would be incongruous to change the definition as set out in proposal 1 and not to do the same here. The test of those to whom the duties lie should be the same. The NIA also agrees that the 'business judgement rule' defence should also apply in the expanded circumstances. The NIA therefore supports the adoption of Proposal 2 and 3.

Improper use of corporate position or information

Proposal 4
Section 182 and s 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation, to any person who performs functions, or otherwise acts, for or on behalf of that corporation.

Proposal 5
Section 183 and s 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation, to any person who performs, or has performed, functions, or otherwise acts, or has acted, for or on behalf of that corporation.

The issue that has been highlighted by the HIH report is that in most corporations now there are a range of different people employed by the corporation to work on their behalf. Not all of these are encompassed by the current terms in the relevant sections as they talk about 'directors, officers and employees', as these definitions do not include people such as contractors and consultants. Many corporations employ consultants and contractors to do a lot of work on their behalf, providing such persons with the potential to improperly use their position or knowledge.

Given the flexibility of modern corporations it does not make sense to limit the applications of section 182, 183 and 184(2) and (3), by the use of generic terms about position (such as employee) rather it would make more sense to adopt the proposals set out in the HIH report that focuses on the functionality rather than title.

Proposals 4 and 5 suggest that the above section should apply to any person performing a function or acting on behalf (or has in the past done so) from misusing their position or corporate information. The NIA supports these proposals as providing a common sense approach. This definition should be broad enough to encompass all persons regardless of their position or title.

Section 1309

Proposal 6: **Subsection 1309(1) (knowingly providing false or misleading information and subsection 1309(2) (ensuring the veracity of 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.**

Subsection 1309(1) prohibits an officer or employee of a corporation from knowingly giving certain persons false or misleading information relating to the affairs of that corporation, while subsection 1309(2) requires that they take reasonable steps to ensure the accuracy of the information they provide to certain persons.

The CAMAC proposal is similar to the previous proposals, that being, the subsections should be extended beyond merely 'officers and employees' to also include other persons who act on behalf of or perform functions for a corporation.

The argument is again that there are many people who are not strictly employees or officers who work for or on behalf of the corporation who may be required to give information to the same people as set out in the subsections. If such persons are not included, then there is the risk that such person would be outside the law. It may

also be convenient to use such persons who are not named, so as to try and get around the requirement.

However, the definition here may be too broad. While contractors may be said to be similar to employees the issue of external consultants and external professionals complicates the situation. Lawyers, accountants and other professionals are often acting for or on behalf of a client, however, such persons have different obligations than someone who is merely engaged by a company to do some work on their behalf. This is not to say that such persons do not have an obligation to act ethically and to not provide false or misleading information (which they do, including their own professional requirements), rather it is to say we need to be careful not to include in the net of persons caught, groups that can not be said to be analogous to officers and employees. The line is not always clear.

The NIA broadly supports the proposition that all persons who are officers, employees or the like should be covered by the subsections. The NIA though believes that further regard needs to be given as to exactly who should be covered by the subsections and how best to define them without bringing in external professionals who should not be regarded in a similar vein to employees and officers of a corporations. However, such persons should also be required to act ethically, the issue is how best to define them.

Section 1307

Proposal 7: **Subsection 1307(1)(misconduct concerning corporate books) should be extended beyond past and present officers and employees of a corporation, to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.**

The NIA believes that similar arguments as raised above for proposal 6 apply equally for proposal 7.

General Dishonesty Prohibition

Should there be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute? If so, should the provision apply to:

- **Obligations under the Corporations Act only; or**
- **Obligations under any Commonwealth, State or Territory statutes applicable to Corporations; or**
- **Obligations under any overseas written law as well as any Australian law.**

The NIA would not support a general prohibition as outlined in the CAMAC paper. It is too broad and ill defined. It would be like passing a law on all Australians to never break a law or be dishonest in their every day life. It will be impractical and could easily be misused by Corporate regulators or others to threaten employees and others with court action for very minor contraventions. If the law is already in place then that provision should be strong enough to stand on its own, if the person breaches that part of the law then they should be charged with that specific breach.

This is not say that people should not act dishonestly, which is simply a truism. It is saying that such a broad provision is unnecessary. While the paper highlights some of the potential problems if such a provision, the NIA would highlight some more:

- There is an issue of double jeopardy here, a person could be charged under numerous provisions in different acts for the same offence, this goes against the tenants of our legal system;
- It opens up the possibility of abuse, the main persons who are likely to be targeted for a breach of this sort are people who are very low on the 'rung' of corporate responsibility. Such person will not have easy access to quality legal representations and may be threatened with charges under the provisions. Such a threat, whether it is backed up by facts or not, may be enough to force such a person to act in a way that they would not otherwise;
- It places many additional people in the position of potentially breaching laws they do not even know exist. While it is fair to expect directors, officers and senior managers to understand the law they operate under, for the average employee such matters will not be a high priority. With the myriad of laws and the different types of legislation (Federal and State) it may be quite easy for them to breach a law without ever intending to;
- There would need to be a defence for lower end personnel who are acting on direct orders from senior management or the Board, the fear of losing their job is likely to be high, their understanding of what they are doing and how they may potentially be breaching may be low. To say that such person should face a similar charge to senior management is unfair and inequitable; and
- There is also the issue of proper use of the regulators resources. With limited resources the regulator should concentrate on the big issues and target those who have real authority in corporations. While such cases are difficult to prove they are the ones that need to be targeted. The regulator may find it easier to go after the 'little fish' as it will likely be cheaper and easier for them to win. Such forcing down of corporate responsibility to the lower levels and away from the real decision makers, is unwelcome and unlikely to create a good corporate culture.

The NIA can not see what good would be done by such a provision. If a person has dishonestly breached part of the law they should be charged with that breach not some 'catch all' charge. There is a great threat of abuse and misuse of such a provision and it is likely to place an unfair burden on lower level personnel that is not commensurate with their level of understanding of the law nor their ability to act independently. If abuse is happening at a lower level, it is the role of senior management to intervene and see that it does not happen. It should not be the role of the regulator to check every minor breach. The NIA also believes rather than helping to improve corporate culture in Australia, it is likely to weaken it, as focus is shifted from the big decisions to the minutiae of every decision and every person in the corporation.

The NIA believes the earlier proposals should be more than sufficient to deal with the current weaknesses in the law without the need for this general provision.

Defining 'Employee'

Is there any deed to define the term 'employee' for the purposes of ss 182-184 or ss 1307 and 1309 in Proposals 4 – 7 are implemented?

The NIA does not believe there is a need to define the term 'employee', however, if such a definition is attempted it needs to be one based on functionality and integration within the corporation rather than a list of titles, positions or strict criteria. The NIA does not believe that it will be possible to reach a consensus view on what the definition of 'employee' should be. Any definition must be able to deal with the constantly changing structure of corporations and the way they do business. A definition that may be applicable now, may not be able to deal with changes in the future.

One advantage of a definition of an employee may help in distinguishing contractors that are effectively employees from professional consultants who merely provide and advice and external services to the corporation. While such a distinction would be welcome, the issue becomes one of how do you come up with such a definition.

It is noted that even the consultation paper does not attempt to come up with a proposed definition, indicating the difficulty that is likely to arise. Given that the earlier proposals are likely to deal with the matters of current concern, it would be better to focus on those issues rather than trying to tackle something as nebulous as definition of employee. This is likely to be a more long term issue than one that can be addressed within the time frame of the discussion paper.

Corporate groups

There was concern raised in the HIH report that where there is the existence of corporate groups, decisions may be made in one company in the corporate group that affect others. It was noted that the current legislation probably does not adequately deal with this. The CAMAC paper asks whether the law needs to be changed in order to bring this about. It is the view of the NIA that if the reforms proposed in proposals 1 to 7 were adopted, then there would not be any need for further changes to the law. If they are a director or officer of one group but makes decisions that affect another, it could be said that such persons where taking part in the management of the corporation, therefore they would be caught. To try and create additional rules is likely only to complicate the matter and may cause a difference in the way the Act is applied. Therefore given the proposed changes would adequately deal with the issue, the NIA does not believe further amendments to the law will be necessary.

Other behaviour

The CAMAC paper asks whether other forms of behaviour should be dealt with. The NIA is not of the view that there is the need to add extra 'sticks', but there is the need to add 'carrots' that will also help to improve Corporate Governance. One issue that I not canvassed is that of 'whistleblower' protection. One of the biggest things that prevents corporate abuses being discovered at an earlier enough time is that often those who may be in the position to report breaches feel they can not without losing their job and potentially being ostracised in their field of work.

The NIA believes it is important to reopen the debate on how best to protect corporate 'whistleblowers'. Mechanisms should be inserted in the law that help those wishing to take such actions from potentially punitive consequences.

Potential reforms to promote 'whistleblowing' include:

- Putting in place statutory protection for people who report genuine concerns about corporate conduct;
- Setting up a statutory body where 'whistleblowers' can raise their concerns about potential misdoing at the corporate level; and/or
- Encourage training at the mid-level of corporate management of issues concerning corporate governance and the proper running of corporations. Such training should first happen when a person becomes a director or senior manager. Greater understanding of proper corporate conduct should engender good corporate culture.

Conclusion

The NIA supports the adoption of proposals 1 through to 5 as they are proposed. The NIA generally supports the principles outlined in proposals 6 and 7, however, there may be a need to have consideration on just how wide the definition should be, and the issue of how professional consultants are to be dealt with needs further consideration. The NIA though does not support the adoption of general dishonesty prohibition. The law already sets out what is prohibited and any breach should be under a specific section not some 'catch all'. There is also concern about the potential for abuse to arise out of such a requirement. The NIA also believes that it would be nearly impossible to set a definition of 'employee' that covered all potential iterations, both now and in the future.

The NIA though believes that one area that was not covered and is one of the most important in relation to promoting good corporate governance, is the adoption in the law of strong and effective mechanism that promote 'whistleblowers' and protects them when they act in good faith.

Overall though the NIA believes that corporate governance in Australia is generally in 'good hands'. There will always be examples of bad corporate governance and the law should be flexible to deal with them, however, it is not possible to catch everything. More important than legislation is ensuring that there is a good corporate governance culture. Russia has some of the heaviest penalties for breaching corporate governance provisions in the world, however, few would say it is a country known for its high level of corporate governance. A large part of this has to do with corporate culture. It does not matter what laws you put in place if the culture is one of avoidance and disrespect. HIH failed for many reasons, a large part had to do with a very poor corporate culture and excessive risk taking. HIH is not reflective of most Australian businesses and while it is important to learn lessons from it, they should not colour the view of corporate culture in Australia and dominate laws dealing with it.