DIRECTORSHIP IN CONTEXT

A practical guide to the Australian corporate governance landscape

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Bruce Cowley FAICD

Australian Institute *of* **Company Directors**

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Foreword

The role and attendant responsibility of the modern director is less finite and less linear than ever before. It is tending toward a requirement for universality, in which the context for decision-making by directors is – like the universe itself – ever-expanding.

In this book Bruce Cowley, has gathered the context of the modern task of directorship and placed it within a legal, regulatory, social and ethical context. It casts wide, and casts forward with a breadth of ambition that is impressively matched by a depth of research.

Directorship in Context draws its strength from its location within the trends and influences that push and pull on the task of contemporary governance. This is not a dry run, but a superbly situational guide that connects to real examples, actual events and realised consequences. It quotes case studies as well as case law. This is a book about the contemporary task of being a director, and as such it draws upon modern instances to inform and support the issues at hand.

The author is a fine lawyer, much recognised for his professional work. He asserts that this is not a legal textbook. If that feels like a disclaimer, I suspect it is a modest one. This book is so much more than a fine compendium of the law; it takes the law as its starting point and impressively scaffolds the issues that define modern directorship around the primary concept of the duties of the director.

To be sure, the author starts with the rules. Of course, the legal context alone could dissuade the budding director (and perhaps even the reflective, experienced director in their quiet moments), but I urge you to read on and press on. As is noted in the text, despite the onerous complexity, thousands of people sign up to be directors because the task to lead, to contribute and to confront the onerous complexity of governing a corporation – whether large or small, commercial or charitable – is also exciting, consequential and impactful.

The specific chapters on remuneration and organisational culture are extremely practical references for even the more experienced director to reflect upon and occasionally re-read. The discussion on technological change and impacts on both business models and workforces is a concise distillation of the broader context of change.

It is perhaps insightful that the consideration of the impacts of one aspect of technological change, artificial intelligence, the author does not suggest that the director will be replaced by an AI algorithm. The need for context alongside the complexity and interconnectedness of issues that inform the balance of judgment of non-binary choices makes this unlikely, at least for now. This book is important because the worth of a broadly diverse set of diligent, thoughtful and considered directors from a range of backgrounds is not about to be supplanted by a bot. In consequence, this book is a tremendous resource for boards – and individual directors – to ensure they are meeting that need collectively and individually.

The chapter on ethical decision-making is in the middle of the book, and it is also at the centre of the implicit thesis of the book: the need for good directors. Ethical decision-making requires diligence and it requires breadth; governance is a team-sport, and an endurance test. Thus, when confronting an issue that can be framed by the contemporary descriptor of *could we / should* we the author draws out the ultimate context crisply:

> Just because an individual, a group, a regulator or the media disagree with a decision which a board has made, does not make the decision unethical *if the directors have, with an open and independent mind, undertaken a comprehensive consideration of the issue and its impacts on others (both direct and indirect), considered possible alternate approaches to the matter, considered differing views and stress tested the decision from multiple perspectives against the organisation's purpose and values. (emphasis added)*

Directors are fiduciaries, charged with acting for others and with trust and fidelity. This book is an impressive work in seeking to guide the modern director on how to meet that test. One could readily adapt the context quoted above to all decision making. If we start with a premise that we must act for others in all that we do, then the test above is a ready reckoner for broader decision-making beyond the board table.

And thus the chief benefit of this book is revealed. It is contextual, as all decision-making is. It goes beyond the law, draws in the threads, and looks to the future. It recognises that changes within society impact upon corporations, and it understands

that corporations impact upon society. It does what is says on the cover, it puts the role of the director in context.

Andrew Fraser
December 2022
Brisbane

Preface

The challenges facing directors in the 2020s are as widespread as they are unpredictable. Most directors will, at some time in their career, face circumstances for which they are ill prepared and unready. How they respond will often be a measure of their skills as directors, but also of their values, their appreciation of the expectations of their stakeholders and the strength of the culture of their organisation.

In the current era, someone is expected to take the blame for nearly every corporate difficulty. More often than not, that "someone" is the board. Whether or not the directors blameworthy, they not infrequently find themselves having to keep steady hands on the tiller while being on the receiving end of censure from the public, the media and the markets.

Whether the issue is the destruction of a sacred Aboriginal site or implementing a computer system which inadvertently omitted to report vast numbers of suspect transactions to the anti-money laundering and counter-terrorism authority — in today's environment, directors are expected both to take responsibility for the company's problems and to find a way through them.

Who in their right mind would take on such a role? Well, many thousands of people across the country do every day, because despite everything, they love the excitement and the challenges which come with having an important strategic leadership role in a corporation.

This book is for those stout at heart directors who, notwithstanding these personal risks and potential tribulations, take on these roles and seek to do their very best at all times to achieve positive outcomes for their corporations' stakeholders and, indeed, the broader Australian economy.

This book isn't necessarily about offering solutions to every challenge directors face. More often than not those challenges will have quite unique elements to them which require bespoke solutions. Rather, the book proposes ways of thinking and actions which directors can take to help them steer their companies through difficult times.

Before concluding, I would like to thank Andrew Fraser for his kind foreword. I would also like to pay tribute to Mercedes (Sadie) Burton who was my research

clerk who provided so much support to me and to those at the Australian Institute of Company Directors who have encouraged me so much, including, in particular, Angus Armor, Louise Petschler, Chris Gergis and my two publishers, Javier Dopico and Ivan Ah Sam.

Chapter 1

Introduction

This book is for those people who are, or plan to be, directors and want to do the very best job they can in the role. It explores the enormous pressures placed on directors ranging from compliance with the *Corporations Act 2001* (Cth) (Corporations Act) and general law duties, to the vast array of state and territory laws (especially in the fields of workplace safety and environmental protection) which lift the corporate veil and expose them to liability personally. It offers advice to help directors negotiate their way through the minefield of regulatory demands and the needs of their shareholders (and their proxy advisers) while being respectful of other stakeholders, meeting community expectations and acting ethically. It also seeks to equip directors with some tools to deal with challenging economic conditions, the impact of global warming, cybersecurity, drastic changes in international markets and unexpected challenges such as were wrought by COVID-19.

The succeeding chapters contain numerous examples of poor governance, poor culture and poor ethical decision making and enquire into how those events occurred and whether a different approach to governance might have avoided the problems. They contain some examples of good governance too which exemplify what exceptional governance can look like. The intent is to assist directors to deal with difficult issues they are likely to confront through a discussion of how challenges can be methodically and thoughtfully addressed and how the many competing interests can be prudently balanced.

While this book is not a legal textbook, there is still a need to understand the nature of directors' legal and regulatory obligations. In order to provide a structure

for later discussion, **Chapter 2** discusses, in a practical way, what the legal duties mean for directors in an every-day sense. Directors also need to be aware of some new laws which are being introduced that make them criminally liable for things such as workplace accidents and underpayment of staff.

Chapter 2 further explores the responsibilities of directors beyond their strict legal obligations. Many bodies, for example ASX and APRA, seek to impose certain standards of behaviour on directors through governance principles or guidelines. While failure to comply with them will not necessarily lead to legal liability, other consequences might follow.

In the past decade, customers have been sold valueless products and have been charged for services they never received, suppliers have struggled through pressures to accept lower prices and unfavourable payment terms and employees have been underpaid billions of dollars across many industries. Stakeholders are now fighting back and demanding more consideration and respect. Companies are expected to ensure the fair treatment of all participants in their supply chains and to pay their staff a fair wage and provide them with a safe workplace which is free from harassment and bullying. **Chapter 3** is about how directors should respond to pressures to respect the interests of stakeholders other than shareholders and how to prioritise their interests vis-à-vis the interests of shareholders who have provided the risk capital that enables the company to operate and, not unreasonably, expect a proper return on their investment.

Not only does the community expect corporations to comply with the law, it also has expectations that directors will make decisions ethically and that their organisations will behave in a sustainable way. The community is increasingly expecting corporations to operate as model citizens because it is argued that they exist only by reason of a tolerant society which has granted them a "social licence to operate". **Chapter 4** discusses how boards need to address community expectations.

There is also much debate about how boards can engage in ethical decision-making practices. Boards are often confronted with practical ethical dilemmas and knowing how to respond is not easy. **Chapter 5** discusses processes for ethical decision-making and encourages boards to gather as much information as they can, to consider the question from as many different perspectives as possible through diversity of membership and to consider the implications of the decision for shareholders and other stakeholders before making a difficult decision.

Many of the recent Royal Commissions, inquiries and investigations have identified deep cultural problems in some of our largest and most trusted institutions. The problems have not only been identified in for-profit entities, but also in religious and charitable organisations, the Australian Defence Force and even the Australian cricket team. Culture is hard enough to identify, especially in large organisations which often have a myriad of sub-cultures, but it is even harder to modify. Boards of corporations that have a poor corporate culture which results in staff taking advantage of customers or suppliers or creating an environment where bullying and abuse is rife are being encouraged to act quickly, to “set the tone from the top” and stamp out poor cultures. **Chapter 6** tackles this difficult subject.

Chapter 7 looks at a range of issues under the general category of improving corporate governance. It begins by asking whether companies with better governance practices actually produce superior investor outcomes and the extent to which good governance is important. It embarks on an overview of the various codes and guides on good governance and, among other things, discusses the need for robust processes for managing conflicts of interest, analyses how important independent directors are to good governance, looks into what is expected of the chair, explores the benefits of diversity, delves into board renewal and succession planning and talks about the need for rigorous risk management and processes.

Chapter 8 looks into processes boards follow to set executive remuneration. It became evident at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, if it wasn’t before, that remuneration practices designed to maximise corporate profit could have serious and long-lasting impacts on corporate brands.

Activist shareholders and hedge funds regularly present challenges to boards of listed (and sometimes unlisted) companies. So too do the challenges posed by the risk of class actions funded by litigation funders that lower the risks for plaintiffs but escalate them for corporations and directors. One of the consequences of their focus on corporate Australia has been the skyrocketing cost of liability insurance for directors, so that all companies are bearing the burden, not only those who have been the subject of these claims. **Chapter 9** looks at how boards can respond when under attack from aggressive opponents who often have little in mind other than exploiting the company for their own advantage.

Chapter 10 examines a number of other recent developments of which directors need to be aware. The chapter begins with a discussion of some of the challenges for directors in securing liability insurance at a reasonable cost. It addresses the need to comply with increased regulatory burdens, such as compliance with anti-money laundering and counter-terrorism legislation and foreign corrupt practices legislation. Responding to disasters is always a challenge for boards, be they financial crises, natural disasters such as floods, bushfires or earthquakes or pandemics such as that caused by COVID-19. **Chapter 10** addresses ways for boards to respond to these kinds of events. The chapter also looks at a range of workforce issues such as remuneration and workplace health and safety.

Chapter 11 looks at four longer-term governance issues. First, it looks at the impacts of new technologies on business, including the need for an IT strategy and issues related to digital transformation, information and data management, information privacy, cybersecurity and the impact technology is likely to have on the workplace. Secondly, the chapter looks at some impediments to long-term growth such as responding to disruptors and the challenges of doing business globally. Next, it looks at the changing role of directors. It is well-known in director circles that there is a misalignment between the legal and governance obligations of directors and what the community and the media think directors should take responsibility for. This section looks at how the existing corporate governance models may be evolving and developing better governance models for the future. Finally, the chapter examines some threats to sustainability, especially economic sustainability, and the challenges for many companies to maintain a stable, experienced and suitably skilled workforce in a rapidly changing environment.

Being a good director in the 2020s will be as hard a task as it has ever been. No matter how diligent directors may be, bad things can still happen to the companies they govern. Those who become directors need to accept that it may be inevitable that unfortunate events are likely to occur and to focus first on doing what they can to prevent those things from happening, or at least minimising their impact and, if (or perhaps, when) they do occur, responding in the best and most thoughtful way possible.

The challenges for directors will be great and many of them will be unforeseen and, perhaps, unforeseeable. However, for those who have the skills and the enthusiasm

for taking on these challenges, the experience and the satisfaction of overcoming them will be well and truly worth it.

Chapter 2

The legal and regulatory environment

This is not a textbook and those who are interested in understanding the legal principles underlying the duties of directors in detail are urged to look elsewhere.[1] This chapter contains a discussion of the broad duties and responsibilities of directors, together with details of other areas which might give rise to personal liability. It looks at the general law duties of directors (which are those which have been established by the courts) as well as those found in the Corporations Act. The chapter also draws attention to the vast array of other legislation that seeks to lift the corporate veil and attach personal responsibility to directors for corporate misconduct. Finally, it looks at some of the regulatory requirements that impact on directors and, if not imposing legal responsibilities on them, create expectations as to how directors should behave and conduct their affairs.

Legal obligations placed on company directors are expanding all the time because their duties are being interpreted having regard to current community expectations. Furthermore, governments are inclined to be alert to community concerns. Sometimes, they see the solution to problems being to lift the corporate veil and to make directors personally liable, because they believe that this is an expedient way to ensure corporate compliance. That approach may not, however, always be fair to directors. We have many laws which can send directors and executives to gaol as a result of their

1 See, for example, B Cowley and S Knight, 2017, *Duties of Board and Committee Members*, Thomson Reuters; R Austin and I Ramsay, 2018, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th edn, LexisNexis Butterworths; R Baxt, 2016, *Duties and Responsibilities of Directors and Officers*, 21st edn, Australian Institute of Company Directors.

companies breaching the law. Some states have already introduced laws that provide for directors to be criminally charged as a consequence of workplace deaths. Laws are also being introduced which will potentially expose directors to criminal liability if they underpay their workers. Emotive terms such as 'industrial manslaughter' and 'wage theft' are used to garner public support on issues that are often complex and result from multiple causes. While these laws are generally well meaning, they are concerning to directors who are feeling more and more at risk.

That said, while there are unquestionably some landmines for directors who do not fully understand their obligations, most of what is expected of them by the law is commonsense, namely to act with care, to make decisions that are in the best interests of the company and to avoid conflicts of interest. Directors who understand their obligations and act carefully are more likely to do the right thing and avoid personal risk than those who fail to keep abreast of what the law expects of them.

2.1 Development of general law duties

Over many hundreds of years, the courts of the United Kingdom and, more recently, Australia, have developed a set of duties to be observed by company directors.

The modern form of the corporation emerged from companies established by Royal Charter which first started to appear as commercial enterprises in the late sixteenth and early seventeenth centuries, but continued as the primary vehicles for the conduct of business for several hundreds of years, only finally starting to wane around the middle of the nineteenth century when legislation was enacted that permitted the incorporation of companies with limited liability.

Early on, these companies were established not so much to derive the benefits of limited liability, but with a view to the sovereign awarding them exclusive trading rights in a particular geographic region.[2] While generally access to those preferential trading rights were the prime motivator of merchants seeking to establish these companies, some of the other side benefits which were valued included perpetual succession,

2 Examples of some of the early, and best known, trading companies established by Royal Charter include: The Russia Company (established in 1555); the Turkey Company (established in 1581) and the Venice Company (established in 1583) which in turn merged into the Levant Company (in 1592); the East India Company (established in 1600); the Virginia Company (established in 1606); the Hudson Bay Company (established in 1670); and the South Sea Company (established in 1711).

having a separate body which could sue and be sued and having an interest (that is, shares) which were readily marketable and had value. While these companies also technically benefited from limited liability, in practice, that did not necessarily confer any great benefit on shareholders because the companies often had the right under their constituent documents to levy members in the event of a shortfall of funds, which negated the benefit of any protection they had from the claims of third parties.

Generally, under the Royal Charters, not a great deal was asked of the members of the governing committees of these companies, although they usually had to submit themselves for re-election each year, so they could be replaced relatively quickly if wrong doings were identified. Amusingly today, the very first statutory duty imposed on the holders of office in corporations in the reign of Charles II was that they receive the sacrament of the Lord's Supper according to the rites of the Church of England (with the intention of excluding any Roman Catholics from holding corporate office).[3]

Over the subsequent two centuries, various laws, perhaps the best known of which was the *Bubble Act 1720*,[4] were passed in an endeavour to limit stock speculation. However, very few of those laws sought to impose any substantive specific general duties on directors. Companies whose directors had behaved improperly were forced to seek redress through the courts, which developed a series of rules, which generally cast directors in the role of fiduciaries.

Those fiduciary duties, as they have evolved today, are that directors owe a fundamental duty of loyalty to their company which incorporates a duty to act in good faith for the benefit of the company as a whole, to act for a proper purpose, to avoid fettering discretions, to avoid conflicts of interest and to exercise care, skill and diligence in the exercise of their roles.

It is important to note that the duties owed by the directors are not owed to shareholders, nor other stakeholders or the community at large but to the company itself. The case of *Foss v Harbottle*[5] established the proposition that the company was the proper plaintiff where it had been wronged and that therefore the company alone could institute proceedings against miscreant directors, except in the case of some

3 See the *Corporation Act* of 1661 and the *Test Act* of 1672, which imposed this obligation on all holders of office in corporations established by charter.

4 See Cowley and Knight, 2017, op cit, [1.90].

5 (1843) 2 Hare 460; 67 ER 189.

limited exceptions.[6] Since 1999, the Corporations Act has permitted shareholders, with the consent of the court, to commence statutory derivative actions against directors.[7]

Until relatively recently, there were no statutory equivalents of the general law duties. In Australia, apart from a brief flirtation in Victoria where a statutory duty to use 'reasonable care and prudence', applied between 1896 to 1910, no statutory duties existed until the Uniform Companies Acts were introduced in the various states and territories between 1961 and 1963 creating a statutory duty of diligence and a duty not to make improper use of information. Those statutory duties have developed over the years into the four core duties in place today.

These duties can now be found in the Corporations Act and are:

- a duty to act with care and diligence (section 180);
- a duty to act in good faith in the best interests of the company and for a proper purpose (section 181);
- a duty not to misuse position (section 182); and
- a duty not to misuse information (section 183).

Although we speak of four core duties, there are really only three, with the latter two duties (in sections 182 and 183) really being slightly different manifestations of the general law duty to avoid conflicts of interest. In seeking to deter directors from acting improperly when they are conflicted, sections 182 and 183 are supported by sections 191 to 195 which apply where directors have 'material personal interests' in matters coming before the board.

In Australia, statutory duties have not displaced the general law duties which have continued in parallel. This is to be contrasted with the position in the UK where statutory duties were not introduced until 2006, and those duties replaced the general law duties.

The introduction of statutory duties enabled directors to be punished for wrongdoing. Prior to that, directors could only be subjected to whatever orders the court might impose to prevent them from doing things that they shouldn't have or to compensate the company for losses suffered by the company as a result of their breach of duty. Generally, a breach of one of the four core duties will result in directors being

6 Austin and Ramsay, 2018, op cit, [10.300.9].

7 Corporations Act Pt 2F.1A.

subjected to civil penalty orders which could include pecuniary penalties of up to $200,000,[8] being disqualified from acting as company officer for a period which the court considers appropriate[9] and possibly being ordered to compensate the company for any loss suffered by the company as a result of the breach.[10]

Directors who breach the duties contained in sections 181, 182 and 183 can also, in some circumstances, be found criminally liable. No criminal liability attaches to a breach of the duty of care and diligence in section 181, because, in essence, it is a duty not to be negligent, and it would be a harsh penalty indeed, to make directors liable criminally for negligence. In order to be liable criminally for a breach of sections 181, 182 or 183, it must be proven, under section 184, that the director acted recklessly or intentionally dishonestly.

The duties in sections 180 and 181 apply to both directors and officers and those in sections 182 and 183 apply to employees as well. The purpose of this book is to reflect on what is expected of directors (both in a legal and a non-legal sense) and accordingly not a great deal will be said about how the statutory duties impact on officers and other employees.

It is not only as a consequence of breaching one of the four core duties that directors can be brought to account under the Corporations Act. Directors can also be liable directly for a range of other failings, including in respect of insolvent trading,[11] breaching their financial reporting obligations[12] or, in the case of directors of a trustee company, for allowing the company to breach its obligations as a trustee so as to lose its right of indemnity against trust assets.[13] Directors can also be liable to compensate aggrieved investors who have suffered a loss as a result of a misleading or deceptive statement in a prospectus or other public disclosure document or a takeover document[14] or through accessorial liability where they have had been 'involved' in a breach by a company of its continuous disclosure obligations under sections 674 or 675.

8 Corporations Act s 1317G.
9 Corporations Act s 206C.
10 Corporations Act s 1317H.
11 Corporations Act s 588G.
12 Corporations Act s 344.
13 Corporations Act s 197.
14 Corporations Act ss 729 and 670B.

The Corporations Act is not, however, the only law under which directors can be exposed to personal liability. The 'director penalty regime' can expose directors to personal liability for certain taxes and other amounts (such as Pay As You Go, Superannuation Guarantee Contribution deductions and Goods and Services Tax) where the company has failed to remit due amounts to the Australian Taxation Office (ATO). Numerous state and territory laws also impose personal liability on directors in an attempt to lift the corporate veil and enforce corporate compliance. The harsh impact of many of those laws was substantially reduced after federal intervention in the early 2000s but the laws still exist and, while directors are no mostly longer automatically exposed to criminal liability where a corporate breach occurs, the standards required of directors to prevent a corporate breach are still very high.

The discussion below focuses first on the four core statutory duties in sections 180 to 183. Largely, the statutory duties align with the general law duties and while the discussion focuses principally on the statutory duties, the same principles apply equally to the general law duties. Following the discussion of the core duties is a discussion of some of the other statutory provisions that can expose directors to liability.

2.2 Statutory duties

2.2.1 Care and diligence – section 180

The duty in section 180 is perhaps the duty under which remedies are most often pursued in court by the regulator. It equates to the broader concept of negligence but is in fact quite nuanced. Section 180(1) provides as follows:

> *(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:*
>
> *(a) were a director or officer of a corporation in the corporation's circumstances; and*
>
> *(b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.*

The drafting of the section allows attention to be paid to:

- the role the director or officer plays in the company, which for example allows the court to take account of whether the director holds office as the chair,[15] or member of a board committee such as an audit committee or has some other responsibilities;[16]
- the skills and experience of the director or officer,[17] which allows the court to have regard to the reasons why the director might have been invited onto the board;[18]
- the size of the company, the industry it operates in, the complexity of its business, any relevant provisions of its constitution, the composition of its board and the distribution of work between the board and executives;[19] and
- what a reasonable person, having regard to all the above circumstances, should have done.

There is abundant case law on the section 180 duty of care and diligence. The facts of many of those cases are discussed in the context of the various themes which are the subject of this book.

In recent years, concern developed that the Australian Securities and Investments Commission (ASIC) had formed the view that if directors had allowed a company to breach a provision of the Corporations Act, or possibly even another Act, that circumstance provided evidence that they had been negligent in the performance of their duties and had consequently breached their duty of care and diligence in section 180. This has become known as the 'stepping stones' approach to establishing liability.

The term 'stepping stones' derives from the decision of Keane CJ in the case of *Australian Securities and Investments Commission v Fortescue Metals Group Ltd*.[20]

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15 *Australian Securities and Investments Commission v Rich* (2003) 44 ACSR 341, [70].

16 *Australian Securities and Investments Commission v Vines* (2005) 55 ACSR 617, [1058]–[1060].

17 Although there is no specific reference to 'skill' in the section, it has been found that there is standard of skill for persons appointed to positions requiring the exercise of skill: *Daniels v Anderson* (1995) 37 NSWLR 438, 505; *Australian Securities and Investments Commission v Vines* (2003) 48 ACSR 322, [38].

18 *Gold Ribbon (Accountants) Pty Ltd v Sheers* [2005] QSC 198. While this decision was overturned on appeal in *Gold Ribbon (Accountants) Pty Ltd v Sheers* [2006] QCA 335, the Appeal Court's decision did not overturn the trial judge's findings on the question of breach of duty.

19 *Daniels v Anderson* (1995) 37 NSWLR 438, 505; *Australian Securities and Investments Commission v Rich* (2003) 44 ACSR 341, [35].

20 (2011) 81 ACSR 563, [10].

The facts of the case involved an announcement by Fortescue to the Australian Securities Exchange (ASX) in which it was alleged that Fortescue had misled the investing public by asserting that certain 'framework agreements' which it had entered into with three Chinese companies were enforceable agreements to build, finance and transfer a railway, port and mine. As Keane CJ put it, the argument was that if liability could be established on the part of Fortescue that it had breached its continuous disclosure obligations,[21] that constituted a stepping stone toward the conclusion that its chairman and chief executive officer, Mr Forrest, had contravened his duties under section 180.

Ultimately, the High Court found that the impugned statements were not misleading and so Mr Forrest was absolved from liability,[22] but the seed had been planted that courts could possibly draw a direct line between a company breaching a statutory obligation and directors breaching their duty of care and diligence in not preventing it from doing so.

The notion was dashed in a number of subsequent cases. In *Australian Securities and Investments Commission v Maxwell*,[23] Brereton J noted:

> *Generally speaking, … ss 180, 181 and 182 do not provide a backdoor method for visiting, on company directors, accessorial civil liability for contraventions of the Corporations Act in respect of which provision is not otherwise made. This is all the more so since the Corporations Act makes provision for the circumstances in which there is to be accessorial civil liability. Whether there were in this case breaches of the directors' duties — and, in particular, of their duty of care and diligence — depends upon an analysis of whether and to what extent the corporation's interests were jeopardised, and if they were, whether the risks obviously outweighed any potential countervailing benefits, and whether there were reasonable steps which could have been taken to avoid them.*

21 Under Corporations Act s 674(2).

22 *Forrest v Australian Securities and Investments Commission* (2012) 291 ALR 399. In absolving Mr Forrest from liability, the High Court at [48], made the rather curious observation: "It is, however, necessary to bear firmly in mind that the impugned statements were made to the business and commercial community. What would that audience make of the statement that Fortescue had made a binding contract with an entity owned and controlled by the People's Republic of China?"

23 (2006) 59 ACSR 373, [110]. These words were cited with approval in *Australian Securities and Investments Commission v Mariner Corporation Ltd* (2015) 106 ACSR 343, [444].

This theme was expanded upon in the *Cassimatis*[24] case, which involved the collapse of the troubled Storm Financial Group. At trial, Edelman J (now on the High Court) made the observation that ASIC had set a 'high bar' for itself in seeking to argue that Storm had breached the Corporations Act and that this breach constituted a 'stepping stone' toward establishing the liability of Mr and Mrs Cassimatis under section 180.

Greenwood J, in the Full Court appeal by Mr and Mrs Cassimatis,[25] explained that in fact rather the reverse was the case and that it was the serious breaches which they committed of their duties under section 180, that caused Storm to act as it did in breaching the law. He said:

> *The finding of contraventions … of the Act by Storm, and the need for ASIC to make good those contended contraventions, was critical to the case under s 180(1) against the appellants not because the contraventions by Storm of those sections of the Act would give rise to a contravention by the directors of s 180(1) in the form of some sort of dystopian accessorial liability, but rather because the contraventions by Storm, deriving from the conduct of the appellants themselves, as described, contained within it a foreseeable risk of serious harm to Storm's interests (that is, a potential loss of its AFSL; a threat to Storm's very existence; and suit by the vulnerable investors to address the consequences of the advice given to them and thus the contraventions by Storm), which reasonable directors, with the responsibilities of Mr and Mrs Cassimatis, standing in Storm's circumstances, ought to have guarded against.*

The decision in *Cassimatis* does not necessarily serve to alleviate concerns which directors might legitimately have of there being a connection between a corporate breach and their potential exposure to liability under section 180. Although the courts may be unlikely now to find that a corporate breach provides automatic evidence of a breach by the directors of their duties, it is still very open to the courts to conclude that serious corporate transgressions were the result of breaches by directors of their duties.

24 *Australian Securities and Investments Commission v Cassimatis (No 8)* [2016] FCA 1023.
25 *Cassimatis v Australian Securities and Investments Commission* (2020) 144 ACSR 107, [77].

There are a number of very good articles which analyse the ‘stepping stones’ argument in more detail.[26]

2.2.1.1 Business judgment defence

A discussion of section 180 would not be complete without some discussion of the ‘business judgment’ defence in section 180(2).

The defence is only available to an allegation of a breach of the duty of care and diligence in section 180 (and the corresponding general law duty) and not to an alleged breach of any of the other core duties. The director has the burden of establishing the availability of the defence.[27] This is to be contrasted with the position in the US state of Delaware (where a form of the defence originated) where there is a presumption that the directors exercised a reasonable business judgment and it is those who assert that they did not who carry the burden of establishing that the director failed to do so.

The intended operation of the defence has been neatly captured by Robinson J in *Australian Securities and Investments Commission v Lindberg*,[28] as follows:

> *Section 180(1) does not seek to punish the mere making of mistakes or errors of judgment. Making mistakes does not by itself demonstrate lack of due care and diligence. The business judgment rule in s 180(2) also recognises that business judgments made in good faith and on a proper basis do not fall within s 180(1). Directors and officers of corporations are expected to take calculated commercial risks. A company run on [the] basis that no risks were ever taken would be unlikely to be successful. The proper taking of risk in making business decisions is entirely consistent with exercising care and diligence. The proper assessment of the risks and potential rewards is a matter that demands the exercise of care and diligence. The two concepts complement each other in the management of corporations.*

26 A Herzberg and H Anderson, 2012, “Stepping stones – From corporate fault to directors’ personal civil liability”, *Federal Law Review*, Vol 40, No 2, p 197; T Bednall and P Hanrahan, 2013, “Officers’ liability for mandatory corporate disclosure: Two paths, two destinations?”, *Company and Securities Law Journal*, Vol 31, No 8, p 474; R T Langford, 2016, “Corporate culpability, stepping stones and Mariner – Contention surrounding directors’ duties where the company breaches the law”, *Company and Securities Law Journal*, Vol 34, p 75.

27 *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1, [628]–[631].

28 (2012) 91 ACSR 640, [72].

In order to be able to make out the defence, directors must establish that they made a business judgment and that they:

- made the judgment in good faith and for a proper purpose;
- did not have a material personal interest in the outcome of the matter;
- informed themselves about the matter to the extent that they believed reasonably appropriate; and
- rationally believed that the judgment was in the best interests of the corporation (which it will be deemed to be unless it is one that no reasonable person in their position would hold).

The business judgment defence will not always be available where it is alleged that a director has breached the duty in section 180. This is because the defence requires there to be a *business* judgment. So, for example, it has been held that the defence will not be available where the breach of section 180 relates to a failure to monitor the company's finances[29] or to comply with a statutory continuous disclosure obligation.[30]

The question of what constitutes a rational belief that a business judgment is in the best interests of the corporation was considered in *Australian Securities and Investments Commission v Rich*[31] where Austin J said he believed that the rational belief argument was satisfied:

> *... if the evidence shows that the defendant believed that his or her judgment was in the best interests of the corporation, and that belief was supported by a reasoning process sufficient to warrant describing it as a rational belief, as defined, whether or not the reasoning process is objectively a convincing one.*

Although there have been relatively few cases where the business judgment defence has been successfully pleaded by directors, the decision in the case of *Australian Securities and Investments Commission v Mariner Corporation Ltd*[32] provides an interesting example. The case involved the decision by the directors of Mariner to

29 *Australian Securities and Investments Commission v Rich* (2009) 75 ACSR 1, [628].

30 *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 81 ACSR 563, [197].

31 (2009) 75 ACSR 1, [635], [636], [7290].

32 (2015) 106 ACSR 343, [541]–[550].

make a takeover bid. ASIC alleged that one of the directors had breached his duty of care and diligence by allowing Mariner to launch the bid when it was unclear whether it would be able to comply with its obligations under the Corporations Act. The judge analysed each of the requirements of section 180(2) and satisfied himself that they had all been met and that the director was able to rely on the defence. The requirements are not onerous, so in a way, it is surprising that the defence has not been successfully invoked more often.

2.2.2 Best interest duty – section 181

Section 181 requires directors and officers to exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose.

Generally, acting in the best interests of the corporation is taken to equate to acting in the best interests of shareholders, except where the company is nearing insolvency, at which point, the directors also need to take into account the interests of creditors.[33] This does not mean that they have a duty to creditors or must act in their interests but rather that in fulfilling their duty to the company, they need to take creditors' interests into account, because if they do not, there may well be adverse consequences for the company, and indeed, failure to do so may threaten the very existence of the company.[34]

In terms of whether directors have made a decision in good faith, courts would generally only intervene if:[35]

- the directors have not acted honestly;
- they have acted recklessly;
- they have made a decision in their own interests;
- they have not genuinely turned their mind to the question before them; or
- the decision is one which no reasonable board could have reached.

Sometimes directors are concerned about the extent to which section 181 might restrict their ability to approve the making of ex gratia payments or donations. Although

33 *Walker v Wimborne* (1976) 3 ACLR 529, 532; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 10 ACLR 395, 401.
34 *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* (2008) 70 ACSR 1, [4418].
35 Cowley and Knight, 2017, op cit, [2.790].

the law in this area has developed somewhat over the last hundred years, the position is now generally well established that directors have considerable discretion "provided there is some reasonable connection between [their] activities and the furtherance of the company's reasonable commercial interests".[36] There is a detailed discussion of some examples of situations where directors have been challenged over the making of philanthropic donations or the payment of other sums which they were under no obligation to make (for example the payment of discretionary bonuses to staff) in **Chapter 3**.

Some guidance as to how the court interprets the duty in section 181 was provided by Justice Neville Owen in the Supreme Court of Western Australia in *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)*.[37] He provided the following principles:

> *(1) The test whether directors acted bona fide in the interests of the company as a whole is largely (though by no means entirely) subjective. It is a factual question that focuses on the state of mind of the directors. The question is whether the directors (not the court) consider that the exercise of power is in the best interests of the company. …*
>
> *(3) It is the directors who make business decisions and courts have traditionally not pronounced on the commercial justification for those decisions. The courts do not substitute their own views about the commercial merits for the views of the directors on that subject.*
>
> *(4) Statements by the directors about their subjective intention or belief are relevant but not conclusive of the bona fides of the directors.*
>
> *(5) In ascertaining the state of mind of the directors, the court is entitled to look at the surrounding circumstances and other materials that genuinely throw light upon the directors' state of mind to show whether they were honestly acting in discharge of their powers in the interests of the company and the real purpose primarily motivating their actions.*
>
> *(6) The directors must give real and actual consideration to the interests of the company. The degree of consideration that must be given will depend on the*

36 Corporations and Markets Advisory Committee, 2006, *The social responsibility of corporations* (Report), p 88.

37 (2008) 70 ACSR 1, [4619].

individual circumstances. But the consideration must be more than a mere token: it must actually occur.

(7) *The court can look objectively at the surrounding circumstances and at the impugned transaction or exercise of power. But it does so not for the purpose of deciding whether or not there was commercial justification for the decision. Rather, the objective enquiry is done to assist the court in deciding whether to accept or discount the assertions that the directors make about their subjective intentions and beliefs.*

(8) *In that event a court may intervene if the decision is such that no reasonable board of directors could think the decision to be in the interests of the company.*

2.2.3 Dealing with conflicts of interest – sections 182, 183, 191 and 195

Sections 182 and 183 are expressed in very similar terms. Section 182 prohibits directors, officers and employees from improperly using their positions and section 183 prohibits them from improperly using information they have obtained because of their positions for one of the prohibited purposes. The prohibited purposes are:

- to gain an advantage for themselves;
- to gain an advantage for someone else; or
- to cause detriment to the corporation.

It seems that in order to be 'improper', conduct does not need to have actually resulted in any gain for the director or someone else or to have caused detriment to the corporation. It is enough that that was the purpose.[38]

Furthermore, the courts have been relatively uniform in making it clear that in order for conduct to be 'improper' it is not necessary that the directors have acted dishonestly or even been conscious that their conduct was improper, but rather that the conduct had breached, "the standards of conduct that would be expected of a person in the position of the alleged offender by reasonable persons with knowledge of the duties, powers and authority" of the director.[39]

38 *Chew v R* (1992) 173 CLR 626.

39 *R v Byrnes & Hopwood* (1995) 130 ALR 529, 538.

While the concept of directors acting to their own advantage is relatively straightforward, complexities can occur. One of these is where a corporate opportunity presents itself to a company, which either can't pursue it (for example, because it does not have sufficient funds to take advantage of the opportunity) or chooses not to pursue it and a director wishes to do so.[40] While the views of courts have from time to time been inconsistent on this question,[41] it would be wise for directors to exercise considerable caution before undertaking an investment which has come to their attention through the company.

One of the areas where directors might potentially be exposed to the risk of using their position or information to gain an advantage for someone else is where they have been appointed as nominees to the board of a company by a shareholder (exercising a contractual right to make such an appointment, for example, under a joint venture agreement or shareholders' agreement) and the appointing shareholder requires the directors to make available confidential or commercially valuable information of the company. This can be challenging for the director. While it can be legitimate for the shareholder to want to know about the performance of the company, if the information is provided and the shareholder uses that information to its commercial advantage, the representative directors will be in a very difficult position. This is because the question is not whether they had dishonest intent or were even conscious of impropriety, but rather it is simply whether, objectively, they failed to comply with their statutory duties. While the directors' position might be defensible if they genuinely believed that the shareholder only wanted the information for assessing the performance of the company, whether they are ultimately determined to be liable is likely to involved a detailed assessment of the evidence, which may often not be as clear cut as the directors would like, especially if the directors handed over the information in response to a shareholder request without further enquiry.

40 The seminal case on this question is *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 where directors were required to account for profits that they made on an investment which they made personally in a subsidiary where the company did not have the funds to make the investment itself.

41 Contrast the decision in *Regal (Hastings)* with that in *Peso Silver Mines v Cropper* (1965) 56 DLR (2d) 117, a decision of the Supreme Court of Canada. The Supreme Court distinguished the decision in *Regal (Hastings)* on the basis that the opportunity to invest in a mine adjacent to the Peso Silver Mine had come to the director as a member of the public, notwithstanding that the board of Peso Silver (of which he was a member) had considered the opportunity (and declined it).

There is some case law which indicates that the courts might be willing, in circumstances where there is shareholder consent, to attenuate the general law duties of joint venture company directors.[42] However, the courts have generally been more reluctant to conclude that shareholders could excuse a breach of statutory duty.[43] That said, if the joint venture company's constitution or a shareholders' agreement provides clarity about what information shareholders are entitled to have access to, that may influence the views of the court about whether disclosure of information by directors is 'improper'.[44]

The last of the proscribed purposes in sections 182 and 183 is causing 'detriment' to the company. While this is less common, it can sometimes occur in circumstances where directors, officers or employees leave on bad terms and seek to use information they obtained during the period they held office to damage the company.

Section 191 of the Corporations Act requires disclosure by all directors of any 'material personal interest' they hold in a matter that relates to the affairs of the company. There are certain exceptions to the prohibition, which include:[45]

- interests which the directors have in common with other members of the company;
- matters which relate to the remuneration of the directors;
- contracts which are subject to shareholder approval;
- insurance protecting directors from liability while acting in the role;
- any indemnity given to directors which is permitted by the Act; or
- an interest which arises because a director is a director of a related body corporate.

Disclosure can be made either when the matter comes before the board or by way of a standing notice which complies with section 192. That section requires that a standing notice either be given to the other directors at a board meeting or, if given outside a board meeting, is tabled at the next board meeting. It is important to

42 *Levin v Clark* [1962] NSWR 686; *Re Broadcasting Station 2GB Pty Ltd* [1964–5] NSWR 1648.

43 *Miller v Miller & Miller* (1995) 16 ACSR 73, 89; *Marson Pty Ltd v Pressbank Pty Ltd* (1987) 12 ACLR 465. In contrast, see *Pascoe Ltd (in liq) v Lucas* (1998) 27 ACSR 737, 772 where the court did consider that shareholders might be able to waive a breach of statutory duty by directors.

44 *Marson Pty Ltd v Pressbank Pty Ltd* (1987) 12 ACLR 465, 472.

45 Corporations Act s 191(2).

remember (and many boards forget this) that a standing notice needs to be renewed every time a new director is appointed.

Section 194 contains a replaceable rule for proprietary companies (which means that it will apply unless overridden by the company's constitution) which says that so long as directors of proprietary companies make disclosure of any material personal interest they have in accordance with section 191, they may attend meetings where those matters are being considered and vote on those matters. It also makes clear that directors are entitled to the benefit of any transactions which they vote on. Irrespective of section 194, it is very common for constitutions of proprietary companies to contain provisions of this kind. These rules are based on the proposition that in the case of proprietary companies, which are generally owned by family members or at least a small number of shareholders, where it will not be uncommon for directors to have conflicts, that sunlight will be adequate disinfectant.[46]

Section 195 of the Corporations Act imposes a different set of rules on directors of public companies. They must absent themselves from any board meeting at which any matter in which they have a material personal interest is being considered. The other directors, who are not conflicted, may pass a resolution, in the absence of the conflicted director, approving that director participating in the meeting if they are "satisfied that the [conflict] should not disqualify the director from voting or being present".[47]

There is some case law which helps to interpret the expression, 'material personal interest'. An interest will be material if it is of sufficient substance to have the capacity to influence the mind of the director.[48] To be personal, there will need to be some connection to the personal interests of the director, so, for example, simply being a director of two companies which are proposing to deal with one another is unlikely to be enough to give rise to a personal interest if the director is not a shareholder in either of them.[49] On the other hand, directors would have a personal interest in seeking to prevent a resolution to remove them from office being considered by a general meeting.[50]

46 L D Brandeis, 1914, *Other People's Money: And how the bankers use it*, F.A. Stokes, New York, p 92.
47 Corporations Act s 195(2).
48 *McGellin v Mount King Mining NL* (1998) 144 FLR 288; *Southern Wine Corp Pty Ltd (in liq) v Perera* (2006) 33 WAR 174.
49 *Grand Enterprises Pty Ltd v Aurium Resources Ltd* (2009) 72 ACSR 75.
50 *Drillsearch Energy Ltd v McKerlie* [2009] NSWSC 517.

The facts of each case will be relevant. So, for example, directors who have a substantial net worth might not be influenced by a contract with minimal value, but they could be influenced if the matter being considered involved making a job offer to one of their children.

It is always appropriate for directors to consider the extent to which their independence of mind might be compromised by a conflict of interest. Even where the statute does not require them to exclude themselves from considering a matter (for example, in the case of a proprietary company) they should still consider whether they ought to do so. Section 192 makes it clear that the obligation to disclose matters in which directors have a material personal interest is not in any way intended to limit the general law obligations of directors and nor is it intended to provide relief from any provision of the company's constitution which addresses how a conflicted director is required to act. Accordingly, directors of proprietary companies ought to remember that just because the statutory duty under the Corporations Act does not require them to step aside when conflicted, the general law duty (or the corporation's constitution) still might. Even if directors are themselves satisfied that a potential conflict will not impair their judgement, it might well be worth them considering whether that potential conflict might undermine the integrity of the decision of the board and expose it to criticism, especially if it relates to a contentious matter.

It is worth mentioning that the ASX Listing Rules also contain rules about situations where directors might be conflicted. The Listing Rules require shareholder approval where the company is proposing to enter into a transaction with a director or an associate of a director in relation to the sale or purchase of a substantial asset,[51] in relation to the issue of shares to a director or an associate,[52] the establishment of an incentive plan under which shares might be able to be issued to directors and in relation to director remuneration.[53]

51 ASX Listing Rules, r 10.1.
52 ASX Listing Rules, rr 10.11, 10.14.
53 ASX Listing Rules, r 10.17.

2.3 Criminal conduct – section 184

Breaches of sections 181, 182 and 183 can, in some circumstances, be criminal. Section 184 provides that a breach of any of these sections can be criminal if they are committed dishonestly or recklessly.[54]

2.4 Defences and other forms of relief

There are certain defences available to directors who are alleged to have breached one of their core duties. The business judgment defence has already been mentioned above.

2.4.1 Relief for directors of wholly owned subsidiaries – section 187

Section 187 applies only to directors of wholly owned subsidiary companies. It protects them from liability for breach of the duty in section 181 to act in the best interests of the subsidiary company if the subsidiary's constitution authorises them to act in the interests of the holding company, they do so in good faith and the subsidiary company is not insolvent.

While section 187 does not specifically provide relief from the corresponding general law duty to act in the best interests of the company, if subsidiary company directors act in the best interest of the holding company in circumstances where section 187 applies and the constitution of the company specifically permits it, it would seem unlikely that the court would impugn their conduct.

It is important to note that this defence is only available where the directors of the wholly owned subsidiary are acting in the best interests of the holding company and is not available if, say, they are acting in the interests of another company in the group. This could occur, for example, where the wholly owned subsidiary is guaranteeing the debts of another group company which is not the holding company. Directors of the subsidiary would need to satisfy themselves that by giving the guarantee, they were also acting in the best interests of the holding company. Issues such as this could

54 Somewhat curiously, in order for a breach of section 181 to be criminal, the director must have been 'intentionally dishonest' whereas in the case of breaches of sections 182 and 183, the director need only have acted 'dishonestly'. The distinction was noted in *Kwok v R* (2007) 64 ACSR 307, [70] and the court remarked that the accused must therefore have been specifically aware that the conduct was dishonest.

come into play where the company whose debts were guaranteed became insolvent, threatening the solvency of the guarantor company.

2.4.2 Reasonable reliance defence – section 189

Section 189 provides a defence for directors where they have relied on others (such as employees or professional advisers) and believe on reasonable grounds that the person giving the advice is reliable and competent in relation to the matter on which the advice was given. A director is also entitled to rely on advice from another director or from a committee of directors on which the director in question did not serve. The reliance must also have been in good faith and after the director has made "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".[55]

The latter is the most challenging hurdle which the director must surmount. The facts will need to show that directors applied 'independent judgment' and brought "their own mind to bear on the issue".[56]

There are some cases where it seems that the courts will never accept that it is reasonable for the directors to rely on the advice of others. In the *Centro* case,[57] in signing off the end of year financial statements, the directors had received advice from their auditors (through their audit plans) and from management that the accounts complied with the auditing standards. The financial statements were, in fact, not in accordance with the standards and the directors, who it was alleged had breached their duties, sought to avail themselves of the reasonable reliance defence in section 198. Justice Middleton concluded that the defence was not available to them and said:[58]

> *Directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the board's responsibilities as with the reporting obligations. The Act places upon the board and each director the specific task of approving the financial statements.*

55 Corporations Act s 189(b)(ii).
56 *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 3 ACSR 207, 225.
57 *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484.
58 *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484, [175].

> *Consequently, each member of the board was charged with the responsibility of attending to and focusing on these accounts and, under these circumstances, could not delegate or "abdicate" that responsibility to others.*

2.4.3 Reliance on a delegate – section 190

Section 190 provides that directors will not be liable when they have delegated a power to a delegate and the directors believed at all reasonable times that the delegate would exercise the power in conformity with the directors' duties and the company's constitution. That belief must have been formed on reasonable grounds in good faith and made after proper inquiry (if the circumstances indicated the need for inquiry) that the delegate was reliable and competent.

Case law suggests that in relying on a delegate, regard should be had to whether the power is one which should properly be conferred on a delegate and also the risk involved in the transaction or matter in question.[59]

2.4.4 Honest conduct – sections 1317S and 1318

Between them, sections 1317S and 1318 offer relief to directors both from liability for breach of their core Corporations Act duties (and any other civil penalty provisions in the Act) and from liability to third parties in civil proceedings for negligence, default, breach of trust or breach of duty. The relief is available if the directors have acted honestly and, having regard to all the circumstances, ought fairly to be excused from liability.

These sections do not provide a defence, but presuppose that the director is in breach, with the court being given a power to relieve the director from liability for the breach. As a result, an application for relief under sections 1317S and 1318 may be a last resort for directors seeking to avoid liability for breach of duty. Because the sections are only available where there has been a breach of duty, from a reputational point of view, directors may not want to have a finding on the record that they have breached their duty. A finding that they had not breached their duty or, at least, that one of the defences was available, may be preferable.

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59 *Re HIH Insurance Ltd; Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72, [372].

The New South Wales Court of Appeal has described the purpose of the section as being:[60]

> *...to excuse company officers from liability in situations where it would be unjust and oppressive not to do so, recognising that such officers are business men and women who act in an environment involving risk and commercial decision making.*

The case law also demonstrates that to be able to invoke the protection of the section, directors must be able to show that they acted honestly:[61]

> *...without deceit or conscious impropriety, without intent to gain improper benefit or advantage for [themselves] or for another, and without carelessness or imprudence to such a degree as to demonstrate that no genuine attempt at all has been [made] to carry out the duties and obligations of [their] office...*

The success rate for directors seeking relief under these sections has been relatively low, and even where relief has been granted, it has often only been granted on a partial basis.[62] One of the most common reasons why relief is refused is because of a failure to act honestly, or some moral turpitude in the director's conduct. It is not enough that the court finds that the director has not acted dishonestly, it must actually find that the director acted honestly.[63] If a director has a financial interest in the outcome of any decision, the court is less inclined to find that the director acted honestly. Other things that have resulted in the court not being able to conclude that a director had acted honestly include gross neglect, lack of candour, concealment or even keeping "a safe distance" from a transaction the director had reason to suspect was questionable.[64]

A number of the leading cases where the court granted relief under section 1317S

60 *Daniels v Anderson* (1995) 37 NSWLR 438, 525 per Clarke and Sheller JJA.
61 *Hall v Poolman* (2007) 65 ACSR 123, [325].
62 S Wong, 2008, *Forgiving a director's breach of duty: A review of recent decisions*, p 12.
63 *Re HIH Insurance Ltd; Australian Securities and Investments Commission v Adler* (2002) 42 ACSR 80, [166]–[169].
64 *Re HIH Insurance Ltd; Australian Securities and Investments Commission v Adler* (2002) 42 ACSR 80, [151], [172].

have involved circumstances where directors breached their duty to avoid insolvent trading (which is discussed below) and been exposed to an order that they reimburse the company under section 588M for its losses as a result of that breach of duty. Where the director has been found to have acted honestly in seeking to save the company, and, for example, has endeavoured to negotiate a reduction in tax liability, taken steps to improve sales, carefully monitored stock levels, sought out investors and followed the advice of insolvency experts, the courts have been willing to afford them the protections of the section.[65]

It is important to note too that the section 1318(1) allows the court to conclude that the director "ought fairly to be excused for the…breach". This adds a discretionary element to the availability of the relief. Courts have sometimes refused relief on the basis that the breach was sufficiently serious that relief should not be afforded. Despite acting honestly, courts can still decline relief if they determine that it is not fair to provide the relief, for example, because directors took too long to act, because the contravention was a serious one or because others were relying on their expertise.[66]

2.5 Liability for insolvent trading

The four 'core' statutory duties are not the only obligations placed on directors under the Corporations Act. Below is a discussion of some of the other areas where the Corporations Act exposes directors to liability. The first of these relates to the potential liability of directors for insolvent trading.

Australia's laws which expose directors to liability for insolvent trading are the harshest in the world.[67] While a small number of other jurisdictions impose criminal liability on directors where they have acted fraudulently, Australia is the only western jurisdiction that imposes civil liability on directors for allowing a company to trade while it is insolvent. Additionally, directors can be exposed to criminal sanctions if they acted dishonestly.[68] To compound the risk for directors, they can also be liable

65 *Hall v Poolman* (2007) 65 ACSR 123; *Re McLellan; Stake Man Pty Ltd v Carroll* (2009) 76 ACSR 67.

66 *Vines v Australian Securities and Investments Commission* (2007) 62 ACSR 1.

67 Australian Institute of Company Directors and Allens, 2019, *Criminal and Civil Frameworks for Imposing Liability on Directors*.

68 Corporations Act s 588G(3).

to compensate the company for any loss or damage suffered by unsecured creditors as a result of the company trading while insolvent.[69]

Unlike other statutory duties under the Act[70] which extend to officers and, sometimes, employees, the duty to avoid insolvent trading and the consequent exposure to compensate the company for its losses falls only on directors.

The prohibition[71] is on a company incurring a debt when the company is insolvent or incurring a debt which would render the company insolvent in circumstances where there are reasonable grounds for suspecting that the company is insolvent.

Not every situation where a company becomes indebted to another person amounts to the incurring of a debt. Continuing to employ staff who were already employed does not amount to the incurring of a debt, nor does continuing to lease an asset where the lease was previously entered into, rolling over a bill of exchange or continuing to receive the benefit of utilities previously contracted.[72]

A company is regarded as being insolvent if it is not able to pay its debts as and when they become due and payable.[73] However, determining whether a company is able to pay its debts when they become due and payable is a complex question because it allows consideration not only of cash resources the company has on hand at any given time, but also any cash it is likely to be able to access within sufficient time to pay its debts. It might well be able to source cash from sales revenues, payment by its own debtors, the sale of any assets, borrowings from banks or other lenders and investments from equity investors.

Similarly, the analysis requires consideration of when the company's debts actually become due and payable because there is often some flexibility about when trade creditors must be paid. The past practice of creditors in accepting late payment might provide some support for an argument that some debts actually become due and payable after their 'due date' for payment. The assessment of whether a company has a reasonable prospect of obtaining sufficient cash from other sources is always a question of judgment.

69 Corporations Act s 588J(1).
70 The duties of care and diligence and the duty to act in the best interests of the company in sections 180 and 181 apply to both directors and officers, and the duties in sections 182 and 183 not to misuse position or information apply to directors, officers and employees.
71 Corporations Act s 588G.
72 *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1.
73 Corporations Act s 95A.

One of the greatest challenges for directors is knowing when the company has become technically insolvent. Often directors pursue options which would put the company in funds to meet its debts. The difficulty for them is in being able to take a step back and consider objectively and dispassionately at what point it has become unrealistic to continue to think that an asset might be realised quickly, that a potential lender or investor will provide funds or that a creditor will grant an extension of time for payment. Making decisions on the run in this kind of heated (and often emotional) environment is very hard, especially when courts, later, will be considering the question in hindsight with full access to the facts and without the various pressures being faced by directors.

Steps directors might take when a company is in danger of becoming insolvent, which might assist them to protect their own positions include:

- paying very close attention to cash flow and receiving regular reports on the company's ability to pay its debts. While there is no hard and fast rule, if the company is likely to be able to pay its debts within 90 days, it is probably not insolvent, but the directors would need to have a reasonable degree of certainty that it will be able to do so;
- considering whether a 'soft landing' might be possible. For example, directors should review all the company's financial commitments and decide whether there are operational steps which might be taken which could save the company from insolvency. These might include terminating or (if possible) standing down staff, reducing or suspending the hours of casual staff, lawfully bringing to an end any contractual arrangements that are contributing to the company's financial distress or seeking to renegotiate those arrangements or putting any capital projects on hold;
- considering whether the company has the support of its bankers and, if so, what the bank requires to maintain that support (for example, the giving of additional security) and whether it might agree to advance additional funds to see the company through a difficult period;
- considering what assets it might be able to dispose of in a relatively short period which might enable it to meet its debts and restore it to solvency;
- considering whether the company might be able to renegotiate the due date for payment of any liabilities;

- assessing whether delaying payment of its creditors for a short time might provide it with sufficient liquidity to survive a difficult period;
- seeking advice on whether the company might be able to arrange a capital injection; and
- considering whether the cash shortfall might be short term and whether revenues are likely to be restored to usual levels in the near term.

In 2017, in an effort to ameliorate some of the hardship directors are exposed to in these circumstances, and also in recognition of the fact that the pressure to avoid liability was encouraging directors to appoint administrators too early and thereby potentially cause significant value loss for investors, the Corporations Act was amended to introduce a safe harbour to protect directors from liability where they have started to develop "one or more courses of action that are reasonably likely to lead to a better outcome for the company".[74] A 'better outcome' means a better outcome for the company than "the immediate appointment of an administrator or liquidator".[75] The protection ceases to be available when the "course of action ceases to be reasonably likely to lead to a better outcome for the company".[76]

There are a number of steps which directors need to take if they wish to avail themselves of the safe harbour. These include:

- properly informing themselves about the company's financial position and ensuring that appropriate financial records are being kept;
- taking steps to prevent misconduct by staff that could adversely affect the company's ability to pay all its creditors;
- taking advice from an appropriately qualified expert who is properly briefed; and
- developing and implementing a plan to restructure the company to improve its financial position.

The Explanatory Memorandum introducing the safe harbour notes that the provision of a reasonable period for directors to seek a better outcome is "not an excuse

74 Corporations Act s 588GA(1)(a).
75 Corporations Act s 588GA(7).
76 Corporations Act s 588GA(1)(b).

to tarry, and directors should move as promptly and decisively towards implementing a suitable course of action (or entering the company into formal insolvency) as is responsible in the circumstances".[77]

The safe harbour will not be available to directors if the company fails to pay employees their entitlements[78] when they fall due or fails to comply substantially with its taxation filing obligations. This means that if directors wish to avail themselves of the safe harbour, they need to ensure that the company has access to enough cash to keep paying employees and enough resources to keep filing all tax returns.

The tax reporting obligation does not extend to the payment of tax, just the fulfillment of the reporting obligations, which includes lodgement of company tax returns, business activity statements and fringe benefit tax returns. However, it is important to note that the director penalty notice regime (which is discussed below) continues to apply notwithstanding the availability of the safe harbour, which will potentially expose directors for personal liability for certain taxes if they are not paid by the company by the due date.[79]

It is important to note that directors are only potentially liable for debts incurred *after* the company becomes insolvent, so if these can be reduced to very low levels, the extent of the potential financial liability can be significantly lessened. There is still the risk, however, even if the amounts involved are small, of ASIC pursuing action based on a breach of the insolvent trading provisions (which have no de minimis threshold) and seeking civil penalty orders against the directors.

Temporary additional relief from insolvent trading liability in response to the COVID-19 pandemic was made available to directors for debts incurred during a limited period after 25 March 2020 provided the debt was incurred in the ordinary course of the company's business.[80]

One of the questions which directors of listed companies who are seeking to avail themselves of the safe harbour may be concerned about is whether they need

77 Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.45].

78 'Employee entitlements' are defined in section 596AA(2) to include superannuation contributions payable by the company.

79 Australian Institute of Company Directors, 2018, "The insolvency safe harbour", [website], https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/director-tools/pdf/06547-1-director-tools-insolvency-safe-harbour-a4-9pp-web.ashx (accessed 22 April 2022).

80 Corporations Act s 588GAAA.

to disclose that fact to the market, because if they do, there is a serious risk that the market will react in a strongly adverse way. ASX addresses this concern in Guidance Note 8 in which it says:[81]

> *Most investors would expect directors of an entity in financial difficulty to be considering whether there is a better alternative for the entity and its stakeholders than an insolvent administration. The fact that they are doing so is not likely to require disclosure unless it ceases to be confidential or a definitive course of action has been determined.*

The Guidance Note goes on to acknowledge that where a listed entity is in financial difficulty, the requirement to disclose material negative financial information could be a significant impediment to it completing a financial restructure or reorganisation necessary for its survival.[82] In that event, ASX urges listed companies to seek a voluntary suspension to manage its disclosure obligations while it completes any transaction.

The position that the ASX takes is to be contrasted to that taken by the Australian Charities and Not-for-profits Commission, which has issued a statement[83] that if any charity trades while insolvent, even though the COVID-19 amnesty is in place for directors, they must notify the Australian Charities and Not-for-profits Commission (ACNC) and its members. Presumably the ACNC takes the same position in relation to charities trading while insolvent where the directors have taken advantage of the more general safe harbour.[84]

2.6 Other statutory obligations of directors

There are a range of other statutory obligations in the Corporations Act which either place specific duties or obligations on directors or potentially expose them to personal liability.

81 ASX Guidance Note 8, p 43.
82 ibid.
83 Australian Charities and Not-for-profits Commission, “ACNC compliance during COVID-19”, [website], https://www.acnc.gov.au/raise-concern/regulating-charities/how-we-ensure-charities-meet-their-obligations/acnc-compliance-during-covid-19 (accessed 14 March 2022).
84 That is to say the safe harbour found in Corporations Act s 588GA(1).

2.6.1 Financial statements

Section 344 requires directors to take "all reasonable steps" to ensure a company complies with the financial reporting requirements in the Act.[85] Principally, these are that the company keeps proper financial records and meets the statutory financial reporting requirements. The latter requirements vary depending on whether the company is a small proprietary company, a large proprietary company, a public company, a listed company or a disclosing entity. It is beyond the scope of this book to discuss the financial reporting requirements in detail, other than to make some over-arching observations.

The financial record keeping obligations[86] require that the records be kept in such a way as to correctly record and explain an entity's transactions, financial position and performance and so as to enable true and fair financial statements to be prepared and audited. The importance of the second requirement was identified in the case of *Love v Australian Securities Commission*,[87] in which Mr Love, as a director, was charged with having failed to take all reasonable steps to secure the company's compliance with its obligation to keep proper accounting records. Owen J noted[88] that the section aims at maintaining certain minimum standards of accounting for corporations and that it is not enough for directors just to ensure that the accounts correctly record and explain the company's transactions, they must also ensure that the company's financial records are kept in an acceptable manner, because if they are not, it could create enormous difficulties for the auditing of the accounts and the accessing of the financial records.

The obligation on directors to take all reasonable steps to ensure that the company meets its financial reporting obligations places a significant burden on directors. In the *Centro case*,[89] directors were charged with breaching those obligations as a result of two material errors in the accounts. The accounts for all companies in the group were over 1000 pages in length. While the court said that it was not expected that the directors had read and understood the accounts in their entirety, it still found

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85 Corporations Act Pts 2M.2 (financial record keeping) and 2M.3 (financial reporting) and ss 324DAA, 324DAB and 324DAC (extension of auditor's term).

86 Corporations Act s 286.

87 (2000) 36 ACSR 363.

88 *Love v Australian Securities Commission* (2000) 36 ACSR 363, [30].

89 *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484.

that they had failed to take all reasonable steps to ensure their accuracy. Justice Middleton said:[90]

> *A board can control the information it receives. If there was an information overload, it could have been prevented. If there was a huge amount of information, then more time may need to be taken to read and understand it. The complexity and volume of information cannot be an excuse for failing to properly read and understand the financial statements. It may be for less significant documents, but not for financial statements.*

Furthermore, while the directors were not expected to have "infinite knowledge or ability"[91] and accordingly, as part of their taking "reasonable steps", could rely upon specialist advice, the court found that whether or not they had satisfied the financial reporting requirements depended on the circumstances of the case, including the complexity of the company's business and internal reporting procedures within the company. Middleton J summarised the obligations of the directors in relation to the financial statements in this way:[92]

> *No one suggests that a director should not personally read and consider the financial statements before that director approves or adopts such financial statements. A reading of the financial statements by the directors is not merely undertaken for the purposes of correcting typographical or grammatical errors or even immaterial errors of arithmetic. The reading of financial statements by a director is for a higher and more important purpose: to ensure, as far as possible and reasonable, that the information included therein is accurate. The scrutiny by the directors of the financial statements involves understanding their content. The director should then bring the information known or available to him or her in the normal discharge of the director's responsibilities to the task of focusing upon the financial statements. These are the minimal steps a person in the position of any director would and should take before participating in the approval or adoption of the financial statements and their own directors' reports.*

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90 *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484, [229].
91 *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484, [20].
92 *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484, [22].

2.6.2 Continuous disclosure

ASX Listing Rule 3.1 requires listed companies to disclose price sensitive information to the market immediately. Listing Rule 3.1A contains some exceptions to this rule where the information is confidential (and ASX has not formed a different view), a reasonable person would not expect the information to be disclosed, and one of the following applies:

- *it would be a breach of the law to disclose the information;*
- *the information concerns an incomplete proposal or negotiation;*
- *the information comprises matters of supposition or is insufficiently definite to warrant disclosure;*
- *the information is generated for internal management purposes of the entity; or*
- *the information is a trade secret.*

The obligation to comply with the Listing Rules falls on the listed entity and not its directors. ASX has issued Guidance Note 8, of some 90 pages, to assist listed companies to comply. Remedies that can be sought by ASX for breaches of the Listing Rules are limited to those things which it can do to the company in breach under its listing agreement such as suspending the company's securities from trading (which punishes security holders, who are not really the ones who should pay the price for the company's default).

In order to cast the liability net more broadly, section 674 of the Corporations Act makes it an offence for a listed entity to breach its continuous disclosure obligations under the Listing Rules. It also provides that any person 'involved' in the entity's contravention will be liable for the breach. The Act contains an extensive definition of 'involved'[93] and extends liability to anyone who has "aided, abetted, counselled or procured the contravention",[94] as well as anyone who has been, "by act or omission, directly or indirectly, knowingly concerned in, or a party to, the contravention".[95] During the COVID-19 crisis, temporary relief for companies and their officers was introduced which meant that a breach of the continuous disclosure laws would only be deemed

93 Corporations Act s 79.
94 Corporations Act s 79(a).
95 Corporations Act s 79(c).

to have occurred where the company or its officers either knew or were reckless or negligent about whether the information would have a material effect on the price of the company's securities if it were generally available. Those temporary changes were made permanent in August 2021.[96] Accordingly, directors may be exposed to liability to the extent that they have been involved in the making of a misleading announcement or a decision not to disclose a price sensitive matter that should have been disclosed, but only if they knew or were reckless or negligent about the potential impact on the company's share price. Involvement in any breach of section 674 may also expose directors to being named in class actions based on a breach of those obligations.[97]

Two of the most prominent directors' duties cases of the past couple of decades, *James Hardie*[98] and *Fortescue Metals*,[99] involved allegations that directors had been involved in a breach of the company's continuous disclosure obligations. The facts of the *Fortescue Metals* case were discussed above. James Hardie involved a statement to the ASX by the company that a foundation which it had established to meet claims by those who suffered asbestos-related diseases from exposure to the group's products was "fully funded" when it was not (to the extent of more than $1 billion). While the facts of that case took place before the introduction of the extended continuous disclosure obligations in the Corporations Act in 2005, it was found that by allowing the issue of the misleading ASX announcement, the directors had breached their duty of care and diligence under section 180.[100]

The Act also extends continuous disclosure obligations to disclosing entities.[101] 'Disclosing entities' are entities which have issued a prospectus or other fundraising document and have more than 100 shareholders. The obligation to disclose price sensitive information under the section is similar to the obligation placed on listed entities but the disclosure is required to be made to ASIC rather than to ASX.

96 *Treasury Laws Amendment (2021 Measures No 1) Act 2021* (Cth) Sch 2, Pt 1 introducing a new s 674A.

97 Class actions are discussed in **Chapter 8**.

98 *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 71 ACSR 368; *Morley v Australian Securities and Investments Commission* (2010) 81 ACSR 285; *Australian Securities and Investments Commission v Hellicar* (2012) 88 ACSR 246.

99 *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 81 ACSR 563; *Forrest v Australian Securities and Investments Commission* (2012) 91 ACSR 128.

100 For a case where directors were found liable under the now repealed section 674(2A), see *Australian Securities and Investments Commission v Padbury Mining Ltd* (2016) 116 ACSR 208; [2016] FCA 990.

101 Corporations Act s 675.

2.6.3 Misleading statements in disclosure documents

Where companies seek to raise capital, they often do so through the issue of a prospectus or a simplified form of disclosure document such as a short form prospectus or offer information statement. An entity may also offer financial products through a product disclosure statement.

The Act specifies details of what must be included in each form of offer document. In the case of a prospectus for a share issue by a company, it must include "all the information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attaching to…the securities offered and the assets and liabilities, financial position and performance, profits and losses and prospects of the body".[102] The need to provide investors with complete and accurate information is well understood by most directors and company officers.

Where a prospectus or disclosure document contains a misleading or deceptive statement or there is a material omission from it, the law not only makes the company itself liable, but also lifts the corporate veil exposing directors, and a range of others involved in the issue of the prospectus or disclosure document (including underwriters), to liability to compensate investors for losses suffered by them.

There are some defences available. Perhaps the better known of these is the 'due diligence' defence. Under this defence, directors are relieved from liability if they have made all inquiries that were reasonable in the circumstances and, after doing so, believed on reasonable grounds that there was no misleading statement in or material omission from the prospectus.[103]

There are other general defences,[104] including the 'reasonable reliance' defence under which directors will be relieved from prospectus liability if they can prove that they placed reasonable reliance on information provided to them by someone else (who is not an employee or agent of the director).[105] As with all provisions of this kind (see, for example, the discussion above about the section 189 reasonable reliance defence to an alleged breach of one of the core directors duties) the principal question for determination is often whether the reliance was reasonable.

102 Corporations Act s 710(1).
103 Corporations Act s 731.
104 Other general defences include not knowing that the document contained a misleading or deceptive statement or that there was a material omission from it.
105 Corporations Act s 733.

While initially the courts were willing to entertain the notion that in order to succeed in claims based on misleading statements in a prospectus, investors needed to prove that they had relied on those misleading statements,[106] the concept of 'market-based causation' has now been widely accepted in Australia.[107] Market-based causation is based on the notion that the making of a misleading statement or the failure to disclose a material matter leads to an inflated price for the company's securities on the market and that investors who have purchased securities during the period while the market was misinformed would not have acquired those securities at the inflated price but for the misleading conduct or the failure to disclose.[108]

2.6.4 Liability under takeover documents

The provisions imposing liability for misleading statements in or omissions from takeover documents[109] (such as bidder's statements and target's statements) are similar to those that apply in the case of prospectuses and disclosure documents. Directors can be ordered to compensate anyone who has suffered loss as a result of a defect in a takeover document. While the reasonable reliance defence and other general defences are available to directors, there is no due diligence defence to liability for defective takeover documents. The two leading cases in the takeovers context are *Australian Securities and Investments Commission v Vines*[110] and *Australian Securities and Investments Commission v Mariner Corporation Ltd*.[111] Both involved action taken for breach of duty under section 180 rather than under the takeover-specific provisions. As has been discussed elsewhere, where a corporation breaches a section of the Corporations Act, directors are always exposed to being pursued by the regulator for having breached their duty of care and diligence.

In *Vines*, action was taken not against a director but a company officer, GIO's Chief

106 In *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Market Ltd* (2008) 68 ACSR 595, Ipp JA at [591] expressed the view that investors would not only need to establish that there was a misleading statement in a prospectus but also that if the company had issued a complying prospectus they would not have invested or that the company would not have issued a prospectus at all.

107 *Caason Investments Pty Ltd v Cao* (2015) 108 ACSR 576; *Re HIH Insurance Ltd (in liq)* (2016) 113 ACSR 318; *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* (2019) 140 ACSR 38.

108 Market-based causation is discussed in detail in **Chapter 8**.

109 Corporations Act ss 670A, 670B.

110 (2005) 55 ACSR 617.

111 (2015) 106 ACSR 343.

Financial Officer. The case involved a hotly contested takeover launched by AMP against GIO. GIO issued a strong defence, but its Part B Statement (the equivalent of a target's statement under the current law) contained some significantly misleading financial information as a result of erroneous forecasts of the profits of its reinsurance business, which had suffered substantial losses as a result of damage reeked by Hurricane Georges in the Gulf of Mexico. The erroneous forecasts were taken by Mr Vines to the due diligence committee which had oversight of the preparation of the Part B Statement. Because of the error, the forecasts contained in the Part B Statement were unlikely to be realised. Although Mr Vines himself did not prepare the reinsurance forecasts, he had responsibility for the person who did and was accordingly found to have breached his duty of care and diligence. No actions were pursued against the directors who had relied on the information provided by Mr Vines.

The facts of *Mariner Corp* were discussed above in the context of the business judgment defence in section 180(2). The question in that case was whether the directors should have allowed Mariner to announce a takeover bid when they did not have certainty about whether funding for the bid would be available. The court found that they had not breached their duties given that the directors, being aware that they needed a high level of confidence about whether funding would be available, took advice on what was required of them and undertook numerous discussions which led to them meeting that threshold.

2.6.5 Liability for dishonest or misleading conduct in relation to financial products and services

The Corporations Act imposes liability on any person who engages in misleading, deceptive or dishonest conduct in relation to a financial product or a financial service.[112] Shares and other securities issued by corporations are financial products and, as a result, these provisions apply to dealings in shares and other securities. However, to avoid the possibility of directors being held to account twice for the same conduct, misleading or deceptive conduct in relation to a fundraising document or a takeover document (which are subject to the specific provisions discussed above) are excluded from the operation of the financial product provisions.

112 Corporations Act ss 1041G, 1041H.

Making a misleading announcement to the ASX can amount to misleading conduct in relation to a financial product (shares), as can information provided in a press conference or a media interview[113] or the placement of a video on a company's website.[114]

2.6.6 Liability of directors of trustee companies

The Corporations Act potentially exposes directors of a corporate trustee to personal liability where the company has lost its right of indemnity against the assets of the trust as a result of a breach of trust by the trustee, because the trustee acted outside its trust powers or because a limitation in the trust deed prevented the trustee from exercising the right of indemnity.[115]

Every trust requires a trustee, and as often as not, the trustee is a company. Because a trust is not itself an entity capable of entering into contracts, owning property or incurring liabilities, the trustee does those things (subject to the terms of the trust deed) for the benefit of those who have beneficial interests under the trust. In the usual course, the trustee will have a right of indemnity over trust assets for liabilities incurred in acting as trustee. However, the trustee must act in accordance with the trust deed and trust law, and to the extent to which it does not, may lose its right to be indemnified from trust assets for those liabilities. Where a corporate trustee has lost its right of indemnity, it must meet trust-related liabilities out of its own (non-trust) assets. To the extent to which it cannot do so, it is will become insolvent and, in the absence of this section, creditors would have had no further recourse. The effect of this provision is to lift the corporate veil so that directors are also made liable for trust-related liabilities to the same extent as the corporate trustee.

This section may operate more harshly than the insolvent trading provisions (which only expose directors to liabilities incurred after a company has become insolvent), because it exposes directors to personal liability for all the debts incurred by the corporate trustee during the period when the right of indemnity was unavailable.[116]

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113 *Australian Securities and Investments Commission v Fortescue Metals Group Ltd (No 5)* (2009) 76 ACSR 506.

114 *Australian Securities and Investments Commission v Cycclone Magnetic Engines Inc* (2009) 71 ACSR 1.

115 Corporations Act s 197.

116 See the discussion on this point in *Intagro Projects Pty Ltd v Australia and New Zealand Banking Group Ltd* (2004) 50 ACSR 224, [66].

2.6.7 Director interests — section 205G

ASIC notes that directors of companies have access to significantly more detailed information about companies than shareholders do and that as a result, shareholders are influenced by the share trading activities of the directors.[117] This is the principal reason why directors are required to disclose their share trading in a timely way to the market.

ASX listed companies have an obligation to disclose the interests directors have in the company's securities at the time of their appointment, any changes in those interests and their interest at the time at which they cease being directors.[118] All disclosures are required to be made within five business days. As the Listing Rules essentially constitute a contract between the company and the ASX, these requirements cannot be enforced directly by the ASX against directors, only against the company.

In order to give some substance to the requirement, the Listing Rules also require a listed company to enter into an agreement with the directors under which the directors agree to provide the company with the information it needs to comply with its obligation to disclose the directors' interests to the market and places a further obligation on listed companies to enforce those agreements.[119]

To provide some further support for the disclosure obligation, section 205G of the Corporations Act imposes a similar (but not identical) obligation on directors of listed companies. The obligation under section 205G need only be satisfied within 14 days (as opposed to five business days under Listing Rule 3.19A). Directors whose interests have been disclosed under Listing Rule 3.19A do not need to comply separately with section 205G.

2.7 State-based legislation

Apart from the well-known and relatively well-understood obligations imposed on directors by the Corporations Act, there are literally hundreds of state and territory laws which impose personal liability on directors where corporations breach local

117 Australian Securities and Investments Commission, *Regulatory Guide 193: Notification of directors' interests in securities: Listed companies,* [193.3].

118 ASX Listing Rules, r 3.19A.

119 ASX Listing Rules, r 3.19B.

laws. Better known among these laws are those which cover worker and community safety and seek to protect the environment. However, these laws extend across the full legislative gamut, imposing potential liability on directors of companies operating in most industries, including agriculture, fisheries, construction, gaming, food, firearms, energy, funerals, liquor supply, mining, ports, health, property, racing, road and rail transport, water as well as many others.[120]

Until the intervention of the Commonwealth Government, through the Council of Australian Governments (COAG) process, which was initiated in 2008, these laws, largely, lifted the corporate veil and imposed automatic personal liability on directors of corporations when the corporations breached those state and territory laws. Contrary to the usual practice where the prosecution has the onus of establishing the guilt of the person charged, the liability placed on directors under these laws was automatic, and directors had the onus of proving their own innocence by establishing the availability of a defence. Defences most commonly involved directors having to show that they had used due diligence to prevent the commission of the offence or that they were not in a position to influence the conduct of the corporation in relation to the matter.[121]

While some of those laws still remain intact, most have now been replaced with provisions under which directors can still be called to account where a corporation commits a breach of the law, but the prosecution must prove some failure or default on their part, such as having authorised or permitted the offence to occur or that they knew or ought reasonably have known that the offence was being committed and failed to take reasonable steps to prevent it.[122]

While the work of the Commonwealth via COAG led to improved outcomes for directors, it did not achieve its secondary desired outcome of achieving uniformity of director liability provisions across Australia. This was an opportunity missed, as each state and territory took its own independent approach to drafting. As a result, directors must still confront the very real possibility that conduct which might be

120 A summary of current state, territory and Commonwealth laws imposing personal liability on directors can be found in B Cowley and S Grant, 2017, "Protecting your position", *MinterEllison*, [website], 2 March, https://www.minterellison.com/articles/protecting-your-position-pyp (accessed 14 March 2022).

121 For a comprehensive discussion of these laws and the reform process see Cowley and Knight, 2017, op cit, Chapter 3.

122 These provisions were widely introduced across many Acts in New South Wales by the *Miscellaneous Acts Amendment (Directors' Liability) Act 2011 No 2* (NSW).

perfectly legal in one state or territory may constitute a criminal offence in another with potentially severe consequences flowing from it.

2.8 Workplace health and safety

An area where some degree of national uniformity has been achieved is in relation to workplace health and safety. Model laws have been adopted in some but not all states and territories.[123] Each of the model laws contains the following provision:[124]

> *If a person conducting a business or undertaking has a duty or obligation under this Act, an officer of the person conducting the business or undertaking must exercise* due diligence *to ensure that the person conducting the business or undertaking complies with that duty or obligation* (emphasis added).

'Due diligence' is defined as taking reasonable steps which include:

- acquiring and keeping up to date knowledge of work, health and safety matters;
- gaining an understanding of the nature of the operations of the business and generally of the hazards and risks associated with those operations;
- using appropriate resources and processes to eliminate or minimise risks;
- having processes for collecting and considering information about incidents, hazards and risks and responding in a timely way; and
- implementing processes to ensure compliance with obligations under the Act.[125]

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123 To date the laws have been adopted in the Australian Capital Territory, New South Wales, the Northern Territory, Queensland, South Australia, Tasmania and the Commonwealth: Safe Work Australia, "Model WHS laws", [website], https://www.safeworkaustralia.gov.au/law-and-regulation/model-whs-laws (accessed 14 March 2022)

124 *Work Health and Safety Act 2011* (Cth) s 27; *Work Health and Safety Act 2011* (ACT) s 27; *Work Health and Safety Act 2011* (NSW) s 27; *Work Health and Safety (National Uniform Legislation) Act 2011* (NT) s 27; *Work Health and Safety Act 2011* (Qld) s 27; *Work Health and Safety Act 2012* (Tas) s 27; *Work Health and Safety Act 2012* (SA) s 27.

125 A note to the section says that processes might include reporting notifiable incidents, consulting with workers, ensuring compliance with notices issued under the Act, ensuring the provision of training and instruction to workers about work health and safety and ensuring that health and safety representatives receive appropriate training.

These obligations are not to be taken lightly as some of the older cases (pre-model laws) have demonstrated.[126]

Some states and territories have introduced 'industrial manslaughter' laws. The Victorian law commenced on 1 July 2020. It provides[127] that a director or other officer of a body corporate (who is not a volunteer) who has acted negligently and in a way that constitutes a breach of a duty that the body corporate owes to a worker which causes the death of the worker, has committed industrial manslaughter and is liable to up to 25 years' imprisonment. Duties of employers include providing a safe working environment for employees. 'Negligent' conduct is defined as involving a great falling short of the standard of care that a reasonable person would have taken in the circumstances, and a high risk of death, serious injury or serious illness.[128]

Queensland has had broadly similar laws since 2017[129] and the ACT since 2003.[130] In the case of the ACT, directors and other officers can also be liable if they have acted recklessly or negligently. Western Australia and the Northern Territory introduced industrial manslaughter legislation in 2020.[131] New South Wales and South Australia both introduced Bills to similar effect but neither have progressed into law as at the date of writing.

While negligence under these provisions must be proven to a criminal standard, the elevation of negligence to a crime is always of concern. As was noted earlier, conduct which breaches the section 180 duty of care and diligence can never amount to criminal conduct under section 184.

126 See, for example, *Kumar v Ritchie* [2006] NWIR Comm 323 where the CEO of a diversified corporate group who appeared to have an extensive understanding of the company's business and work place practices was still found to be ignorant of key aspects of the safety procedures and permitted deficiencies in the training of senior personnel to exist and *WorkCover Authority (NSW) v Kirk Group Holdings Pty Ltd* (2004) 135 IR 166 in which Mr Kirk, a director of a company which ran a farming operation was prosecuted when the farm manager overturned a vehicle on the farm. In the latter case, on appeal to the High Court (*Kirk v Industrial Relations Commission (NSW); Kirk Group Holdings Pty Ltd v WorkCover Authority (NSW)* [2010] HCA 1), while the director was finally exonerated, High Court Justice Heydon was motivated to comment on the severe toll which eight years of court proceedings had wrought on the director, when he noted (at [125]) that: "It is time for the WorkCover Authority of NSW to finish its sport with Mr Kirk".

127 *Occupational Health and Safety Act 2004* (Vic) s 39G(2).

128 *Occupational Health and Safety Act 2004* (Vic) s 39E(1).

129 *Work Health and Safety Act 2011* (Qld) s 34D.

130 *Work Health and Safety Act 2011* (ACT) s 34A.

131 *Work Health and Safety Act 2020* (WA); *Work Health and Safety (National Uniform Legislation) Act 2011* (NT) s 31.

2.9 Wage theft laws

In recent times, many well-known Australian companies have admitted to underpaying staff, often in substantial amounts.[132] In response, some state governments have moved to introduce so called 'wage theft' laws. Victoria was the first state to introduce such an Act, the *Wage Theft Act 2020*. Section 13 of that Act provides that if a body corporate commits what is called an 'employee entitlement offence', each director and other officer of the body corporate is automatically also deemed to have committed the offence. The only defence available is where directors or officers are able to prove that they exercised due diligence to prevent the commission of the offence.

This is a return to the style of drafting discussed earlier, whereby state laws comprehensively lift the corporate veil and reverse the onus of proof, compelling directors to establish their own innocence by proving to the requisite standard that the one, very narrow, defence, is available to them. While dishonesty is an element which needs to be established to prove liability by a corporation, it is not an element of liability for directors. It will not always be possible for directors to know whether a staff member is acting dishonestly because more often than not when they do act dishonestly, employees take steps to conceal their behaviour. Consequently, the section leaves open the very distinct possibility that directors will be exposed to liability in circumstances where they neither participated in nor had any knowledge of the offence which was committed.

The Queensland Criminal Code contains an offence related to wage theft but it does not target directors specifically.[133] In 2019, the Federal Government issued a White Paper[134] exploring the possibility of amendments to the *Fair Work Act 2009* (Cth) to better protect workers' interests, but those changes did not ultimately proceed.

132 V Winter, 2019, "Here's a running list of Australian businesses that have underpaid staff in 2019", *SBS World News,* 9 December, https://www.sbs.com.au/news/the-feed/here-s-a-running-list-of-australian-businesses-that-have-underpaid-staff-in-2019 (accessed 14 March 2022).

133 *Criminal Code Act 1899* (Qld) Sch 1, s 391.

134 Attorney-General's Department, 2019, *Improving protections of employees' wages and entitlements: Strengthening penalties for non-compliance* (Discussion Paper).

2.10 Anti-money laundering and counter-terrorism financing

Later in this book, there is some discussion of how breaches of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) have impacted on a number of Australian corporations, including some of the banks, and what it has meant for directors serving on boards of corporations that have committed the breaches.

The purpose of the legislation is to require regulated corporations to help identify, mitigate and manage money laundering and terrorism financing risks. They are required to do this by undertaking due diligence on their customers through identifying and verifying their identity, monitoring their transactions and notifying the regulator, the Australian Transaction Reports and Analysis Centre (AUSTRAC) of suspicious matters and international fund transfer instructions.

While there are no specific obligations placed on directors under this Act, directors can be liable where breaches occur under the extended liability provisions. Section 174 attaches civil liability to anyone who aids, abets, counsels or procures a contravention of a civil penalty provision of the Act, induces a contravention, is directly or indirectly knowingly concerned in, or party to, a contravention of a civil penalty provision or conspires with others to effect a contravention of a civil penalty provision.

2.11 Modern slavery

Australia has joined a growing number of G20 countries in addressing the problems of modern slavery by introducing the *Modern Slavery Act 2018* (Cth). The International Labour Organization estimates that over 40 million people globally are victims of forced labour or other forms of slavery, with 71 per cent of victims being women and girls and 25 per cent children.[135] In Australia, the purpose of the legislation is to require larger companies (those with more than $100m in revenue) to examine their supply chains and report on any forms of slavery perpetrated by suppliers (such as human trafficking, forced labour, deceptive recruiting for labour or services, forced marriage and debt bondage). The report is required to describe the corporation's business

135 The International Labour Organization and the Walk Free Foundation, 2017, *Global estimates of modern slavery: Forced labour and forced marriage* (Report), p 5.

structure, operations and supply chains, the risks of modern slavery practices in its operations and supply chains, the actions which it has taken to assess and address those risks (including due diligence and remediation processes) and how it assesses the effectiveness of its actions. The Act requires reports to be approved by an entity's board and to be signed by a member of the board.

While no penalties are imposed under the Act, its purpose is to provide transparency through public access to the reports, thereby discouraging Australian-based corporations from engaging suppliers who are using discredited practices.

The New South Wales Government has passed a similar Act which has a reporting threshold for businesses with revenues of $50m operating in New South Wales. At the time of writing, the Act has not yet commenced. The New South Wales law (unlike the Commonwealth Act) will impose penalties on companies that do not report or which provide information which the company knows, or ought reasonably to know, is false or misleading. It is likely that the New South Wales law will exempt corporations which report in accordance with the Commonwealth Act.

2.12 Director penalty notice tax regime

If a company fails to meet certain tax obligations, the directors can potentially become personally liable for the company's unpaid tax debt. If a company fails to meet a Pay As You Go (PAYG) withholding or a goods and services tax (GST) or Superannuation Guarantee Contribution (SGC) liability in full by the due date, directors can become personally liable for director penalties equal to the unpaid amounts under the director penalty notice regime. The regime applies to these taxes because they all involve the collection of amounts due to the ATO or which are deducted from payments due to others for on-payment to the ATO.

Before initiating recovery proceedings, the ATO must deliver a director penalty notice to the directors of the company. If the company has lodged its return notifying the ATO of the amount payable by the required date,[136] directors will be given the option, within 21 days of the date of the notice of:

- ensuring that payment of the due amount is made;

136 In the case of PAYG and GST the required date is within three months of the due date for lodgement, and, in the case of SGC it is the due date for lodgement.

- appointing an administrator to the company; or
- commencing steps for the winding up of the company.

Where the amount required to be paid is not notified to the ATO by the required date, the only option the directors will be given is to ensure that the debt is paid. Where the directors do not take one of the available steps within the 21 day period, the ATO can commence proceedings to recover the unpaid tax debt from the directors, and may take other steps including the garnisheeing of their wages or offsetting any tax credits they have against the debt.

There are some defences to a director penalty notice, and they include where:

- a director did not take part (and it would have been unreasonable to expect the director to take part) in the management of the company during the relevant period because of illness or other acceptable reason; or
- a director took all reasonable steps (unless there were no reasonable steps which could have been taken) to ensure that the company paid the amount outstanding, an administrator was appointed to the company or steps were commenced for the winding up of the company.

2.13 Regulatory environment

Not all requirements placed on directors are legislative in nature. Many are found in regulation, and some of them are not even binding at all.

The ASX Corporate Governance Council has issued its *Corporate Governance Principles and Recommendations* (ASX Corporate Governance Principles)[137] containing eight Principles, each supported by a number of Recommendations. Although not obligatory, they are imposed on listed entities on an "if not why not" basis.[138] Previously, there was Principle 10 which was entitled "Recognise the legitimate interests of stakeholders". In the second edition released in 2010, Principle 10's Recommendations were integrated into Principles 3 and 7.

137 ASX Corporate Governance Council, 2019, *Corporate Governance Principles and Recommendations*, 4e, February.

138 It is not obligatory for listed entities to comply with the Principles and Recommendations, but where it does not, an entity must explain why not: see ASX Listing Rules, r 4.10.3.

Most of the Principles are drafted so as to impose obligations on the listed entity (rather than its board) and a range of expectations on directors and the way that they conduct their affairs, requiring board leadership to implement. Only a relatively small number of the Recommendations place obligations directly on boards. These mostly relate to the establishment of committees, such as a nomination committee,[139] an audit committee,[140] a risk committee[141] and a remuneration committee.[142]

There are many more Recommendations which have a significant impact on how boards ought to conduct their affairs. These include expectations about a majority of independent directors on the board and its committees and the chair being an independent director.[143] Other requirements related to directors include that listed entities have agreements with directors,[144] that directors should set measurable diversity objectives,[145] have in place processes for periodically reviewing board member performance,[146] have a board skills matrix,[147] have a code of conduct for directors[148] and receive reports on breaches of the entity's code of conduct and incidents occurring under the entity's whistleblower and anti-bribery and corruption policies.[149]

The Australian Prudential Regulation Authority (APRA) too has regulatory standards that apply to directors. In contrast to the ASX Corporate Governance Council's Corporate Governance Principles, APRA's Prudential Standards are binding on regulated entities although they are not specifically enforceable against directors of those entities. APRA does, however, have power to deal with directors who do not meet APRA's standards through the 'fit and proper' regime which is supported by a number of Prudential Standards and Prudential Practice Guides.[150] These Standards

139 ASX Corporate Governance Council, 2019, op cit, Recommendation 2.1.
140 ibid, Recommendation 4.1.
141 ibid, Recommendation 7.1.
142 ibid, Recommendation 8.1.
143 ibid, Principles 2, 4, 7 and 8.
144 ibid, Recommendation 1.3.
145 ibid, Recommendation 1.5.
146 ibid, Recommendation 1.6.
147 ibid, Recommendation 2.2.
148 ibid, Recommendation 3.2.
149 ibid, Recommendations 3.2, 3.3 and 3.4.
150 See Prudential Standard CPS 520 which applies to APRA-regulated institutions (banks, insurance companies and life insurance companies) and Prudential Practice Guide SPS 520 which applies to regulated superannuation entities under the *Superannuation Industry (Supervision) Act 1993* (Cth). Those Prudential Standards are supported by Prudential Practice Guides APG 520 and SPG 520.

require regulated entities to adopt fit and proper standards which apply to directors and others who hold senior office. The determination of whether directors meet the fit and proper standards must be made before their appointment and then annually while they hold office. If a person ceases to meet the fit and proper standard, the regulated entity is required to takes steps to have them removed. APRA also has certain powers to require the removal of directors who it considers not to be fit and proper, should the regulated entity not act itself.[151]

In terms of fit and proper policies,[152] APRA says that boards should consider a host of issues when making a decision about whether a candidate (or existing director or officer) is fit and proper. These include things such as character, competence, experience, skills and integrity. Boards are also encouraged to check whether the candidate has any history of breaching fiduciary obligations, has been negligent or deceitful or been dealt with previously by a regulator or professional body or is of 'bad repute'. Boards must also consider whether the candidate has previously been involved with a body which has failed by reason of insolvency or failed to manage personal finances satisfactorily.

APRA's Prudential Standards place various expectations on boards of directors of regulated entities. For example, in the case of APRA-regulated institutions:[153]

> *The Board must ensure that directors and senior management of the institution collectively have the full range of skills needed for the effective and prudent operation of the institution, and that each director has skills that allow them to make an effective contribution to Board deliberations and processes.*

APRA's Prudential Standard CPS 510 *Governance* contains a range of other requirements for boards of APRA-regulated institutions, many similar to those contained in the ASX Corporate Governance Principles, which address the issue of board remuneration, the establishment of audit and risk committees, the independence of board members and board performance assessment and renewal. Prudential

151 See *Banking Act 1959* (Cth) s 23; *Superannuation Industry (Supervision) Act 1993* (Cth) s 133.
152 See Prudential Standard CPS 520; Prudential Practice Guide SPS 520; Prudential Practice Guide APG 520; Prudential Practice Guide SPG 520.
153 Prudential Standard CPS 510, p 8.

Standard SPS 510 contains a range of similar, but not identical, governance standards for boards of regulated superannuation entities.

2.14 Further resources

Additional information about the duties and responsibilities of directors can be found at:

- B Cowley and S Knight, 2017, *Duties of Board and Committee Members*, Thomson Reuters;
- R Austin and I Ramsay, 2018, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th edn, LexisNexis Butterworths; and
- R Baxt, 2016, *Duties and Responsibilities of Directors and Officers*, 21st edn, Australian Institute of Company Directors.

Chapter 3

Taking into account the interests of stakeholders other than shareholders

As discussed in **Chapter 2**, the duty in section 181 of the Corporations Act to act in good faith in the best interests of the company and for a proper purpose has historically been interpreted so as to equate the duty to the company as a duty to act in the interests of shareholders (except where the company is insolvent or approaching insolvency). Two inquiries in recent decades, one by the Corporations and Markets Advisory Committee (CAMAC)[154] and another by the Parliamentary Joint Committee on Corporations and Financial Services (PJC)[155] concluded that our current laws provided adequate opportunity for directors to take into account the interests of non-shareholder stakeholders. While that put a temporary stop to the corporate social responsibility movement in Australia, the United Kingdom soon moved to expand the duty of directors to include taking into account the interests of a range of other stakeholders such as employees, suppliers, customers and the community.

It is clear from the views expressed by Commissioner Hayne in his Final Report arising from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) that he also believes that current laws were adequate, although he made it clear that he thought the interests of all stakeholders would converge in the long run which necessitated boards taking into

154 Corporations and Markets Advisory Committee, 2006, *Corporate social responsibility* (Discussion Paper).
155 Parliamentary Joint Committee on Corporations and Financial Services, 2006, *Corporate responsibility: Managing risk and creating value* (Report).

account the interests of all of them.[156] Directors, however, are not obligated to consider only the long term. Short- and medium-term outcomes can sometimes be important too. One of the lessons from the Final Report of the Hayne Royal Commission is that single-mindedly pursuing profit at the expense of customers and other stakeholders and damaging a company's reputation in the process is seldom a good approach and will certainly be damaging to the company's brand and business in the long term. While there are times when it will be appropriate to consider short-term outcomes, boards should equip themselves with sufficient information about the long-term impacts of their decisions, especially if they are likely to affect stakeholders in a materially adverse way.

While there is much debate about the need for directors to have regard to the interests of non-shareholder stakeholders, it is important to remember that there is no duty owed by directors to stakeholders. Shareholders retain their position of primacy. Ultimately it remains their interests which the board should have as its primary focus.

However, the purpose of taking the interests of other stakeholders into account is to help board members to make decisions in the best interests of the corporation. Without taking the interests of stakeholders into account, the board will have an incomplete picture and will not be best placed to make the right decision for the company and the best decisions for shareholders.

This Chapter will examine the extent to which directors will need to be aware of and respond to the interests of all stakeholders in the post-Hayne world and some of the pitfalls in doing so. It looks at how directors might seek to prioritise and align the competing interests of various classes of stakeholders.

3.1 The developing focus on stakeholder interests

It is probably fair to say that until the last few decades of the 19th century, the notion of directors paying regard to the interests of anyone but shareholders was quite improper. While it is true that there were isolated attempts to improve the working conditions of employees during the Industrial Revolution and some significant examples of corporate philanthropy by 19th century corporate titans, the established view was that

156 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission), 2019, Final Report, February.

a company's constitution set out what its objects and powers were and any attempt to expend members' funds in a way which was not wholly consistent with those objects and powers was regarded as ultra vires and beyond the power of directors.[157]

Nevertheless, there were still instances when philanthropic gestures were given the green light by the courts. In the 1864 case of *Taunton v Royal Insurance Company*,[158] it was held that an insurance company might pay losses caused by lightning damage, even though the damage was outside the scope of the policy, because the company's generosity of purpose was regarded as good for business and might assist it to attract new customers. In the 1876 case of *Hampson v Price's Patent Candle Co*,[159] it was held that the directors of the company could pay a gratuity to their employees when they had had a very good year, giving each staff member who was "of good character" an amount equal to a week's wages on the basis that the directors necessarily had an incidental power to do things which were ordinary and reasonable with a view to getting the best out of their employees. The court thought that, having received the payment, employees might reasonably expect that if they were to stay in the service of the company and it were to have another good year, they would probably be dealt with in a similar way and so would be motivated to work hard to ensure that the company recorded good years in the future.

While those principles were generally accepted in the 1883 case of *Hutton v West Cork Railway Co*,[160] the court still found that the directors (and even the company in general meeting) were precluded from paying termination benefits to employees on the basis that the company had sold its business and under its constitution once it was sold, it continued to exist only for the purpose of winding up. The court found that while the employee benefits may have been reasonable of themselves, there was no way they could be construed as providing a benefit to the company. In a celebrated judgment, the Court of Appeal described the notion succinctly in this way: "The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company."[161]

157 A Carroll, 2008, "A History of Corporate Social Responsibility: Concepts and practices" in A Crane et al. (eds), 2008, *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press.
158 (1864) 2 Hem & M 135.
159 (1876) 45 LJ Ch 437.
160 (1883) 23 Ch D 654.
161 *Hutton v West Cork Railway Co* (1883) 23 Ch D 654, [672]–[673].

It was not only in England that controls on how directors spent corporate funds were being relaxed. Across the Atlantic, in New York too, the courts were starting to take a more liberal view of expenditure which directors could lawfully undertake. In a case involving the famous piano making company, Steinway,[162] it was alleged that the directors had, among other things, improperly expended corporate funds on providing housing for employees, and a church, a school, a free library and a free bath. The court noted that as industrial conditions change, business methods needed to change with them, such that acts become permissible which at an earlier period would not have been considered to be within corporate power. In a judgment which seems to foreshadow an even more liberal approach in future times, the court said:[163]

> *The mass of these employees are skilled operatives, who have been permanently in the service of the company for many years in harmonious [pun unintended] relations with their employer, which have been practically uninterrupted by strikes or suspension of business for any cause. It may be fairly inferred from this that this policy of the company in dealing with its operatives has been a wise one, and apart from its moral aspects has materially contributed to the resources of the corporation.*

As recently as 1962, the decision in *Hutton v West Cork Railway Co*[164] was followed in the case of *Parke v Daily News Ltd.*[165] In that case, the company had sold its two newspapers, and although expressing an intention that it would continue in business, planned on distributing nearly the whole of the sale proceeds to its employees. In proceedings to prevent the distribution, the court said:[166]

> *...the defendants were prompted by motives which, however laudable, and however enlightened from the point of view of industrial relations, were such as the law does not recognise as a sufficient justification. Stripped of all its side issues, the essence*

162 *Steinway v Steinway and Sons* 17 Misc. 43 (N.Y. Sup. Ct 1896).
163 *Steinway v Steinway and Sons* 17 Misc. 43 (N.Y. Sup. Ct 1896), 46.
164 (1883) 23 Ch D 654.
165 [1962] 2 All ER 929.
166 *Parke v Daily News Ltd* [1962] 2 All ER 929, 948.

> *of the matter is this, that the directors of the defendant company are proposing that a very large part of its funds should be given to its former employees in order to benefit those employees rather than the company, and that is an application of the company's funds which the law, as I understand it, will not allow.*

By 1967, however, the High Court of Australia was prepared to acknowledge that directors had a considerable discretion in relation to the making of 'ex gratia' payments. In *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*,[167] the High Court said:

> *Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith, and not for irrelevant purposes, is not open to review by the courts.*

In the 1991 Australian case of *Woolworths Ltd v Kelly*[168] (which involved a proposal to make a retirement payment to a director), Mahoney J confirmed for the purposes of Australian law that companies could be generous with corporate funds, provided there were benefits for the company in doing so. He said:[169]

> *I do not mean…that a director…must be mean or cheeseparing. A company may decide to be generous with those with whom it deals. But — I put the matter in general terms — it may be generous or do more than it need do only if, essentially, it be for the benefit or for the purposes of the company that it do such. It may be felt appropriate that the company acquire the reputation of being such.*

Interestingly, though, some of the old views still prevailed. Following the 2001 Boxing Day tsunami which killed hundreds of thousands of people in southern Asia, a significant number of Australian companies made sizable corporate donations to charities which were providing support to the millions who had lost their homes in

167 (1968) 121 CLR 483, 493.
168 (1991) 4 ACSR 431.
169 *Woolworths Ltd v Kelly* (1991) 4 ACSR 431, 446.

the tragedy. A spokesperson for the Australian Shareholders Association was quoted as saying:[170]

> *[F]irms should not generally give without expecting something in return...in most circumstances, donations should only be made in situations that are likely to benefit the company through greater market exposure.*

In 2002, Sir Gerard Brennan, former Chief Justice of the High Court of Australia, wrote, giving some support to the views of the Australian Shareholders Association:[171]

> *There are sound reasons of policy for imposing a limitation on directors' powers to donate corporate assets. Investors, whose charitable inclinations are diverse, do not authorise directors to dispose of corporate assets to charitable objects of the directors' choice. The choice should remain with the individual investor when he or she obtains his or her share of the distributed profits. From the moral viewpoint, there is no virtue in a directors' resolution to dispose of corporate assets to a charitable object. Virtue consists of the giving of what is one's own, not in the giving of assets that belong to another.*

In the Report of the Royal Commission into the Failure of HIH Insurance,[172] Commissioner Owen addressed the question of the extent to which boards could expend corporate funds for community rather than corporate purposes. He had this to say:[173]

> *The board and management of a company have a good deal of discretion as to how they use the company's funds so long as they act reasonably in the interests of the company. Beyond normal business expenditure, companies not uncommonly make donations to charitable or philanthropic causes or other discretionary contributions including to political parties.*

170 M Standen, 2005, "The corporation in society: Time to revise its role?", *Australian Law Reform Commission Reform Journal*, Vol 12, No 87, pp 12–16.

171 Sir G Brennan, 2002, "Law values and charity", *Australian Law Journal*, Vol 76, No 8, p 497.

172 Royal Commission into the Failure of HIH Insurance (The Failure of HIH Insurance), 2003, Report, 4 April.

173 ibid, Vol 1, Section 6.2.13.

While there is nothing inherently wrong with any of this, it is an area where a board's stewardship responsibilities call for deliberation on how a payment will serve the company's interests and appropriate accountability to shareholders on whose behalf that discretion has been exercised.

In 2004, the Australian Institute of Company Directors' (AICD) *Company Director* magazine featured two views on the role of corporate social responsibility in boardrooms by experienced corporate lawyers.[174] In the first part of the article, Bill Beerworth noted that "there is a broad societal expectation that [corporations] will conduct themselves as 'good corporate citizens', act ethically and take into account in their decision-making the interests of those affected by their operations". However, he expressed concern that, while it is generally accepted that making charitable donations, supporting the arts and making political donations is part of making the company more effective in business, it is not at all clear that boards can make decisions "intended primarily to benefit stakeholders or the community". He went on to advocate for the Corporations Act to be amended to authorise directors to pay regard to stakeholder interests in their decision making and to provide them with a defence to any allegation that they may have breached their duties if they do so.

In the second half of the article, Tom Bostock argued stridently against any change to the law saying:[175]

It is important to keep in mind that the shareholders, far from being in any position of privilege, are the most at risk should the company fail. In its liquidation, all that they are entitled to is such of the company's wealth, if any, as remains after the company's liabilities to its creditors, be they employees, creditors, suppliers or other outside parties have been met. While the company remains in operation, the shareholders' return depends entirely on the profits earned by the company: no profits, no dividends.

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174 Australian Institute of Company Directors, 2004, "Finding the balance cover story", *Company Director Magazine*, 1 December, http://www.companydirectors.com.au/director-resource-centre/publications/company-director-magazine/2000-to-2009-back-editions/2004/december/finding-the-balance-cover-story (accessed 26 April 2022).

175 ibid.

> *It follows that the company's business, under the stewardship of its directors, should be directed towards maximising the return to its shareholders. That is the basis of company law as we know it. In pursuing that objective, the company must comply with its obligations to outside parties whether assumed by contract or imposed by law. That is not to say that the company may not impose upon itself obligations, such as for employee benefits, OH&S and product safety over and above those imposed by law; but in doing so, the law requires its directors to be satisfied that it is in the interests of the company and its shareholders.*

He made an important point, and one that is sometimes lost in the debate about the social obligations of corporations, namely that shareholders have provided the capital which has allowed the company to engage in its endeavours, and that, if it fails, they are the ones who take primary risk, ranking after creditors in a winding up. So, should they not expect their interests to be prioritised over those of other stakeholders?

In an interview with the *Australian Financial Review* in 2005, a former James Hardie chair said that the decisions of their board to quarantine and separate asbestos liability from the group's holding company had been driven, in part at least, by concern that the directors could be liable to shareholders if they did not take some action along the lines they did.[176] The article reported that the chair said that Hardie's agreement to provide funding for asbestos liability still required shareholder approval and that "required a 'hard-nosed argument and not a mere statement of support' for corporate social responsibility, showing shareholders why it was in Hardie's long-term interests".

3.1.1 CAMAC and PJC enquiries

In 2004, David Jackson QC was appointed to head a Special Commission of Inquiry established by the New South Wales Government to report on events related to James Hardie's quarantining of its asbestos-related liabilities into a separate entity and whether that entity was likely to be able to meet those liabilities. The

176 F Buffini, 2005, "Calls to protect corporate conscience", *The Australian Financial Review*, 23 November, https://www.afr.com/companies/calls-to-protect-corporate-conscience-20051123-jg7hz (accessed 14 March 2022).

Jackson Report,[177] which is discussed in detail in **Chapter 4**, estimated that there would be a $1.5 billion shortfall in funds available to compensate asbestos victims and found that the matter had exposed "significant deficiencies in Australian corporate law".[178]

As a consequence, in March 2005, the government referred a number of questions concerning directors' duties and corporate social responsibility to CAMAC[179] for consideration. In particular, the referral asked CAMAC to consider: (a) the extent to which boards may take into account the interests of specific classes of stakeholders or the broader community; (b) whether they ought to be required to do so; and (c) whether Australian companies should be encouraged to adopt socially and environmentally responsible business practices.[180]

CAMAC did not support amendments to the Corporations Act, noting that existing directors' duties allowed directors sufficient flexibility to take relevant interests and broader community considerations into account and that amendments along the lines proposed would not provide meaningful clarity for directors but would obscure their accountability.[181] In particular, CAMAC noted that the common law and statutory obligations of directors are sufficiently broad to enable them to "take into account the environmental and other social impacts of their decisions, including changes in societal expectations about the role of companies and how they should conduct their affairs".[182] On the question of whether companies should be encouraged to adopt socially and environmentally responsible business practices, CAMAC took the view that this was the role of government by setting boundaries in legislation and through the work of regulatory agencies and policy setting.[183]

More generally CAMAC noted:[184]

177 D Jackson, 2004, *Report of the special commission of inquiry into the Medical Research and Compensation Foundation*.

178 ibid, [30.67].

179 CAMAC was established in 1989 to provide independent advice to the federal Treasurer on any aspect of corporate or financial markets law reform. The Committee was comprised of corporate lawyers, company directors and regulators, and was abolished in 2018.

180 See, Corporations and Markets Advisory Committee, 2006, *The social responsibility of corporations*, op cit, pp 3–4.

181 ibid, p 7.

182 ibid, p 111.

183 ibid, p 9.

184 ibid, p iv.

> *On a rounded view, social responsibility, like effective corporate governance, can be seen as part and parcel of the way a company's affairs are conducted. It is not an "add-on", something to be addressed incidentally to the core of the business in order to satisfy particular third party concerns. Those in charge of a company's affairs should have an interest in managing external impacts of the business in relation to the environment, human rights and other matters that may impinge on the success of the business. To go further and expect a company to place greater emphasis on a particular issue that some groups may consider important for the community overall, but that is not germane to the company's business, may only distract attention from its business purpose for no real gain.*
>
> *On this rounded approach, a company will be seen to be socially responsible if it operates in an open and accountable manner, uses its resources for productive ends, complies with relevant regulatory requirements and acknowledges and takes responsibility for the consequences of its actions. For some companies, this will require them to engage with particular social and environmental issues.*

CAMAC noted that[185] under the general law and section 181 of the Corporations Act, "directors, in acting in good faith, in the best interests of the company and for a proper purpose, may take into account a range of factors external to the shareholders if this benefits the shareholders as a whole".

About six months after the referral to CAMAC, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) announced its own inquiry into corporate social responsibility. Its terms of reference were very similar to the terms of referral to CAMAC and included whether directors had or should have regard to the interests of stakeholders other than shareholders, whether the existing legal framework discouraged them from doing so, whether amendments were required to the Corporations Act to enable them to have regard to the interests of stakeholders and any other mechanisms, including voluntary ones, which would enhance consideration of stakeholder interests.

The PJC considered several different options for possible reform, including:[186]

185 ibid, p 107.
186 Parliamentary Joint Committee on Corporations and Financial Services, 2006, op cit, [4.40].

- taking a permissive approach to possible reform, which would involve permitting directors to take the interests of non-shareholder stakeholders into account (thereby providing comfort to those who, like Bill Beerworth, were concerned that that they may be breaching their duties if they were too enthusiastic in supporting the interests of non-shareholder stakeholders);
- taking a directive approach to mandate directors taking into account the interests of stakeholders; and
- a "whole of law" set of reforms which would involve considering how economic, social and environmental matters might be best regulated across all laws.

Ultimately, the PJC, like CAMAC, concluded that there was no compelling case for change[187] because directors should act in a socially and environmentally responsible manner at least partly because that is likely to lead to the long-term growth of their company. They described their position as being one of "enlightened self-interest". That is to say corporations should do the right thing by stakeholders because it is in the interest of the corporation to do so, for example, by improving the company's reputation, making it easier to recruit and retain staff, to forestall regulatory measures and to make themselves more attractive to large investors.[188]

In particular, the PJC noted:[189]

> *Directors' duties as they currently stand have a focus on increasing shareholder value. This is important, because the provision is first and foremost intended to protect those investors who trust company directors with their savings and other investment funds. Directors' duties enable such investors to have some confidence that their funds will be used...in order to increase the income and value of the company they part-own.*

After making reference to irresponsible corporate conduct (noting allegations which had been made against the James Hardie Group and the Australian Wheat Board

187 ibid, [4.39].
188 ibid, p xiv.
189 ibid, [4.58].

which are both discussed in detail in **Chapter 4**), the PJC went on to conclude:[190]

> *Progressive, innovative directors, in seeking to add value for their shareholders, will engage with and take account of the interests of stakeholders other than shareholders.*

3.1.2 UK approach

Given that Australian corporate law owes its origins almost entirely to UK corporate law, as it has developed over the centuries, and much of the Australian jurisprudence on director liability has its foundations in the decisions of the English courts, it is interesting to examine the different approach now being taken in UK companies legislation to the responsibility of directors to consider the interests of stakeholders other than shareholders.

Prior to the new UK Companies Act in 2006, in contrast to Australia, there were no statutory equivalents to the general law duties of directors. When statutory duties were finally introduced under that Act, common law duties were abolished and replaced entirely with the statutory duties.[191] This differs from the position in Australia where statutory duties sit alongside common law duties.

In an apparent expansion of the duty to act in the best interests of the company, the statutory equivalent in the 2006 UK Act required that:[192]

> *(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other things) to:*
> *(a) the likely consequences of any decision in the long term;*
> *(b) the interests of the company's employees;*
> *(c) the need to foster the company's business relationships with suppliers, customers and others;*
> *(d) the impact of the company's operations on the community and the environment;*

190 ibid, [4.59].
191 *Companies Act 2006* (UK) s 170.
192 *Companies Act 2006* (UK) s 172.

> *(e) the desirability of the company maintaining a reputation for high standards of business conduct; and*
> *(f) the need to act fairly between members of the company.*

It is an interesting formulation in that it not only requires directors to have regard to the interests of various stakeholders, but also requires them to have regard to the long-term impact of their decisions, maintaining a high business reputation and acting fairly between members. Notably, "members" retain their position of primacy (because the success of the company must be promoted for their benefit). Further, the provision does not create any duty to stakeholders because the duty is, like the duties with which we are familiar in Australia, a duty to the company itself.

The scope of section 172 of the UK Act has recently been extended by the introduction of some new reporting provisions which require directors, in their strategic report for a financial year,[193] to describe how they have had regard to the list of matters described above.[194] They are also required in their annual directors' report to make further disclosures in relation to employees, customers, suppliers and others in a business relationship with the company. In the case of employees, that disclosure must extend[195] to how they have provided employees with information on matters of concern to them as employees, consulted with them or their representatives on a regular basis about their views so that they can be taken into account in board decisions which are likely to affect their interests, encouraged the involvement of employees in the company's performance through an employee share scheme or similar, and endeavoured to achieved a common awareness on the part of all employees of the financial and economic factors affecting the performance of the company. The directors are also required to summarise how they have engaged with employees and had regard to their interests including in relation to principal decisions made by the company during the financial year.

In the case of those in a business relationship with the company, the directors'

193 All companies other than those which fall within the definition of "small companies" are required to prepare strategic reports. See, *Companies Act 2006* (UK) s 414A.
194 *Companies Act 2006* (UK) s 414CZA.
195 *SI 2008/410 The Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008* (UK) Sch 7, cl 11.

report is required to contain a statement summarising[196] how the directors have had regard to the need to foster the company's business relationships with suppliers and customers, including how their consideration of those matters has impacted on the principal decisions taken by the company during the financial year.

Interestingly, the PJC which had access to a 2005 draft of the proposed UK Companies Act, did not take kindly to the extension of the duty to act in the best interests of the company, observing:[197]

> *The committee does not support the British approach…[it] requires directors to have regard to a menu of non-shareholder interests, but gives no guidance as to what form this "regard" should take, and therefore gives no guidance to directors on what they must do in order to comply.*
>
> *As a matter of general principle, the committee considers that a law which imposes duties should give those upon whom the duty is imposed clear guidance as to whom the duty is owed, and how it is to be discharged. A law which does not is bad law, and at the very least magnifies the uncertainties faced by directors.*

Since the PJC report, there has been no further serious suggestion that the Corporations Act should follow the UK model.

3.1.3 Social licence to operate

It is probably fair to say that for a time, the 'corporate social responsibility' movement lost some momentum after the 'double whammy' of the CAMAC and PJC reports rejecting legislative change. Over time, however, even though legislative reform was ruled out, pressure has continued to grow for boards to ensure that companies pay respect to the interests of non-shareholder stakeholders.

In the last 20 years or so, there has been considerable discussion of the concept of corporations being able to conduct business only because they have been granted 'social licence to operate'. This is very much a recent construct and has no basis in the

196 *SI 2008/410 The Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008* (UK) Sch 7, cl 11B.

197 Parliamentary Joint Committee on Corporations and Financial Services, 2006, op cit, [4.46]–[4.47].

history of corporate law. According to The Ethics Centre[198] the term 'social licence to operate' first came to prominence in the mining and resources industries. At a time when those industries were under pressure in relation to environmental protection and sustainability, they accepted that in order to maintain the trust of the communities in which they operated, they would need to work hard to gain their acceptance, and so acknowledged the existence of such a social licence.

The idea of a social licence is designed to respond to the erosion of confidence and trust in corporations. It mandates that companies not only comply with their legal obligations but also do the right thing by the communities with which they are connected.

The Ethics Centre notes[199] that we are living in an era in which business (and indeed capitalism itself) is "blamed for many of the world's problems — whether they be climate change, income inequality, modern slavery or fake news" and that many people perceive globalisation to have had a negative impact on their quality of life.

In its report into corporate social responsibility, the PJC noted[200] that it had received submissions that argued that by "effectively engaging with the communities in which they operate, companies gain tacit permission to continue in operation".

Although the notion of a social licence to operate may be a modern construct without a legal basis, it would be unwise for directors to dismiss the concept, as it has gained widespread acceptance. When contemplating a recent round of changes to its *Corporate Governance Principles and Recommendations*, members of the ASX Corporate Governance Council contemplated making reference to the existence of such a licence. Opponents to the notion ultimately prevailed, but not without extensive debate.[201]

If one considers the notion of the licence objectively, one can see that society does

198 The Ethics Centre, 2018, "Ethics Explainer: Social license to operate", [website], 23 January, https://ethics.org.au/ethics-explainer-social-license-to-operate (accessed 14 March 2022).

199 ibid.

200 Parliamentary Joint Committee on Corporations and Financial Services, 2006, op cit, [4.33].

201 J Mather, 2019, "ASX Governance Council dumps 'social licence to operate' from guidance", *The Australian Financial Review*, 27 February, https://www.afr.com/work-and-careers/management/asx-governance-council-dumps-social-licence-to-operate-from-guidance-20190225-h1bp43#:~:text=ASX%20governance%20council%20dumps%20'social%20licence%20to%20operate'%20from%20guidance,-Joanna%20Mather&text=The%20contentious%20phrase%20%22social%20licence,a%20furore%20over%20political%20correctness (accessed 14 March 2022).

in fact confer on corporations certain benefits that are not necessarily available, legally or practically, to others. For example, corporations have the benefit of limited liability protection for their members, they have preferential taxation status and they have preferential access to capital and to listing on public markets.

3.1.4 Hayne Royal Commission

Commissioner Hayne, notwithstanding the significant examples of poor corporate behaviour in the financial services industry which he chronicled in the Royal Commission's Interim and Final Reports, did not recommend any changes to directors' and officers' duties. The Commissioner believed that existing duties were adequate for the task. The Commissioner noted that because section 181 stipulates that directors must act in the best interests of the *corporation* that they must give consideration to more than the financial returns that will be available to shareholders in any particular period. He went on to emphasise that it is not inconsistent for directors to take into account the interests of non-shareholder stakeholders as well as shareholders because in the long run their interests will converge. He said:[202]

> *The longer the period of reference, the more likely it is that the interests of shareholders, customers, employees and all associated with any corporation will be seen as converging on the corporation's continued longterm financial advantage. And long-term financial advantage will more likely follow if the entity conducts its business according to proper standards, treats its employees well and seeks to provide financial results to shareholders that, in the long run, are better than other investments of broadly similar risk.*

The Commissioner's fundamental premise is that in order to comply with their duties in section 181, directors need to have an eye not only to financial returns for shareholders in the short term but also in the longer term, and if they do that, then they will generally find that they need to address the needs of all stakeholders, or at the very least, consider their interests in the decision making process.

202 Hayne Royal Commission, 2019, Final Report, Vol 1, p 403.

3.2 The current legal position on shareholder primacy in Australia

This brief history of the development of the law in this area shows the journey the courts have taken over the years to reach their current position. There is no doubt today that directors have a very wide discretion about how they can decide to expend corporate resources (so long as the expenditure can broadly be characterised as being in the company's interests) and they cannot use the confines of the law as an excuse for not taking into account the interests of non-shareholder stakeholders. As the PJC put it, perhaps a little confrontationally, the "current directors' duties were intended to provide protection for shareholders, not to create a safe harbour for corporate irresponsibility".[203]

Even though Australia did not follow the legislative path pursued in the UK, it is still clear that directors can take into account the interests of non-shareholder stakeholders, but the question remains, must they do so?

The PJC said that it is the role of directors to create value for shareholders in the long term and that in order to do that, they need to engage with non-shareholder stakeholders.[204] CAMAC emphasised the need for directors to manage external impacts on the company's business, which in some cases, will require them to engage with particular social or environmental issues. It noted that to go further and expect that they pay regard to particular issues which some interest groups regard as important for the community but are not germane to the company's business may not be appropriate.

The Report of the Hayne Royal Commission encourages directors to look to the long term when the interests of all stakeholders should converge. The Commissioner was trying to explain, within the bounds of the existing law, why directors are required to pay regard to the interests of customers. There is no doubt that the Royal Commission uncovered some most egregious conduct in the financial services industry and the Commissioner's findings have undoubtedly made a strong impression on the views of the community.

203 Parliamentary Joint Committee on Corporations and Financial Services, 2006, op cit, [4.18].

204 The PJC do note, that acting in the long-term interests of the company may mean acting contrary to the interests of at least some shareholders, who may experience a decline in the value of their shares, if the directors' view is that short-term losses need to be incurred in order for the company to prosper in the longer run. See Parliamentary Joint Committee on Corporations and Financial Services, 2006, op cit, [4.6].

Having regard to all this, one question which remains open is whether, if directors only have regard to short-term interests, they will inevitably be breaching their duty to act in the best interests of the company. CAMAC said in its report:[205]

> *Directors are not confined in law to short-term considerations in their decision-making, such as maximising immediate profit or share price return. The interests of a company can include its continued long-term well-being. Equally, however, there is no case law that directors who act in the short-term interests of present members have breached their duty. Rather, it is a matter for companies themselves and the commercial judgment of directors how to balance or prioritise shorter-term and longer-term considerations. These principles apply equally to the statutory fiduciary duties…*

How do we then rationalise the CAMAC Report with the PJC Report and the Report of the Hayne Royal Commission?

CAMAC made reference to the case of *Provident International Corporation v International Leasing Corp Ltd*,[206] where Helsham J said that directors should consider the interests of future as well as existing shareholders. Authors, Ford, Austin and Ramsay[207] cast some doubt on whether this is entirely correct but content themselves with noting that it may be in the interests of existing shareholders for the directors to take a long-term view of shareholder welfare.

Ultimately, it may depend very much on the facts of each case as to whether directors are actually obligated to take a long-term view in making a decision, because there still seems to be broad acceptance of the proposition that directors have considerable discretion as to what they take into account. That said, it is probably fair to say that after the Hayne Royal Commission, the pendulum is swinging towards putting more emphasis on the longer term.

It is important to be clear that whatever duties the directors have under section 181 or the general law to pay regard to the interests of stakeholders, those duties form

205 Corporations and Markets Advisory Committee, 2006, *The social responsibility of corporations*, op cit, pp 84–5.
206 [1969] 1 NSWR 424, 440.
207 Austin and Ramsay, 2018, op cit, [8059.6].

part of their duty to the company and confer no rights on stakeholders themselves to pursue remedies against the board.

3.3 Who are stakeholders in the Australian context?

It is worthwhile turning now to consider who comprises the various classes of stakeholders whose interests the board might consider. The UK *Companies Act 2006* specifically identifies employees, suppliers, customers and the community. For most companies, these groups will be among their most important stakeholders, yet there have many recent examples where the interests of each group have been neglected in a desire to earn increased returns for shareholders. A great many Australian companies (including some of the country's largest and best known) have admitted to underpaying their staff. Some of the largest companies in Australia have imposed policies under which payments to suppliers have been delayed for lengthy periods and it has been asserted that some of our largest grocery retailers have forced their suppliers to accept unfavourable terms. Further, the Hayne Royal Commission has revealed, at times, astonishing mistreatment of customers by financial services industry participants and one of Australia's largest mining companies has destroyed an Indigenous cultural site of some considerable importance. The reaction of the community to much of this corporate behaviour has been savage and is discussed in more detail in **Chapter 4**. If they aren't already (and most directors are well aware of the issue), boards must be consulting with, or, at least, considering the interests of all these key groups of stakeholders in their decision making.

Government and regulators are important stakeholders, especially for companies operating in highly-regulated industries. Apart from industry-specific regulators such as APRA, the Australian Charities and Not-for-profits Commission, AUSTRAC and the various energy industry regulators there are, of course, some regulators whose role is more generic such as ASIC, the ATO, the Australian Competition and Consumer Commission (ACCC) and Fair Work Australia. Understanding the needs and requirements of those regulators is essential. Many of them provide policies and regulatory guides, the material and relevant provisions of which boards should acquaint themselves.

For listed companies, the ASX or other securities exchange on which a company is

listed will be a key stakeholder, regulating the basis on which the entity can become and remain listed, and imposing rules about continuous and periodic disclosures, capital raisings and dealing with conflicts of interest. In the case of ASX, through the ASX Corporate Governance Principles, Recommendations are made about preferred corporate governance practices.

Users of financial statements and annual reports are another group of stakeholders who will often need to be considered because they can exert some influence over what disclosures are expected to be made, both in terms of financial statements as well as by way of general public disclosures. This group includes not only shareholders but prospective shareholders, proxy advisers, brokers, analysts and other participants in the capital markets, banks and other creditors as well as participants in merger activity such as potential acquirers and shareholders in potential target companies.

Proxy advisers are now playing a major role in the shaping of resolutions by listed companies and determining whether or not those resolutions are likely to be passed at shareholder meetings. They cannot be ignored by boards in their decision-making processes. Proxy advisers are usually keen to engage with companies and there is wisdom in listed companies doing so.

In fully or partly unionised workplaces, trade unions are an important stakeholder with whom a good relationship is likely to be worthwhile.

Industry bodies can also be a source of valuable information for members about relevant industry affairs, as can business associations with an economy-wide perspective.

In specific sectors, particular stakeholders can assume prominence as well. In the not-for profit sector, for example, a company's or association's members may be of little or even no relevance, being replaced in importance by the group whose interests the company has been established to support. It might therefore be those who are suffering from a particular illness or disease, those who wish to participate in a particular sporting pursuit or artistic endeavour or a particular disadvantaged group. For not-for-profits, donors and volunteers are also likely to be important groups of stakeholders. Especially in the case of organisations which have been established for a charitable purpose, one needs to distinguish between those whom the organisation was formed to support and those who wish to provide the support, which are quite different groups and may sometimes have quite different views about how the organisation should conduct its affairs.

Interestingly, the *UK Companies Act 2006* provides that where the purposes of a company include purposes other than the benefit of its members, the obligation on directors to promote the success of the company for the benefit of its members includes achieving those purposes.[208] While there is no corresponding provision under Australian law, it seems likely that courts would interpret the duty in section 181 with a similar expectation.

Universities are another good example. They have longstanding traditions of being strongholds of academic independence, such that academic staff and research students can be free from interference in their academic pursuits and expression of ideas. For that reason, most universities have academic boards or senates which have considerable independence from the university's governing council and have oversight of academic affairs within the university. Most publicly funded universities have no shareholders as such but do have a range of stakeholders whose interests are important for the university council to consider. They include the federal government (which provides funding and supervises quality), the state government (under whose laws most university have been established), students, academic staff, non-academic staff, alumni (who often play a major continuing role in the university's affairs, in some cases having specifically reserved seats on the university council) and the broader community with which the university engages (and which is perhaps even more important in regional centres where the university is often one of the largest local institutions and employers).

It is worth noting that in the case of some superannuation funds, which often rank among the largest financial institutions in the country, directors and trustees are required to give priority to the interests of fund members over the interests of any shareholders in the fund trustee.[209]

Boards should also not neglect the media as potentially being an important stakeholder in shaping the community's view about the organisation, especially in a time of crisis.

Creditors are a special class of stakeholders whose interests the law requires to be taken into account by directors when a company is approaching insolvency, as noted above. The attention of directors is especially drawn to the need to pay heed to their

208 *Companies Act 2006* (UK) s 172(2).
209 *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A.

interests by section 588G of the Corporations Act which places directors in breach of the law if they allow a company to trade if there are reasonable grounds for suspecting that it is insolvent and section 588J which exposes directors to personal liability to compensate the company for any debts incurred after it became insolvent.[210] Generally, the creditors whose interests need to be taken into account under these provisions are those whose right to be repaid is unsecured. Often banks (and sometimes other creditors, including suppliers) will have security which will give them priority over other creditors. The classes of creditors can be very wide and include employees with claims for unpaid wages and other entitlements, suppliers owed for their goods and services, customers and other contracting parties who may have entitlements to damages under contract or consumer law or entitlements under a loyalty or gift card, the ATO for unpaid taxes and federal, state and local governments for an array of unpaid fees and charges.

3.4 Statutory obligations to have regard to the interests of stakeholders

In some cases, there are statutory obligations on corporations (and sometimes directors) to have regard to the interests of various groups of stakeholders, or the community at large.

Perhaps one of the best examples can be found in the uniform *Work Health and Safety Act 2011*[211] which places an obligation on employers to ensure, as so far as reasonably practicable, the health and safety of employees and a further obligation on officers of corporate employers to use diligence to ensure, in so far as reasonably practicable, a safe workplace.[212]

210 Liability under section 588G has since 2017 been subject to a safe harbour (s 588GA) where directors can avoid liability if they have, for a limited period, been engaging in conduct designed to save the company from insolvency, and taken professional advice.

211 *Work Health and Safety Act 2011* (ACT) s 19; *Work Health and Safety Act 2011* (NSW) s 19; *Work Health and Safety Act 2011* (Qld) s 19; *Work Health and Safety Act 2012* (SA) s 19; *Work Health and Safety Act 2012* (Tas) s 19.

212 *Work Health and Safety Act 2011* (Qld) s 27. The obligation to provide a safe workplace under the uniform legislation is not the only place where directors can be found to have specific duties to use diligence to protect workers. See, for example, *Coal Mining Safety and Health Act 1999* (Qld) s 47A which requires the use of due diligence. Other legislation can be found regulating safety in specific fields including mining and quarrying, and petroleum and gas and radiation.

Other examples of laws which impose liability on directors where they act contrary to the interests of a particular group of stakeholders include consumer protection legislation which protects the interests of suppliers and customers,[213] industrial laws and fair work legislation which protect the interests of employees[214] and legislation which protects the environment for the benefit of the community.[215] The laws referred to above requiring directors of trustees of superannuation funds to give priority to the interests of fund members over corporate shareholders[216] provides another example of laws which seek to protect the interests of stakeholders potentially over those of shareholders.

There are many other laws that are designed to ensure corporations consider the interests of the community in areas as diverse as public health, public safety, food safety, biosecurity, dangerous goods, planning and heritage, building and construction, heavy vehicles, protection of privacy, greenhouse gases and nature conservation. It is important for directors to have a broad understanding of any stakeholder protection laws which are relevant to their company's business or industry and for management to provide regular reporting on compliance.

3.5 Reporting obligations

Apart from legislation which looks to protect the interests of corporate stakeholders, there are also a number of laws and other regulatory requirements which mandate or encourage reporting on matters of interest to stakeholders.

213 See, for example, *Competition and Consumer Act 2010* (Cth) s 75B. As examples of cases where directors have been held to have been involved in a contravention by a corporation under s 75B see, *Australian Competition and Consumer Commission v Safety Compliance Pty Ltd (in liq)* [2015] FCA 211; *Hewett v Court* (1983) 149 CLR 639; *Australian Competition and Consumer Commission v Joystick Co Pty Ltd* [2017] FCA 397.

214 See, for example, *Fair Work Act 2009* (Cth) s 550. As an example of a case where director has been held to have been involved in a corporate breach under s 550 of this Act, see *Fair Work Ombudsman v Step Ahead Security Services Pty Ltd* [2016] FCCA 1482.

215 See, for example, *Protection of the Environment Operations Act 1997* (NSW) ss 169–169B; *Environmental Protection Act 1994* (Qld) s 493; *Environmental Protection Act 2018* (Vic) ss 349–351; *Environmental Protection Act 1986* (WA) s 118. As an example of a case where a director has been found liable in connection with a corporate breach under s 169 of the NSW Act see, *Environmental Protection Authority v Foxman Environmental Development Services* [2016] NSWLEC 120.

216 *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A.

Perhaps the most obvious form of stakeholder reporting is the requirement for most larger corporations to issue financial reports and directors' reports in accordance with the Corporations Act.[217]

Sections 299, 299A and 300 specify what the annual directors' report is required to contain.[218] Section 299A, which applies only to listed companies, requires directors to include in their report information which "members of a listed company would reasonably require to make an informed assessment of" the operations of the company and the company's business strategies and prospects for future financial years. Section 299A was introduced in response to a recommendation of the Royal Commission into the Failure of HIH Insurance.[219] While the requirement is to disclose what *members* of a listed company would reasonably require, it is worth remembering that the financial statements and directors' reports are public documents which are used by a much larger group of stakeholders.

Section 299(1)(f) requires the directors to report on the company's compliance with environmental regulations where it is subject to any "significant" regulation in that area.

While most corporations have annual reporting obligations to ASIC (via annual returns) or the Australian Charities and Not-for-profits Commission (ACNC) (annual returns by not-for profits) or APRA (for example, under the *Financial Sector (Collection of Data) Act 2001* (Cth)), there are a number of other stakeholder-related reports which are mandated.

One example is the modern slavery reporting requirement under the *Modern Slavery Act 2018* (Cth). It applies only to companies with greater than $100 million

217 The importance of directors ensuring the accuracy of financial statements was emphasised by the decision in *Australian Securities and Investments Commission v Healey* (2011) 83 ACSR 484 where the accounts of the Centro Group were deficient in that they incorrectly classified liabilities of about $2 billion as non-current rather than current and failed to disclose substantial post-balance date guarantees. Middleton J found that the directors had failed to exercise the requisite level of care and diligence when approving the accounts and in so doing had breached their duty under section 180 of the Corporations Act.

218 Generally, only small proprietary companies and those regulated by the Australian Charities and Not-for-profits Commission are exempt from the requirement to prepare an annual report and directors' report, see Corporations Act s 292.

219 The Failure of HIH Insurance, 2003, op cit, Vol 1, Section 7.2.6; Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth), [4.391].

in consolidated revenue.[220] Statements lodged under that Act are required to explain what a company is doing to assess and address the risks that modern slavery practices may be occurring in its global and domestic operations and supply chains and the operations and supply chains of any of its subsidiaries. Reports are required to be approved by the board and signed by a director. The term 'modern slavery' is used to describe serious exploitation where coercion, threats or deception are used to exploit victims and undermine or deprive them of their freedom. It does not include practices such as substandard working conditions or the underpayment of workers. The purpose of the reporting is to improve transparency and focus the attention of business on improving work practices in supply chains.

The *Workplace Gender Equality Act 2012* (Cth) requires non-public sector employers with 100 or more employees to submit an annual report to the Workplace Gender Equality Agency (WGEA).[221] Among the goals of the reporting are to improve workplace gender equality between men and women, especially in relation to remuneration, to recognise women's disadvantage in the workforce and to help employers remove barriers to equality.[222]

Listed companies are required under ASX Listing Rule 4.10.3 to include in their annual reports either a corporate governance statement that meets the requirements of that rule, or reference to a website where such a statement is located. The statement must address the extent to which the company has followed the Recommendations in the ASX Corporate Governance Principles[223] on an "if not, why not" basis.

Recommendation 7.4 provides that a "listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks". The commentary goes on to state:[224]

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220 Department of Home Affairs, *Commonwealth Modern Slavery Act 2018: Guidance for Reporting Entities*, p 5, https://www.homeaffairs.gov.au/criminal-justice/files/modern-slavery-reporting-entities.pdf (accessed 14 March 2022). Similar legislation has been proposed in New South Wales with a reporting threshold of $50 million in revenue.

221 *Workplace Gender Equality Act 2012* (Cth) Pt IV.

222 Workplace Gender Equality Agency, 2018, "Reporting", [website], https://www.wgea.gov.au/reporting (accessed 14 March 2022).

223 ASX Corporate Governance Council, 2019, op cit.

224 ibid, p 27.

> *How an entity manages environmental and social risks can affect its ability to create long-term value for security holders. Accordingly, investors increasingly are calling for greater transparency on the environmental and social risks faced by listed entities, so that they in turn can properly assess the risk of investing in those entities.*

The Council sounds a note of warning to companies that believe they do not have any material exposure to environmental or social risks and encourages them to benchmark their disclosures against those made by their peers.

The Recommendation goes on to note that the disclosures recommended do not require a listed company to publish an 'integrated report' or 'sustainability report', but that any company which does publish a report prepared in accordance with the International Integrated Reporting Council's International <IR> Framework,[225] or a sustainability report in accordance with a recognised international standard,[226] can meet this Recommendation simply by cross-referencing that report.

The International Integrated Reporting Council says that the purposes of integrated reporting include, among other things, improving the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital. It should enhance accountability and stewardship for the various sources of capital employed by business (which the Council identifies as financial, manufactured, intellectual, human, social and relationship and natural) and support decision making which focuses on the creation of value over the short, medium and long term.[227]

The 'triple bottom line' approach to integrated reporting first achieved some popularity in the mid-1990s with its focus on financial, social and environmental

225 The International Integrated Reporting Council, 2021, *The International <IR> Framework – Integrated Reporting*.

226 The ASX Corporate Governance Council says that these include the Global Reporting Initiative's standards, available online at Global Reporting Initiative, [website], https://www.globalreporting.org/standards/download-the-standards (accessed 14 March 2022), the various sustainability accounting standards published by the Sustainability Accounting Standards Board, accessible online from Sustainability Accounting Standards Board, [website], https://www.sasb.org (accessed 17 March 2022), and the Climate Disclosure Standards Board's Framework for reporting environmental and natural capital, available online at Climate Disclosure Standards Board, 2022, "CDSB Framework: Framework for reporting environmental and social information", [website], https://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital (accessed 17 March 2022).

227 The International Integrated Reporting Council, 2021, op cit, p 2.

reporting underpinned by the notion that if a business only looks at profit, and ignores its people and its impact on the planet, it is unable to account for the full cost of doing business.[228] The Global Reporting Initiative which was established in 1997, has issued some standards designed to help organisations understand their impacts on the economy, environment and society.[229]

Recommendation 7.4 of the ASX Corporate Governance Council's *Corporate Government Principles and Recommendations* discusses climate change as a particular source of environmental risk. The ASX Corporate Governance Council notes that many listed companies will be exposed to climate change risks, even when they are not directly involved in mining or consuming fossil fuels, and makes specific reference to risks related to the transition to a lower-carbon economy (including policy and legal risks, technology risk, market risk and reputation risk) as well as water availability and quality, food security and how extreme temperature changes might impact the company.

The ASX is not the only body that has produced corporate governance standards. The AICD has produced a set of *Not-for-Profit Governance Principles*[230] which are available for voluntary adoption by not-for-profit organisations. The AICD encourages not-for-profit organisations to report to stakeholders annually on their performance against the Principles because it provides an opportunity for them to communicate with stakeholders about their governance. Principle 8 focuses on stakeholder engagement and proposes that not-for profit organisations should have meaningful engagement with their stakeholders so that their interests are understood and considered by the board. The Principle notes the importance of boards of not-for-profits identifying and understanding who their stakeholders are (because, as noted above, the stakeholders in many not-for-profits are very different from those of for-profit companies). It also encourages boards to establish a framework for engaging with stakeholders, and (if appropriate) how the organisation works with and protects vulnerable people.

228 W Kenton, 2022, "Triple Bottom Line (TBL)", *Investopedia*, [web blog], 9 January, https://www.investopedia.com/terms/t/triple-bottom-line.asp (accessed 17 March 2022).

229 Global Reporting Initiative, "How to use the GRI Standards", [website], https://www.globalreporting.org/how-to-use-the-gri-standards/ (accessed 1 July 2022).

230 Australian Institute of Company Directors, 2019, *Not-for-Profit Governance Principles*, January, https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/not-for-profit-resources/nfp-principles/pdf/06911-4-adv-nfp-governance-principles-report-a4-v11.ashx (accessed 28 April 2022).

The AICD's *Not-for-Profit Governance Principles* also emphasises how important annual reports are as a way of connecting with stakeholders, especially donors and volunteers, and demonstrating to them how their contributions assisted in achieving the organisation's goals.

3.6 Balancing and prioritising the interest of stakeholders

In 2004, then AICD Chief Executive Officer Ralph Evans, commenting on reforms being considered in response to the James Hardie situation, said[231] that great care needed to be exercised in any amendments to the law because if directors had to "constantly balance the interests of shareholders with those of other 'stakeholders', it would often be impossible for them to reconcile their duties".

As we have seen, while the law has not been amended, there appears now to be a much greater expectation that directors will, at least, pay some regard to the interests of stakeholders in making decisions. So, what of Evans' concerns that it may become impossible for directors to reconcile their duties if they have to consider the interests of stakeholders as well as those of shareholders?

Commissioner Hayne certainly does not think so. He notes that,[232] "[r]egardless of the period of reference, the best interests of a company cannot be reduced to a binary choice". In the case of a financial institution, he notes, that pursuit of the best interests of the organisation is much more complicated than just choosing between the interests of the institution and the interests of the customer. He goes on to say:[233]

> *It is not right to treat the interests of shareholders and customers as opposed. Some shareholders may have interests that are opposed to the interests of other shareholders or the interests of customers. But that opposition will almost always be founded in differences between a short term and a longer-term view of prospects and events. Some shareholders may think it right to look only to the short term.*

231 Australian Institute of Company Directors, 2004, "CEO report James Hardie CEO report", *Company Director Magazine*, 1 December, http://www.companydirectors.com.au/director-resource-centre/publications/company-director-magazine/2000-to-2009-back-editions/2004/december/ceo-report-james-hardie-ceo-report (accessed 28 April 2022).

232 Hayne Royal Commission, 2019, Final Report, Vol 1, p 403.

233 ibid.

While the Commissioner focuses on the convergence of the interests of all stakeholder groups in the long term,[234] he notes that prioritising competing interests is something directors have always had to deal with because even among shareholders there are usually many differing views. For example, small shareholders may be unhappy about a company undertaking a share placement to a large shareholder at a discounted price which results in their interests being diluted. We often see disputes, especially among shareholders in mining companies with limited financial resources, about the strategic direction of the company, and how it should best deploy its resources.

There is no doubt, however, that having to have regard to the interests of many different categories of stakeholders will increase the challenges boards face in that they will need to consider, balance, and sometimes prioritise many more competing interests than when they were just dealing with the different views of shareholders. The grocery industry provides some good examples of how the interests of different classes of stakeholders are balanced against one another in determining what is in the best interests of the company. As discussed in **Chapter 4**, with a view to ensuring strong customer demand and revenue growth, grocery companies are focusing on keeping prices low (which is in the interests of customers) but at the potential cost of farmers and producers who are being paid such low prices for their products that they assert that their livelihoods are potentially being put at risk.

Michael Ullmer, director at Lendlease and Woolworths, was quoted in an article in an *Australian Financial Review* Special Report on "Rebuilding corporate trust" as follows:[235]

> *…keeping the customer at the heart of the business helps the engagement with the wider array of stakeholders, says Michael Ullmer, director at Lendlease and Woolworths.*
>
> *"There's research that shows that the key impacts on shareholder value are driven by the views of customers, government/regulators and employees, in that order.*

234 ibid.

235 J Dunn, 2018, "Customers first among the many stakeholders", *The Australian Financial Review*, 28 February, p 3, https://assets.kpmg/content/dam/kpmg/au/pdf/2018/afr-special-report-rebuilding-corporate-trust-feb-2018.pdf (accessed 17 March 2022).

There's something like 1 million feedback surveys a year that are done as part of the Woolworths' program in terms of listening to the customer, and we put the voice of the customer into our integrated report now in terms of targets, and measuring performance against that."

What Woolworths finds, he says, is that while the company's promise of good food at reasonable prices is a key concern of customers, the feedback also tells it that customers are very mindful of issues such as fairness to suppliers, the environment, use of plastic bags, animal welfare, and food waste. "There's a whole lot of things that some people would say, 'well, they're nice to have', but they're actually intrinsically important to customers – to the most important driver of our relationship, which is what drives shareholder value," says Ullmer.

From what he says, it is clear that conflicts between the interests of various categories of stakeholder are well understood by the board, and that they have formed the view that the prioritisation of customer interests is likely to have the greatest impact on shareholder value. The protection of the environment and the interests of suppliers are being taken into account, but that is principally because of customers' concerns.

Sometimes the interests of other groups of stakeholders have to be prioritised as well.

In 2016, it was reported that Rio Tinto was doubling the payment terms for its suppliers from 45 days to 90 days.[236] The company explained that it was doing this to preserve and maintain jobs and to improve cash flow in a challenging global market for commodities and offering suppliers access to a financing program. Ultimately Rio backed down from its plans, reportedly in the face of an outcry from suppliers and government threats of legislation which would set a maximum period for payment to suppliers.[237]

This is another example of a situation where directors potentially face challenges

236 P Gosnell, 2016, "Australia's Rio Tinto to take longer to pay as resource slump bites", *Reuters*, 9 April, https://www.reuters.com/article/us-riotinto-payment/australias-rio-tinto-to-take-longer-to-pay-as-resource-slump-bites-idUSKCN0X606J (accessed 17 March 2022).

237 N Evans, S Morris and P Williams, 2016, "Rio Tinto backs down on payment delay", *The West Australian*, 15 April, https://thewest.com.au/business/finance/rio-tinto-backs-down-on-payment-delay-ng-ya-104059 (accessed 17 March 2022).

having to balance the interests of one group of stakeholders (employees) against another (suppliers). The question becomes one of whether you prioritise supporting your employees at some cost to your suppliers who have to wait longer to be paid, or whether you pay your suppliers promptly and make some employees redundant. These are not easy questions and necessitate a comprehensive analysis of the issues and risks for the company, including how the decision may be regarded by the community, before deciding which course to pursue.

The courts so far have not been inclined to intervene in the decisions of boards about how they take into account the interests of stakeholders. Indeed, throughout history, so long as boards have acted reasonably, courts have been very reluctant to impose their own decisions over those of boards. Notably, notwithstanding the conduct brought to light by the Hayne Royal Commission in regard to the failure to pay due regard to the interests of customers, no directors were referred for prosecution.

3.7 Further resources

For further information about the importance of stakeholders, see:

- Corporations and Markets Advisory Committee, 2006, *The social responsibility of corporations* (Report);
- Parliamentary Joint Committee on Corporations and Financial Services, 2006, *Corporate responsibility: Managing risk and creating value* (Report);
- Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission), 2019, Final Report, February, Vol 1, pp 401–3;
- Australian Institute of Company Directors, 2021, *Elevating stakeholder voices to the board*, available from the AICD website.

About the author

Bruce Cowley was a practising corporate and governance lawyer for nearly 40 years, retiring from the profession in 2019. Since retirement from the law, he has taken on a number of non-executive director roles across multiple sectors, including tertiary education, health, financial services, environmental protection and disability. During his professional life, Bruce spoke and wrote widely about contemporary corporate law issues and has been active in corporate law reform. He has chaired the Law Council of Australia's Corporations Committee and served on multiple AICD committees including serving a term as chair of the Institute's Law Committee and currently serves on the Not-for-Profit Chairs Forum. In 2017, Bruce co-authored the book entitled *Duties of Board and Committee Members* which addressed the varying duties and responsibilities of directors of entities with special characteristics, such as listed and APRA regulated entities, statutory corporations, superannuation funds, university councils and not-for-profits.

Bruce holds a Bachelor of Commerce and Bachelor of Laws (Honours) and is a Fellow of the Australian Institute of Company Directors. He is an adjunct Professor in the University of Queensland Law School and is the recipient of an Honorary Senior Fellowship at the University of the Sunshine Coast. He has also been the recipient of the Australian Institute of Company Directors' Gold Medal in Queensland for services to governance in 2021 and the Queensland Law Society's President's Medal for services to the legal profession in 2022.

Bruce is married with three adult children. Outside work, he can be found body surfing on the Sunshine Coast, kayaking, bush walking and glued to the cricket.

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