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Mr Alan Cameron AO
Chair Steering Committee
Review of State Owned Corporations
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Dear Alan,

Review of the Legislative Framework that provides for the Governance and Accountability of State Owned Corporations

The Australian Institute of Company Directors (Company Directors) is pleased to provide comments in response to the Issues Paper titled '*Review of the Legislative Framework that provides for the Governance and Accountability of State Owned Corporations*' released in November 2013 (the Issues Paper). Through providing our views we hope to assist the Steering Committee, the NSW Department of Premier and Cabinet, NSW Treasury and the NSW Department of Finance and Services with their deliberations.

Company Directors is the second largest member-based director association worldwide, with over 34,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies.

As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

1. General Comments

We have commented below on matters set out in the Issues Paper which are particularly relevant to company directors of state owned corporations and to the good governance of those corporations. We have not commented on all of the matters raised in the Issues Paper.

The key themes to which our comments relate are as follows:

(a) Company Directors welcomes this review of the State Owned Corporations Act 1989 (SOC Act) provisions, and the careful analysis which is evident in the Issues Paper regarding options for how to achieve best practice for, among other stakeholders, directors.

(b) Directors benefit from simplicity, consistency and ready access in relation to the governance requirements and duties imposed on directors. State Owned Corporations (SOCs) similarly benefit where their directors are able to clearly identify and understand their duties. For this reason we recommend that the Corporations Act duties regime apply to SOCs.

(c) Where there is no SOC-specific factor which mandates against this, SOCs should generally operate under the same type of governance framework as private sector corporations, to best position the SOC to achieve the same commercial benefits for the state as are pursued by a private sector corporation.

(d) Applying Corporations Act duties to SOCs will ensure that SOCs obtain the benefit of commercial good practice principles that govern the way directors duties have evolved under the Corporations Act, and that those duties will automatically be updated over time without the need to amend the SOC Act.

(e) It is generally beneficial to have a level playing field between SOCs and private sector companies, to help ensure that SOCs are run as commercial enterprises.

In responding to the Issues Paper we note the enactment, at a federal level, of the Public Governance Performance and Accountability Act 2013 (C'th) and the work recently undertaken by the Queensland Commission of Audit in relation to Government Owned Corporations in QLD. The Steering Committee may be assisted in their deliberations by having regard to the work undertaken in these jurisdictions where appropriate.

Our detailed comments in response to particular issues raised in the Issues Paper are set out below.

2. Policy Intent of the Legislative Framework

Question 2.1(1)

Is the original policy intent of the SOC Act and the enabling Acts still valid to meet current and potential future needs of the State? If not, what other policy objectives should be considered?

Company Directors has no issue with the current policy intent of the SOC Act and the enabling Acts.

The NSW Government may wish to consider including a general sentence to emphasise the importance of the SOC Act's role in maximising the effective allocation of SOCs' finite resources and ensuring that SOCs adopt good corporate governance practices.

Question 2.2

Should the governance provisions be centralised in the SOC Act? What benefits or disadvantages would flow from this?

Company Directors supports governance provisions which apply to directors being:

- easily accessible to directors; and
- as consistent as is practical across different directorships,

so that directors can readily identify and understand what is required of them.

Subject to the comments made below in relation to the Corporations Act, it would be advantageous for governance provisions to be centralised in the SOC Act for the following reasons:

- a centralised approach provides an efficient and consistent approach to ensuring effective good corporate governance across all SOCs. To account for any governance provisions which are unique to a particular SOC, any variances to the SOC Act which are specific to a particular SOC could be contained in the SOC's constitution;

- having all provisions in the SOC Act removes the possibility for conflicts between the SOC Act, enabling Acts, other acts and regulations;
- in terms of easy access, it is less burdensome for the board to ensure compliance with corporate governance provisions if they are contained in one Act, as opposed to considering all overriding and modifying provisions in the enabling Acts, other acts, regulations and guidelines; and
- to the extent that directors vary across the different SOC boards, access to governance provisions in one centralised Act will help ensure consistency in applying good corporate governance practices across the different boards.

We suggest however, that the Corporations Act directors duties, defences and penalties should apply to SOC directors as set out in the Corporations Act (see our response to question 8.2 below). Many directors serve on private sector boards as well as SOCs, and therefore are familiar with, trained in, and have developed understanding of the Corporations Act directors' duties.

Further, applying the directors duties as set out in the Corporations Act will ensure that SOCs obtain the benefit of commercial good practice principles as reflected in the way directors duties have evolved under the Corporations Act.

As commercial and good governance practices – and, consequently, directors duties - continue to evolve, this approach has the benefit that amendments to the Corporations Act directors duties will automatically apply to SOC directors, without the need to amend the SOC Act to incorporate such changes.

Question 2.3

Would a single, consistent arrangement for periodic review of all legislation governing SOCs benefit the overall accountability and governance framework and what should be the frequency of review?

Yes. We agree that legislation governing SOCs should be periodically reviewed and, if necessary, reformed to ensure its continued efficiency and effectiveness.

We would support the proposal of introducing a 'catch-all' requirement for any legislation which governs SOCs that has more than a minor impact on SOCs to include a requirement to review that legislation, and preferably have a sunset clause (being a clause that provides for the expiry of the SOCs legislation at a particular time) embedded into the legislation itself to further enhance the likelihood of review.

It would be beneficial if the review arrangements detail when the review of the legislation which governs SOCs is to be carried out and how it is to be conducted. For example, it would be appropriate if the review process was proportionate to the nature and significance of the legislation and broad enough to assess the performance of the SOCs legislation.

The appropriate timing for a review will depend on the significance of the SOCs legislation and the circumstances of its formulation, but Company Directors suggests that it should typically be every three to five years.

3. Principal objectives and functions of a SOC

Question 3.1(1)

In what circumstances (if any) should the government allocate responsibility for social, environmental and regional development objectives to SOCs? If not done by SOCs how can these objectives be met?

Question 3.1(2)

Should SOCs' principal objectives be clarified, amended or repealed?

Question 3.1(3)

If kept, how can the objectives be relocated, prioritised, or better expressed to improve the commercial focus and performance of SOCs?

Directors consider that clarity of purpose is a critical success factor for SOCs. For a SOC to be successful there must be clarity around the objectives of the SOC and clarity as to the purpose of the board. The board's fundamental role in overseeing the strategic direction of the SOC towards its objectives should not be unnecessarily hindered by Ministerial intervention or by prescribing objectives of equal weighting in statute that are potentially irreconcilable.

We are of the view that the SOC Act should only set high level commercial objectives for SOCs similar to those reflected in section 8 of the original SOC Act.[1] We are concerned that giving potentially divergent objectives equal weighting hinders board decision-making. The benefit to a SOC of having a board of directors is that the board can exercise judgment. The board can consider and then balance the different social, environmental and regional development objectives of a SOC, just as the board of a private sector company does. It is the SOC board's responsibility to balance competing objectives by assessing and making decisions that weigh up the interests of a range of stakeholders, but which ultimately are in the SOC's best interests. The exercise of the board's duty to act in the best interests of the SOC will therefore require the board to take the SOC's objectives into account.

If the SOC Act seeks to allocate responsibility for social, environmental and regional development objectives to SOCs, this could potentially result in conflicts between the commercial outcomes of the SOC and the prescribed objectives, or between the prescribed objectives themselves. Further, having many principal objectives may impede improvement of a SOC's commercial performance and make governance arrangements difficult or at least more complex than necessary.

Setting only a high level commercial objective for SOC's and then requiring directors to act in the best interests of the company would align the SOC position with that of private sector companies and would also contribute to a level playing field between SOCs and private sector companies.

If social, environmental and regional development objectives are removed from the SOC Act, it may be appropriate in rare situations (for example where the public is at risk, or if there is a significant safety issue at hand), for the portfolio Minister to give

[1] "Under section 8 of the original SOC Act, a SOC's principal objective was to be a successful business and to this end:

- operate as least as efficiently as any comparable businesses; and
- to maximise the net worth of the State's investment in the corporations; and
- To exhibit a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate these when able to do so."

a direction to SOCs under section 20N of the SOC Act 'to do (or not do) certain activities'. This is discussed further in relation to question 5.4(1) below.

4. Corporatisation Models

Question 4.1(1)

Should the SOC Act provide for both company and statutory SOCs, or only one model?

As discussed in response to question 2.2 Company Directors' preference is that the Corporations Act directors' duties which are in force at any given time, apply to SOCs. One way to achieve this easily would be for the SOC Act to provide for a company model. This option would not require any ongoing amendment to the SOC Act to reflect amendments that are made to the Corporations Act.

As to whether the statutory model should also be retained, Company Directors does not have a strong view on this point. We agree that retaining provision for both statutory and company SOCs without further changes would not impact on the performance of current NSW SOCs, but may increase the government's workload (as voting shareholders, for example, may need to review statutory and company SOC performance reports prepared under different legislative requirements). Further, although adopting a 'statutory model' only would mean that there would be no need to transition existing SOCs to a different governance model, changes to the governance model for statutory SOCs are clearly needed, as outlined in detail in the Issues Paper.

5. Roles and Responsibilities

Question 5.1(2)

What, if any, changes are needed to improve or clarify Ministerial roles and responsibilities in relation to SOCs?

We suggest that SOCs should, as far as possible, operate in the same way as private sector companies, where the board and chairman should decide on corporate matters and corporate roles and responsibilities in relation to SOCs without undue restriction from Ministerial intervention. Our reasons for this include:

- A separation of policy and ownership roles of government will help ensure a level playing field between SOCs and private sector companies. This is an important part of ensuring that SOCs operate as commercial enterprises with directors being able to act in the SOC's best interests.
- Applying the corporate governance structures of private sector companies will encourage SOCs to create value and provide accountability and control systems commensurate with the risks involved (for example, as adopted by the ASX Corporate Governance Council Principles and Recommendations).
- We suggest that the role of a SOC board should, as far as possible, replicate that of a board of a private enterprise. As private sector companies have developed, the board and chairman of the board are accepted to be best placed to judge what skills are needed to manage the SOC at a given point in time and which person has the best skills for the role. Therefore, one option would be for the board to decide on the skills and criteria for an opening on

the board (without undue restriction on criteria) and to recommend potential board candidates to the shareholder Ministers for approval. This would be consistent with the goals of increasing the commerciality of SOCs and creating a more independent 'arm's length' relationship with the government. A single simpler process for appointing directors to each of the SOCs would also improve efficiency.

- Similarly, we suggest that the role of the shareholder ministers should, as far as possible, replicate that of shareholders of private enterprises. In Australia, shareholders in private sector enterprises cannot directly instruct the board and management as to how they should exercise their powers. Rather, shareholders have the ability to elect and remove directors and to amend the company constitution to limit the powers vested in the directors. On this basis, the key function of the voting shareholders in a SOC context would be to elect and remove directors. We note that there has been much discussion within the public sector as to the appropriate number of shareholder Ministers in a SOC. While we do not have a firm view on this issue, we note that one disadvantage of having two shareholder Ministers is the potential for the voting shareholders to disagree, creating a deadlock which may lead to uncertainty for the board and the SOC. In this regard, we note that the QLD Commission of Audit recommended that there be only one shareholder Minister.[2] Finally, some directors serve on a number of SOCs. Therefore the more consistent the approach to determining ministerial roles and responsibilities, the more efficient SOCs will be across the board.

Question 5.2

Should the SOC Act be amended so that shareholders must communicate their strategic, long-term objectives and priorities?

Consistent with Company Directors' view that SOCs should operate in the same way as private enterprises, we propose that the SOC board should have the freedom to set strategies in order to maximise the commercial and social outcomes of the SOC. We suggest that strategies, objectives and priorities should be determined by the board independently, and that the board should engage with shareholders, where appropriate, to consult with the shareholders on the strategies the board proposes.

Question 5.4(1)

Should existing provisions be amended to better define, expand and/or limit Ministerial directions/approvals?

In ordinary circumstances, we suggest that it should be for the board to set the SOCs strategies and make decisions about the operations of the SOC. However, where the Portfolio Minister is empowered to give written directions to the board of a SOC, we suggest that, in the absence of special circumstances, any power of a minister to give written directions should replicate the powers of shareholders of a private enterprise (e.g. the capacity to remove directors).

We note that currently, the Minister is empowered to issue a direction to a SOC:

[2] See QLD Commission of Audit – Final Report, Volume 2, Part B Commercial Enterprises, February 2013 at page 2-49.

- to undertake action or cease to take action in circumstances where the board considers that it is not in the commercial interests of the SOC to do so (section 20N of the SOC Act);
- to apply public sector policies in the public interest (section 20O of the SOC Act); or
- because of exceptional circumstances, give a direction in the public interest (section 20P of the SOC Act).

These powers go significantly beyond the powers of shareholders of a private sector company to direct the board.

We suggest that the portfolio Minister should be more limited - the Minister should only be empowered to issue a direction to a SOC in circumstances when the public is at risk, or if there is a significant public safety issue at hand. We also recommend that any direction given by a portfolio Minister to a SOC should be tabled in parliament. In circumstances where the directors consider that a ministerial direction is not in the best interests of the company, the SOC should be entitled to be reimbursed for the cost of complying with the ministerial direction.

We note that the SOC Act, under section 33AA, currently provides a defence for directions issued under section 20O and section 20P of the SOC Act, but not section 20N. We agree that it would be appropriate to amend the SOC Act to make it clear that directors cannot incur personal liability for compliance with a Ministerial direction under section 20N. This is because it is inappropriate that SOC directors incur personal liability in such a circumstance because they are acting at the direction of the State.

Question 5.5(1) and (2)

What, if any, legislative changes are required to improve or clarify the roles and responsibilities of the board?

Should it be clarified that the role of SOC boards is to provide direction and oversight, with management being vested in the executive of the SOC?

We are of the view that the same principles as set out in the Corporations Act should apply to SOCs, under which the board determines, through delegation and direction as appropriate, whether the board, a committee or the executive should be responsible for a particular matter.

The board of directors has a monitoring, oversight and strategic role in relation to the company. The executive on the other hand is responsible for the day to day operations of the company and for the implementation of strategy set by the board. Despite the expectation gap which may exist in relation to these roles, Company Directors is very reluctant for legislation to prescribe the demarcation between the roles and responsibilities of the board and the executive, because:

- amendments seeking to clarify the role of SOC boards and the executive may have the unintended consequence of limiting the information which is provided by the executive to the board. For example, the executive may take the view that a particular commercial issue falls clearly within the executive's area of responsibility and so may not raise the issue with the board at all;

- attempting to clarify the roles and responsibilities of the board and management in legislation could lead to gaps where there is not a clear responsibility on either the board or the executive on particular matters;
- what is appropriate for the board to do and the executive to do is very much dependent on the circumstances at a given time; and
- finally, there is a risk that the demarcation of powers and responsibilities may have the unintended consequence of diminishing the effectiveness of the board's monitoring function (and conversely the ability of the executive to seek valuable input from the board) if the executive is seen to be vested with more substantial power than the board. If these concerns eventuate, the dynamics of the board may shift, potentially distorting the accountability of the board to the company and its shareholders.

6. Accountability and Reporting

Question 6.2(2)

Should any Corporations Act provisions be applied to statutory SOCs, for instance regarding disclosure of remuneration to reflect best practice corporate governance in the private sector?

We do not see it as necessary to have prescribed requirements for disclosure of director's remuneration apply to statutory SOCs, because this information can be easily requested by, and provided to, the voting shareholders. Further, the Corporations Act level of detail on remuneration levels and the requirements governing remuneration levels in Australia would be over-engineered for, and not advantageous to, the effective management of SOCs. For example, the current 'two strikes rule' (see Corporations Act sections 250U-Y) is not relevant or consistent with the concept of 'best practice corporate governance' in the context of SOCs as SOCs only have two shareholders who can readily liaise with the board (and can also easily remove board members if they choose to do so).

Question 6.4(3)

What additional measures, if any, should be available to voting shareholders to allow them to take action when they believe there is a serious risk of insolvency?

In practice, directors and voting shareholders would likely cooperate in taking action if they believed there to be a serious risk of insolvency.

We note there is a slight anomaly under the current legislative framework in the circumstance that the board considered the SOC to be insolvent, but the voting shareholders disagreed. Under the current legislative framework directors have a duty to prevent insolvent trading and will commit an offence if they do so.[3] Directors may also be personally liable for the debts incurred if the company trades while insolvent.[4] However, section 12 of the Act provides that if the directors suspect insolvency the directors must inform the voting shareholders who can either agree or disagree with the board's assessment. As discussed in response to question 5.4(1), a practical way to address this issue is to ensure that the SOC Act is amended to make it clear that directors cannot be penalised in any circumstance if the voting shareholders disagree with the board's assessment of insolvency or for compliance

[3] Section 7, State Owned Corporations Act 1989 (NSW)
[4] Section 8, State Owned Corporations Act 1989 (NSW)

with a Ministerial direction. Alternatively, directors have the option to resign if they are not comfortable with the view and direction of the Portfolio Minister, and voting shareholders also have the ability to a remove a director to allow them to take action if they believe there is a serious risk of insolvency.

Therefore, additional measures are not required to be made available to voting shareholders to allow them to take action if they believe there to be a serious risk of insolvency.

7. Boards and Executive Officers of SOCs

Question 7.1(1)

Should there be consistency in the legislative provisions for the appointment and removal of directors to SOC boards, and should these provisions be solely in the SOC Act?

We agree that consistency in the legislative provisions for the appointment and removal of directors to SOC boards is desirable, and that they should be contained in the SOC Act (see our response to 7.1(2) below).

Question 7.1(2)

Should voting shareholders alone appoint and remove directors?

Generally, we suggest the board and chairman is best placed to judge what skills are needed to oversee and manage the SOC at a given point in time and which person has the best skills for the role. As noted above in relation to question 5.1(2), one option would be for the board to decide on the skills and criteria for an opening on the board (without undue restriction on criteria) and to recommend potential board candidates to the shareholder Ministers for approval.

Regarding the removal of a director, a voting shareholder should be able to remove a director or not approve the reappointment of a director. As such, if a voting shareholder is not happy with a director's performance, the voting shareholder can remove that director. This is discussed further in response to question 7.5.

Question 7.1(3)

Should there be a legislative requirement to advertise for board positions?

We suggest that the board is best placed to decide how to fill board positions, including whether to advertise them or to use the services of an executive/director search firm, having regard to the particular circumstances.

Question 7.2

Are any changes required to the legislative framework for setting SOC directors' remuneration?

As noted in our response to question 6.2(2), we suggest that the Corporations Act disclosure regime on director remuneration would not be advantageous to the effective management of SOCs (as mentioned above, SOCs currently only have two shareholders and they can readily liaise with the board). Although we recognise that remuneration for SOCs and other government organisations may be set by remuneration tribunals or other similar structures, one appropriate approach would be for the voting shareholders to set a cap on the board's total remuneration and the board could then decide how to split the cap between the directors.

Questions 7.4(1) and (2)

How should SOC legislation best ensure directors have the necessary skill sets?

If one high level criterion to address directors' skills is supported, what should that criterion be?

As noted with respect to questions 5.1(2) and 7.1(2), we suggest that the board and chairman of the board is best placed to judge what skills are needed of directors to fill board vacancies and oversee the management of the SOC. We do not consider it necessary or desirable to prescribe high level criterion in the SOC legislation because:

- each director opening on a board should be filled by a director with appropriate skills necessary for that opening, and those skills will differ for each director opening;
- it is important that boards remain diverse and board members have a broad skill set range, depending on the nature of the SOC, in order to enhance the commercial performance of the SOC; and
- the board should generally consider the composition and performance of directors and the board as a whole at regular intervals whether by using a self-assessment tool or the assistance of an external service provider. Company Directors' Governance Analysis Tool (GAT), for example, is a guided self-assessment tool for boards to evaluate their performance on a range of governance issues and provides an opportunity for boards to identify their strengths and weaknesses.

There may be benefit, however, in requiring the directors of SOCs to meet similar eligibility criteria to that set out in the Corporations Act before being able to accept a board position on a SOC. We refer in this regard to the criteria set out in section 201B of the Corporations Act as to who can be a director and the circumstances within which a director may be automatically disqualified from managing corporations as set out in section 206B of the Corporations Act.

Question 7.5

What arrangements are appropriate for the duration of a SOC director's term of appointment, and any limits to reappointment? Which of these arrangements, if any, should be provided for in legislation?

Our preference is that the legislation should stay silent on the duration of a SOC director's term of appointment, and any limits to reappointment. We support the view that arrangements regarding the duration of a director's term of appointment and limits on reappointment should be left to the board to determine and monitor (having regard to regular performance evaluations), subject to the view of the voting shareholders which have the overriding power to remove a director at any time. We do note, however, that currently the SOC Act permits directors to be appointed for a term of not more than five years.

Question 7.6(1)

Should there be a consistent legislative provision for all SOCs (centralised in the SOC Act) stating that the CEO may be appointed as a director?

We suggest that the board should determine whether the CEO should be appointed as a director, as the board is in the best position to assess when it is appropriate to do so. It is important that this power remains with the board in order to ensure flexibility and the option of a fully independent board. The legislation could provide that the board may, but does not have to, appoint a CEO as director. This is the distinction between a CEO and a Managing Director.

Question 7.6(2)

Should there be consistent legislative provisions (centralised in the SOC Act) for the appointment, removal and/or determination of remuneration of CEOs for all SOCs and should shareholders have a say?

We are of the view that there should be a consistent legislative provision (centralised in the SOC Act) which provides that the board of a SOC has the responsibility for appointing, removing and setting the remuneration of the CEO.

We recognise that in a public sector context SOCs and other government organisations are often bound by remuneration tribunals and other similar remuneration structures. Despite this, we are of the view that there is value in considering whether for a SOC (as with companies in the private sector) it is appropriate that the board be responsible for the appointment and removal of the CEO and for the determination of the CEO's remuneration. If necessary this could occur with guidelines or a fee cap. We anticipate that this will ensure that the selection of a CEO is a commercially (and not politically) driven decision. It also allows the board to select a suitably qualified candidate who has the ability to drive performance, suits the culture of the organisation and who can relate to, and work well with the Chairman and the board. While we agree that the voting shareholders should have a say over the directors appointed to the board, we do not believe that the voting shareholders should have input into the selection or dismissal of the CEO. This would align the practice with that undertaken by companies in the private sector.

8. Directors' Duties

Question 8.1

Which Corporations Act provisions governing directors' duties, defences and penalties should be reflected in the SOC Act to better align with the Corporations Act?

As noted in response to question 2.2, we are of the view that the Corporations Act directors duties, defences and penalties should apply to SOC directors. This will ensure that SOC directors are able to focus their attention on enhancing the efficiency and accountability of running a company, whilst having the benefit and protection of provisions such as the business judgment rule and reliance on expert advice. This will also result in the expectations and protections of private sector company directors applying equally to SOC directors.

Further, because a number of directors hold directorships in a number of SOCs, the more consistent the approach to governing directors' duties, defences and penalties, the more efficient directors of SOCs will be in overseeing the strategies, objectives and priorities of SOCs across their portfolio of directorships.

We note that the directors' duties in the Corporations Act, with minimal exceptions, do not differentiate between the duties owed by directors of small, large, private, public, listed or unlisted companies. Essentially the same general duties apply to all directors of companies registered under the Corporations Act. Given the range of company types to which the Corporations Act directors' duties apply, we are of the view that the same duties can, and should, apply to SOCs.

We therefore consider it would be appropriate to expressly state in the SOC Act that the Corporations Act directors' duties, defences and penalties apply to SOC directors as set out in the Corporations Act at any given time. This approach has the benefit of not requiring ongoing amendment to the SOC Act to reflect any amendments made to the Corporations Act.

Our position on this issue should not suggest that the defences available to directors in the Corporations Act are as rigorous as they need to be. Company Directors has long suggested that the limited protection afforded by the business judgment rule, for example, should be re-visited. We are concerned that requiring directors, who perform their roles honestly and diligently, to operate in a regulatory environment where there is a lack of an effective business judgment rule defence and a high risk of personal liability is detrimental to Australia's economy and prosperity. It deters good directors from accepting board positions, stifles innovation and entrepreneurialism, slows decision-making and dampens productivity. If the liability situation were to be resolved in a NSW context we anticipate that NSW SOCs would be able to attract candidates from a wider pool.

At a federal level, we are of the view that the insertion of an overarching and broad-based defence into the Corporations Act is now required to protect directors that act honestly and with integrity, but who now work in an increasingly complex and compliance focussed regulatory environment.

At present the SOC Act does not contain a business judgment rule similar to that set out in section 180(2) of the Corporations Act. It was suggested at a recent NSW SOC Review forum that the insertion of a business judgment rule or another similar defence may not be necessary given that the SOC Act contains an 'unusual' relief provision in Schedule 10, Clause 10 of the Act.[5] We are of the view that the relief provision in Schedule 10, Clause 10 of the Act is not unusual given that it is almost identical in wording to the relief provision in section 1318 of the Corporations Act.[6]

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[5] Schedule 10, Clause 10(2) provides: "If, in a proceeding against a person to whom this clause applies for negligence, default, breach of trust or breach of duty as a person to whom this clause applies, it appears to the court that:
(a) the person is or may be liable for the negligence, default or breach, but
(b) the person has acted honestly and, having regard to all the circumstances of the case (including the circumstances connected with the person's appointment) the person ought fairly be excused for the negligence default, or breach,
the court may relieve the person (in whole or part) from liability on terms that the court considers appropriate.

[6] Section 1318 of the Corporations Act provides: "If, in any civil proceeding against a person to whom this section applies for negligence, default, breach of trust or breach of duty in a capacity as such a person, it appears to the court before which the proceedings are taken that the person is or may be liable in respect of the negligence, default or breach but that the person has acted honestly and that, having regard to all the circumstances of the case, including those connected with the person's appointment, the person ought fairly to be excused for the negligence, default or breach, the court may relieve the person either wholly or partly from liability on such terms as the court thinks fit."

However, unlike the SOC Act, the Corporations Act contains *both* the business judgment rule and relief provisions.

We are of the view that it is important to note the difference between relief provisions and appropriate defences. Relief provisions generally operate to *relieve* a director once they are found to be in breach of a legislative provision. On the other hand, a defence, if made out, will prevent a finding that there has been a breach of a legislative provision. We are of the view that appropriate defences are required in legislation governing the duties and responsibilities of directors and that relief provisions alone are not sufficient. From a reputational standpoint, being *relieved* from liability as a director will rarely be satisfactory, if there is still a finding that the director is in breach of the relevant legislation. We are of the view that appropriate defences should be available to directors so that in appropriate circumstances directors are found not to be *liable* (regardless of any relief which may follow).

Despite the improvement that could be made to the Corporations Act by the insertion of an over-arching and broad based defence for directors we are of the view that the SOC Act should still align with the Corporations Act duties, defences and penalties in force at any given time. We believe that this consistency would assist directors who serve on multiple boards in the public and private sectors.

In addition, we consider that if the Corporations Act directors duties are to apply to directors of SOCs, it is appropriate to pare back state legislation (e.g. enabling legislation, regulations and other public sector guidelines), which imposes duties and requirements on SOC directors, so it is only the SOC Act and the Corporations Act that applies in respect of governance. This will assist to ensure that board members are not expected to comply with a myriad of potentially conflicting legislation.

Separately, we mention for your consideration the comment made in paragraph 8.33 of the Issues Paper which refers to the 'limited powers of statutory SOCs', whereby 'SOCs are restricted by the SOC Act and their enabling Act, their constitution, their objectives, the relevant Statement of Corporate Intent and any relevant directions, notifications and approvals'. We suggest that like section 124 of the Corporations Act, section 20ZB of the SOC Act gives all the powers of a natural person to statutory SOCs.

9. Dividends and Statutory Payments

Question 9.1(3)

Which provisions, if any, from the Corporations Act should the Government consider adopting for SOC dividends?

Company Directors' longstanding position is that section 254T of the Corporations Act (*Circumstances in which a dividend may be paid*), should be repealed and replaced with a well-formulated and express solvency test. We are of the view that the 'net assets' test perpetuates the issues that were experienced under the original 'profits based' test and does not improve the ability of a company to pay a dividend to its shareholders. A solvency test would provide certainty, reliability and objectivity in determining whether to pay a dividend. A solvency test also provides a high level of comfort to directors in complying with their obligation under section 588G of the Corporations Act to prevent insolvent trading by the company.

We note that Commonwealth Treasury is currently considering amendments to the Corporations Act to address whether the 'net assets' test is a credible proxy for company solvency. We therefore suggest that either the NSW government wait for the outcome from the federal government on this point (and so dividend provisions currently contained in the SOC Act should remain until that time), or adopt a solvency test for the purpose of determining the amount of SOC dividends.

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In conclusion, Company Directors is committed to ensuring that corporate governance in Australia is of a high standard and we encourage the development of clear and strong frameworks that assist companies to implement efficient and effective corporate governance practices. In order to achieve this outcome in a NSW SOC context, the regime developed as a result of this Review should have regard to, and then make clear, which aspects of the regime are intended to be legal or statutory requirements (enforceable by Courts) and which aspects are intended to be suggested good practice recommendations, principles or guidelines (which are optional and do not have the force of law). Clarity is required so that potential conflicts between competing 'obligations' are avoided and because companies and directors are required to comply with the law first, before considering guidelines or other good practice documents. We hope that our comments will be of assistance to you.

If you would like to discuss any of our views in more detail please contact me or Senior Policy Advisor Leah Watterson on (02) 8248 6600.

Yours sincerely

Rob Elliott

General Manager Policy &
General Counsel