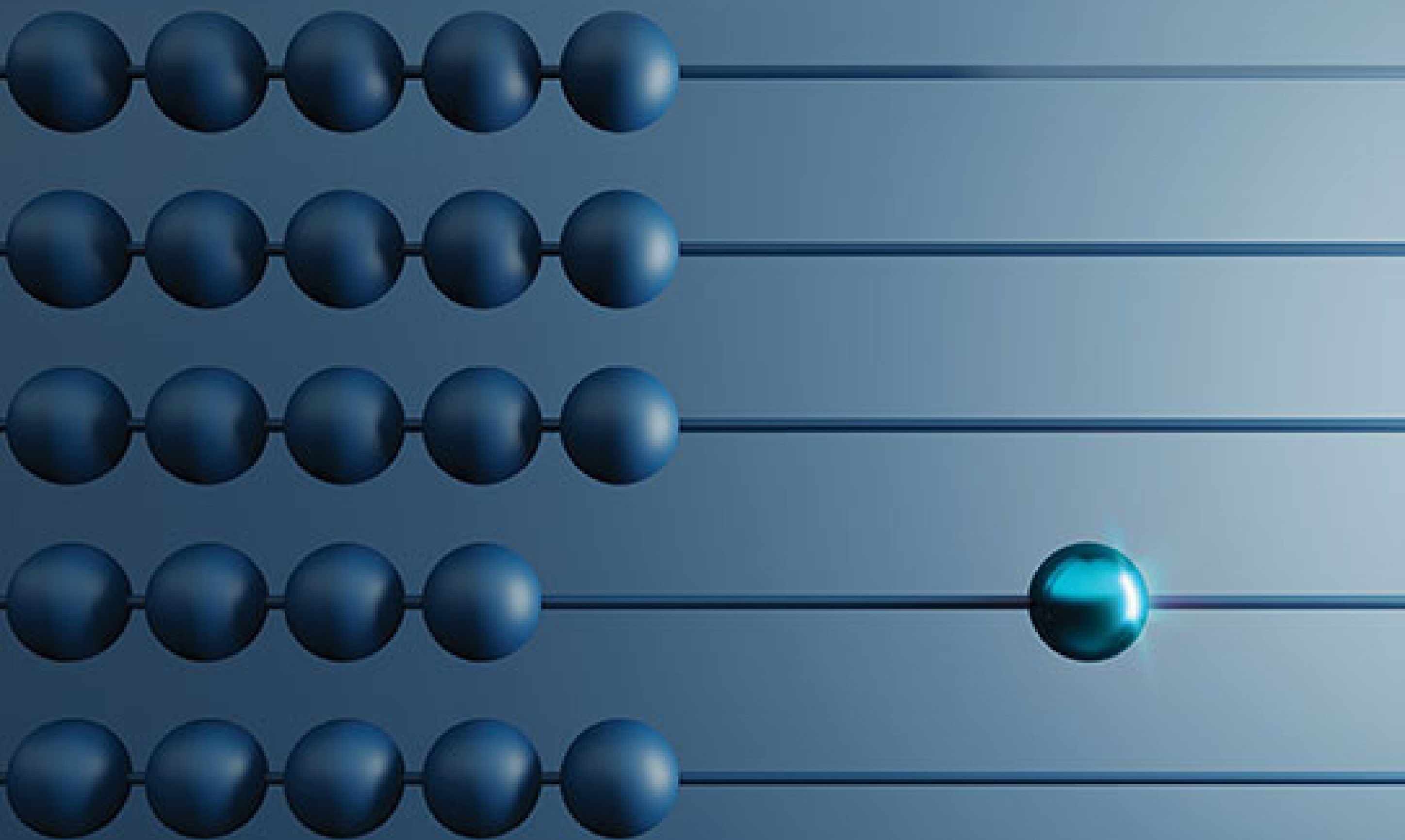
Australian Institute of Company Directors

DIRECTORS' LEGAL RESPONSIBILITIES

A handbook for Australian boards



Professor Pamela Hanrahan

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AICD_DLR – V3

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Foreword

Company directors play an integral role in the Australian economy. There are over three million companies in Australia — public and private, large and small, family businesses, start-ups, not-for-profits. They employ millions of Australians and contribute hundreds of billions annually in GDP.

The directors who run those companies operate in a complex and high-stakes environment, characterised by an array of sometimes labyrinthine statutory obligations, significant community, social and ethical expectations, and a dynamic and evolving set of challenges and risks to manage.

This handbook demystifies that environment and explains those obligations. It does that with precision, rigour, and a refreshing clarity. Written as a practical guide, it is accessible and easy to read, puts the rules in context and gives examples of the real-life consequences of non-compliance.

In focusing on the things that matter most in running a company, to help directors do their job better, this handbook will also advance the interests of shareholders, regulators, and the Australian economy.

While the handbook is aimed at practising company directors, not academics or lawyers, I would observe that even very experienced legal practitioners of long standing can learn something from it — as I found I did.

Many of the myriad challenges that face today's company directors — whether they relate to governance, disclosure, sustainability, cyber security or technology — are also areas of focus for ASIC; as is enforcement of the duties owed by directors under the law. Thus, from the perspective of a regulator, I welcome the promotion by this handbook of greater understanding of those issues and responsibilities among the director community.

The handbook moves from the historical, in charting the evolution of the Australian legislative framework, to the contemporary, in its commentary on the role of directors in digital governance, managing risk and shaping culture.

A nationally recognised corporate legal academic, company director and former senior corporate and non-profit regulator, Professor Hanrahan brings a wealth of experience to the topic and is ideally placed to guide the director community in understanding their obligations.

I commend the AICD for its ongoing commitment to good governance and building the capability of Australian directors, and for commissioning this handbook to advance those aims.

Of course, directors should obtain their own legal, accounting, or other professional advice in conducting the business of a company, and my words here should not be taken to endorse any particular course of action.

The author has dedicated her work to the late Professor Bob Baxt AO. This handbook is a worthy tribute to him, and a valuable addition to scholarship in the field that he contributed to for so long with such distinction.

I suggest it be on every company director's reading list.

Joseph Longo
Chair, ASIC
July 2022

Preface

This is a handbook for people who are — or aim to be — executive and non-executive directors of Australian companies. It sets out to expound, contextualise, and bring to life the complex and dynamic laws that govern how directors in different types of companies must discharge their role and the responsibilities that come with it.

The handbook keeps the practising company director at its centre. This distinguishes it from other books dealing with directors' and officers' legal duties and responsibilities, where the audience is lawyers or law and business students. The legal cases and statutes are referenced accurately but simply, and there are no long footnotes. The handbook is designed so that it can be read from beginning to end to give a comprehensive overview of directors' legal responsibilities or dipped into for guidance on issues when they arise.

Australian directors operate in a unique and multi-layered legal environment. Obligations arise under Commonwealth and State legislation, legislative instruments, caselaw, rules, codes and regulatory guidance. The Australian Securities and Investments Commission (ASIC) plays a significant role in enforcing directors' duties, including in situations which in other jurisdictions would be a private law matter between the director and their company. The heart of the regime is the *Corporations Act 2001* (Cth). The statutory duties are fleshed out and supplemented by an extensive and developed body of caselaw and by 'soft law' principles such as the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (4th ed, 2019) for listed entities.

The law is one of the three legs of the tripod of norms that support good decision-making by individual directors. Understood and applied in the conjunction with the other legs — directors' ethical responsibilities and their commercial and social accountability to stakeholders — the legal duties provide the framework for the proper and principled discharge of a director's corporate office.

The book was largely completed during the COVID-19 lockdowns of 2021. The resilience and adaptability of the director community, and the responsiveness of governments and regulators, in managing the impact of the pandemic on companies and their governance provides an encouraging model for responding to future challenges.

Stability and certainty are important, but the law must not be allowed to ossify. Business law and regulation is important national infrastructure; it needs constant attention and maintenance to stay current. It must strike an appropriate balance between protecting the public interest and encouraging and facilitating entrepreneurial activity. Working out how to bring the community along with necessary (and ongoing) law reform to foster innovation and long-term prosperity, while ensuring socially responsible business behaviour, remains a challenge.

I thank AICD for commissioning the book, which in many respects is a successor to *Duties and Responsibilities of Directors and Officers*, written and updated over three decades by the late Professor Bob Baxt AO AICD*Life*. The economic, environmental, social and governance challenges of this century will be significant. We need our director community to be informed and empowered in steering Australian companies. This makes AICD's ongoing commitment to director education across all sectors more important than ever.

I am grateful to my editor Philippa Findlay BA LLB(Hons) for her careful and thorough work on the manuscript. I also thank my professional and board colleagues, my fellow members of the AICD's National Corporate Governance Committee, and my readers in *Company Director* magazine whose feedback and insights informed its approach. As always, my thanks and love go to my family and especially my children, Harriet and Bill.

The law is stated as at 1 June 2022, and therefore includes legislation enacted up to the end of the 46th Parliament of the Commonwealth.

The book is dedicated to my wonderful friend and mentor, the late Bob Baxt.

Professor Pamela Hanrahan
Sydney, June 2022

Abbreviations

AASB	Australian Accounting Standards Board
ABCC	Australian Building and Construction Commission
ABRS	Australian Business Registry Services
ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law
CAN	Australian Company Number
ACNC	Australian Charities and Not-for-profits Commission
ACNC Act	*Australian Charities and Not for profits Commission Act 2012* (Cth)
ACSC	Australian Cyber Security Centre
ADI	authorised deposit-taking institution
AFP	Australian Federal Police
AICD	Australian Institute of Company Directors
ALRC	Australian Law Reform Commission
AML/CTF Act	*Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth)
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission (later ASIC)
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001 (Cth)*
ASIO	Australian Security Intelligence Organisation
ASX	Australian Securities Exchange, operated by ASX Ltd
ATO	Australian Taxation Office
ATSI corporation	Aboriginal and Torres Strait Islander corporation

AUSTRAC	Australian Transaction Reports and Analysis Centre
BEAR	Banking Executive Accountability Regime.
Bergin Inquiry	Inquiry by the Hon PA Bergin SC pursuant to section 143 of the *Casino Control Act 1992 (NSW)* into Crown Resorts (2020–2021)
CAMAC	Corporations and Markets Advisory Committee
CDPP	Commonwealth Director of Public Prosecutions
CGPR	ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (4th ed, 2019)
CLERP	Corporate Law Economic Reform Program (1998–2005)
COAG Principles	Council of Australian Governments, *Principles for the Imposition of Personal Liability for Criminal Fault* (2009)
Cole Inquiry	Inquiry into certain Australian companies in relation to the UN Oil-for-Food Programme (2006–2007)
Competition and Consumer Act	*Competition and Consumer Act 2010* (Cth)
Corporations Act	*Corporations Act 2001* (Cth)
Corporations Regulations	*Corporations Regulations 2001* (Cth)
Criminal Code	*Criminal Code Act (1993)* (Cth) Sched 1
CSF	crowd-sourced funding
DIN	director identification number
D&O insurance	directors' and officers' insurance
EC	European Commission
Eggleston Committee	Corporate Law Advisory Committee, chaired by Richard Eggleston, established August 1967 by the Standing Committee of Attorneys-General of the States
ESG	environmental, social and governance
FAR	financial accountability regime proposed in the Financial Accountability Regime Bill 2021 (Cth)

FIRB	Foreign Investment Review Board
Finkelstein Royal Commission	Royal Commission into the Casino Operator and Licence (2021)
GBE	government business enterprise
GFC	global financial crisis of 2007–2008
GST	goods and services tax
Hayne Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2017–2019)
HIH Royal Commission	Royal Commission into the Failure of HIH Insurance (2002–2003)
ICAC	Independent Commission Against Corruption, New South Wales
IOSCO	International Organisation of Securities Commissions
IPO	initial public offering
ISSB	International Sustainability Standards Board
KMP	key management personnel
MCI	mutual company interest
National Credit Code	*National Consumer Credit Protection Act 2009* (Cth) Sched 1
NCSC	National Companies and Securities Commission
OAIC	Office of the Australian Information Commissioner
OECD	Organisation for Economic Cooperation and Development
ORIC	Office of the Registrar of Indigenous Corporations
OVIC	Office of the Victorian Information Commission
PAYG	pay as you go withholding tax
PDS	Product Disclosure Statement

PJC CFS	Parliamentary Joint Committee on Corporations and Financial Services
Rae Committee	Senate Select Committee on Securities and Exchange, chaired by Senator Peter Rae, established March 1970
RSE licensee	a superannuation trustee licensed by APRA under s 29D of the SIS Act
SGC	superannuation guarantee charge
SIS Act	*Superannuation Industry (Supervision) Act 1993* (Cth)
Taxation Administration Act	*Taxation Administration Act 1953* (Cth)
WHS	work health and safety

Chapter 1

Directors and the law

1.1 Introduction

This book deals with the *Corporations Act 2001* (Cth) and related general law and other statutes that impact the duties and responsibilities of company directors. The emphasis is on the law as it applies to directors and other officers of business corporations that are companies registered under the Corporations Act and regulated — at least as to matters of corporate governance — by the Australian Securities and Investments Commission (ASIC). However, where appropriate we discuss the different settings that apply to officers of other types of bodies corporate including not-for-profit entities regulated by the Australian Charities and Not-for-profits Commission (ACNC), financial institutions regulated by the Australian Prudential Regulation Authority (APRA), indigenous corporations regulated by the Office of the Registrar of Indigenous Corporations (ORIC), and government business enterprises (GBEs) and other entities that operate under their own constituting legislation.

The Corporations Act is a lengthy and complex statute. It provides for the formation, operation and governance of corporations ranging from small privately-owned companies to larger listed entities. And it also includes the law relating to corporate reporting and disclosure, corporate insolvency and reconstruction, managed investment schemes, securities, takeovers, and financial services and markets.

The duties and responsibilities of corporate officers and their relationship with the corporation and its shareholders are defined for the most part by Ch 2D (officers and employees), 2E (related party transactions) and 2F (members' rights and remedies) of the Corporations Act. The rules relating to insolvent trading and conduct by officers that may adversely impact creditors are contained in Ch 5 (external administration).

The Corporations Act provisions both inform and are informed by the judge-made general law (that is, common law and equity) which interprets and applies, and in some instances augments, the statutory regime. The Corporations Act provisions are modified or supplemented by legislative instruments such as the *Corporations Regulations 2001* (Cth), ASIC instruments, and accounting standards made by the AASB. The statutory regime is further developed by non-binding regulatory guidance provided by regulators. And increasingly, local and global corporate governance codes and norms such as the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (4th ed, 2019) (CGPR) and the G20/OECD *Principles of Corporate Governance* (2015) explicate and contextualise the legal requirements.

Officers of listed entities must also have regard to the listing rules of the relevant exchange, which are given legal enforceability by ss 793B–793C and 1101B of the Corporations Act. The ASX Listing Rules deal with (among other matters) continuous and periodic disclosure to the market, and transactions with persons in a position of influence, in ways that impact on officers.

Officers of prudentially regulated financial institutions — banks and other authorised deposit-taking institutions (ADIs), insurers and superannuation trustees that are RSE licensees — are subject to addition requirements and controls contained in legislation (including the Banking Executive Accountability Regime (BEAR) for ADIs) and in prudential standards and practice guides made by APRA dealing with matters such as governance, remuneration, and 'fit and proper' requirements.

Where the corporation is a trustee, an additional overlay of trust law affects the legal obligations of its officers, including by requiring of the directors the same standard of care as a prudent trustee.

Officers' legal liabilities are extended by Commonwealth, state and territory legislation dealing with (among other matters) taxation and workplace health and safety, privacy and information security, and environmental protection and animal welfare. These laws create what the Australian Law Reform Commission (ALRC) describes as 'extended management liability' (ALRC 2020, 407) in the form of either deemed liability (for example, s 188 of the Corporations Act) or liability for a failure to prevent corporate offending (for example, ss 494–495 of the *Environment Protection* *and Biodiversity Conservation Act 1999* (Cth)). These apply alongside criminal law complicity liability and analogous extensions of civil penalty liability for involvement in corporate contraventions. Extended management liability and complicity and involvement liability are discussed in **Chapter 9**.

This multi-layered legal and regulatory framework — comprising legislation, legislative instruments, caselaw, rules, codes and regulatory guidance — provides the legal context within which directors and other corporate officers operate.

1.2 Evolution of the legal framework

This work, written primarily for directors and officers of companies, is intended to provide an overview of the major legal responsibilities and duties imposed on directors and officers in carrying out their roles. These legal responsibilities and duties have evolved rapidly over the last 50 years, both through legislative amendment and the development of judicial precedent.

Three trends are evident. The first is the incremental progression from state-by-state to Commonwealth regulation. The second is towards a more public-facing conceptualisation of directors' and officers' duties, which regards the proper performance of those duties as a matter of public interest and not just a private matter between an officer and their corporation. The third is towards more exacting standards for corporate officers and more significant penalties for breach of those standards.

1.2.1 From state to Commonwealth law

Early Australian corporate law was state law. The colonial parliaments had each enacted local versions of the English company law statute of 1862, with some regional variations and innovations (for example, the creation by the Victorian Parliament of no-liability mining companies in 1871 and of proprietary companies in 1896). When Federation occurred, s 51(xx) of the Commonwealth Constitution conferred on the Commonwealth 'the power to make laws … with respect to foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth' but this did not extend to the power to legislate for the incorporation of companies, a position confirmed soon after by the High Court of Australia in *Huddart, Parker & Co Pty Ltd v Moorehead* (1909).

The consequence was that the Commonwealth did not have the power to pass corporations legislation. That power remained with the states. Companies incorporated in one state were governed by the law of that state and treated as foreign corporations elsewhere, resulting in overlapping and sometimes inconsistent regulation for companies with offices or investors throughout Australia.

This persisted throughout the first half of the 20th century. But the growth in interstate commerce and increased centralisation of the Australian economy (and financial markets) following the Second World War led to calls for harmonisation and consistency of corporate and securities law across Australia. In the 1960s, the states adopted a more uniform approach to company law in the Uniform Companies Acts of 1961–62, which standardised the structure and some of the content of the legislation but left regulatory responsibilities with state authorities. The work of the Eggleston and Rae Committees in the early 1970s — given urgency by the share trading scandal culminating in the notorious Poseidon bubble (1969–70) — resulted in the adoption of similar securities and takeovers laws in the different states and the establishment of the Interstate Corporate Affairs Commission as a national co-ordinating (but not regulatory) body.

In 1981, a formal cooperative scheme between the Commonwealth and the states for the regulation of companies was adopted. Each state agreed to enact (mostly) identical legislation based on Commonwealth laws and styled the *Companies ([Name of State]) Codes, the Securities Industry ([Name of State]) Codes and the Companies (Acquisition of Shares) Codes* of 1981. The National Companies and Securities Commission (NCSC) was formed with responsibility for regulating takeovers and markets, replacing the earlier co-ordinating body. However, the registration and regulation of companies and corporate fundraising remained the responsibility of the separate state Corporate Affairs Commissions.

The cooperative scheme lasted for 10 years, until 1991. The Hawke Government's attempt at national legislation for companies — the *Corporations Act 1989* (Cth) — was successfully challenged by the states on constitutional grounds in the High Court of Australia in *New South Wales v Commonwealth* (1990), but by then the commercial pressures in favour of national regulation were irresistible. In 1991, each state adopted the *Corporations Law* — reconfigured as a schedule to an amended *Corporations Act 1989* (Cth) — as the law in its jurisdiction and handed over exclusive administration of that law to the newly formed Australian Securities Commission (ASC) under the ministerial responsibility of the Commonwealth Treasurer.

The story does not end there. Enforcement of the *Corporations Law* depended on complex cross-vesting arrangements between federal and state courts and enforcement agencies. These arrangements were successfully challenged in the High Court in a series of cases that included *Re Wakim* (1999) and *R v Hughes* (2000). The High Court decisions created significant uncertainty about the constitutional underpinnings of the *Corporations Law* and, following urgent discussions at inter-governmental level, the states agreed to address that uncertainty by referring exclusive legislative power over companies to the Commonwealth.

The referral was duly made in accordance with s 51(xxxvii) of the Commonwealth Constitution, and the Corporations Act was enacted and came into effect as a national law on 15 July 2001. These constitutional arrangements are reflected in ss 3 and 4 of the Corporations Act, which describe the Commonwealth's power under the referral to legislate in relation to 'the formation of corporations, corporate regulation and the regulation of financial products and services'. The interaction between the Corporations Act and state and territory laws is governed by ss 5D–5I of the Corporations Act.

The effect is that, since 2001, the Commonwealth has had legislative power for corporate law and Australia has a national corporations statute administered by ASIC, a Commonwealth regulatory agency formed and operating under the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act).

1.2.2 From private to private/public duties

The second evident trend has been towards a more public-facing conceptualisation of directors' and officers' duties, with an increased role for ASIC in enforcing the duties in the public interest.

In other jurisdictions, directors' legal duties are often analysed through the lens of the agency problem that is said to arise when ownership of the corporation (by its shareholders) is separated from control (by board and management), a feature of widely-held corporations first described in the United States by Adolph Berle and Gardiner Means in *The Modern Corporation and Private Property* (1932). Legal duties are seen as one means of managing the risk of shirking or self-dealing by board and management in circumstances where significant information asymmetries and structural disincentives for active monitoring by shareholders exist. While directors' duties are owed to the corporation itself and not to the shareholders individually or collectively, on this model the duties are conceptualised as operating primarily to protect the shareholders' financial interests in the corporation from misconduct or mismanagement by its directors and other officers.

However, Australian corporate law is different. It is clear that Australian directors' statutory duties have a more public-facing character and that the law operates to safeguard the broader community — and not just the shareholders of the relevant corporation — from negligent or improper conduct by officers in the management of a corporation's affairs. This can be inferred from the following attributes of the Australian law, that: (i) shareholders cannot forgive or ratify a breach of statutory duties; (ii) ASIC can bring proceedings to enforce the duties independently of the corporation or its shareholders (that is, without requiring their cooperation or consent); (iii) directors can be disqualified for breach of duty; and (iv) courts can impose criminal or civil penalties for breach of the duties regardless of whether the corporation or its shareholders suffered any loss. Australian directors' duties, therefore, are not just concerned with private rights. As Ward J observed over a decade ago in *International Swimwear Logistics Ltd v Australian Swimwear Company Pty Ltd* (2011):

> *The concepts of public interest, public policy and commercial reality in the context of corporate governance encompass considerations of community confidence in the management of commercial businesses by directors. Various indicators point to the fact that there is a public interest in the enforcement of the duties owed by directors to their companies. Indeed, the role of the State (via ASIC) in the enforcement of statutory duties, the existence of civil penalty provisions, and the ability for directors to be held criminally liable for their actions, confirms the recognition of a public interest in the enforcement of directors' duties.* (at [106])

The public nature of directors' duties in Australia was discussed by Edelman J in *ASIC v Cassimatis* (No 8) (2016). His Honour recognised the longstanding dual character of directors' duty of care as both private and public; he pointed out that the Victorian companies legislation of 1958 set out directors' duties in modern statutory form and created criminal penalties for their contravention. This aspect of his Honour's decision is discussed in **Chapter 6**. Edelman J also raises, without answering, the interesting question of whether the duties are best understood as replicating the private duties owed to the corporation with additional public sanctions and enforcement, or creating an independent public duty requiring consideration of a general norm of conduct which is not limited to the interests of the corporation. The former seems the better view; we return to this question in the context of stakeholder theory in **Chapter 13**.

The public nature of the duties distinguishes the Australian legal and regulatory framework from that of other OECD countries, where the enforcement of directors' duties (at least in private companies) is a matter for the company itself.

In 2019, a study conducted for the AICD by the law firm Allens concluded that the Australian law was more likely to impose personal liability on directors than the law in Canada, Hong Kong, New Zealand, the United Kingdom and the United States of America. It found that:

> *Australia utilises the same general frameworks for imposing criminal and civil liability on directors as do the Comparator Jurisdictions; namely, direct, accessorial and deemed liability. However, several aspects of Australia's director liability environment bear comment, as compared with the Comparator Jurisdictions.*
>
> *(a) First, Australia regulates a relatively broad range of subject matter through the imposition of director liability.*
>
> *(b) Second, Australia imposes criminal liability on directors relatively liberally, particularly in relation to dishonest or reckless contraventions of their corporate governance obligations.*
>
> *(c) Third, Australian directors are exposed to relatively harsh criminal penalties.*
>
> *(d) Fourth, Australia alone primarily utilises a public mechanism for civil enforcement of directors' duties.*
>
> *(e) Fifth, the emergent doctrine of stepping stone liability has the potential to further expand the ambit of director conduct that may be subject to public civil enforcement.*
>
> *(f) Sixth, Australia's public civil enforcement mechanism utilises a unique*

> *penalties regime, and Australia's civil penalties are harsh, even as compared with Australian and Comparator Jurisdiction criminal pecuniary penalties.* (at 2)

As demonstrated in **Chapters 6** and **7**, Australian directors can be the subject of civil penalty proceedings where their lack of care and diligence has exposed the company to a foreseeable risk of harm resulting from a compliance or disclosure failure. This form of 'stepping stones' liability, which is enforced by ASIC and not the company, is not generally available to a regulator in the comparator jurisdictions.

1.2.3 Towards higher standards and penalties

The third evident trend is towards more exacting standards, and higher penalties for non-compliance. While the fundamental duties have always existed, what they require of directors and the penalties for contravening them have evolved.

Directors and officers have always owed fiduciary and common law duties to their corporations. The core duties of honesty, loyalty, and care owed to the corporation — discussed in **Chapters 4–6** — have been a feature of Australian corporate law (originally as private duties, and now as both private and public duties) since its inception and have appeared in legislation since the 1950s. These duties have been supplemented over time by specific statutory duties in relation to corporate disclosure (see **Chapter 7**) and to prevent insolvent trading (see **Chapter 8**), and by the expansion of the various forms of extended managerial liability and complicity liability in Commonwealth and state laws, including for failure to prevent, or involvement in, contraventions of law by the corporation itself (see **Chapter 9**).

While the broad architecture of the duties has remained fairly stable, the standards applied within that framework have progressively recalibrated to reflect rising commercial and community expectations of directors and other officers. In *ASIC v Rich* (2003), a decision concerning the responsibilities of the non-executive chair of One.Tel, Austin J said it was 'commonplace to observe that the standard of care expected of company directors, both by the common law … and under statutory provisions, has been raised over the last century or so' (at [71]). In *Commonwealth Bank of Australia v Friedrich* (1991), concerning the collapse of the National Safety Council, Tadgell J said:

> *As the complexity of commerce has gradually intensified (for better or for worse) the community has of necessity come to expect more than formerly from directors whose task is to govern the affairs of companies in which large sums of money are committed by way of equity capital or loan. In response, the parliaments and the courts have found it necessary in legislation and litigation to refer to the demands made on directors in more exacting terms than formerly …* (at 126)

This recalibration is evident in important cases like *Statewide Tobacco Services Ltd v Morley* (1990) dealing with the duty to prevent insolvent trading, *Daniels v Anderson* (1995) (the AWA case) dealing with the duty of care, *ASIC v Macdonald* (2009) (the James Hardie case) dealing with continuous disclosure, and *ASIC v Healey* (2011) (the Centro case) dealing directors' responsibility for financial reporting. What is reasonably to be expected of directors — particularly non-executive directors of listed entities — now reflects the important and professional role directors play in the governance of major corporations.

Recently there has also been a significant ratcheting up of maximum statutory penalties and other consequences for breaches of those duties.

When civil penalties for breaches of directors' duties were introduced in February 1993, the intention was to reduce reliance on criminal prosecutions as a means of deterring improper conduct by directors. This was achieved by creating a court-based enforcement mechanism that allowed for significant public sanctions — including pecuniary penalties and disqualification — to be imposed on individuals for breaches of duty (including the duty of care) that fell short of the criminal standard. Criminal prosecutions, conducted by the Commonwealth Director of Public Prosecutions (CDPP), remained available for behaviour engaged in knowingly, intentionally, or recklessly that was dishonest and intended to gain an advantage, or to deceive or defraud. The civil penalty regime allowed for ASIC to bring proceedings against defaulting directors and officers in situations where this level of scienter was absent or could not be proved beyond a reasonable doubt.

For many years, the number of civil penalty provisions that applied to directors and officers across the Commonwealth statute book was limited, and the maximum penalty remained fixed — for Corporations Act civil penalty provisions — at $200,000. However, over the last decade, both the number of civil penalties provisions (in the

Corporations Act and other statutes) and the maximum penalties have increased significantly. The maximum pecuniary penalty that can be imposed on an individual for a contravention of a civil penalty provision is now the greater of 5,000 penalty units (equivalent in 2022 to $1.11 million) and, if the Court can determine the benefit derived and detriment avoided because of the contravention, that amount multiplied by three.

Maximum criminal penalties have also increased. For example, criminal breaches of directors' duties under s 184 of the Corporations Act can now attract up to 15 years' imprisonment or fines of up to 4,500 penalty units or three times the benefit gained or detriment avoided by the offending.

The penalties regime and ASIC's role in enforcement are discussed in **Chapter 10**.

1.3 Corporate law and corporate governance

Corporate law — and the law of directors' duties in particular — is at the heart of the Australian corporate governance model. But the two concepts are not identical, and many aspects of corporate governance arise from market practice and market aspiration, rather than legal compulsion.

In 2003, Justice Neville Owen in the HIH Royal Commission defined corporate governance as 'the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies and those in control are held to account.' In the Bergin Inquiry into Crown Resorts in 2021, Commissioner Bergin described corporate governance as 'the term used to describe the internal structures by which a company operates and is accountable to its stakeholders'.

In Farrar and Hanrahan (2017), we adopted a broader description of corporate governance, as 'a double helix, comprised of the interrelated strands of corporate purpose and corporate ordering. The first strand relates to what the corporation is for, and in whose interests it ought to be operated. The second relates to how to arrange and control decision-making within the corporation, to ensure its purpose is achieved.' The idea of corporate purpose is now so important we think it is difficult to discuss one without the other.

The first strand of the helix — what the company is for — informs how we understand the company's 'interests', and how we interpret and apply the directors' duties to exercise their discretions and powers in the company's interests and to take care to protect the company's interests. In contemporary capitalism, boards must balance the concerns of the providers of capital — including the company's members (shareholders) and creditors — with those of other contractual and non-contractual stakeholders, whose ongoing participation in the overall project of the company is necessary to its sustained and sustainable success. The way in which the law recognises the relevance of both financier and non-financier stakeholders to determining what is in the company's interests is explored in **Section 13.3**.

The second strand — which allocates responsibility and accountability for the operation and actions of the company — defines the respective roles of the board, management, and the members in general meeting and creates the checks and balance that ensure their ongoing loyalty to the overall project of the company. The efficiency and robustness of these arrangements drives the success of the company in achieving its purpose. Key challenges include having the right people operating under the right reward structures, allocating responsibilities properly, having the right flow of information from management to the board and (where relevant) from the company to its members and the market, and having robust processes for managing financial and non-financial risks.

The two strands of the helix are bound together by the company's culture — that is, what Beach J in *ASIC v Mitchell* (No 2) (2020) describes as the 'organisation's set of shared values and assumptions' (at [1416]). Culture describes the 'values, norms, customs, traditions, symbols, and language that are widely shared by members of a group and that govern their collective behaviour' (Gorton and Zentefis 2020); in s 12.3(6) of the *Criminal Code* it is defined for those purposes as 'an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities takes place'. The different understandings of culture (in this context) are discussed in **Section 14.4**.

In her report into Crown Resorts in 2021, Commissioner Bergin said, '[w]hile corporate governance establishes the rules, policies and principles, culture is "what people do when no-one is watching". It is therefore critical that the boundaries that are set by the corporate governance principles are understood and respected by individuals in the company' (at 327). At the heart of the Hayne Royal Commission was the question, 'what more can be done to achieve effective leadership, good governance and appropriate culture so that financial services entities obey the basic norms of behaviour that underpin the proper regulation of the financial services industry?' (at 43).

Corporate law anchors the broader governance framework. That is, it sets the conditions and requirements that directors must navigate in organising and carrying out the governance of the company. However, the self-regulatory penumbra — including listing rules and accounting standards, industry or institutional codes and guidelines, company's own codes of practice, and business ethics — are equally important in practice. These non-law and 'soft law' requirements have a significant impact on the way the law discussed in this book is interpreted and applied.

The work of the board and its role in governance is explored in **Chapter 14**.

1.4 Directors and officers — definitions and roles

The duties and responsibilities explained in this book apply to people who are directors or other officers of companies. In *ASIC v Healey* (2011), Middleton J said:

> *A director is an essential component of corporate governance. Each director is placed at the apex of the structure of direction and management of a company. The higher the office that is held by a person, the greater the responsibility that falls upon him or her. The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.* (at [14])

This part explains who comes within the definition of a director or officer, and the different roles that directors can occupy. Who is eligible to be appointed as a director, and how they are appointed, is discussed in **Section 2.4**.

As we will see, there are no formal vocational qualifications required for appointment as a director in Australia; all that is required is that the person is a natural person aged at least 18 who is not disqualified from managing a corporation under Pt 2D.6 of the Corporations Act. From 2021, directors and alternate directors of companies (and of ATSI corporations, registered Australian bodies, and registered foreign companies carrying on business in Australia) must have a unique director identification number (DIN) issued by the Australian Business Registry Services (ABRS). This includes directors resident overseas. Directors appointed before 31 October 2021 have until 30 November 2022 to obtain their DIN; those appointed from 1 November 2021 onwards must have it within 28 days of their appointment. The DIN rules are contained in Pt 9.1A of the Corporations Act.

1.4.1 Definition of director

'Director' is defined in the dictionary in s 9 of the Corporations Act in a way that now largely overtakes the common law definition. It includes a person who is appointed to the position of a director (or appointed to the position of an alternate director when acting in that capacity) regardless of the name given to their position. It also includes a 'de facto director' and a 'shadow director' explained below.

An ***alternate director*** is usually appointed to stand in for a director who is unavailable, for example because of illness or other absence, in accordance with s 201K of the Corporations Act. The alternate has all the rights, powers, duties and responsibilities of a director, and is in the same legal position as any other director. The alternate is not usually the agent of the appointer. If the appointer has a personal interest that disqualifies them for being present or voting on a matter (see **Chapter 5**), this will not disqualify the alternate; conversely an alternate director who has a personal material interest in a matter being considered at a board meeting will be disqualified from being present and from voting notwithstanding that the appointor director has no disqualifying interest.

The definition also includes a person who is not validly appointed as a director but who acts in the position of a director — sometimes referred to as a ***de facto director***. This may arise where there is a defect in the person's purported appointment, or because the person assumes the role of director without having been appointed (for example, by holding themselves out as a director or participating in board meetings) or continues in that role after they have resigned or been removed.

Natcomp Technology Australia Pty Limited v Graiche (2001) is a case involving a de facto director. In that case, the New South Wales Court of Appeal was asked to determine whether Dr Graiche was acting as a de facto director of a company, Amtech. Dr Graiche had accompanied directors of Amtech to a trade fair in Taiwan where he made various representations as to his role with Amtech, including distributing a business card that carried the logo of Amtech and describing himself to others as CEO of the company. The Court emphasised that, in deciding whether he was a de facto director of Amtech, his involvement in the affairs of the company 'must be examined in the context of the overall nature of the company's business' (at [14]). It found 'no evidence that the respondent was involved in any fashion in this principal aspect of the company's business [being the sales of computer packages], nor in its day-to-day operations. Dr Graiche's involvement with Amtech was, it appears, limited to an interest in the development and marketing of possible new products' (at [15]). This was insufficient to establish that he was either a de facto director or a shadow director.

The question of whether a person was a de facto director also arose before the Full Federal Court in *Chameleon Mining NL v Murchison Metals Ltd* (2012). The facts are complicated, but in essence Chameleon made claims for breach of fiduciary duty and for contraventions of the Corporations Act against Phillip Grimaldi, who it alleged was a de facto director of Chameleon, in respect of transactions with Murchison. Mr Grimaldi was also a director of, and at all relevant times the controlling mind of Murchison. Further complicating matters, he was also a director of several of Chameleon's subsidiary companies, one of which was said to have been a consultant for Chameleon.

The Full Court was satisfied that Mr Grimaldi was both a director and an officer of Chameleon for Corporations Act purposes. On the evidence, it found that:

> *Even though not authorised to be a director, Mr Grimaldi was either given, or had arrogated to himself with the acquiescence of at least the two executive directors … functions in the affairs of Chameleon which would properly be expected to be performed by a director of that corporation given its circumstances. Given the extent and the significance of those functions, he so acted in the position of a director as to warrant the imposition on him of the liabilities, statutory and fiduciary, of a director.* (at [141])

It was also satisfied that he was guilty of contraventions of ss 181 and 182 of the Corporations Act and had breached his fiduciary duties to Chameleon — these aspects of the case are discussed in **Chapter 5**.

The Full Court set out ten principles for applying this part of the statutory definition (at [64]–[73]), including its relationship with the concept of shadow director and the extended definition of 'officer' discussed below. The principles include that a person 'may be a director even without any purported appointment of that person to that position at any time. The definition applies as much to a person who is a true usurper of the functions of a director in a company … as to a person who takes "an active part in directing the affairs of [a] company" with the acquiescence of de jure directors' (at [64]). A de facto director is someone who has been acting in a role (or roles) within the company and performing functions one would reasonably expect to have been performed by a director of that company given its circumstances. That said:

> *The roles and functions so performed will vary with the commercial context, operations and governance structure of the company … Whether a person has acted in the position of a director 'is a question of substance and not simply of how that person has been denominated in, or by, the company … The fact that a person has been designated a "consultant" for the performance of functions for a company will not as of course mean that person cannot be found to be a director. Whether or not he or she will be a director will turn on the nature and extent of the functions to be performed (both in and beyond the consultancy) and on the constraints imposed thereon.* (at [66]–[68])

The fourth category included in the statutory definition is usually referred to as a ***shadow director***. This is a person (not validly appointed as a director) in accordance with whose instructions or wishes the directors of the company are accustomed to act. A shadow director may be a natural person or a corporation. The definition goes on to provide that an adviser (such as a lawyer or investment banker) is not a shadow director 'merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company'.

There is extensive caselaw on when someone is a shadow director. The ordinary relationship between a company and a person that controls it (such as a majority or sole shareholder) is not enough to make the controller a shadow director, reflecting the relationship between the members and the board explained in **Section 2.3**. Nor is the ordinary relationship between a company and its bank or other creditor, even where the financier is engaging with the company in a pre-insolvency or workout context. However, there is a line that cannot be crossed.

In *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2011), Young JA set out five important principles to be applied in deciding whether a person is a shadow director. First, 'not every person whose advice is in fact heeded as a general rule by the board is to be classed as a de facto or shadow director' (at [228]). Secondly, 'if a person has a genuine interest of his or her or its own in giving advice to the board, such as a bank or mortgagee, the mere fact that the board will tend to take that advice to preserve it from the mortgagee's wrath' will not make them a shadow director (at [229]). Thirdly, 'the vital factor is that the shadow director has the potentiality to control. The fact that he or she does not seek to control every facet of the company or the fact that from time to time the board disregards advice is of little moment' (at [230]). Fourthly, the evidence must show something more than just being in a position of control — it must show 'whether that power to control was put into practice' (at [231]). It is highly fact specific. Fifthly, 'although there are problems with cases where the board of the company splits into a majority and minority faction, so long as the influence controls the real decision makers, the person providing the influence may be a shadow director' (at [232]).

In *Palmer v Parbery; QNI Metals Pty Ltd v Parbery* (2019), the liquidators of Queensland Nickel sought orders to freeze the assets of Mr Palmer, arguing that he was a shadow director of Queensland Nickel against which future claims for breach of duty might lie. The Queensland Court of Appeal agreed with the judge at first instance that there was a good arguable case that during periods when Mr Palmer was not formally appointed as a director of Queensland Nickel, he was a shadow director because the appointed directors were accustomed to act in accordance with his instructions or wishes. This depended on the evidence, including from its chief financial officer that throughout 2015 (and including after Mr Palmer ceased formally to be a director) Mr Palmer commonly gave instructions to him about the operations of Queensland Nickel, maintained a tight control on his approval of expenditure by Queensland Nickel and retained to himself the ability to approve new contracts entered into by Queensland Nickel. The liquidator gave evidence of Mr Palmer's position as an authorised signatory for Queensland Nickel and of 'particular actions and correspondence by Mr Palmer which betoken the requisite degree of control'. Mr Palmer's ownership position in relation to the entities that owned Queensland Nickel, and evidence that suggested that he 'regards the assets of private companies which are wholly (or virtually wholly) owned directly or indirectly by him as sufficiently within his control to be regarded broadly as his with which to deal' was also relevant.

Extending the definition of director to include de facto directors and shadow directors means that (unless the contrary intention appears), the statutory duties and liabilities of directors can apply to people and corporations who have not been formally appointed to that role. As directors, they are then subject to some duties that do not apply to other officers, including the statutory duty to prevent insolvent trading discussed in **Section 8.3**. For that reason, the question of whether someone is a de facto or shadow director often arises in the insolvency context. In other circumstances, it may be enough to show that the person comes within the wider concept of 'officer' (see **Section 1.4.3**).

1.4.2 Executive, non-executive, independent and nominee directors

In corporate governance, directors are usually described as executive or non-executive directors. A subset of non-executive directors may be described as independent directors. Directors who are directly appointed by, or closely affiliated with, individual shareholders or third parties may be described as nominee directors. These descriptors are useful, but it is important to remember their primary significance is commercial rather than legal, at least for companies that are not APRA-regulated.

Usually, the structure of the board is a matter for the company and its relevant stakeholders to decide. (The position is different for an APRA-regulated ADI or insurer, where the structured of the board is prescribed by APRA *Prudential Standard 510 — Governance* (2019).) While modern corporate governance practice (including the CGPR) recommends majority independent boards for listed companies, this is not appropriate in all circumstances and is not mandated by the Corporations Act.

Executive and ***non-executive directors*** typically perform different functions. In *AWA Ltd v Daniels (No 2)* (1992), Rodgers CJ in Comm observed that:

> *... many companies today are too big to be supervised and administered by a Board of Directors except in relation to matters of high policy. The true oversight*

> *of the activities of such companies resides with the corporate bureaucracy. Senior management and, in the case of mammoth corporations, even persons lower down the corporate ladder exercise substantial control over the activities of such corporations involving important decisions and much money. It is something of an anachronism to expect non-executive directors, meeting once a month, to contribute anything much more than decisions on questions of policy and, in the case of really large corporations, only major policy. This necessarily means that, in the execution of policy, senior management is in the true sense of the word exercising the powers of decision and of management which in less complex days used to be reserved for the Board of Directors.* (at 832)

On appeal in *Daniels v Anderson* (1995), the Court of Appeal did not accept that this meant non-executive directors had lesser responsibilities, but it does point to the emerging monitoring role of the board.

The role of non-executive director was considered in the interesting case of *AIG Australia Ltd v Jaques* (2014) which, like *ASIC v Lewski* (2018) discussed in **Chapter 14**, arose out of the collapse of Australian Property Custodian Holdings Limited (APCH). Under a D&O insurance policy held by APCH, executive directors were insured for losses up to $5,000,000; non-executive directors were entitled to extended cover by way of a special excess limit of an additional $1,000,000. When Mr Jaques claimed under the policy, he argued that he was a non-executive director at the time the insured events occurred and therefore entitled to the extended cover, but the insurance company took the opposite view. The policy itself did not include a definition of non-executive director.

The Victorian Court of Appeal considered the various authorities, including the comments of Rodgers CJ in *AWA Ltd v Daniels* (1992) about the role of non-executive directors. In giving the term 'non-executive director' its ordinary commercial meaning, the Court made some useful observations about the legal character of executive and non-executive directorship. These include that the 'essential element of the distinction for the purposes of construing the term non-executive director in the [insurance] policy, is whether the director is performing executive functions in the management and administration of the company'. Contemporaneous records kept by the company are relevant to the extent that they provide evidence of the roles and tasks undertaken by a particular director, or of a delegation of authority to perform particular functions. Whether 'a director is involved in the operations of the company, and performs work in connection with the business of the company' is relevant; however, 'when broadly framed in this way, the approach does not distinguish between an executive and a non-executive director and begs the question of what kind of involvement of the director is sufficient, and what kind of connection with the business a director's work must have in order for that director to be regarded as an executive of the company'. Ultimately, this is a question of fact. The Court accepted that, in the absence of some further authority conferred upon a director by the company (be it under a contract of employment, a services agreement, or via an express delegation or acquiescence in a director's exercise of executive powers), the director should generally be treated as a non-executive director; the starting position must be that the mere fact of appointment does not normally give a director any executive powers. This is consistent with the discussion of corporate powers and their exercise in **Section 2.3**.

In corporate governance, the ***independence*** or otherwise of directors is also relevant. The ASX Corporate Governance Council recommends that listed companies have majority independent boards. The commentary to its Recommendation 2.3 says that:

> *A director of a listed entity should only be characterised and described as an independent director if he or she is free of any interest, position or relationship that might influence, or reasonably be perceived to influence, in a material respect their capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity as a whole rather than in the interests of an individual security holder or other party.*

APRA's prudential standards for ADIs and insurers require (rather than just recommending) independent directors on regulated institution's boards. APRA's *Prudential Standard 510* defines an 'independent director' as a non-executive director 'who is free from any business or other association — including those arising out of a substantial shareholding, involvement in past management or as a supplier, customer or adviser — that could materially interfere with the exercise of their independent judgement'.

The concept of a ***nominee*** director is also a commercial, rather than a legal, one. In unlisted companies, an individual shareholder or other person (such as a financier) may have the right to appoint directors to the board (see **Section 2.4**). Their affiliation to the appointer is acknowledged and is, of course, the point — and they play an important role in bringing the appointer's issues and perspectives to the board room discussions. It is open to nominee directors to act with the interests of their appointors in mind, providing that they do so in the genuine belief that they are also acting consistently with the interests of the company as a whole. As is the case with all directors, their duties are to the company and they must always act in the interests of the company, not the appointer.

In **Chapter 5** we look closely at directors' duties of loyalty, including their duties of confidentiality. *Harkness v Commonwealth Bank of Australia Limited* (1993) was a case concerning a nominee director's duty to keep information about a third party, obtained through their office, confidential from their appointor. It arose out of the collapse of money market trader Spedley Securities. An officer of the bank served on the disputes committee of Austraclear (though which Spedley trades cleared) and in that capacity became aware of issues around the solvency of Spedley. The question was whether the officer was permitted, or required, to disclose that information to the bank and whether his knowledge should be imputed to the bank. The position is clearly stated by Young J, who said:

> *While ordinarily there will be a duty to communicate knowledge received, where the director is functioning within another corporate organisation and information comes to the director in the course of that work with the other organisation, his duty of confidentiality to that other organisation will subsume any duty he might otherwise owe to the company which appointed him to that organisation. The use of the word 'representative' does not take the matter any further. Whether a person is elected by a special interest group, considered to be a representative of one group on another group, or a nominee director, does not alter the fact that the person owes the duty of confidence to the board to which he or she has been appointed.* (at 177)

1.4.3 Definition of officer

Several of the key statutory duties discussed in this book apply to all officers, not just directors. These include the duties in ss 180–184 of the Corporations Act. In *ASIC v King* (2020), the High Court said:

> *The extension of statutory duties to those below board level takes account of the fact that many companies are managed under the broad direction of the board of directors rather than by the board itself. It recognises that there is substantial room for people outside the boardroom to have a significant effect on a corporation and that modern structured corporate groups are often run day-to-day by key group executives or executive committees of the holding company whose decisions, made on a group rather than an entity basis, are implemented across the various companies within the group.* (at [95])

An important policy question is, how deep into the organisation should these duties extend? This was discussed by CAMAC in its report, *Corporate Duties Below Board Level* (2006) and also informs the debate over executive accountability regimes like the BEAR (in Pt IIAA of the *Banking Act 1959* (Cth)) and its proposed successor, the Financial Accountability Regime (FAR). The concept of an officer is narrower than, for example, a 'high managerial agent' which is defined in s 12.6 of the *Criminal Code* as 'an employee, agent or officer of the body corporate with duties of such responsibility that his or her conduct may fairly be assumed to represent the body corporate's policy'.

Whether someone is an 'officer' of the corporation can also be relevant to determining whether the person has authority to bind the company in its dealings with third parties, and in attributing knowledge or conduct to the corporation, for example for the purposes of the insider trading laws under s 1042G of the Corporations Act. Attribution is discussed in **Section 9.2**.

The statutory definition of 'officer' of a corporation (including a company) is contained the dictionary in s 9 of the Corporations Act. It includes (in para (a)) a director or secretary and, by para (c)–(g), also includes various external administrators of the company, including receivers and liquidators.

The definition is further extended by para (b), to capture a person:

> *(i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or*
> *(ii) who has the capacity to affect significantly the corporation's financial standing; or*
> *(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation).*

A person who falls into para (b)(iii) is probably a shadow director: see **Section 1.4.2**.

Paragraph (b)(i) of the definition contemplates a management, rather than operational, function. In *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) a money-market dealer was held not to be an officer of the bank, despite his relatively large trading limits. Jacobson J concluded that 'an officer is involved in policy making and decisions that affect the whole or a substantial part of the business of the corporation (at [490]). In its report on corporate criminal responsibility in 2020, the ALRC said that the statutory definition captures the very top tier of management (often referred to as the 'C-suite') but the extent to which it reaches to lower levels of management is less clear. In very large corporations, senior executives below the C-suite may direct and control significant aspects of the company's business on a day-to-day basis; but the extent to which officers' duties apply to such individuals remains 'relatively untested' (at [9.42]). That said, in *Hodgson v Amcor* (2012) a group general manager, responsible for the largest division of the company, was held to fall within the definition of 'officer', even though he reported to the upper tier of management rather than directly to the board.

In *Shafron v ASIC* (2012) the High Court decided that the general counsel and co-company secretary of James Hardie was an officer of that company, both because of his role as secretary and because he came within para (b) of the definition. The plurality observed that para (b) is different from (and a wider class than) the persons identified in the other paragraphs of the definition, all of whom hold a named office in or in relation to the company. Those identified in para (b) are identified by what they do (sub-para (i)), what capacity they have (sub-para (ii)) or what influence on the directors they have had and continue to have (sub-para (iii)).

Mr Shafron was one of the three most senior executives of James Hardie who was responsible for formulating and arguing the case for the planned restructure of the company, the purpose of which was to ringfence its future liabilities for asbestos-related damages and to transfer its incorporation to The Netherlands. The Court found that he participated in decisions affecting a substantial part of the business. Participating in making decisions is not intended primarily, let alone exclusively, to deal with cases where there are joint decision makers. The Court observed that the 'case of joint decision making would be more accurately described as "making decisions (either alone or with others)" than as one person "participating in making decisions". Rather … the idea of "participation" directs attention to the role that a person has in the ultimate act of making a decision, even if that final act is undertaken by some other person or persons.' (at [26])

The nature of Mr Shafron's participation, and the significance of the decision to the future of the company, were both highly relevant. The Court concluded that:

> *The fact that Mr Shafron was an employee of the company, and not an external adviser, is important. What he did was not confined to proffering advice and information in response to particular requirements made by the company. And what he did went well beyond his proffering advice and information to the board of the company. He played a large and active part in formulating the proposal that he and others chose to put to the board as one that should be approved. It was the board that ultimately had to decide whether to adopt the proposal but what Mr Shafron did, as a senior executive employee of the company, was properly described as his participating in the decision to adopt the separation proposal that he had helped to devise.* (at [30])

To come within para (b) of the statutory definition of officer, there is no need to show that the person occupied a formal role in the company. In *ASIC v King* (2020), the High Court considered whether Michael King — who was CEO and an executive director of the (formerly) listed public company MFS Ltd — was also an officer of one of the MFS group subsidiaries, despite not being a member of its board or employed by it. The subsidiary, MFSIM, had been the responsible entity of several managed investment schemes that failed after the global financial crisis of 2008, meaning that s 601FD (which imposes statutory duties on officers of responsibility entities) applied. The Queensland Court of Appeal had decided that a person could not be an officer unless they held 'a recognised position with rights and duties attached to it' in the company, but this was reversed by the High Court. The High Court concluded that Mr King was an 'officer' as defined by para (b)(ii); the factual findings of the primary judge that Mr King acted as the 'overall boss of the MFS Group' and assumed 'overall responsibility for MFSIM' were sufficient to establish that Mr King had the capacity to affect significantly the financial standing of MFSIM.

1.4.4 Chair of the board

Most boards choose one of their number as chair. The CGPR describe the chair as 'responsible for leading the board, facilitating the effective contribution of all directors and promoting constructive and respectful relations between directors and between the board and management. The chair will also usually be responsible for approving board agendas and ensuring that adequate time is available for discussion of all agenda items, including strategic issues' (at 7).

This focuses on the role of the chair in managing board meetings; this is discussed in **Section 2.5**. There are other roles, that include representing the company and leading its culture, and being the primary point of contact between the board and management outside the meeting cycle. It can also fall to the chair to resolve matters when the board fractures or falls out; the response of the chair in addressing dissent is discussed, for example, in *ASIC v Mitchell (No 2)* (2020).

The chair does not have special legal duties (as distinct from governance responsibilities). However, the courts do recognise the distinctive governance functions performed by board chairs in applying the general statutory duties in cases like *ASIC v Rich* (2003) (the One.Tel case), *ASIC v Flugge and Geary* (2016) (the AWB case) and *ASIC v Mitchell (No 2)* (2020) (the Tennis Australia case) discussed in **Chapter 6**.

1.4.5 Company secretary

The office of company secretary is recognised by s 204A of the Corporations Act, which provides that every public company must have at least one secretary who ordinarily resides in Australia. It is optional for a proprietary company to have a secretary, but if one or more is appointed, at least one must be resident here. The secretary must be a natural person aged at least 18 who is not disqualified from managing a corporation under Pt 2D.6 of the Corporations Act. The secretary is appointed by the directors under s 204D of the Corporations Act.

A secretary is an officer of the company, to whom the relevant statutory and general law duties apply. As the High Court noted in *Shafron v ASIC* (2012), what responsibilities the company secretary has in a particular company is a question of fact.

Company secretaries are subject to s 188 of the Corporations Act, which provides that if the company contravenes a 'corporate responsibility provision' listed in s 188, the secretary contravenes that provision. These include various responsibilities related to the registered office, the maintenance of registers, and filing obligations. If a proprietary company that does not have a secretary contravenes one of those provisions, the directors are liable instead. This is subject to a statutory defence, in s 188(3), that applies if the person 'took all reasonable steps to ensure that the company complied with' the corporate responsibility provision.

1.5 Future directions

This book is about the legal rules that govern the acts and omissions of company directors. Those rules are constantly evolving and adapting to meet new conditions and new concerns, including those explored in **Chapter 13** (dealing with corporate social responsibility) and **Chapter 14** (on some key risks and issues confronting contemporary boards).

The governance arrangements for large companies are also evolving. A unitary board dominated by non-executive directors is not the only alternative. In some systems, non-executive directors have a lesser role, and in others two-tiered boards comprising a management board and a supervisory board (sometimes, for example in Germany, including employee representatives) are used. The 'decentralised autonomous organisation' (DAO) has no board at all; and now the Australian government is considering conferring legal personality on it. These alternative governance models encourage us to think creatively about what is fit-for-purpose for Australian companies.

Boards are spending more time on understanding and managing non-financial risks and the pressure on governments and regulators to make directors personally accountable for risk management failures (arising from failed processes or poor culture or both) is high. The ALRC's work on individual liability mechanisms (ALRC, 2020, Ch 9) suggests that directors' and executives' legal liability for corporate lawbreaking remains a live issue. This may take the form of proposals to make directors presumptively liable for corporate failures unless they can establish a 'reasonable steps' or 'due diligence' defence. This approach greatly increases the legal risk associated with being a director.

It is likely that companies and their boards will be subject to greater scrutiny in the areas of human rights violations and environmental harms, reflected in the European Union's new proposals on sustainable corporate governance in 2021. The ethical implications of the use of artificial intelligence is also an emerging area of focus.

Meanwhile, the ALRC will continue to progress its review of the legislative framework for corporations and financial services regulation which began in 2020 and is scheduled to report to government in 2023.

It sometimes appears that increased individual accountability for directors is a recent phenomenon. But it has been with us for some time. The trend that began after the stock market crash of 1987 is evident in the case law and the steady ratcheting-up of expectations of individual accountability in corporate governance codes, beginning with the UK Cadbury Code (1992) and continuing through the various iterations of the ASX CGC *Corporate Governance Principles and Recommendations*. Thirty years ago, Rogers CJ said in *AWA Ltd v Daniels* (1992) that '[o]ne of the most striking features of the law concerning directors' duties is the insistence that directors accept more and more responsibility for the oversight of a company's affairs at the same time as the affairs of the company become more and more complex and diverse' (at 865).

In his 1997 article entitled 'The Duty of Care of Directors: Does It Depend on the Swing of the Pendulum?', the late Professor Bob Baxt AO FAICD*Life* argued that the views expressed by Rogers CJ in *AWA* on personal responsibility could be traced back to comments of Sir Douglas Menzies made in 1961. Professor Baxt's article was published a decade after he assumed responsibility for this book from its fifth edition published in 1987. Plus ça change. We will see where the pendulum swings.

Chapter 2

The company and its components

2.1 Introduction

A company, which is a separate legal person in the eyes of the law, comprises the board, management, members, and other stakeholders. The board and the members in general meeting are the organs of the company by which corporate powers are exercised. While this is true of all corporations, there are significant differences in governance practice between closely-held companies (including family enterprises) where shareholders are routinely involved in the day-to-day operations of the business, and public listed entities whose members include institutional and retail investors who hold their securities as part of a diversified investment portfolio. A tension exists between the diverse nature of companies and their governance practices, and the universal nature of legislative and general law rules which often apply irrespective of an individual company's size and character.

This chapter explains the nature of the company and its different components. A 'company' is a type of corporation that is registered under the Corporations Act. The wider term 'corporation' is defined in s 57A of the Corporations Act to include bodies corporate formed under other legislation, such as incorporated associations, ATSI corporations, and GBEs formed under their own constituting statutes. The discussion starts with the structure of the company, the different types of companies, the company as a separate legal person, and limited liability issues. It also explains the corporate constitution and the source and exercise of corporate powers. The next part describes the two governance organs of the company — the shareholders in general meeting and the board — and explores the relationship between them. It also considers the relationship between the board and management. We then look at how the board is constituted, including questions of directors' eligibility, appointment, retirement, and removal. The Chapter concludes with a brief discussion of directors' remuneration.

2.2 Structure and attributes of a company

A company is formed by being registered under Pt 2A.2 of the Corporations Act or predecessor legislation. Registering companies was a function of state registrars until 1991 when it transferred to the ASC and subsequently ASIC. The mechanics of registration are dealt with in Pt 2A.2 of the Corporations Act.

From 2021, the Australian Business Registry Services (ABRS) (operated by the ATO) will progressively take over the function of maintaining the companies register (and 30 other business registers currently operated by ASIC) under the *Treasury Laws Amendment (Registries Modernisation and Other Measures) Act 2020* (Cth).

The registration process sets up the basic structure of the company, which must have at least one member, and at least one (for most proprietary companies), two (for proprietary companies that raised capital through crowd-sourced funding (CSF) platforms) or three (for public companies) directors. Single director/shareholder proprietary companies, which have been permitted since 1998, have the same natural person as both director and member. A company secretary is optional for proprietary companies and mandatory for public companies. The company must have a distinctive name (which may be its ACN) and a registered office.

The company's internal management may be governed by provisions of the Corporations Act that apply to the company as replaceable rules, by a constitution, or by a combination of both. The internal governance rules are explained in **Section 2.2.4**.

2.2.1 Types of companies

The Corporations Act distinguishes between different types of companies and in so doing switches on or off different reporting, regulatory and governance requirements. This adds to the complexity of what is already a very complex statute.

Companies are first classified according to whether they are proprietary or public.

The second order classification is according to whether, and if so on what basis, the members' liability is limited.

Table 2.1: Section 112(1) of the Corporations Act

Proprietary company	Limited by shares
	Unlimited with share capital
Public company	Limited by shares
	Limited by guarantee
	No liability
	Unlimited with share capital

Companies may be proprietary or public. ***Proprietary*** companies are restricted in their ability to raise capital by way of public securities offers (other than through CSF offers), are unlisted, and are usually limited to 50 shareholders (excluding employee shareholders or CSF shareholders). Some governance rules — for example, the requirement to appoint a company secretary or hold an annual general meeting — do not routinely apply to proprietary companies. A subset of proprietary companies are ***single director/shareholder companies***, where a natural person is both the sole director and the sole member of the company. ***Public*** companies are not subject to the fundraising restrictions that apply to proprietary companies; they may be listed on ASX or another exchange, but most public companies in Australia are unlisted.

Most Australian companies — proprietary or public — are companies ***limited by shares***. This means the company issues share capital and liability of its members is limited to the amount (if any) unpaid on the shares respectively held by them. A smaller number — usually not-for-profit entities because they cannot pay dividends — are limited by guarantee. All companies ***limited by guarantee*** are public companies. No shares are issued, and a small number of members guarantee to contribute a notional amount to the property of the company if it is wound up. A public company with share capital may be registered as a ***no liability*** company if its constitution states that its sole objects are mining purposes, and the company has no contractual