



Australian Government

Corporations and Markets  
Advisory Committee

# CORPORATE DUTIES BELOW BOARD LEVEL

## Report

April  
2006

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Corporations and Markets **Advisory**  
**Committee**

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Corporate duties below  
board level

Report

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28 April 2006

The Hon. Peter Costello, MP  
Treasurer  
Parliament House  
Canberra ACT 2600

Dear Treasurer

I am pleased to present a report by the Advisory Committee on  
*Corporate duties below board level.*

The report was prepared in response to a request from the then  
Parliamentary Secretary to the Treasurer in May 2004.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michael St John', written in a cursive style.

R.A. St John  
Convenor



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# 1 Introduction

*This Chapter provides background to the review, explains the review process, and summarises the conclusions reached by the Advisory Committee in response to the questions posed in the terms of reference.*

## 1.1 Coverage of report

This report reviews the personal duties and liabilities under the Corporations Act of corporate officers, employees and other individuals below board level. It puts forward recommendations to clarify, and in some circumstances to widen, the classes of persons subject to various duties and obligations and also considers other matters, including whether a general dishonesty provision should be introduced and whether additional provision needs to be made for decision-making within corporate groups.

Where changes are recommended, the aim is to address possible shortcomings in the current position below board level. The recommendations are not designed to permit directors to derogate from their responsibilities or avoid their statutory duties.

## 1.2 Background

The traditional focus of corporate law in relation to responsibility for corporate actions has been on the role of directors. In smaller companies especially, this may still reflect the way they are in fact run. However, the reality in most medium to large enterprises is that operational decision-making devolves to managers and other individuals below board level who conduct the ongoing business of the company subject to higher level supervision by the board of directors. Also, many enterprises are structured as corporate groups (see Advisory Committee *Corporate Groups Final Report* (May 2000) paras 1.1 ff, available at [www.camac.gov.au](http://www.camac.gov.au).) and are 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.

In some cases, such as the use of corporate position or information, the Corporations Act imposes obligations and liabilities for breach on directors, other officers and employees. However, not all individuals involved in carrying out the business of a company fall within these categories. Some persons who perform functions for a company may be contractors, rather than employees, of that company or may be employed by another company in the same corporate group.

The report of the HIH Royal Commission *The failure of HIH Insurance* (April 2003) (the HIH report) raised a series of questions about whether the Corporations Act fully takes into account these commercial practicalities and developments in regulating the range of individuals below board level who may be involved in running modern corporate enterprises. The report highlighted the importance of:

- taking account of modern corporate structures, particularly of large companies, where decisions may be collective and/or be made without involvement of the board
- clarifying the duties of managers, without shifting responsibility from the board
- clarifying the responsibilities of consultants in circumstances where they perform corporate functions, and
- ensuring that appropriate corporate governance standards apply throughout the company.

This Advisory Committee report considers whether changes are needed in the current regulation of persons below board level to ensure these policy goals, in particular:

- whether to extend the duties and liabilities in ss 180–184 and ss 1307 and 1309 of the Corporations Act to broader categories of persons
- whether to introduce a general dishonesty prohibition
- how to take into account the role of persons other than officers and employees, such as consultants and independent contractors, in corporate decision-making, and

- whether other changes are necessary to accommodate the decision-making processes within corporate groups.

### 1.3 Terms of reference

#### 1.3.1 HIH report

In Recommendation 2 of the HIH report, the Commissioner, the Hon. Justice Neville Owen, proposed changes to the duties and liabilities imposed by the Corporations Act on various individuals. The full text of his recommendation is as follows:

I recommend that the *Corporations Act 2001* be amended to repeal the existing legislative provisions relating to the definition of the extended classes of personnel upon whom duties are imposed by the Act and to substitute instead a definition that is clear, simple and certain of application.

The definition would focus on the function performed by the relevant person—not the classification of their legal relationship to the corporate entity—and avoid expressions such as ‘employee’ in favour of a functional orientation.

The definition would then form the basis of a regime having the following features:

- All the general duties imposed by Chapter 2D of the Corporations Act should be imposed on directors, secretaries and the wider class of personnel encompassed within the functional definition.
- The duties imposed by ss 182(1), 183(1) and 184(2), (3) of the Act should be imposed on all persons performing functions for and on behalf of corporations, whether employees or suppliers of services under contract.
- The liabilities created by s 1309 of the Act should be imposed on all persons and not be restricted to a limited class of management personnel.
- The classes of personnel prohibited from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on the company by any written law should be extended.

In putting forward Recommendation 2, Justice Owen made the following observations.

- The HIIH recommendations were not designed to reduce the liability of directors or shift responsibility to management. Rather, there is a gap in liability below board level.
- Many of the practices within HIIH found to be undesirable were undertaken by middle managers, not directors.
- In larger companies, many significant decisions are made by management without reference to the board.
- It is common for management decisions to be made on a collegiate basis.
- The current law on the liability of middle managers is unclear. Any legal regime for enforcement of corporate governance standards that does not include the acts or omissions of at least some categories of middle managers may be ineffective.
- Many persons who perform corporate functions may be consultants or contractors, rather than employees, and therefore may fall outside the Corporations Act provisions that impose duties on directors, officers and employees.
- Changes in March 2000 to the statutory duties may have resulted in some undesirable conduct (for instance, falsification of accounts) no longer constituting a breach of the relevant duty.
- There should be a general duty on all managers not to act dishonestly in their corporate capacity, regardless of their motives for so acting. For instance, managers should be liable for dishonesty, even where their actions resulted from pressure from higher corporate echelons.
- The duties owed by executives who operate within a corporate group structure should be clarified. Corporate collapses often involve complex corporate group structures. Any functional definitions of persons who should be liable may need to take into account that the 'head office' decision-makers and

functionaries who determine what group companies shall be used for certain purposes are not necessarily the directors of those companies (and also may be the employees of other group companies).

The relevant extract from the report is set out in Appendix 2 to this report.

### **1.3.2 Reference from the Government**

In May 2004, the then Parliamentary Secretary to the Treasurer, the Hon. Ross Cameron MP, wrote to the Convenor of the Advisory Committee, stating that:

In the HIH Royal Commission Final Report ('the Report'), the Hon Justice Neville Owen ('the Commissioner') suggested that the *Corporations Act 2001* ('the Act') be amended to repeal the existing legislative provisions relating to the definition of the extended classes of personnel, such as 'officers', upon whom duties are imposed by the Act and to substitute instead a definition that is clear, simple and certain of application.

In formulating Recommendation 2 the Commissioner identified four issues that required attention from the perspective of future policy direction:

- (a) correction of anomalies in the current legislation relating to directors' and officers' duties;
- (b) identification of which other officers should be subject to some or all of the current directors' duties;
- (c) identification of what duties should be imposed on some/all officers other than directors; and
- (d) clarification of the duties owed by officers serving a corporate group.

The Parliamentary Secretary pointed out that:

At the time of the Report's release, the Government noted that the uncertain state of the law could be attributed, in part, to current usages of the defined terms 'officer', 'executive officer' and 'employee' throughout the Act. There are anomalies in the legislation, notably the two

definitions of ‘officer’ in sections 9 and 82A of the Act, which have resulted in overlaps and some degree of uncertainty as to their application.

The aim of Schedule 9 of the CLERP (Audit Reform & Corporate Disclosure) Bill 2003 (‘the CLERP 9 Bill’) [since enacted] entitled ‘Officers, senior managers and employees’ is to clarify the distinct classes of personnel who have duties and obligations under the Act. The amendments are designed to ensure clear and consistent use of various terms by: correcting current anomalies in relation to the definition of ‘officer’; removing the definition of ‘executive officer’ and replacing it with ‘senior manager’; removing the definition of ‘examinable officer’; and making consequential changes as required to clearly specify the persons that are to be covered by particular provisions.

The Parliamentary Secretary requested that, in light of the CLERP amendments, the Advisory Committee consider and report on the following outstanding matters identified in the HIH report:

1. Does the approach taken by the law (incorporating the CLERP 9 Bill amendments) clearly and adequately impose sufficient duties on persons other than directors, particularly in the case of complex corporate structures where high level decision making may be performed by so-called ‘middle management’ (Part 6.4, and particularly Part 6.4.3 of the HIH Report refers)?
2. Is the definition of a wider class of personnel by reference to the term ‘employee’ and the potential exclusion of consultants and independent contractors problematic (Part 6.4.4 of the HIH Report refers)?
3. Are there particular difficulties with the application of the current provisions to corporate groups (Part 6.4.5 of the HIH Report refers)?

If difficulties are identified concerning matters 1–3 outlined above, I request that the Advisory Committee recommend the most appropriate course of action to deal with them, including possible amendments.

In considering these matters, the Parliamentary Secretary requested that:

the Advisory Committee should have regard to the Commissioner's findings, in particular the discussion of the issues in the Report, and the importance of the accountability and responsibility of the board and other senior company officers when considering whether a wider set of personnel should be subject to greater duties under the Act.

## 1.4 The review process

### 1.4.1 The Discussion Paper

In May 2005, the Advisory Committee published a discussion paper that reviewed the personal duties and liabilities under the Corporations Act of corporate officers, employees and other individuals below board level.

The Advisory Committee invited submissions on any aspect of the matters referred to in the terms of reference, including the following proposals put forward in the discussion paper:

- ss 181 and 184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation
- s 180(1) (the duty of care and diligence) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation
- as a corollary of the previous proposal, s 180(2) (the business judgment rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation
- ss 182 and 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation

- ss 183 and 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation
- s 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation
- s 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company.

The Advisory Committee also sought views on:

- whether the term ‘management’ of the corporation, for the purpose of the proposals dealing with ss 180 and 181, should be defined. If so, should the definition be along the lines of ‘activities which involve policy and decision-making related to the business affairs of a corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs’
- whether the categories of persons subject to s 1309(2) (ensuring the veracity of information) should be extended in the same manner as proposed for s 1309(1), namely to cover any other person who performs functions, or otherwise acts, for or on behalf of the corporation
- whether there is any need to define the term ‘employee’ for the purposes of ss 182–184 or ss 1307 and 1309 if the proposals to expand the categories of persons subject to those provisions were to be implemented
- whether any person who:
  - is a director, officer or employee of a corporation, or

- takes part, or is concerned, in the management of that corporation, or
- performs functions, or otherwise acts, for or on behalf of that corporation

and who makes, or participates in making, any decision that subsequently is implemented in whole or in part by a related corporation, should, in addition to the duties he or she owes to the first corporation, owe the related corporation the duties of care and diligence (s 180(1)) and good faith (s 181) in relation to that decision (with that person having the business judgment defence in s 180(2) and, where the related corporation is a wholly-owned subsidiary, the benefit of s 187)

- whether there should be a general provision prohibiting individuals from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a company by any statute. Should any such provision apply to:
  - obligations under the Corporations Act only, or
  - obligations under any Commonwealth, State or Territory statutes applicable to corporations, or
  - obligations under any overseas written laws as well as Australian laws
- whether there are any forms of behaviour of individuals below board level (not otherwise dealt with in the paper) that should be prohibited, or differently regulated, under the Corporations Act.

#### **1.4.2 Submissions in response to the discussion paper**

The Advisory Committee received submissions on the proposals and other issues in the discussion paper from the respondents who are listed in Appendix 3 to this report.

The Advisory Committee was greatly assisted in its consideration of the issues by these responses. It expresses its appreciation to all respondents for their contributions.

This report contains a brief summary of the submissions on each of the issues raised. The submissions are available at [www.camac.gov.au](http://www.camac.gov.au).

### 1.4.3 Structure of the report

Chapter 2 deals with some key Corporations Act provisions that impose duties and liabilities on individuals below board level.

Chapter 3 reviews the proposals and other issues identified in the discussion paper, taking into account the responses and other matters raised in submissions. The format adopted in discussing each proposal/issue is as follows:

- background context, including relevant extracts from the HIH report
- the analysis in the discussion paper leading to the proposal/issue
- a summary of the submissions
- a statement of the Advisory Committee's recommendation or view
- the reasons for that recommendation or view.

This report incorporates all the information and analysis found in the discussion paper and replaces that paper.

## 1.5 Conclusions reached

The Advisory Committee's response to the questions posed in the terms of reference (1.3.2 above) is as follows.

### 1.5.1 Question 1: persons subject to duties

Does the approach taken by the law (incorporating the CLERP 9 amendments) clearly and adequately impose sufficient duties on persons other than directors, particularly in the case of complex corporate structures where high-level decision making may be performed by so-called 'middle management' (Part 6.4, and particularly Part 6.4.3 of the HIH Report refers)?

The Advisory Committee considers that:

- the classes of persons subject to the statutory duties in ss 180 and 181 of the Corporations Act need to be clarified, to overcome what appears to have been an inadvertent narrowing, in consequence of amendments to the Corporations Act in 2000, of the persons subject to those provisions
- the classes of persons subject to ss 182 and 183 should be widened to reflect fully the realities of modern corporate life
- the classes of persons subject to ss 1309 and 1307 should also be widened to ensure that those provisions cover all persons who perform functions or otherwise act for or on behalf of a company.

These recommendations are intended to remedy apparent weaknesses. They are not designed to permit those who run companies to delegate their responsibilities or avoid their statutory duties, nor would they have that effect.

In this context, the Committee makes various recommendations, as analysed in Sections 3.2–3.5 of this report:

- ss 181 and 180 should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation (Recommendations 1 and 2). Also, the business judgment defence in s 180(2) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation (Recommendation 6)
- ss 199A and 199B (restrictions on indemnification and insurance) should be extended beyond an officer or auditor of the company to any other person who takes part, or is concerned, in the management of that company (Recommendation 3)
- s 187 (decision-making within wholly-owned subsidiaries) should apply to any director, officer or other person who takes part, or is concerned, in the management of a wholly-owned subsidiary. The elements of the section should be amended accordingly (Recommendation 4)

- s 189 (reliance on information and advice provided by others) should apply to any director, officer or other person who takes part, or is concerned, in the management of a corporation (Recommendation 5)
- ss 182 and 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation (Recommendation 7)
- ss 183 and 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation (Recommendation 8)
- s 1309(1) (knowingly providing false or misleading information) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation (Recommendation 9)
- s 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company (Recommendation 10)
- the categories of persons subject to s 1309(2) (ensuring the veracity of information) should be extended in the same manner as proposed for s 1309(1), namely to cover any other person who performs functions, or otherwise acts, for or on behalf of the corporation (Recommendation 11).

The Advisory Committee does not consider that the concept of ‘management’ for the purposes of the recommendations dealing with ss 180 and 181 needs to be defined in the Corporations Act.

Also, the Committee does not consider it necessary that a general dishonesty prohibition be enacted if the recommendations in this report concerning ss 180–184 and 1307 and 1309 are implemented.

### 1.5.2 Question 2: employees

Is the definition of a wider class of personnel by reference to the term ‘employee’ and the potential exclusion of consultants and independent contractors problematic (Part 6.4.4 of the HIH Report refers)?

Given the other changes recommended in this report, the Advisory Committee considers that it is unnecessary to define ‘employees’ or make any specific reference in the relevant provisions of the Corporations Act to consultants or independent contractors.

### 1.5.3 Question 3: corporate groups

Are there particular difficulties with the application of the current provisions to corporate groups (Part 6.4.5 of the HIH Report refers)?

Given the other changes recommended in this report, the Advisory Committee considers that no further amendments are needed in the context of the matters dealt with in this report to cover decision-making by corporate group executives.

## 1.6 Application to managed investment schemes

There is a question whether the recommended changes to the class of persons subject to the general duties in ss 180-183 should be extended to comparable provisions applicable to persons involved in administering managed investment schemes.

Listed and unlisted managed investment schemes are a significant part of the financial investment market. For instance, listed property trusts now comprise over 10% of the ASX 200 index.

Managed investment schemes are administered by responsible entities. Each ‘officer’<sup>1</sup> of a responsible entity is subject to various duties under s 601FD. Some of those duties are comparable to those in ss 180–183 (or their forerunner provisions).<sup>2</sup> However, other duties relate to the particular way managed investment schemes are

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<sup>1</sup> A responsible entity must be a public company: s 601FA. Accordingly, an ‘officer’ of a responsible entity is an officer of a corporation, as defined in s 9 of the Corporations Act.

<sup>2</sup> s 601FD(1)(a), (b), (d) and (e).

structured.<sup>3</sup> Likewise, each employee of a responsible entity has duties under s 601FE that are comparable to those in ss 182 and 183.

The Advisory Committee has not considered in detail whether the changes it recommends to the classes of persons subject to the general duties of corporate officers in ss 180-183 should also be made to ss 601FD and 601FE, nor has the Committee consulted with interested parties on this matter. The Committee therefore makes no recommendation in relation to these managed investment provisions.

## 1.7 The Advisory Committee

The Advisory Committee is constituted under Part 9 of the *Australian Securities and Investments Commission Act 2001*. Its functions under s 148 of that Act include, on its own initiative or when requested by the Minister, to provide advice to the Government on any aspect of corporate or financial markets law reform or any proposal to improve the efficiency of the financial markets.

The members of the Advisory Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

### Advisory Committee

The members of the Advisory Committee during the course of settling this report were:

- Richard St John (Convenor)—Special Counsel, Johnson Winter & Slattery, Melbourne. It is noted that Richard St John was Secretary to the HIH Royal Commission from 2001 to 2003
- Zelinda Bafile—General Counsel and Company Secretary, Home Building Society Ltd, Perth
- Louise McBride—Director, Grant Samuel Corporate Finance, Sydney

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<sup>3</sup> s 601FD(1)(c) and (f).

- Alice McCleary—Company Director, Adelaide
- Marian Micalizzi—Chartered Accountant, Brisbane
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, Blake Dawson Waldron, Sydney
- Greg Vickery AM—Chairman and Partner, Deacons, Brisbane
- Nerolie Withnall—Company Director, Brisbane
- the ASIC Chairman or his nominee.

### **Legal Committee**

The function of the Legal Committee is to provide expert legal analysis, assessment and advice to the Advisory Committee in relation to such matters as are referred to it by the Advisory Committee.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The members of the Legal Committee during the course of settling this report were:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Julie Abramson—General Manager, National Australia Bank, Melbourne
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Brett Heading—Partner, McCullough Robertson, Brisbane
- Jennifer Hill—Professor of Law, University of Sydney
- Francis Landels—former Chief Legal Counsel, Wesfarmers Ltd, Perth

- Laurie Shervington—Partner, Minter Ellison, Perth
- Simon Stretton—South Australian Crown Solicitor, Adelaide
- Gary Watts—Partner, Fisher Jeffries, Adelaide
- Elizabeth Whitelaw—Partner, Minter Ellison, Canberra.

### **Executive**

The Executive during the course of settling this report comprised:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thaumani Parrino—Office Manager.

## 2 Current position

*This Chapter covers some key Corporations Act provisions that impose duties and liabilities on individuals below board level. Reference is also made to some State legislative provisions.*

### 2.1 Relevant terms

The Corporations Act uses various terms to refer to corporate participants below board level.

#### 2.1.1 Officer

An ‘officer’ is defined to include a ‘director’ (as also defined in s 9) and also extends to others who may be below board level:

- (b) 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).

The extension beyond directors is relatively limited in that:

- subparagraph (b)(i) only covers persons who are involved in ‘the whole or a substantial part’ of the corporation’s business
- subparagraph (b)(ii) only covers those persons involved in the financial affairs of the company who have ‘the capacity to affect significantly the company’s financial standing’

- subparagraph (b)(iii) is confined to shadow directors (cf subparagraph (b)(ii) of the s 9 definition of director).

The current definition of ‘officer’ was introduced as part of amendments to the Corporations Act in 2000. Previously, ‘officer’, for the purpose of the forerunner of ss 180–184 (the now-repealed s 232), had been defined to include an ‘executive officer’. An ‘executive officer’ was defined in s 9 as ‘a person who is concerned in, or takes part in, the management of the body’. An analysis of the relevant case law on the elements of ‘executive officer’ is set out in Appendix 1 to this report. In 2004, the term ‘executive officer’ was repealed.

### **2.1.2 Senior manager**

A ‘senior manager’ is defined in s 9 as:

a person (other than a director or secretary of the corporation) who:

- (i) makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- (ii) has the capacity to affect significantly the corporation’s financial standing.

The use of identical tests in the definitions of ‘senior manager’ and ‘officer’ may suggest that the current definition of ‘officer’ is intended to be limited to persons in senior managerial positions, and not to cover others who may in fact be concerned, or take part, in the management of a corporation.

### **2.1.3 Other persons**

The Corporations Act uses, but does not define, the term ‘employee’. There is no reference to consultants or independent contractors, who generally speaking fall outside the common law notion of employee.

## 2.2 Grounds of liability

The Corporations Act and other statutes (for instance, the *Crimes Act 1900* (NSW) (NSW Crimes Act)) impose personal liability on various individuals below board level for their breaches of:

- internal management duties
- information disclosure duties
- financial reporting duties
- external administration duties.

In addition, ‘officers’ are subject to duties that may be imposed under other laws, including the common law: s 179.

### 2.2.1 Internal management duties

#### *Statutory duties*

Persons falling within the Corporations Act definition of ‘officer’ have the following duties under that Act (as well as equivalent common law duties):

- to exercise care and diligence, subject to a business judgment defence (s 180). This is a civil liability only
- to act in good faith in the best interests of the corporation (s 181(1)(a)—civil liability; s 184(1)—criminal liability). Directors, but not other corporate officers, of wholly-owned subsidiaries have a statutory immunity when acting in good faith in the best interests of the holding company (s 187)
- to act for a proper purpose (s 181(1)(b)—civil liability; s 184(1)—criminal liability).

Other statutory duties, which apply to employees as well as officers, are:

- not to misuse their position to gain an advantage for themselves or someone else or to cause detriment to the corporation (s 182—civil liability; s 184(2)—criminal liability)

- not to misuse corporate information to gain an advantage for themselves or someone else or to cause detriment to the corporation (s 183—civil liability; s 184(3)—criminal liability).

In relation to the duties of good faith and not to misuse corporate information or position, the relevant persons incur criminal liability if the necessary mental elements, such as dishonesty, recklessness or intention, are satisfied (s 184). This section does not define dishonesty. It differs from ss 1041F and 1041G, which define ‘dishonest’ for their purposes as ‘(a) dishonest according to the standards of ordinary people; and (b) known by the person to be dishonest according to the standards of ordinary people’.

### *Other internal management duties*

Individuals, whether at or below board level, may be liable as ‘persons involved in a contravention’ of the Corporations Act by the company. This concept, which is defined in s 79, applies to a range of provisions in the Corporations Act, including those affecting share capital (ss 254L, 256D, 259F and 260D). Involvement under the latter provisions results in a civil penalty or, if the involvement is dishonest, the commission of an offence.

Any officer of a body corporate who fraudulently misappropriates or destroys any property of that body corporate commits a criminal offence (NSW Crimes Act s 173).

Any officer who cheats or defrauds the body corporate, or acts or fails to act with intent to cheat or defraud, commits a criminal offence (NSW Crimes Act s 176A).

### **2.2.2 Information disclosure duties**

The analysis below does not extend to the disclosure and other duties and liabilities of individuals in relation to fundraising, continuous disclosure and takeovers, which have separate disclosure and liability regimes.

#### *Information about books*

An officer of a company, registered scheme or disclosing entity must allow an auditor access to the company’s books and give any required information, explanation or assistance (s 312).

### ***Information in books***

A current or former officer, employee or shareholder who engages in conduct that results in the concealment, destruction, mutilation or falsification of any books relating to the affairs of the company is guilty of an offence (s 1307(1)). It is a defence if the defendant proves (on the balance of probabilities) that he or she acted honestly and that in all the circumstances the act or omission constituting the offence should be excused (s 1307(3)).

An officer of a body corporate who, with intent to defraud, does not provide a true and sufficient entry in the company's books of any property of the body corporate in the possession of that person commits a criminal offence (NSW Crimes Act s 174).

Any officer of a body corporate who destroys, alters, mutilates or falsifies any book belonging to the body corporate with intent to defraud commits a criminal offence (NSW Crimes Act s 175).

### ***General disclosure***

A person, whether or not a corporate officer, who knowingly makes or authorises the making of a false or misleading statement in any document required under the Corporations Act or submitted to ASIC is guilty of an offence (s 1308(2)). Individuals are also liable if they fail to take reasonable steps to ensure the veracity of any relevant statement they make or authorise in any such document (s 1308(4)).

An officer or employee of a corporation who knowingly provides false or misleading information to various persons, including a director, an auditor or a market operator, is guilty of an offence (s 1309(1)). An officer or employee who fails to take reasonable steps to ensure the veracity of information so provided is guilty of an offence (s 1309(2)).

An officer of a body corporate who publishes a statement that he or she knows to be false in a material particular, with intent to deceive or defraud a member, shareholder or creditor of that body corporate, or with intent to induce a person to become a shareholder or provide property to a body corporate, commits a criminal offence (NSW Crimes Act s 176).

### 2.2.3 Financial reporting duties

A person who performs a chief executive function or a chief financial officer function in a listed entity must also provide a declaration concerning the accuracy of the financial records (s 295A).

An officer of a controlled entity must give the controlling entity all requested information that is necessary to prepare consolidated financial statements and notes to those statements (s 323). An officer is also required to provide information to and otherwise assist an auditor of the controlling entity in preparing the consolidated financial statements (s 323B).

### 2.2.4 External administration duties

#### *Duties to assist liquidator*

The liquidator of a company may require officers or former officers of the company, or other stipulated persons, to prepare a report on specified matters concerning the affairs of the company (s 475(2)).

As soon as practicable after the commencement of a winding up, an officer must deliver to the liquidator all books in that person's possession that relate to the company, other than books to which that person is entitled, and tell the liquidator where any other books are (s 530A(1)). An officer must also attend on the liquidator and give the liquidator such information relating to the affairs of the company as the liquidator reasonably requires (s 530A(2)) and give any other help the liquidator reasonably requires (s 530A(3), (4)). An officer must also, on request, inform the liquidator of his or her address (s 530A(5)).

There is also a duty on an officer, an employee and other stipulated persons to deliver money, property or books of the company in their hands when ordered to do so by a court (s 483).

#### *Liquidation offences*

Past and present officers and employees are subject to a penalty for:

- failing to disclose to the appropriate person, or concealing, various details about property of the company
- various forms of fraudulent conduct (s 590(1)).

Past and present officers and employees of a company are also liable for:

- failure to deliver books and property of the company in their possession (s 590(4))
- failure to inform the appropriate officer that a false debt has been proved (s 590(4A)).

The fault element of these offences is intentional or reckless failure to comply (s 590(4B)).



## 3 Issues from the HIH report

*This Chapter considers various recommendations in the HIH report, and other related matters, including whether to extend the duties and liabilities in the Corporations Act to additional classes of individuals below board level, whether to introduce a general dishonesty prohibition, and whether further provision needs to be made to take account of the way in which corporate groups are managed.*

### 3.1 Overview

#### 3.1.1 Terms of reference

The terms of reference ask the Advisory Committee to consider three principal issues arising from the question posed by Part 6.4 of the HIH report about whether the current legislative coverage is adequate and appropriate to regulate the diverse range of individuals who may be involved in running modern corporate enterprises:

**persons subject to duties:** does the approach taken by the law (incorporating the CLERP 9 amendments) clearly and adequately impose sufficient duties on persons other than directors, particularly in the case of complex corporate structures where high-level decision-making may be performed by so-called ‘middle management’?

**employees:** is the definition of a wider class of personnel by reference to the term ‘employee’ and the potential exclusion of consultants and independent contractors problematic?

**corporate groups:** are there particular difficulties with the application of the current provisions to corporate groups?

#### 3.1.2 Persons subject to duties

This aspect of the reference involves the consideration of a series of issues raised in the HIH report:

- what, if any, additional classes of persons should be subject to the statutory duties of good faith in s 181 and care and diligence in s 180? This is discussed in 3.2, below
- what, if any, additional classes of persons should be subject to the prohibition on improper use of corporate position or information in ss 182 and 183? This is discussed in 3.3, below
- what, if any, additional classes of persons should be subject to the prohibition on providing false information in s 1309 (and s 1307)? This is discussed in 3.4, below.

The HIH report also raises the question whether there should be a general dishonesty prohibition. This is discussed in 3.5, below.

### **3.1.3 Employees**

This aspect of the reference is discussed in 3.6, below.

### **3.1.4 Corporate groups**

This aspect of the reference is discussed in 3.7, below.

### **3.1.5 Other behaviour**

The discussion paper also raised the question whether there are any forms of behaviour of individuals below board level (not otherwise dealt with in the paper) that should be prohibited, or differently regulated, under the Corporations Act.

This matter is discussed in 3.8, below.

## **3.2 Duties under ss 180 and 181**

### **3.2.1 Background**

#### ***The HIH report***

The HIH report recommended that:

All the general duties imposed by Chapter 2D of the Corporations Act should be imposed on directors, secretaries and the wider class of personnel encompassed within the functional definition [defined by reference to a person's role in a corporation, rather than by that person's formal status].

In support of those recommendations the HIH report stated that:

Both before and after the CLERP amendments it was accepted that there is a class of personnel upon whom the general duties of directors should also be imposed.

In my opinion, that class should not distinguish between employees and non-employees. Instead, it should be functionally defined. That is because it is increasingly common for a wide range of corporate functions to be performed by consultants or other contractors who are not strictly 'employees'. In my opinion it is the performance of the relevant function that should attract the legal duty, not the precise legal relationship between the person performing that function and the relevant corporate entity. The definition which applied prior to the CLERP amendments—namely, that which embraced a person who 'is concerned, or takes part, in the management of the relevant entity'—seems to be appropriate. It should be sufficient to distinguish between those who are at the more senior levels of the organisational structure, and who should be subject to the general legal duties imposed upon directors, and those at a lower level, more properly described as functionaries, who should not be subject to all the general duties imposed upon directors.

### ***Sections 181 and 180***

Section 181 imposes duties on each director and any other 'officer' of a corporation to exercise their corporate powers and discharge their duties to the corporation in good faith in its best interests, and for a proper purpose. This is a civil penalty provision, with criminal liability arising under s 184(1) if the director or other officer is either reckless or intentionally dishonest in breaching those duties.

Subsection 180(1) imposes a duty on each director and any other 'officer' of a corporation to exercise their corporate powers and discharge their corporate duties with care and diligence. This is a civil penalty provision only. A director or other officer has a business judgment defence, as set out in s 180(2).

The s 9 definition of 'officer', as introduced in 2000, includes various categories of persons, in particular (for the purpose of this paper) anyone:

- who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation, or
- who has the capacity to affect significantly the corporation's financial standing.

The importance of these provisions in corporate regulation is reflected in the significant civil and criminal consequences for breach. For instance, the civil penalties for breach of s 181 or s 180 can include a pecuniary penalty order of up to \$200 000, compensation orders and possible disqualification from managing a corporation. The criminal penalties for breach of s 181, where the relevant fault elements in s 184(1) are established, can include up to 5 years imprisonment. A convicted person is also automatically disqualified from managing a corporation for at least 5 years.

### 3.2.2 Proposals in the discussion paper

The discussion paper set out various proposals to define the classes of persons subject to ss 180(1) and 181 in a manner that would restore the position as it was for 20 years, prior to amendments to the Corporations Act in 2000.

**DP Proposal: *persons subject to duties of good faith and proper purpose.*** Section 181 and s 184(1) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

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

### 3.2.3 Context of these proposals

#### *1980–1990*

Section 229 of the Companies Code (introduced in 1981 to replace the previous 1961 Uniform Companies Act) imposed duties on an 'officer of a corporation', including duties comparable to those now found in ss 180 and 181 of the Corporations Act.

Under s 229(5), ‘officer’ was defined to cover, in addition to various external administrators, ‘a director, secretary or executive officer of the corporation’. Section 5 defined ‘executive officer’ as ‘any person, by whatever name called and whether or not he is a director of the corporation, who is concerned, or takes part, in the management of the corporation’. A review of the pre- and post-1990 case law on the concept of ‘executive officer’ is set out in Appendix 1 of this report.

### **1990–2000**

The Corporations Law s 232 was in the same terms and applied to the same categories of persons, including executive officers, as s 229 of the Companies Code.

### **The 2000 amendments**

Sections 180 and 181, which replaced part of the old s 232, applied to a new definition of ‘officer’ in s 9, which included (in addition to directors, shadow directors and other specified office holders) a person:

- who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- who has the capacity to affect significantly the corporation’s financial standing.

The term ‘executive officer’ remained in the legislation, but was not included in the definition of ‘officer’ and therefore did not apply to ss 180 and 181.

The Explanatory Memorandum to this legislation did not refer to, or analyse, this change in definitions, though the language of the EM appeared to suggest that the only changes concerned the formulation of the statutory duties, not the categories of persons covered by those duties.

Ford, Austin and Ramsay *An Introduction to the CLERP Act 1999* (Butterworths, 2000), at 2.5, also expressed the view that no change to the class of regulated persons was intended:

It is therefore clear that Parliament has endeavoured to codify in the definition of officer the principles

emanating from judgments such as *Bracht* which define executive officer.

### **The 2004 amendments**

The definition of ‘executive officer’ was repealed in the 2004 amendments. According to the Department of Treasury *Commentary on the Draft Provisions, CLERP (Audit Reform & Corporate Disclosure) Bill* (October 2003) (the Treasury Commentary), at para 569:

the general thrust of the court judgments [on the term ‘executive officer’] was codified [in 2000] as part of the s 9 definition of ‘officer’.

This supports the view that no change to the categories of affected persons was intended in the 2000 amendments.

The Treasury Commentary also said, at para 570, that:

the concept of being ‘concerned in management’ as described by the definition of ‘executive officer’ is not easily definable, and subsequent reliance on judicial interpretation is unwelcome.

### **3.2.4 The HIH report: s 181**

The HIH report noted that the extrinsic material, including the Parliamentary debates, concerning the 2000 amendments indicated that the two limbs of the current definition of ‘officer’ (set out above) were intended to represent a statutory codification of the definition of ‘executive officer’, as determined by Ormiston J in *Commissioner for Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728. However, the report commented that:

If that is so, it seems to me that the amendment did not achieve that objective. Although some of the terminology is reminiscent of the language used by Ormiston J, the failure to include a person ‘concerned in’ management, which was considered by his Honour to have had a significant effect in expanding the scope of operation of the definition of ‘executive officer’, was a material omission.

The HIH report considered that:

the class of persons to whom the definition ‘officer of a corporation’ applied was significantly smaller than the class of persons embraced by the definition of ‘executive officer’.

On this basis, the report concluded that the statutory duties in s 181 should:

embrace a class of senior personnel engaged in management functions broader in operation and application than that embraced by the current definition of ‘officer of a corporation’.

The report recommended the return of the executive officer test, namely, any person who ‘is concerned in, or takes part in, the management’ of a corporation.

### **3.2.5 Comparable amendments to s 180**

The discussion paper pointed out that the clear intention of the current provisions is that the same categories of persons should be subject to the statutory duties of care and diligence (s 180) and good faith and proper purpose (s 181). To maintain consistency, any amendment to these categories in s 181 should also be made to s 180(1).

### **3.2.6 Submissions on proposals concerning ss 180 and 181**

Some respondents supported,<sup>4</sup> while others opposed,<sup>5</sup> the proposals to extend the classes of persons subject to ss 180 and 181.

#### ***Support***

Reasons given in support of the proposals included that:

- the increasing complexity of corporate managerial structures, or the broader diffusion of responsibilities, may lead to situations

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<sup>4</sup> ASIC, AICD (the Commercial Law Association of Australia generally supported the AICD submission), National Institute of Accountants, Chartered Secretaries Australia, Alan du Mée.

<sup>5</sup> Freehills, Law Council, Law Society of New South Wales, AARF, CPA Australia, ABA, Promina, Chamber of Commerce and Industry WA, Insurance Council of Australia.

where persons with particular corporate managerial roles or responsibilities might have a significant impact on a corporation and its stakeholders, even though they are not sufficiently centrally placed in the corporate structure to come within the current definition of ‘officer’ in s 9

- all those who accept the responsibility (and rewards) of management positions that can affect the wellbeing of a corporation should have general fiduciary duties in relation to that corporation
- the classes of persons subject to ss 180 and 181 should be the same as before the 2000 legislative amendments.

### *Oppose*

Reasons given for opposing the proposals included:

#### *Roles within companies*

- extending ss 180 and 181 in the manner suggested would change the respective roles of:
  - directors and senior executives (who can make or influence overall corporate policies or decisions), and
  - other persons below board level (who are employed merely to assist in implementing these policies or decisions).

These sections should only apply ‘to those who are both involved in a decision *and* can determine (alone or with others) the outcome of that decision’. To extend these provisions to middle management could be interpreted as permitting the law to interfere with the day-to-day conduct of business affairs and impose fiduciary duties on persons who have no capacity to determine the outcome of corporate decisions

#### *Managers*

- these persons may inadvertently become involved in a breach of duty, without their knowledge or intent. For instance, a director may instruct a middle manager to perform an action which that manager would not otherwise perform, had he or she been given all the relevant information or been in a position to investigate the circumstances

### *Dilution or shifting of responsibility*

- the proposals could provide a mechanism for delegating blame for corporate failure down the management chain, thereby diluting directors' duties. For instance:
  - 'the legislature must be cautious not to foster a climate in which directors can inappropriately delegate responsibilities to persons below board level, and thereby pass the risk of prosecution for non-compliance to those with less information, knowledge and training'
  - 'a dilution of primary duties is likely to confuse management roles within the company particularly as directors, other officers and other employees would share responsibility for the same matters'

### *Remuneration*

- the proposals may create practical problems in that officers below board level might argue that they are not adequately remunerated for the type of responsibility contemplated by the proposals

### *Cost*

- business may incur substantial time and compliance costs in accommodating the changes

### *Shareholder trust*

- an extension of s 181 will impose a duty to act for the benefit of the company as a whole on persons in whom the shareholders have not vested the same trust as directors, and potentially create uncertainty in the conduct of a corporation's affairs

### *Other regulation adequate*

- other laws (such as the *Insurance Act 1973*) impose liability on individuals below board level. Also, it would be premature to extend the statutory duties in the Corporations Act before APRA settles its prudential *Fit and Proper* and *Corporate Governance Standards* and guidance notes for APRA-regulated entities, including authorised deposit-taking institutions and general insurance and life insurance institutions

### *Disincentive*

- extending the duties is likely to act as a disincentive for individuals to take up managerial roles within an organisation

### *Contrast with Sarbanes-Oxley Act*

- the broad extension of liability contemplated by the proposals contrasts with the US Sarbanes-Oxley Act, under which only a company's chief executive officer and chief financial officer are liable for misrepresentation in relation to financial information

### *Implications for D&O insurance*

- D&O and PI insurance premiums could be forced to rise to cover the wider classes of management exposed to risk. Risks based on work done for companies by external contractors, consultants and advisers are not covered by traditional D&O insurance.

### *Counterproposal*

One respondent submitted that the proposals in the discussion paper would require major changes to longstanding corporate governance structures, policies and procedures, for instance, by requiring an extension to persons below board level of the following rights and protections available to directors and senior executives:

- access to information (for instance, board papers and management reports across the full range of the company's activities)
- procedural and administrative rights (for instance, actual and ostensible authority to bind the company and take action on its behalf, authority to direct employees and to determine outcomes and information flows, the right to attend board and committee meetings to discuss significant issues, access to independent legal advice and training, procedures for the appropriate management of conflicts)
- protections (for instance, defences such as the business judgment rule, due diligence defences in various circumstances and reasonable reliance on delegates, rights of indemnity under corporate constitutions and deeds of indemnity, deeds guaranteeing access to information).

In this context, it was submitted that, rather than review the classes of persons subject to ss 180 and 181, the range of defences available to directors in complying with their statutory duties under ss 180 and 181 (such as under ss 187 [decision-making within wholly-owned subsidiaries] and 189 [reliance on information and advice provided by others]) should be extended to all other individuals who are currently subject to those duties.

### 3.2.7 Advisory Committee Recommendations 1 and 2

**Recommendation 1.** Section 181 and s 184(1) (the duties of good faith and proper purpose) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

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

These recommendations are intended to overcome any inadvertent reduction of the class of persons subject to the statutory duties in ss 180 and 181 in consequence of the legislative amendments in 2000. They seek to put beyond any doubt that those duties do apply to all persons who have some real involvement in corporate management. Also, relevant case law, including *ASIC v Vines* (2005) 55 ACSR 617 (analysed in Appendix 1 of this report), provides useful guidance on the meaning of the concept of ‘takes part or is concerned in management’. The Advisory Committee does not consider that this concept requires further legislative elaboration.

### 3.2.8 Reasons for Recommendations 1 and 2

The functional approach taken in the now-repealed ‘executive officer’ test of ‘is concerned in, or takes part in, the management’ better reflects the nature of the modern corporation, in that the larger the corporation, the less involved the board is likely to be in its day-to-day management, with a wider group of people undertaking significant managerial functions and responsibilities. The duties in ss 180 and 181, which are central to the proper management of

companies, should apply to all persons undertaking managerial responsibilities and not be confined to directors and those holding senior executive positions.

The recommendations do not involve any departure from the classes of persons subject to the duties now found in ss 180 and 181, as applied throughout the 1980s and 1990s. Rather they seek to clarify who should be subject to those duties, in line with the apparent intended purpose of the amendments in 2000 not to change the classes of regulated persons. They will overcome any unintended reduction of the class of persons subject to those statutory duties. In this respect:

- the amendments in 2000, which introduced the current definition of ‘officer’, which applies to ss 180 and 181, appear to have inadvertently narrowed the classes of regulated persons in the following respects:
  - the requirement in one part of the definition of ‘officer’ that the person ‘makes or participates in making, decisions that affect *the whole, or a substantial part*, of the business of the corporation’ may not cover, for instance, some divisional managers whose areas of corporate responsibilities, while significant in their own right, may be less than a substantial part of the company’s overall business
  - some managers may not satisfy the alternative ‘officer’ test of a person who has ‘the capacity to affect significantly the corporation’s financial standing’
  - the definition of ‘officer’ no longer includes any reference to persons involved in policy and decision-making in relation to a corporation that ‘may have some significant bearing.... on the conduct of its affairs’ (as the test of ‘executive officer’ was interpreted by Ormiston J in *Bracht*)
  - the definition of ‘officer’ no longer includes the concept of being ‘concerned in management’
- the Department of Treasury *Commentary on the Draft Provisions, CLERP (Audit Reform & Corporate Disclosure) Bill* (October 2003) stated that the concept of being ‘concerned in management’ as described by the definition of ‘executive

officer' was 'not easily definable, and subsequent reliance on judicial interpretation is unwelcome' (para 570). A key problem at that time was the division in the case law between a narrower and a broader interpretation of what that notion involved (as summarised in Appendix 1). However, some of these issues have now been clarified by the decision of Austin J in *ASIC v Vines* (2005) 55 ACSR 617, who, at [1037] – [1056], reviewed the relevant case law on 'executive officer' and applied the broader rather than the narrower interpretation of that term, including that:

- the concept of 'management' is not confined to central management, but extends to activities involving a segment of the company's overall business. It may also cover intermediate executives who undertake managerial activities even though they are not directors and do not report directly to the board
- being 'concerned in' management has a wide application. It covers activities that involve policy and decision-making related to the business affairs of the corporation. The question is whether a person is given some measure of responsibility or some area of discretion, or the person's opinion is given some weight in the decision-making processes of management. Also, management is not confined to central management of the affairs of a company, but extends to activities involving a segment of the company's overall business
- a single instance of taking part or being concerned in management would suffice to attract the duty in relation to those activities (but not necessarily for all purposes).

In applying these principles, Austin J held at [1052] that two officers of a subsidiary company were also 'in the first layer of management' (and therefore executive officers) of the holding company through their central role in preparing the subsidiary's contribution to the profit forecast to be included in the takeover bid target response statement of the holding company. He reached this conclusion even though this was a one-off activity and not on the basis of any pattern of longer-term involvement of those two officers of the subsidiary company in the affairs of

the holding company. This case is further analysed in Appendix 1

- the recommendations only cover persons involved in some aspect of management. They are not intended to catch persons who perform purely clerical or administrative roles. Austin J in *ASIC v Vines* at [1038] considered that the following activities do not constitute management:
  - the execution of instructions by an agent while obeying orders
  - merely administrative work of the kind performed by a company secretary or accountant
  - carrying out day-to-day routine functions in accordance with predetermined policies.

The recommendations do not contemplate any change to the definition of ‘officer’ in s 9, given that this definition applies to many other provisions in the Corporations Act that this report does not review. Instead, it is proposed that the additional concept of a person ‘taking part or being concerned in management’ be added to the class of persons subject to the duties in ss 180 and 181.

In regard to matters raised in submissions opposing the proposals:

#### *Roles within companies*

- the recommendations would merely restore the law to what it was for two decades prior to 2000, not create powers or obligations for classes of persons that were unregulated throughout that period, change the relationship between directors and senior executives on the one hand and persons below board level on the other, or otherwise interfere with the day-to-day conduct of business affairs
- to confine ss 180 and 181 to ‘those who are both involved in a decision *and* can determine (alone or with others) the outcome of that decision’ would unduly narrow their application and arguably be even more restrictive than the existing ‘officer’ test that applies to these sections

### *Managers*

- ss 180 and 181 largely focus on the proper performance of functions at whatever level the relevant person operates. They do not impose duties unrelated to the officer's actual position in the company or the responsibilities which that person has for the affairs of the company. For instance, s 181 provides that directors and officers 'must exercise *their powers* and discharge *their duties* in good faith in the best interests of the corporation and for a proper purpose'. Likewise, s 180 has the same reference to 'their powers' and 'their duties', and also refers to the care and diligence 'that a reasonable person would exercise' if that reasonable person 'occupied the office held by, and had the same responsibilities within the corporation as, the director or officer'
- the argument that managers 'may become inadvertently involved in a breach of duty without their knowledge or intent' overlooks the fault elements that must be established for breach of s 181 or s 180. For instance, criminal liability for breach of s 181 requires proof that the person was 'reckless' or 'intentionally dishonest' (s 184(1))

### *Dilution or shifting of responsibility*

- the recommendations would not provide a mechanism for diluting directors' duties or delegating blame for corporate failure down the management chain. The recommendations seek to clarify the range of persons additional to directors who are subject to the duties in ss 180 and 181 by restoring the broader pre-2000 test, not reduce the classes of regulated persons, diminish their respective duties, or deny that ultimate responsibility for corporate decisions rests with the board

### *Shareholder trust*

- to restore the pre-2000 position is more likely to increase, rather than reduce, shareholder confidence that the legislation properly takes into account the nature of corporate management below, as well as at, board level. Also, the recommendations are not designed to reduce the duties or liabilities of directors

### *Other regulation*

- other laws or regulatory guidelines relevant to individuals below board level in some situations do not obviate the need to amend

ss 180 and 181, given that those sections are of general application

*Cost to companies, remuneration, disincentives*

- these concerns seem to be based on the premise that the recommendations are intended to expand markedly the range of persons subject to ss 180 and 181, rather than redress an inadvertent reduction in the classes of regulated persons under the 2000 amendments

*Contrast with Sarbanes-Oxley Act*

- the US legislation is designed for the specific purpose of ensuring the accuracy and reliability of financial information and is not directly analogous to the matters dealt with in Recommendations 1 and 2.

### 3.2.9 Advisory Committee Recommendation 3

**Recommendation 3.** Sections 199A and 199B (indemnification and insurance) should be extended beyond an officer or auditor of the company to any other person who takes part, or is concerned, in the management of that company.

### 3.2.10 Reasons for Recommendation 3

In relation to indemnification and insurance, Recommendations 1 and 2 would simply restore the position that applied for some 20 years prior to 2000. Amending ss 181 and 180 in the manner recommended will not have any insurance or indemnification impact on external contractors, consultants and advisers unless, in the particular circumstance, they are in fact taking part, or are concerned, in the management of that company.

However, Recommendations 1 and 2 will have consequences for ss 199A and 199B, which impose restrictions on the circumstances in which companies can indemnify against, exempt from or pay insurance premiums concerning various liabilities incurred by ‘an officer or auditor of the company’. These restrictions should extend to all persons subject to ss 180 and 181 in regard to any liability under those provisions.

### 3.2.11 Advisory Committee Recommendations 4 and 5

**Recommendation 4.** Section 187 (decision-making within wholly-owned subsidiaries) should apply to any director, officer or other person who takes part, or is concerned, in the management of a wholly-owned subsidiary. The elements of the section should be amended accordingly.

**Recommendation 5.** Section 189 (reliance on information and advice provided by others) should apply to any director, officer or other person who takes part, or is concerned, in the management of a corporation.

### 3.2.12 Reasons for Recommendations 4 and 5

Section 187 provides that in certain circumstances directors of a wholly-owned subsidiary are taken to act in good faith in the best interests of that subsidiary if they act in good faith and in the best interests of the holding company. In principle, this section should apply to the same class of persons as recommended for ss 181 and 180 (Recommendations 1 and 2), to protect this extended category of persons where the constitution of a subsidiary authorises them to act in the interests of the holding company and the subsidiary is not insolvent.

Section 189 provides that in certain circumstances a director may rely on information or advice provided by another person. In principle, this section should apply to the same class of persons as recommended for ss 181 and 180 (Recommendations 1 and 2). The effect would be that a manager could generally rely on information provided by directors or other managers, provided that the manager made ‘an independent assessment’ of the information by bringing his or her own judgment to bear. The Committee considers that the obligation to make an independent assessment does not necessarily require that person to obtain advice from a third party.

In contrast to ss 187 and 189, various other provisions giving rights to directors are based on the central role of directors in managing the business of a company and should not be extended to other persons.

For instance, ss 190 and 198D permit directors in certain circumstances to delegate their powers without incurring liability for

the actions of the delegate. They are facilitative provisions, aimed at directors who, under corporate law principles, have ultimate responsibility for corporate decisions, but who in practice may need to delegate some of their powers to make corporate decision-making workable. These delegation provisions are not necessary for persons below board level.

Likewise, s 198F, which gives individual directors a right of access to company books for certain purposes, reflects their right to be informed about all aspects of the affairs of a company. Persons below board level do not have the same need for access to all corporate information. Their rights of access normally stem from the terms of their employment or other contract with the corporation or the actual managerial authority and delegation rights under which they operate.

### **3.2.13 Business judgment defence proposal in the discussion paper**

The discussion paper proposed, as a corollary of extending the classes of persons subject to s 180(1), a consequential amendment to the business judgment rule in s 180(2).

**DP Proposal: *business judgment defence*.** As a corollary of extending the classes of persons subject to s 180(1), the business judgment defence in s 180(2) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

### **3.2.14 Submissions on business judgment defence proposal**

#### ***Support***

Respondents who supported the extension of the categories of persons subject to s 180(1) consequently supported the extension of the business judgment defence in s 180(2).<sup>6</sup>

One respondent favoured a business judgment defence for matters potentially dealt with under s 181(1)(a) (good faith and best interests) (though not s 181(1)(b), as courts have typically dealt

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<sup>6</sup> ASIC, AICD, National Institute of Accountants, AARF, Chartered Secretaries Australia, Alan du Mée.

strictly with aspects of ‘proper purpose’), particularly given that the concepts of ‘good faith’ and ‘best interests of the corporation’ are common to s 180 and s 181.

### *Oppose*

Respondents who did not favour the extension of the categories of persons subject to s 180(1) also expressed opposition to the proposal to extend the business judgment defence.<sup>7</sup> However, some of those respondents recognised the need to extend that defence if, contrary to their view, the categories of persons subject to s 180(1) were extended.

#### **3.2.15 Advisory Committee Recommendation 6**

**Recommendation 6.** As a corollary of Recommendation 2, s 180(2) (the business judgment rule) should be extended beyond directors and other officers of a corporation to any other person who takes part, or is concerned, in the management of that corporation.

In making this recommendation, the Committee notes that the extended application of the business judgment defence would not require all affected persons, in making business judgments, to satisfy the standards applicable to directors. Rather, the defence would be construed in the context of the position held in the corporation by each individual.

#### **3.2.16 Reasons for Recommendation 6**

Consistent with the current approach in s 180, all persons who are subject to the statutory duties of care and diligence in s 180(1) should have the benefit of the business judgment defence in s 180(2), which applies to those duties.

This extension of the class of persons covered by the business judgment defence in s 180(2) would not require them to have access to all relevant corporate information as a prerequisite to using the defence. A person’s position in the company is an integral element of that defence, which assumes that the individual’s belief that the judgment is in the best interests of the corporation is a rational one ‘unless the belief is one that no reasonable person *in their position*

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<sup>7</sup> Freehills, CPA Australia, Promina.

would hold'. Persons other than directors are not expected to have access to all corporate information.

One respondent proposed that the business judgment defence also apply to s 181(1)(a) (duty to act in good faith in the best interests of the corporation). However, s 181(1)(a) imposes a different form of duty than s 180(1). Also, the Advisory Committee Report *Sections 181 and 189 of the Corporations Act* (October 2000) pointed out that while the element of 'good faith' is common to the business judgment defence in s 180(2) and s 181(1)(a), the latter provision:

requires directors to act in 'the best interests of the corporation' [an objective test], whereas the business judgment rule only requires directors to act in what they 'rationally believe' to be in the best interests of the corporation.

To introduce a business judgment defence based on s 180(2) in the context of s 181(1)(a) may require some change to the formulation of the duty in s 181(1)(a). This raises matters of policy going beyond the terms of this review.

### 3.2.17 Definition of management

The discussion paper raised the question whether there would be a benefit in clarifying what activities come within the concept of 'management' of a corporation if the proposals to extend the classes of persons subject to ss 180(1) and 181 were adopted (see now Recommendations 1 and 2).

One option raised in the discussion paper would be to define 'management' in the Corporations Act along the lines adopted by Ormiston J in *Bracht*, for instance:

activities which involve policy and decision making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs.

That formulation would not include the restrictive requirement (found in the definition of 'officer') that the decisions must 'affect the whole, or a substantial part, of the business of the corporation'.

**DP Issue: *definition of management.*** For the purpose of the proposals concerning ss 180 and 181, should ‘management’ of a corporation be defined? If so, should the definition be along the lines of ‘activities which involve policy and decision-making, related to the business affairs of a corporation to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs’?

### 3.2.18 Submissions on defining management

Some respondents supported including a definition of ‘management’ along the lines set out in the discussion paper.<sup>8</sup> One of those respondents argued that:

- the proposed definition might make it more difficult for people who have been involved in critical decisions to escape responsibility due to technical reasons
- the caveat that the consequences of policy or decision-making should ‘have some significant bearing on the financial standing of the corporation or the conduct of its affairs’ may overcome any concern that:
  - the definition might accidentally include persons who have some minor decision-making capacity, but no real impact on the corporation itself
  - blame might be shifted from those responsible for leading the corporation to those who have been given small decision-making powers.

Other respondents opposed a statutory definition,<sup>9</sup> either because they opposed amending the classes of persons subject to ss 180(1) and 181 and therefore the term ‘management’ was irrelevant, or because they considered that the meaning of that term should remain ‘somewhat elastic’, to be appropriately interpreted by the court on the basis of the relevant facts before it.

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<sup>8</sup> ASIC, National Institute of Accountants.

<sup>9</sup> ABA, AICD, Promina.

### 3.2.19 Advisory Committee view

To leave courts to determine what conduct may come within the concept of management in particular situations is preferable to attempting an indicative or exhaustive definition in the legislation.

For instance, Austin J in *ASIC v Vines* analysed the concept of ‘management’, taking into account relevant case law and its application in practice. His Honour held that being concerned in management covers activities that involve policy and decision-making related to the business affairs of the corporation. The question is whether a person is given some measure of responsibility or some area of discretion, or the person’s opinion is given some weight in the decision-making processes of management. Also, management is not confined to central management of the affairs of a company, but extends to activities involving a segment of the company’s overall business. However, management does not include the execution of instructions by an agent while obeying orders, merely administrative work performed by a company secretary or accountant, or carrying out day-to-day routine functions in accordance with pre-determined policy. See further Appendix 1.

## 3.3 Improper use of corporate position or information

### 3.3.1 Background

#### *Sections 182 and 183*

Section 182 prohibits any director, other officer or employee of a corporation from improperly using his or her corporate position to gain an advantage for that person or someone else or to cause detriment to the corporation. This is a civil penalty provision, with criminal liability arising under s 184(2) if the behaviour is dishonest.

Section 183 prohibits any present or past director, other officer or employee of a corporation from improperly using corporate information to gain an advantage for that person or someone else or to cause detriment to the corporation. This is a civil penalty provision, with criminal liability arising under s 184(3) if the behaviour is dishonest.

According to the High Court in *Doyle v ASIC* (2005) 56 ACSR 159 at [35], the concept of ‘improper use’ in these provisions involves:

a breach of the standards of conduct that would be expected of a person in his position by reasonable persons with knowledge of the duties, powers and authority of his position ... and the circumstances of the case, including the commercial context. Such standards, expressed according to objective criteria, are ultimately stated, as necessary, by the courts.

The importance of these provisions in corporate regulation is reflected in the significant civil and criminal consequences for breach. For instance, the civil penalties for breach of s 182 or s 183 can include a pecuniary penalty order of up to \$200 000, compensation orders and possible disqualification from managing a corporation. The criminal penalties for breach where the relevant fault elements in s 184(2) or (3) are established can include up to 5 years imprisonment. A convicted person is also automatically disqualified from managing a corporation for at least 5 years.

### *The HIH report*

The HIH report recommended that:

The duties imposed by ss 182(1), 183(1) and 184(2), (3) of the Act should be imposed on all persons performing functions for and on behalf of corporations, whether employees or suppliers of services under contract.

The HIH report was critical of relying only upon the concept of ‘employee’ to give the duties in ss 182 and 183 an extended application beyond directors and other officers, arguing that:

by defining the wider class of personnel by reference to the word ‘employee’, consultants or independent contractors are excluded, notwithstanding that they may in fact be performing functions very analogous to those performed by employees. As suggested above, it seems that function rather than contractual classification is a more appropriate criterion for definition in this area.

### 3.3.2 DP proposals on ss 182 and 183

The discussion paper raised the question whether the prohibitions on improper use of corporate position or corporate information should be extended beyond directors, other officers and employees to a wider category of persons.

The discussion paper pointed out that to apply the ‘executive officer’ test in the context of ss 182 and 183 would only marginally extend the provisions, namely, to anyone who, whilst not a director, officer or employee, was nevertheless involved in the management of a company. It would not cover other persons with some functional link to the company.

A broader approach raised in the discussion paper would be to extend the prohibitions on misuse of corporate position or information to any other person who performs functions, or otherwise acts, for or on behalf of the corporation. This would ensure that these prohibitions apply to everyone who carries out some role for the company, regardless of their employment status.

The discussion paper pointed out that this approach is consistent with the general approach in the HIH report recommendations to adopt a functional test and avoids technical questions about whether a particular individual who satisfies the test is also a director, other officer or employee of the company.

**DP Proposal: *persons subject to prohibition on improperly using corporate position.*** The persons subject to ss 182 and 184(2) should be extended beyond directors, other officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

**DP Proposal: *persons subject to prohibition on improperly using corporate information.*** The persons subject to ss 183 and 184(3) should be extended beyond past and present directors, other officers and employees of a corporation to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

### 3.3.3 Submissions on the proposals

Some respondents supported,<sup>10</sup> while others opposed,<sup>11</sup> these proposals.

#### *Support*

Reasons given in support of the proposals were that:

- a person who accepts the responsibilities and rewards of a role that is functionally similar to that of an officer or employee and abuses his or her position should not be shielded by the technicalities of his or her retainer
- given the flexibility of modern corporations, it does not make sense to limit the application of ss 182, 183 and 184(2), (3) by the use of technical terms about position (such as ‘employee’)
- many companies employ consultants and contractors to do work on their behalf, providing such persons with the opportunity to make improper use of their position or knowledge.

One respondent referred to the need to ensure that affected persons cannot contract out of their statutory liability.

#### *Oppose*

Reasons given for opposing the proposals included:

#### *Underlying principle*

- there is no reason in principle why a consultant should not take advantage of information acquired by him or her in that capacity from a corporation, except:
  - in the context of insider trading in securities
  - where the information is confidential, or
  - where fraud or theft is involved

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<sup>10</sup> ASIC, National Institute of Accountants, Law Society of New South Wales, Chartered Secretaries Australia, Promina, Alan du Mée.

<sup>11</sup> AICD, Freehills, Law Council (at least in regard to proposal 4), AARF, CPA Australia, ABA.

### *Nature of the obligation*

- the nature of the obligation in s 182 is for persons not to ‘improperly use their position’. Third party contractors, for instance, do not have a ‘position’ with the corporation

### *Corporate governance questions*

- the governance provisions of the Corporations Act are designed to regulate the company and its internal administration, not any person’s dealings with a company
- it is for the officers of the company to ensure that the work done for the company is performed to standards that are in the interests of the company. That responsibility should not be able to be delegated
- extending the duties to consultants, advisers, contractors and agents may result in directors and other officers being uncertain about their responsibilities in terms of engaging specialised services. It is also unreasonable to assume that a consultant, adviser, contractor or agent would, in all circumstances, understand what is in the best interests of a company, if indeed this is how the extension of the prohibitions is to apply

### *Regulation by contract as an alternative*

- persons who fall outside the definition of director, executive officer or employee and deal with a company should be regulated by contract. Australia is a relatively small market for consulting services and the proposed extension might limit the availability of those services. Consultants are usually engaged precisely because they have gained knowledge from other companies and are invariably bound by contractual confidentiality provisions

### *Regulatory neutrality*

- independent contractors or consultants with a corporation should not be subject to different rules than those that apply to persons who deal with partnerships, trusts, government bodies or other entities
- if such offences are thought appropriate, they should be dealt with in a broader context (for example, in the *Crimes Act* or *Trade Practices Act*) so that it is the principal conduct which is

relevant, not the fact that the conduct was committed in relation to a corporation.

### ***Counterproposals***

One of the respondents who opposed the proposals nevertheless saw some logic in applying ss 182 and 183 to persons who work under a contract with a company and perform functions that are essentially similar to those performed by an employee, though not to all persons who perform any function for a company (for example, subcontractors, service providers, landlords, information providers, government agencies and regulators). That respondent also proposed extending ss 184(2) & (3) to employees of related companies, to deal with the situation where the individuals who brief the company's board and auditors are employed by a service company.

Another respondent who opposed the proposals would nevertheless support applying the prohibition on abuse of position where fraud or negligence is involved.

A further respondent proposed reintroducing the 'executive officer' definition in the context of ss 182 and 183, arguing that this would solve the problem identified in the HIH report, as it is a functional definition that applies to any person, whether or not a director, who is concerned, or takes part, in the management of the body or entity.

### **3.3.4 Advisory Committee Recommendations 7 and 8**

**Recommendation 7.** Section 182 and s 184(2) (improper use of corporate position) should be extended beyond directors, other officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

**Recommendation 8.** Section 183 and s 184(3) (improper use of corporate information) should be extended beyond past and present directors, other officers and employees of a corporation to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that corporation.

### 3.3.5 Reasons for Recommendations 7 and 8

The recommendations are designed to ensure that the prohibitions on improper use of corporate position or information operate effectively in circumstances where companies choose to use a variety of personnel arrangements, going beyond employment contracts, including outsourcing and temporary contractual arrangements. However, they retain a functional link to the company through the requirement that the person performs functions or otherwise acts for or on behalf of the company, while avoiding technical questions about whether that individual is a director, other officer or employee of the company.

The requirement to prove impropriety would reduce any opportunity for speculative or mischievous litigation (including seeking damages under s 1324(10)), simply in consequence of broadening the categories of persons subject to the prohibitions.

In regard to matters raised in submissions opposing the proposals:

#### *Underlying principle*

- the prohibitions only apply where there has been ‘improper’ use of corporate position or information. They therefore do not interfere with the lawful intellectual property or other rights of consultants or other persons acting or performing functions for or on behalf of corporations

#### *Nature of the obligation*

- the Committee does not interpret the term ‘position’ in s 182 as requiring, or being limited to, a formal designated position in the company. Recommendation 7 would apply s 182 to all persons whose position involved performing functions or otherwise acting for or on behalf of the company

#### *Corporate governance questions*

- it is difficult to see how extending the application of ss 182 and 183 to a broader class of persons acting for or on behalf of the company would result in directors and other officers being uncertain about their responsibilities in terms of engaging specialised services or somehow permit those officers to delegate their responsibilities. Also, ss 182 and 183 do not impose any duty on affected persons to have an understanding of, or to act in, the ‘best interests’ of the company. This concept

applies to s 181, which is the subject of an earlier recommendation, applicable to a narrower range of persons (Recommendation 1)

#### *Regulation by contract as an alternative*

- there are significant civil penalty and criminal consequences for breach of the current prohibitions. It would be inconsistent with that legislative policy, and could lead to anomalous results, if some persons were so regulated, while others were regulated only according to the terms of particular contracts. However, corporations could supplement the statutory obligations by entering into confidentiality agreements with particular individuals in relation to their use of corporate information or position

#### *Regulatory neutrality*

- the terms of reference of this review, and the recommendations in this report, apply only to companies and therefore do not seek to resolve the regulatory neutrality argument raised in some submissions. Also, reform of the Corporations Act should not depend on equivalent changes to legislation (much of which is State-based) or common law regulating other entities.

#### *Counterproposals*

In relation to the counterproposals, the Committee does not consider it appropriate, or in the interests of consistent, clear and enforceable legislation, to draw further distinctions between classes of persons who are or are not subject to the prohibitions, or apply the provisions more generally only where fraud or negligence is involved, as proposed in some submissions. Also, as pointed out in the discussion paper, to apply the ‘executive officer’ test in the context of ss 182 and 183 would only marginally extend the provisions, namely, to anyone who, whilst not a director, officer or employee, was nevertheless involved in the management of a company. It would not cover other persons with some functional link to the company.

#### *Contracting out*

In regard to the concern expressed in submissions about possible contracting out of statutory duties, recent case law confirms that only

the courts may relieve persons from liability for contravention of a civil penalty provision under the Corporations Act.<sup>12</sup>

### 3.4 Sections 1309 and 1307

#### 3.4.1 Background

##### *Sections 1309 and 1307*

Subsection 1309(1) makes it an offence for an officer or employee of a corporation to give certain classes of persons (stipulated in the provision) information relating to the affairs of that corporation that, to the knowledge of that officer or employee, is materially false or misleading.

Subsection 1309(2) requires an officer or employee of a corporation to take reasonable steps to ensure that information relating to the affairs of that corporation that he or she gives to certain classes of persons (stipulated in the provision) is not materially false or misleading.

Subsection 1307(1) makes it an offence for any current or former officer, employee or shareholder of a company to conceal, destroy, mutilate or falsify any books affecting or relating to the affairs of the company. A defence is set out in s 1307(3).

These provisions impose criminal liability for breach. The penalties can include up to 2 years imprisonment for breach of s 1307(1) or s 1309(2) and up to 5 years imprisonment for breach of s 1309(1). A convicted person is also automatically disqualified from managing a corporation for at least 5 years.

##### *The HIH report*

The report recommended that:

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<sup>12</sup> s 1317S, as interpreted by the High Court in *Angas Law Services Pty Ltd v Carabelas* (2005) 53 ACSR 208 at 219. See also Palmer J in *ASIC v Australian Investors Forum Pty Ltd (No 2)* (2005) 53 ACSR 305 at [30]-[32].

Under this provision, a court may exercise its power to provide relief from liability for contravening a civil penalty provision if the defendant has acted honestly and ought to be excused, having regard to all the circumstances of the case.

In relation to the power of the court to grant relief in civil proceedings under s 1318, see *ASIC v Vines* (2005) 56 ACSR 528.

The liabilities created by s 1309 of the Act should be imposed on all persons and not be restricted to a limited class of management personnel.

The report observed that:

... the liabilities in s 1309 of the Corporations Law in relation to the provision of false or misleading information to directors and auditors are imposed upon 'an officer of a corporation'. Prior to the CLERP amendments those liabilities would have extended to all employees, because of the extended definition contained in s 82A. It seems however that because the very phrase 'officer of a corporation' used in s 1309 is that now defined by s 9, the only persons now subject to the liabilities imposed by the section (other than directors or secretaries and so on) are those who make or participate in making decisions that affect the whole or a substantial part of the business of the corporation or who have the capacity significantly to affect the corporation's financial standing.

For my part, I can see no reason why the legislature would have intended to narrow the class of persons upon whom the liabilities created by s 1309 were imposed. If an employee provides information to a director or auditor which he or she knows to be false or misleading, I can see no reason why they should not be held to have contravened the law.

### ***Amendments after the HIH report***

The CLERP 9 legislation (enacted in 2004, after the release of the HIH report) extended the range of persons subject to ss 1307 and 1309 beyond directors and other officers to include employees.

The discussion paper raised the question whether these provisions should be extended beyond these three classes to a wider category of persons.

#### **3.4.2 DP proposals concerning ss 1309(1) and 1307(1)**

The discussion paper argued that the concerns arising from the HIH report could be resolved by further widening the categories of persons subject to s 1309(1), and the categories of persons subject to s 1307(1), to cover any person who performs functions, or otherwise

acts, for or on behalf of a corporation (and, with s 1307(1), persons who have so performed or acted in the past).

The discussion paper also argued that to go further and extend s 1309(1) to, say, ‘any person’ would be inappropriate, given that this extension would eliminate any requirement that the person be functionally linked to the corporation. Maintaining a functional link would prevent a possible argument that the section could apply, for instance, to a competitor of a corporation who provides false information about itself to, say, a director of the corporation. In some cases, that false information could ‘relate to the affairs’ of the deceived corporation, and therefore could come within s 1309(1). In these circumstances, the deceived corporation may have various common law and other remedies, without the need for additional regulation under s 1309(1).

**DP Proposal: *knowingly providing false or misleading information.***

Subsection 1309(1) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

**DP Proposal: *misconduct concerning corporate books.***

Subsection 1307(1) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company.

### 3.4.3 Submissions on s 1309(1) proposal

Some respondents supported<sup>13</sup> and others opposed<sup>14</sup> the proposal to extend s 1309(1) beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

<sup>13</sup> ASIC, Law Council, Law Society of New South Wales, Chartered Secretaries Australia, ABA, Promina, Alan du Mée.

<sup>14</sup> AICD, Freehills, National Institute of Accountants, AARF, CPA Australia.

### *Support*

Reasons given in support of the proposal were:

- a contractor or consultant to a company, who might not be considered an ‘employee’ and who provides false information relating to the affairs of the company to a relevant person, should not be able to escape responsibility for such misconduct because of the form of the contractual arrangements
- extending the liability to consultants or contractors acting on behalf of the company should ensure that such persons act with due care, thereby assisting the implementation of governance frameworks within companies by those charged with such responsibilities
- maintaining accurate records of a company is essential for good corporate governance.

One respondent said that s 1309(1) should not apply to the normal external adviser who merely gives advice in the ordinary course. Some extra element of connection to the corporation should be required.

### *Oppose*

Reasons given for opposing the proposal were:

#### *External consultants and professionals*

- the proposal may be too broad: while contractors may be similar to employees, the issue of external consultants and external professionals complicates the situation. Lawyers, accountants and other professionals often act for or on behalf of a client, but have different obligations than someone merely engaged by a company to do some work on its behalf. It is necessary to be careful not to include in the net of persons caught groups that are not analogous to officers and employees

#### *Ultimate responsibility*

- ultimately, the directors, officers and employees of the company must make and implement corporate decisions

### *Accessorial liability*

- the general law, including s 79 (involvement in contraventions), already provides the extended scope sought.

One respondent argued that the identified problems would be overcome if the 'executive officer' test was also applied to s 1309(1).

Another respondent who opposed the s 1309(1) proposal nevertheless proposed extending s 1309(1) to employees of related companies, to deal with the situation where the individuals who brief the company's board and auditors are employed by a service company.

### **3.4.4 Advisory Committee Recommendation 9**

**Recommendation 9.** Subsection 1309(1) (providing information known to be false or misleading) should be extended beyond officers and employees of a corporation to any other person who performs functions, or otherwise acts, for or on behalf of that corporation.

### **3.4.5 Reasons for Recommendation 9**

The recommendation would ensure that the prohibition in s 1309(1) on a person providing information relating to the affairs of a corporation that the person knows is materially false or misleading applies to all persons with a functional link to the corporation. It could not be avoided through particular contractual arrangements. For instance, an employee of company A who knowingly makes a false or misleading statement on behalf of and concerning the affairs of related company B would, in making that statement, be performing a function for company B and therefore would come within s 1309(1). The current provision would only apply if the person were an officer or employee of company B.

Also:

- s 1309(1) applies to statements made to various designated parties, including a director, auditor or trustee for debenture holders. It is not an obligation to the world. For instance, it does not oblige directors fully and candidly to answer media questions that could lead to the disclosure of confidential takeover negotiations

- the obligation in s 1309(1) only applies to information that relates to the affairs of a company and is false or misleading ‘to the knowledge of’ the relevant person. It is not an obligation always to be accurate.

Adopting the additional ‘executive officer’ test in the context of s 1309(1) would not go far enough, as that test only covers persons who are involved in the management of a company. It would not cover persons who, while they perform functions or otherwise act for or on behalf of a company, are not officers or employees of the company or are not otherwise involved in the managerial functions of the company.

In regard to matters raised in submissions opposing the proposals:

#### *External consultants and professionals*

- the fault element in s 1309(1), namely that the person providing the information relating to the affairs of the company must know that it is materially false or misleading, would protect consultants and professionals who provide corporate information in good faith and without any knowledge of its falsity

#### *Ultimate responsibility*

- s 1309(1) is a prohibition on giving corporate information known to be false or misleading, not about ultimate responsibility for corporate decision-making

#### *Accessorial liability*

- s 79 has an extended effect, but primarily only applies to persons who have been involved with someone else in a contravention. The section does not fully cover persons who have acted on their own and not in concert

#### *Employees of related companies*

- the recommendation would cover the situation where individuals who briefed the company’s board and auditors were employed by a service or other related company.

### **3.4.6 Submissions on s 1307(1) proposal**

The submissions that supported or opposed the proposal concerning the extension of the classes of persons subject to s 1309(1) took a similar approach to the proposal that s 1307(1) be extended beyond

past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company.

### *Support*

The arguments put forward by respondents for supporting the proposal concerning s 1309(1) were also given in support of the proposal concerning s 1307(1).

Other reasons given in support of the s 1307(1) proposal were:

- misconduct in relation to corporate books can result in the loss or falsification of vital evidence and records which ASIC or the external administrator of a company might require
- the keeping of accurate records is fundamental to good governance and administration
- there is no basis for differentiating between persons on the basis of their legal character: any one who has the capacity to falsify books should be regulated.

### *Oppose*

The arguments put forward by respondents for opposing the proposal concerning s 1309(1) were also given for opposing the proposal concerning s 1307(1).

Other reasons given for opposing the s 1307(1) proposal were:

### *Inappropriate extension*

- the proposal would inappropriately extend the prohibition to, for example, persons operating a storage or recycling facility to which the relevant corporation had sent 'books'

### *Accessorial liability*

- it is difficult to conceive of circumstances where 'books' had been destroyed by an independent contractor without an officer or employee of the corporation having engaged in conduct to that end. The contractor would be involved in the contravention by the officer or employee and would therefore be liable under s 79.

### 3.4.7 Advisory Committee Recommendation 10

**Recommendation 10.** Subsection 1307(1) (misconduct concerning corporate books) should be extended beyond past and present officers, employees and shareholders of a company to any other person who performs, or has performed, functions, or otherwise acts or has acted, for or on behalf of that company.

### 3.4.8 Reasons for Recommendation 10

The maintenance of books relating to the affairs of companies is central to good corporate governance and effective regulatory investigation and enforcement. The obligation not to conceal, destroy, mutilate or falsify books should apply to all persons with a functional connection with the company and not depend, for instance, on technical questions concerning whether a person is an employee of the company.

In regard to matters raised in submissions opposing the proposals:

#### *Inappropriate extension*

- s 1307(3) provides a defence that the person ‘acted honestly and that in all the circumstances the act or omission constituting the offence should be excused’. This defence would be available to, say, a third party carrying out a storage or other function on behalf of a company

#### *Accessorial liability*

- s 79 only applies to persons who are involved in a contravention with some other person. However, s 1307(1) should also cover any situation where a person functionally related to a corporation acts unilaterally.

### 3.4.9 DP issue concerning s 1309(2)

The discussion paper raised the question of whether it would be appropriate for s 1309(2) to cover the same functional class of persons as proposed for s 1309(1). Subsection (2) deals with persons having to take reasonable steps to ensure that corporate information that they give to various stipulated classes of recipients is not false or misleading.

An argument referred to in the discussion paper for not amending s 1309(2) is that it may be burdensome to extend the obligation to take reasonable steps to check the accuracy of corporate information beyond officers and employees of a corporation to all persons who perform functions, or otherwise act, for or on behalf of that corporation.

A contrary view to which the discussion paper referred was that it would not be burdensome for s 1309(2) to apply to the same classes of persons as proposed for s 1309(1), given that what would constitute reasonable steps in each particular situation would depend on the nature of the relationship between the person and the corporation.

DP Issue: *ensuring the veracity of information*. Should the categories of persons subject to s 1309(2) be extended in the same manner as proposed for s 1309(1), namely to any other person who performs functions, or otherwise acts, for or on behalf of a corporation?

#### 3.4.10 Submissions on s 1309(2)

Some respondents supported<sup>15</sup> and others opposed<sup>16</sup> extending the categories of persons subject to s 1309(2) in the same manner as proposed for s 1309(1), namely to any other person who performs functions, or otherwise acts, for or on behalf of a corporation.

##### *Support*

Reasons given in support of extending s 1309(2) were:

- a person who is retained as a contractor or consultant to a company, but who might not be considered an ‘employee’ of that company, should not be able to escape responsibility for misconduct due to contractual technicalities
- persons performing functions akin to those carried out by a director, officer or employee should be in a position to ensure the veracity of information that they are providing.

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<sup>15</sup> ASIC, Chartered Secretaries Australia, Promina.

<sup>16</sup> Freehills, Law Council, AARF, ABA.

### *Oppose*

Reasons given for opposing any change to s 1309(2) were:

#### *Cost*

- an independent contractor could not readily, or at least without incurring considerable cost, take reasonable steps to ensure that any particular information was not false or misleading

#### *Impractical*

- to require any individual who performs functions for or on behalf of the company to take reasonable steps in relation to all information would be impractical

#### *Compliance burden*

- s 1309(2) is a positive obligation, essentially requiring individuals to warrant that they have exercised due diligence in providing information to directors, auditors or shareholders: if extended to any person who performs functions for a company, it would impose an enormous compliance burden on those persons.

### **3.4.11 Advisory Committee Recommendation 11**

**Recommendation 11.** The categories of persons subject to s 1309(2) (ensuring the veracity of information) should be extended in the same manner as proposed for s 1309(1), namely to any other person who performs functions, or otherwise acts, for or on behalf of a corporation.

### **3.4.12 Reasons for Recommendation 11**

Extending s 1309(2) to any person who performs functions, or otherwise acts, for or on behalf of a corporation would ensure a consistency of approach within s 1309, while overcoming the possibility of avoidance, or inconsistent application, of the provision due to the nature of particular contractual arrangements. Also:

- the functional test in this recommendation would cover corporate group situations, such as where a person was employed by company A but provided information regarding related company B

- the obligation under s 1309(2) would only apply to persons who have some functional link to the corporation. It would not extend to independent third parties, such as media outlets, simply because they report particular corporate information
- persons supplying information could include a caveat putting recipients on notice of the extent to which they have checked the information. This may assist, for instance, an outside consulting firm that has been contracted to present corporate information
- the requirement is to take ‘reasonable steps’ to check the veracity of information, not to guarantee its accuracy. This would accommodate the role and functions of individuals in the corporation and their reasonable capacity to check the veracity of the information.

In regard to matters of cost, practicality and compliance burden raised in submissions opposing the recommendations, what would constitute reasonable steps in each particular situation would depend on various factors, such as the nature of the relationship between the person and the corporation, the circumstances in which the information was provided and for what purpose or purposes.

### 3.5 General dishonesty prohibition

#### 3.5.1 The HIH report

The HIH report recommended that:

The classes of personnel prohibited from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on the company by any written law should be extended.

In proposing a catch-all provision under the Corporations Act or otherwise, the HIH report observed that:

... an appropriate balance between the broad ambit of operation of the law prior to March 2000 [namely, the duty of honesty in the now-repealed s 232(2), which applied to all executive officers], and its unduly narrow operation now, would be a legislative provision which operated by reference to the performance of obligations imposed either by the *Corporations Act 2001* or some other statutory provision. Such a legislative provision

would catch, for example, the preparation of accounts which are required to be maintained by the *Corporations Act 2001*, and the lodgment of returns to regulatory authorities required by other legislative provisions—such as the Insurance Act, or the *Australian Prudential Regulation Authority Act 1998*. If the obligations imposed by those statutory provisions are performed dishonestly, it seems to me that whoever undertakes those dishonest acts should be liable for a contravention of the law, whatever their classification or function within the corporate organisation.

This would necessitate the introduction into the *Corporations Act 2001* of a provision which would prohibit any person from acting dishonestly in connection with the performance or satisfaction of any obligation imposed upon a corporation under either the *Corporations Act 2001* or any other written law. The objective of a provision of this type is to make it clear to people at various levels of management and not just directors and senior managers that they will be held to account for their part in dishonest conduct by or on behalf of a company.

### **3.5.2 Analysis in the discussion paper**

The discussion paper reviewed the question whether there should be a general provision, in the *Corporations Act* or elsewhere, prohibiting any person from acting dishonestly in connection with the performance or satisfaction of any obligation imposed on a corporation by any written law.

The discussion paper noted that the general dishonesty prohibition recommended in the HIH report is stated very broadly. The examples given in that report related to statutory disclosure obligations on corporations to prepare and lodge accounts or returns with, or provide other information to, regulatory authorities. However, the recommendation and commentary in that report went beyond specific disclosure requirements by referring to corporate compliance with ‘any obligation’ imposed on a corporation under the *Corporations Act* or any other written law.

The discussion paper commented that introducing a general dishonesty offence of this nature may comprehensively deal with the types of reporting and other obligations to which the HIH report refers. Corporations only act through individuals, who should be

criminally liable for any dishonesty they perpetrate in the corporate name. These persons could be prosecuted under a general dishonesty prohibition if, for instance, their conduct was not fully or appropriately covered under relevant specific legislation.

The discussion paper also outlined some possible difficulties in introducing a general dishonesty prohibition:

*Possible availability of more than one charge and perceived risks of double jeopardy*

- other legislation may already deal with this type of dishonest conduct in particular contexts, thereby raising the issue of statutory duplication. Such regulatory overlap could provide regulators with a choice of possible provisions under which to lay a charge of dishonesty, depending on the circumstances. However, it would be necessary to guard against persons being open to double jeopardy

*ASIC responsibility for enforcement*

- would ASIC have the responsibility for enforcing this provision if included in the Corporations Act? Alternatively, would or should other Commonwealth, State or Territory regulators have the right to enforce that Corporations Act provision? Regulators may need to agree on enforcement protocols to clarify these matters

*Meaning of ‘any written law’*

- is the reference to ‘any written law’ confined to Australian law? For instance, would the provision apply to an officer of a company, either incorporated or conducting business in Australia, where that company had breached an obligation imposed by an overseas written law?

*Meaning of ‘any obligation’*

- is the reference to ‘any obligation’ confined to specific obligations imposed on companies to act, such as to disclose certain information? Does the recommendation extend to obligations on companies not to breach written laws? This matter could be clarified by indicating that ‘obligation’ in this context refers to the former, rather than the latter

### *Ensuring appropriate penalties*

- a ‘catch-all’ dishonesty prohibition of the kind contemplated would need to encompass a very broad range of behaviour, with differing levels of seriousness. The penalty regime for any such offence may need to take into account that lower penalties may often be appropriate, to avoid a disproportionately large penalty applying where the specific offence was relatively minor.

The discussion paper also noted that consideration would need to be given to the constitutional aspects of any general dishonesty provision, including whether such a prohibition, if included in the Corporations Act, could extend to all State legislation that applies to a corporation.

The discussion paper also outlined another view, namely that extending the classes of persons subject to ss 180–184 and ss 1307 and 1309, together with the current obligations in s 1308, would adequately cover the circumstances raised in the HIH report, without the need for a general dishonesty offence. For instance, the current s 181 imposes generic good faith and proper purpose obligations. It is not confined either to the exercise of powers or discharge of duties under the Corporations Act or to circumstances where a person is acting pursuant to ‘any obligation imposed on a corporation’. There is an argument that a corporate officer (or anyone else coming within the extended categories proposed for s 181) who lodged, or arranged for someone else to lodge, with any regulator corporate returns or other corporate information that the person then knew to be false or misleading would breach the obligation in s 181 to act in good faith in the best interests of the corporation and for a proper purpose.

The discussion paper did not put forward a proposal, but instead sought submissions on the following issue:

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

- obligations under the Corporations Act only, or
- obligations under any Commonwealth, State or Territory statutes applicable to corporations, or

- obligations under any overseas written laws as well as Australian laws?

### 3.5.3 Submissions on a general dishonesty prohibition

#### *Support*

Some submissions supported a general dishonesty prohibition for obligations under the Corporations Act only.<sup>17</sup> One of those submissions pointed to the difficulties raised in the discussion paper in opposing the provision going beyond the Corporations Act. The other respondent considered that statutory prohibitions against dishonesty in respect of other conduct are best dealt with in the specific legislation that regulates that conduct.

ASIC and another respondent<sup>18</sup> supported a general dishonesty prohibition for all obligations other than under overseas laws (though ASIC added the caveat that it supported extension to obligations under State and Territory statutes ‘if possible under the Australian Constitution’). In taking this approach, ASIC pointed out that:

- a general dishonesty provision would assist in providing an enforcement response where there has been a significant instance of dishonesty to which the current Commonwealth prohibitions do not apply
- currently, where ASIC identifies misconduct not prohibited by Commonwealth laws, charges may be laid in accordance with general offence provisions under State law, such as general fraud offences. However, the use of State charges, sometimes in combination with Commonwealth charges, can lead to procedural complications and inevitably result in some variation in the enforcement responses available to ASIC from State to State, which is undesirable in a national regulatory regime.

ASIC said that the test for ‘dishonesty’ in the context of the provision should be clearly specified so that there is no confusion about the appropriate standard.

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<sup>17</sup> Chartered Secretaries Australia, ABA.

<sup>18</sup> Alan du Mée.

ASIC also commented on the concerns raised in the discussion paper as follows.

*Possible availability of more than one charge and perceived risks of double jeopardy*

- ASIC considered this reservation to be misconceived. A particular instance of misconduct might already be prohibited by a number of sections. Prosecutorial authorities routinely have to consider which of a number of possible charges is most appropriate. The Commonwealth Director of Public Prosecutions (DPP) has published his approach to these decisions in the Prosecution Policy of the Commonwealth. There are several systemic safeguards against double jeopardy and the legal principles in relation to this are clear.

*ASIC responsibility for legislation that ASIC does not administer*

- ASIC suggested that a general dishonesty provision should appear in the Commonwealth Criminal Code, rather than in the Corporations Act. ASIC would thereby have no particular responsibility in relation to breaches occurring beyond its regulatory horizon (that is, by persons who were not directors or corporations).

*Ensuring appropriate penalties*

- ASIC noted that the discussion paper raised the perceived need to ensure that the penalty regime recognises that the offence will cover contraventions of varying degrees of seriousness. There are already general offence provisions that apply in this way. Such general offences often attract fairly high maximum penalties, but the courts have, and are experienced in exercising, a discretion to impose a lesser penalty if appropriate. The Prosecution Policy of the Commonwealth sets out the approach of the DPP where misconduct may be covered by both a general offence, with a high maximum penalty, and a specific offence, with a lower maximum penalty.

*Oppose*

No submission supported introducing a general dishonesty prohibition covering obligations under overseas laws as well as Australian laws.

Most submissions that commented on this matter opposed a general dishonesty prohibition in its entirety.<sup>19</sup> However, one respondent said that if, contrary to its advice, a general dishonesty prohibition were adopted, it should only apply to obligations under the Corporations Act.

Some of these submissions referred to the problems raised in the discussion paper in opposing a general dishonesty prohibition. Additional reasons were also put forward for opposing the prohibition, including:

- the other proposals in the discussion paper should be sufficient, without the need for such a general dishonesty prohibition
- to avoid duplication, a person who has dishonestly breached a law should be charged with that breach, not some 'catch-all' charge
- offences on the part of officers or employees relating to specific statutory obligations should be dealt with in the particular legislation concerned, to allow the policy issues related to the particular legislation to be taken into account when determining the nature and extent of liability
- the responsibility for enforcement should rest with the individual regulator in question, rather than placing a further level of regulatory responsibility on ASIC and possibly blurring lines of regulatory responsibility
- the trend in overseas legislation (for instance, the US Sarbanes-Oxley Act) is to focus on higher level executives, rather than impose general dishonesty requirements
- the prohibition is too broad and ill-defined
- it places many additional people in the position of potentially breaching laws they do not know exist
- there may need to be a defence for junior personnel who act on direct orders from senior management or the board and whose fear of losing their job is likely to be high and understanding of

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<sup>19</sup> AICD, Freehills, Law Council of Australia, National Institute of Accountants, Law Society of NSW, AARF, Promina.

the legal consequences of what they are doing low; it would be unfair and inequitable to expose these persons to charges similar to those faced by senior management.

#### **3.5.4 Advisory Committee view**

The notion of a general dishonesty offence has some attraction. In addition to the arguments that have been put forward in submissions in support, such a provision could help underpin the principle of honesty in relation to meeting compliance standards as a fundamental corporate governance standard, applicable to everyone within a corporation. Also, some of the concerns about such a provision may not have fully taken into account the requirement to prove ‘dishonesty’.

However, notwithstanding the possible benefits of a general dishonesty prohibition, the Committee does not consider it necessary that such a prohibition be enacted, taking into account that:

- the recommendations in this report would deal with many of the problems identified in the HIH Royal Commission report
- the full implications of a general dishonesty prohibition, in either the Corporations Act or the Commonwealth Criminal Code, would be difficult to gauge.

### **3.6 Employees and others**

#### **3.6.1 Terms of reference**

The terms of reference posed the following question:

Is the definition of a wider class of personnel by reference to the term ‘employee’ and the potential exclusion of consultants and independent contractors problematic?

#### **3.6.2 Analysis in the discussion paper**

The discussion paper reviewed that question in terms of two issues:

- whether the Corporations Act should define the term ‘employee’ for the purpose of the provisions under review that refer to this term (namely ss 182, 183, 184, 1307 and 1309)

- in what circumstances, if any, is it also necessary to make specific provision for a broader class of persons, such as consultants and independent contractors?

The discussion paper pointed out that ss 182–184, 1307 and 1309, like many other provisions in the Corporations Act that apply to ‘employees’, do not define that term. The lack of a statutory definition means that whether particular persons in a position analogous to that of employees are subject to those provisions can turn on the application of common law tests to distinguish between employment under a contract of service and provision of services under other, non-employee, contractual arrangements. As pointed out by WorkCover NSW in *Definition of a Worker* (January 2005):

Many of the common law tests rely on evidence that is unknown or yet to be established at the commencement of a contract, which makes it difficult to determine the contractor’s status in advance. Also, a contractor’s status cannot necessarily be determined by the terms of the contract, as courts will look at the whole circumstances of the relationship between the parties when deciding whether an employment relationship exists (at 9).

The discussion paper noted that the proposals to extend ss 182–184, 1307 and 1309 to anyone who performs functions, or otherwise acts, for or on behalf of a corporation (see now Recommendations 7–11) may obviate the need for any definition of ‘employee’ for the purpose of those sections or any specific provision for consultants and independent contractors. Any person who so performs or acts (whether or not an employee, a consultant or an independent contractor) would be covered.

Given this, the discussion paper sought submissions on the following issue:

**DP Issue.** Is there any need to define the term ‘employee’ for the purposes of ss 182–184 or ss 1307 and 1309 if the proposals to extend the classes of persons to whom they apply are implemented?

### 3.6.3 Submissions on defining the term 'employee'

#### *Support for definition*

One respondent<sup>20</sup> suggested that the definition of 'employee' in Accounting Standard AASB 1028 'Employee Benefits' may provide a useful starting point:

Employee means a natural person (including a director) appointed or engaged under a contract for services who is subject to the direction of an employer in respect of the manner of execution of those services, whether on a full-time, part-time, permanent, casual or temporary basis.

#### *Oppose definition*

All other submissions on this matter opposed defining 'employee' in the Corporations Act.<sup>21</sup> Reasons included:

- the other proposals in the discussion paper reduce any need for a definition of 'employee'
- the Corporations Act and its predecessors reaching back to the Uniform Companies Act have used the word 'employee' without attempting to define it, and without giving rise to any obvious difficulty
- the common law tests for distinguishing between a contract of service and a contract for services are adequate
- it would be difficult to reach a consensus view on the definition, given that it would have to deal with the constantly changing structure of corporations and the way they do business
- attempting to go further than the definition in s 596AA (a person who is or has been an employee of the company) risks excluding some persons who might otherwise have been caught.

One of the submissions that opposed a definition said that, if a definition were introduced, it should be based on functionality and

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<sup>20</sup> AARF.

<sup>21</sup> ASIC, Chartered Secretaries Australia, AICD, Freehills, National Institute of Accountants, Promina.

integration within the corporation rather than titles, positions or strict criteria.

### **3.6.4 Advisory Committee view**

The Advisory Committee does not consider it necessary to define the term ‘employee’ in the Corporations Act, given that the functional approach to defining relevant persons in Recommendations 7–11 does not depend on establishing whether someone is an employee of the company.

## **3.7 Corporate groups**

### **3.7.1 Terms of reference**

The terms of reference pose the following question:

Are there particular difficulties with the application of the current provisions to corporate groups?

### **3.7.2 Summary of HIH report**

The HIH report referred to the common practice of corporate groups being managed as an integrated enterprise, with group executives making decisions affecting, or on behalf of, a particular group company, notwithstanding that they may not be employed by that company nor previously have made any decision on its behalf:

The reality of modern public companies is that they are managed and controlled at a group level ... with executives often employed by a subsidiary once or twice removed from the main listed entity. With some of the transactions I inquired into, a consideration of the separate legal existence of a subsidiary arose almost as an afterthought as the relevant transaction was being finally documented. Serious issues could arise (and did during the inquiry) under the current legislation as to whether the executive in question, who was neither employed by the company that became a party to the transaction and who had never previously made any particular decision concerning that individual company, nevertheless owed it the duties specified in ss 180–184. A further question is whether their actions were capable of constituting a breach of the duties they might owe to the company employing them, or perhaps to the ultimate holding company of the group.

### 3.7.3 Analysis in the discussion paper

#### *General principles*

The discussion paper reviewed the question whether any amendments are necessary to ensure that corporate group executives are properly subject to the duties in ss 180–184, taking into account that a corporate group may be treated by these persons as a unitary economic enterprise, functioning to further the interests of the group as a whole or the interests of the parent company.

The discussion paper pointed to a distinction between:

- (i) the duties and liabilities of group executives making decisions concerning a group company (whether or not they are formally directors, officers or employees of that company), and
- (ii) the duties and liabilities of those who are formally appointed as directors of that group company, but did not participate in that decision-making.

The HIH report and this analysis focus on persons in category (i). Persons in category (ii) would not be free of liability merely because they did not participate in decisions concerning their group company. Those non-participating directors would remain subject to the duties in ss 180–184 in relation to that group company.

In regard to persons in category (i), the HIH report pointed out that it is not uncommon for one company in a corporate group to employ all the persons working for that group or to engage all independent contractors or consultants for the group. Individuals employed or contracted by one group company may nevertheless make decisions for other companies within that group.

In some circumstances, a group executive may be a de facto director or officer of group companies for which he or she has made a decision in that:

- ‘director’ is defined under s 9 to include anyone who, while not validly appointed as a director, nevertheless acts in the position of a director

- ‘officer’ is defined under s 9 to include anyone who:
  - makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation, or
  - has the capacity to affect significantly the corporation’s financial standing.

An individual who is a de facto director or officer of a group company is subject to the duties in ss 180–184 in relation to that company.

An individual may also be a director or officer under the s 9 definitions where ‘the directors of the company are accustomed to act in accordance with the person’s instructions or wishes’ (other than anyone performing professional advisory functions). This test requires a course of conduct and would not cover once-only or rare situations of decision-making by a corporate group executive in regard to a particular group company.

### ***Relevance of other proposals***

The discussion paper pointed out that its proposals (as now reflected in the recommendations of this report) can apply to group executives who make decisions concerning another group company. The proposals extend to ‘any person taking part or being concerned in the management of a corporation’ or anyone who ‘performs functions, or otherwise acts, for or on behalf of a corporation’. They do not require that a group executive be a director, officer or employee of that corporation.

### ***The issue***

The discussion paper posed the question whether further amendments are needed to cover corporate group executives either making a one-off decision regarding a particular group company or making a general commercial decision for the corporate group, but without considering which of the subsidiaries will be used to implement that decision.

**DP Issue.** Should there be a provision to the effect that where any person who:

- is a director, officer or employee of a corporation, or
- takes part, or is concerned, in the management of that corporation, or
- performs functions, or otherwise acts, for or on behalf of that corporation

makes, or participates in making, a decision that is implemented in whole or part by a related corporation, that person, in addition to the duties he or she owes to the first corporation, will also owe the related corporation the duties of care and diligence (s 180(1)) and good faith (s 181) in relation to that decision? If this proposal is adopted, that person should have the business judgment rule defence in s 180(2). Also, where the related corporation is a wholly-owned subsidiary, that person should have the benefit of s 187.

The discussion paper also raised the question, if this proposal is not supported, of what, if any, alternative proposal should be adopted to deal with the concern raised in the HIH report.

### **3.7.4 Submissions on corporate group executives**

Some submissions supported,<sup>22</sup> but most opposed,<sup>23</sup> any further amendment to cover corporate group executives.

#### ***Support***

Reasons given for supporting a further amendment included:

- the law must recognise the reality of the increasing use of intricate corporate group structures and the tendency of executives to make decisions for these groups as a whole, rather than on a company-by-company basis
- it might be difficult to establish that executives who make a decision in the interests of the corporate group as a whole (for instance, that a particular transaction should occur), without

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<sup>22</sup> ASIC, Alan du Mée.

<sup>23</sup> Freehills, Law Council of Australia, National Institute of Accountants, Chartered Secretaries Australia, ABA, Promina.

considering which group company should be a party to this transaction, are officers of the particular company that ultimately takes part in the transaction. This might require the prosecution (or ASIC in civil proceedings) to establish that the executives are officers of a corporation of which they might not even be aware and which they certainly may not have consciously considered at the time the decision was made. Even the broader duties contemplated in the proposals concerning ss 181 and 180(1) (see now Recommendations 1 and 2) might not cover this situation.

One of the submissions supporting further amendment acknowledged that a provision of the nature referred to in the issue raised in the discussion paper may result in a divergence between the interests of the group and the potential interests of individual companies that might be called upon to implement decisions. However, it considered that the executives making the decisions should deal with that misalignment of interests to avoid a conflict.

### *Oppose*

These submissions gave the following reasons:

- the current definition of ‘officer’ deals adequately with situations that should be covered, in particular, where a director, officer or employee of a group service company ‘makes or participates in making decisions that affect the whole or a substantial part of the business’ of another group company or ‘has the capacity to significantly affect ...the financial standing’ of that group company
- the directors of a corporation are entitled to delegate functions to any person, including a service company, but may not abdicate their responsibility for performing those functions. Accordingly, directors have an obligation under the current law to manage the company and are required to supervise services provided by other group companies
- the reforms in the proposals (see now the recommendations in this report) would be adequate
- any provision along the lines suggested would be complex and confusing.

However, some submissions suggested alternative ways for dealing with corporate group issues:

- extend ss 184(2), (3) and 1309(1) to employees of related companies, to deal with the situation where the individuals who brief the company's board and auditors are employed by a service company
- widen ss 588V and 588W (recovery of compensation for loss resulting from insolvent trading) along the lines originally suggested by the ALRC
- make the following changes to the definition of 'officer':
  - combine subparagraphs (b)(i) and (ii) of that definition and slightly amend it to refer to 'a person who makes, or substantially participates in making, decisions that significantly affect the business affairs or financial standing of the corporation'
  - confirm that the officer is an officer of any corporation that is affected by the decision
  - confirm that that definition is not limited by the existence of the definition of 'senior manager'.

### 3.7.5 Advisory Committee view

The Advisory Committee *Corporate Groups Final Report* (May 2000) pointed to the key commercial role of corporate groups and the economic and business benefits that the group structure offers. It is important that these groups be properly regulated and that individuals involved in managing them not avoid personal responsibility by relying on the formalities of the group structure.

The Committee considers that, in relation to the matters raised in the current review, no additional recommendation is needed to cover corporate group executives in view of the analysis at 3.7.3, above, the other recommendations in this report and relevant case law, in particular:

- *ASIC v Adler* (2002) 41 ACSR 72 at [71]-[75], in which Santow J held that the defendant, as a member of the parent company's investment committee, was also an 'officer' of a

wholly-owned subsidiary, given that, under the particular corporate group structure, decisions of the committee clearly affected ‘the whole or a substantial part’ of the business of the subsidiary. Likewise, the defendant, as a member of the parent board, was also an ‘officer’ of the subsidiary by virtue of his capacity to ‘affect significantly’ the financial standing of the subsidiary

- *ASIC v Vines* (2005) 55 ACSR 617 at [1052], in which Austin J held that two officers of a subsidiary company were also ‘in the first layer of management’ (and therefore executive officers) of the holding company through their central role in preparing the subsidiary’s contribution to the profit forecast to be included in the takeover bid target response statement of the holding company. He reached this conclusion even though this was a one-off activity and not on the basis of any pattern of longer-term involvement of those two officers of the subsidiary company in the affairs of the holding company.

These outcomes reflect the manner in which corporate groups may be managed in practice, while ensuring that individuals cannot avoid duties and obligations through the technicalities of their particular employment relationships within a corporate group.

### 3.8 Other behaviour

#### 3.8.1 The issue

Chapter 2 of this report outlines a range of Corporations Act provisions applicable to persons below board level. They include:

- internal management duties
- information disclosure duties
- financial reporting duties
- external administration duties.

These provisions include, but also go beyond, those raised for review in the HIH report and already dealt with in this report.

The discussion paper asked the following question:

DP Issue: *other behaviour*. Are there any forms of behaviour of individuals below board level (not otherwise dealt with in this paper) that should be prohibited, or differently regulated, under the Corporations Act?

### 3.8.2 Submissions on other behaviour

No submission identified any other forms of behaviour that should be prohibited.

However, two submissions considered that there should be whistleblower protection additional to that provided in ss 1317AA–1317AE.<sup>24</sup>

### 3.8.3 Advisory Committee view

The Advisory Committee does not propose any further changes in this review, and in that context considers that any questions concerning the adequacy of the whistleblower provisions are outside the ambit of this review.

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<sup>24</sup> National Institute of Accountants, Alan du Mée.



## Appendix 1 Meaning of 'Executive officer'

The Corporations Act definition of 'executive officer', prior to its repeal in 2004, covered any individual who is 'concerned in, or takes part in, the management' of a corporation.

### Summary

The concept of being concerned in or taking part in the management of a company was considered in the leading decision of Ormiston J in *Commissioner for Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728.

Some subsequent cases considered the notion of taking part in management in the context of the insolvent trading provisions, at a time when personal liability for insolvent trading extended beyond directors to any other person who 'took part in the management of the company' (repealed s 556: see now s 592). In that context, the courts narrowly interpreted the notion of taking part in management by confining it to persons whose corporate managerial role may be likened to that of a director: *Holpitt Pty Ltd v Swaab* (1992) 6 ACSR 488 at 491, *Sycotex Pty Ltd v Baseler* (1994) 13 ACSR 766 at 782, *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1 at 66. The current provision imposing personal liability for insolvent trading (s 588G) is confined to directors.

Cases outside the area of insolvent trading have given the concept of being concerned in or taking part in management a wider interpretation. For instance, Santow J in *Forkserve Pty Ltd v Jack and Aussie Forklift Repairs Pty Ltd* (2001) 19 ACLC 299 at 312 ruled that the concept should be given a wide definition to include activities involving some responsibility and participation in the decision-making processes of the company, other than routine clerical or administrative duties associated with management. Likewise, a credit controller was held to be an 'executive officer' for the purpose of signing a statutory demand: *Hornet Aviation Pty Ltd v Ansett Australia Ltd* (1995) 16 ACSR 445 at 447. Also, authorising a person to use company cheques was evidence that the person giving the authority (who held the corporate title 'financial controller') took

part in the management of the company: *ASIC v Parkes* [2001] NSWSC 377, para 84.

In *ASIC v Vines* (2005) 55 ACSR 617, Austin J at [1037]-[1056] considered the elements of 'executive officer' in the context of a corporate group and adopted the wider interpretation.

## Elements of the term

An executive officer was any person who 'is concerned in, or takes part in, the management' of a corporation.

## Management

In *Bracht*, Ormiston J considered that:

the concept of 'management' ... comprehends activities which involve policy and decision making, related to the business affairs of a corporation, affecting the corporation as a whole or a substantial part of that corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs (at 733–734).

His Honour found it unnecessary to reach any conclusion on whether management must be confined to the central direction of the company's affairs, though he doubted that the term must necessarily be confined in that way.

It is the management of the corporation which is the subject of the prohibition. Thus, although the decisions of a branch manager, subject to predetermined restrictions, may not be comprehended, there are those involved in large, discrete parts of a corporation's business, who, although not participating in the central administration of that corporation, nevertheless are involved in its management to the extent that their policies and decisions have a significant bearing on its business and its overall financial health (at 734).

In *ASIC v Vines*, Austin J at [1038] stated that the following activities do not constitute management:

- the execution of instructions by an agent while obeying orders

- merely administrative work performed by a company secretary or accountant
- carrying out day-to-day routine functions in accordance with predetermined policy.

His Honour then considered:

- (i) *segment responsibilities*: whether 'management' is confined to central management of the affairs of the company or whether it extends to activities involving a segment of the company's overall business (such as production, sales or trading), and
- (ii) *intermediate executives*: whether 'management' may cover corporate officers who are not directors and do not report directly to the board.

### ***Segment responsibilities***

Austin J in *ASIC v Vines* at [1040] noted that Ormiston J in *Bracht* doubted that 'management' should be confined to 'central management'. Austin J at [1041] quoted with approval the following observations of Ormiston J:

... Thus, although the decisions of a branch manager, subject to predetermined restrictions, may not be comprehended, there are those involved in large, discrete parts of a corporation's business, who, although not participating in the central administration of that corporation, nevertheless are involved in its management to the extent that their policies and decisions have a significant bearing on its business and its overall financial health (at 734).

Austin J contrasted this broader approach of Ormiston J in *Bracht* with the narrower approach of Burchett J in *Holpitt* who appeared to equate management with central management. Burchett J considered that 'management' extends to a delegate of the board with 'full discretion to act independently' or a person who has 'the management of the whole affairs of the company' or who is 'entrusted with power to transact the whole of the affairs of the company'.

In adopting the approach of Ormiston J in *Bracht*, Austin J concluded:

In my view Ormiston J's decision in *Bracht* should be followed ... in preference to Burchett J's approach in *Holpitt*. In this statutory context, the purpose of the definition of 'executive officer' is to identify, among those who work for the corporation, that group whose responsibilities are significant enough to justify the imposition of special statutory duties. It would be very odd if, say, the national sales manager of a major listed corporation, whose dishonesty or disloyalty or negligence could cause very substantial harm to the corporation, were not an 'executive officer' subject to the statutory duties because his or her responsibilities were limited to the sales segment of the business, in circumstances where the statutory duty clearly applies to the company secretary. In *Holpitt*, Burchett J was concerned [about] the potential unfairness of making a company executive responsible for debts which he or she had no role in incurring. The problem does not arise in the present context, where the issue is intrinsically confined to assessing the proper discharge of the executive's own responsibilities in his or her position in the corporation (at [1049]).

### *Intermediate executives*

In *ASIC v Vines*, Austin J at [1051] noted that Ormiston J in *Bracht* considered that, in the case of a large company, management activities may be undertaken even by persons who are not directors or who do not communicate directly with the board (the broader view). His Honour also noted that Burchett J's approach in *Holpitt* might suggest that only directors and those executives who communicate directly with the board fall within the concept of management (the narrower view).

Austin J at [1052] found it unnecessary to decide the matter, given his conclusion that, on either view, the defendants in the case before him were involved in management.

### **'Concerned in' and 'takes part in' management**

According to Ormiston J in *Bracht* (at 734), the expression 'takes part in':

both connotes and proscribes the active participation of a ... person in the management of a corporation. Such participation would have to be real and direct, but not necessarily in a role in which ultimate control is exercised, although it would have to be more than the administrative carrying out of the orders of others responsible for a company's management.

Ormiston J in *Bracht* (at 735–736) said that the expression 'concerned in' has a much wider operation than 'takes part in'. It covers:

a wide range of activities relating to the management of a corporation, each requiring an involvement of some kind in the decision-making processes of that corporation. That involvement must be more than passing, and certainly not of a kind where merely clerical or administrative acts are performed. It requires activities involving some responsibility, but not necessarily of an ultimate kind whereby control is exercised. Advice given to management, participation in its decision-making processes, and execution of its decisions going beyond the mere carrying out of directions as an employee, would suffice.

In *ASIC v Vines*, Austin J at [1054] quoted Ormiston J in *Bracht* in support of his conclusion that being 'concerned' in management has a much wider operation than the concept of 'taking part in' management:

The idea of being 'concerned' in management was held by Ormiston J to have 'a much wider operation' [than 'taking part in' management], connoting 'participation at a variety of levels and at differing intensities', some of which 'may be relatively modest'. It covered 'a wide range of activities relating to the management of a corporation, each requiring an involvement of some kind in the decision-making processes of that corporation'. Merely clerical or administrative activities would be insufficient. 'It requires activities involving some responsibility, but not necessarily of an ultimate kind whereby control is exercised. Advice given to

management, participation in its decision-making processes, and execution of its decisions going beyond mere carrying out of directions as an employee would suffice.

Austin J also noted at [1054] that, according to Ormiston J in *Bracht*, the question is whether the defendant:

is given some measure of responsibility or some area of discretion, or ... his opinion is given some weight in the decision-making processes of management.

Austin J also noted that Ormiston J's approach to the expression 'concerned in ... management' was accepted by the New South Wales Court of Appeal in *Forge v ASIC* (2004) 52 ACSR 1 at [200].

## Appendix 2 Extract from the HIH report

The extract below includes the matters that form the basis of the reference.

### **6.4 Officers other than directors**

Reference was made earlier to the role of management as a component of a company's governance systems. It is customary in such discussions to focus upon the role of senior or executive level management. But elsewhere in this report I have remarked upon the significant role played by HIH employees who would be described as 'middle management' in practices that I have found to be undesirable. As I remark elsewhere, I have been frustrated by the disinclination of those persons to accept responsibility in relation to such practices. The uncertain state of the law in this area has been a source of difficulty in my assessment of those cases where there might have been a breach of the law that might be referred for further consideration by relevant authorities.

Because of the complex corporate structure of the HIH group, many of the senior executives were in fact directors of subsidiary companies within the group. However, this proved to be of limited significance in the identification of the legal duties to which they were subject because the acts and omissions which were in question were not, in the main, undertaken by them in their capacity as directors of subsidiary companies.

I have therefore had occasion to review the current legal regime governing the duties imposed upon persons other than directors. These issues seem to me to be of considerable significance, because it is clear that in larger companies many significant decisions are made by management without reference to the board. It follows that any legal regime for the enforcement of corporate governance standards that does not extend to the acts or omissions of at least some levels of management is unlikely to be wholly effective.

The evidence I have heard also suggests that it is common for management decisions to be made on a

collective or collegiate basis, or at least after interaction with other managers. There is therefore an opportunity for the law significantly to influence the mind-set or culture of those managers, and reinforce their obligations to the company and its shareholders.

In considering the current legal regime pertaining to the duties imposed upon persons in corporate roles other than directors, I have identified four issues which merit attention from the perspective of appropriate policy direction for the future. Those issues are:

- the correction of what appear to me to be anomalies in the current legislative structure pertaining to directors' duties
- the identification of which other officers ought be subject to some or all of the legal duties imposed upon directors
- the identification of what duties should be imposed upon the class or classes of officers other than directors
- clarification of the duties owed by officers serving a corporate group.

#### **6.4.1 Anomalies in the existing legislation**

In order to explain what I consider to be some anomalies in the existing legislative provisions relating to the duties imposed upon officers of corporations other than directors it is necessary to set out briefly the history of those provisions.

##### *The law prior to March 2000*

Prior to the CLERP amendments which came into effect in March 2000 the Corporations Law identified two classes of personnel: 'executive officer' and 'officer'.

Executive officer was defined as follows:

In relation to:

- (a) a body corporate; or
- (b) an entity within the meaning of Parts 3.6 and 3.7;

means a person by whatever name called and whether or not a director of the body or entity, who is concerned, or takes part, in the management of the body or entity.

The expression 'officer' was defined by s 82A, also by reference to either a body corporate or an entity within the meaning of Parts 3.6 and 3.7 and, significantly, included 'employees'.

Prior to March 2000 the general duties imposed upon personnel acting on behalf of corporate entities were those imposed by s 232. That section contained its own definition of 'officer', which by s 232(1) meant, amongst other things, 'director, secretary or executive officer'. Thus, for the purposes of the section, the word 'officer' included the statutory office holders, such as directors or secretaries, and also persons who were 'concerned, or took part, in the management' of the corporate entity. Because all the duties imposed by s 232 were imposed upon 'officers' as defined by that section, for the purposes of those duties no distinction was drawn between directors, secretaries or those who were concerned, or took part in, the management of the entity. In addition, one of the duties imposed by the section, namely the duty not to make improper use of position to gain advantage or cause detriment to the corporation, was imposed upon both officers (as defined) and employees, with the result that that duty applied to all personnel employed by the corporate entity, whether engaged in management functions or not.

It is also necessary to note that the duties imposed by s 232 were imposed in respect of 'a corporation' whereas, as I have pointed out, both 'executive officer' and 'officer' were defined by reference to 'a body corporate' or an entity within the meaning of Parts 3.6 and 3.7. However, it seems that nothing was thought to turn upon this distinction, because s 57A defined 'corporation' to

include any body corporate. 'Body corporate' was in turn defined in s 9 in an inclusive rather than an exclusive way.

The identification of the class of persons who fell within the definition of 'executive officer' was considered by Ormiston J in *Commissioner for Corporate Affairs v Bracht* (1989) VR 821. In that case his Honour considered what was meant by the expression 'management' in the definition of 'executive officer' and concluded that it should be regarded as encompassing:

Activities which involved policy and decision making, relating to the business affairs of a corporation, affecting the corporation as a whole or a substantial part of that corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs (at 830).

Ormiston J then went on to consider the meaning to be given to the expressions 'concerned in' and 'takes part in' and concluded that the former had a significantly wider ambit of operation than the latter, but nevertheless still required an involvement of some kind in the decision-making processes of the corporation. His Honour expressed the view that the degree of involvement had to be 'more than passing' and not merely clerical or administrative. On the other hand, in his Honour's view, it was not necessary that the person concerned have ultimate control. The provision of advice to management, participation in decision-making processes and the execution of decisions going beyond the mere carrying out of directions as an employee would, in his Honour's opinion, be sufficient to lead to the conclusion that the relevant person was 'concerned in' management.

#### **6.4.2 The CLERP amendments**

The CLERP amendments, which took effect in March 2000, resulted from a review designed to simplify the Corporations Law and make it more certain. Regrettably, as a result of what appears to me to have been an oversight, in the area currently under consideration the amendments appear to have had precisely the opposite effect.

The definition of ‘executive officer’ was retained in s 9 of the Corporations Law, but the definition of ‘officer’ in that section was amended to delete reference to s 82A and instead to insert a definition of ‘officer of a corporation’ to mean, amongst other things, a director, a secretary, and a person:

- (i) who makes or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation;
- (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 ...

The third limb of the definition is the traditional formulation of the class of person often referred to as the ‘shadow’ director and is not germane to the present issue.

It seems from the extrinsic material, including the parliamentary debates, that the first two limbs of the definition were intended to represent a statutory codification of the decision of Ormiston J in *Bracht*. If that is so, it seems to me that the amendment did not achieve that objective. Although some of the terminology is reminiscent of the language used by Ormiston J, the failure to include a person ‘concerned in’ management, which was considered by his Honour to have had a significant effect in expanding the scope of operation of the definition of ‘executive officer’, was a material omission.

It seems to me that the deletion of that expansive terminology had the effect that the class of persons to whom the definition ‘officer of a corporation’ applied was significantly smaller than the class of persons embraced by the definition of ‘executive officer’. Further, in relation to the suggestion that this definition was intended to embody, in statutory terms, the decision of Ormiston J, it seems curious that the legislature would retain the definition of ‘executive officer’ in much the same terms, given that it was that definition, after all, to which the decision of Ormiston J was addressed.

The confusion created by the location of two similar but distinct definitions of classes of personnel within s 9 was compounded by the retention of s 82A, which defines 'officer' in relation to a body corporate or an entity coming within Parts 3.6 and 3.7 in a broader way again, including all 'employees'.

If the retention of s 82A was intended, it suggests that some distinction was intended to be drawn between the circumstance in which the word 'officer' was used in relation to a body corporate or entity within the meaning of Parts 3.6 or 3.7, as compared with the word 'officer' used in relation to a corporation. However, because s 57A was also retained the expression 'corporation' includes 'a body corporate' thus producing the somewhat anomalous consequence that the phrase 'officer of a corporation' embraces a significantly smaller class than the word 'officer' when used in relation to a body corporate, notwithstanding that all bodies corporate are 'corporations'.

Further, the definitional restructure appears to have had some consequences that were unintended, or if they were intended, appear to me to be undesirable. For example, the liabilities in s 1309 of the Corporations Law in relation to the provision of false or misleading information to directors and auditors are imposed upon 'an officer of a corporation'. Prior to the CLERP amendments those liabilities would have extended to all employees, because of the extended definition contained in s 82A. It seems however that because the very phrase 'officer of a corporation' used in s 1309 is that now defined by s 9, the only persons now subject to the liabilities imposed by the section (other than directors or secretaries and so on) are those who make or participate in making decisions that affect the whole or a substantial part of the business of the corporation or who have the capacity significantly to affect the corporation's financial standing.

For my part, I can see no reason why the legislature would have intended to narrow the class of persons upon whom the liabilities created by s 1309 were imposed. If an employee provides information to a director or auditor which he or she knows to be false or misleading, I can see no reason why they should not be held to have contravened the law. However, as I construe the current legislation (the *Corporations Act 2001* being in

essentially the same terms as the Corporations Law after the CLERP amendments) such persons will only be found to have contravened the law if they occupy a relatively senior position in the management structure as required by the current definition of ‘officer of a corporation’.

Further, the sections of the Corporations Law following the CLERP amendments (and the *Corporations Act 2001*) which impose general duties upon officers of corporations, namely ss 180–184, also use the expression ‘officer of a corporation’ and therefore presumably invoke the somewhat narrower definition of that phrase contained within s 9. As I shall point out shortly, some of those duties are imposed also upon ‘employees’, but a number of the duties are only applied to the narrower class of personnel. Again, it seems to me to be somewhat unlikely that the legislature would have intended to restrict the class of persons upon whom the general duties were to be imposed when enacting ss 180–184.

The law governing the imposition of duties upon persons who act for or on behalf of corporate entities should be clear, simple, and as far as reasonably possible, certain of application. In my opinion the current law does not meet these objectives. The three definitions—‘executive officer’, ‘officer of a corporation’ and ‘officer’—are confusing and seem to have the anomalous results set out above. I recommend that the legislative structure be reviewed with a view to achieving the objectives of clarity, simplicity and certainty of application. After considering the other issues which appear to arise in this general area, I will make some suggestions as to how those objectives might be achieved.

#### **6.4.3 Individuals subject to general duties**

Both before and after the CLERP amendments it was accepted that there is a class of personnel upon whom the general duties of directors should also be imposed. For reasons outlined above, it seems that prior to March 2000 that class was wider than it currently is. For my part I cannot identify any sound policy reason for narrowing the class of persons upon whom those general duties are imposed. It seems to me, based upon my consideration of the evidence received in the course of this inquiry, that the general objectives of the *Corporations Act 2001* would be more readily achieved if those duties were cast upon a broader range of persons.

In my opinion, that class should not distinguish between employees and non-employees. Instead, it should be functionally defined. That is because it is increasingly common for a wide range of corporate functions to be performed by consultants or other contractors who are not strictly ‘employees’. In my opinion it is the performance of the relevant function that should attract the legal duty, not the precise legal relationship between the person performing that function and the relevant corporate entity. The definition which applied prior to the CLERP amendments—namely, that which embraced a person who ‘is concerned, or takes part, in the management of the relevant entity’—seems to be appropriate. It should be sufficient to distinguish between those who are at the more senior levels of the organisational structure, and who should be subject to the general legal duties imposed upon directors, and those at a lower level, more properly described as functionaries, who should not be subject to all the general duties imposed upon directors.

It is perhaps sufficient if I record the observation that, whatever terminology is used in the relevant provision, it should be calculated to embrace a class of senior personnel engaged in management functions broader in operation and application than that embraced by the current definition of ‘officer of a corporation’ and which is, as far as possible, clear and certain of application. A useful model in this regard is that found in the *Commonwealth Authorities and Companies Act 1997*. That Act essentially imposes the general duties imposed by ss 180–184 of the Corporations Act upon directors and officers of Commonwealth authorities and companies. By s 5 of that Act, any person who ‘is concerned in, or takes part in, the management of’ an authority is an ‘officer’ for the purposes of the liabilities imposed.

#### **6.4.4 Persons subject to duties**

As already indicated, prior to March 2000 the general duties imposed by s 232 were imposed upon directors, secretaries, and executive officers and, in addition, the duty not to make improper use of position was imposed upon all employees. Amongst the general duties imposed by s 232 was the duty to ‘act honestly in the exercise of his or her powers or in the discharge of the duties of his or her office’.

Since March 2000 the general duties imposed by ss 180–184 have been imposed upon the somewhat narrower class of ‘officer of a corporation’, except that the duties imposed by ss 182(1), 183(1) and 184(2) are also imposed upon ‘employees’. Those duties are, respectively, the duty not to use their position improperly to gain an advantage for themselves or someone else or cause detriment to the corporation, the duty not to use improperly information obtained through their position to gain an advantage for themselves or someone else or cause detriment to the corporation, and the duty not to use their position dishonestly with the intention of gaining advantage for themselves or causing detriment to the corporation or recklessly as to those consequences.

There is another apparent anomaly in that s 182(1) alone of these sections refers to a class of persons being ‘a director, secretary, other officer or employee’. The reference to ‘secretary’ seems entirely superfluous, as the term ‘officer’ includes both director and secretary (s 9). It is also curious that a distinction is superficially made between s 182 on the one hand, and ss 183 and 184 on the other, in relation to this express reference to secretaries, but without any apparent difference in substantive effect, because of the definition to which reference has been made.

The classes of general duty which have been chosen by the legislature to be applied to the widest class of personnel seem to me to be appropriate, but I would offer the following comments.

First, by defining the wider class of personnel by reference to the word ‘employee’, consultants or independent contractors are excluded, notwithstanding that they may in fact be performing functions very analogous to those performed by employees. As suggested above, it seems that function rather than contractual classification is a more appropriate criterion for definition in this area.

The second observation I make is that, by contrast to the position which applied prior to March 2000, dishonesty only results in contravention of the law by the extended class of personnel if their actions have the additional element of being undertaken with the intent of gaining an advantage for themselves or someone else or causing detriment to the corporation or recklessly in relation to

those consequences. By contrast, prior to March 2000, any act of dishonesty in the exercise of powers or the discharge of the duties of office constituted a contravention of s 232 of the Law.

This narrowing of the prohibition has had practical consequences in my consideration of the evidence adduced in the inquiry. It has been particularly relevant where persons acting for or on behalf of the relevant corporate entity have, for example, taken steps which resulted in falsification of the corporation's accounts or the returns lodged with relevant regulatory authorities. In some of those instances it would be difficult to conclude that the actions were taken for the purpose of gaining an advantage for the person concerned or someone else, or causing detriment to the corporation—rather, the actions were taken for the purpose of misleading those who might act in reliance upon the accounts or relevant regulatory return. This consequence was particularly significant having regard to the narrowing of the ambit of operation of s 1309 occasioned by the legislative definitional anomaly to which I have already referred.

In the case of information provided or returns lodged in fulfilment of obligations imposed other than by the Corporations legislation, such as the returns lodged with APRA pursuant to the *Insurance Act 1973*, often the specific penalty provisions in that legislation had no application because they are limited to penalising a signatory who knew the information to be false, whereas the person who knew the information to be false was the person who prepared the document, not the signatory.

On the other hand, I can see some force in the observation that the statutory duty imposed prior to March 2000 was too broad and all embracing, extending to all activities undertaken in the exercise of powers or the discharge of the duties of office.

It seems to me that an appropriate balance between the broad ambit of operation of the law prior to March 2000, and its unduly narrow operation now, would be a legislative provision which operated by reference to the performance of obligations imposed either by the *Corporations Act 2001* or some other statutory provision. Such a legislative provision would catch, for example, the preparation of accounts which are required to be maintained by the *Corporations Act 2001*, and the

lodgment of returns to regulatory authorities required by other legislative provisions—such as the Insurance Act, or the *Australian Prudential Regulation Authority Act 1998*. If the obligations imposed by those statutory provisions are performed dishonestly, it seems to me that whoever undertakes those dishonest acts should be liable for a contravention of the law, whatever their classification or function within the corporate organisation.

This would necessitate the introduction into the *Corporations Act 2001* of a provision which would prohibit any person from acting dishonestly in connection with the performance or satisfaction of any obligation imposed upon a corporation under either the *Corporations Act 2001* or any other written law. The objective of a provision of this type is to make it clear to people at various levels of management and not just directors and senior managers that they will be held to account for their part in dishonest conduct by or on behalf of a company.

I have given consideration to the possible generality and lack of imprecision in the use of the word ‘dishonest’ as the touchstone for liability. However, the word is in common and regular legal use and has now evolved a meaning which is well known to the law and which has been the subject of considerable judicial enunciation and explanation. It therefore seems to me to be an appropriate criterion for the imposition of liability. The word has been the subject of statutory definition and, while this is essentially a matter for the parliamentary drafter, I incline to the view that its meaning established at common law is quite adequate.

#### **6.4.5 Duties owed to individual group companies**

A further difficulty with the current provisions concerns their application to corporate groups. The reality of modern public companies is that they are managed and controlled at a group level. As with HIH, the group structure can be complex with executives often employed by a subsidiary once or twice removed from the main listed entity. With some of the transactions I inquired into, a consideration of the separate legal existence of a subsidiary arose almost as an afterthought as the relevant transaction was being finally documented. Serious issues could arise (and did during the inquiry) under the current

legislation as to whether the executive in question, who was neither employed by the company that became a party to the transaction and who had never previously made any particular decision concerning that individual company, nevertheless owed it the duties specified in ss 180–184. A further question is whether their actions were capable of constituting a breach of the duties they might owe to the company employing them, or perhaps to the ultimate holding company of the group. I consider that the question of what duties are owed to what entities is an important issue which needs to be clarified. The answer is not simple because of the possibility of competing duties owed to different companies. To some extent the recommendation I have made with respect to the adoption of the criterion of function rather than employment relationship may alleviate this problem if adopted, but any review of the legislation should bear this issue in mind.

## Appendix 3 List of respondents

- Australian Bankers' Association
- Australian Institute of Company Directors
- Australian Securities and Investments Commission
- Chamber of Commerce and Industry of Western Australia
- Chartered Secretaries Australia
- The Commercial Law Association of Australia Limited
- CPA Australia
- Alan du Mée
- Freehills
- Insurance Council of Australia
- Law Council of Australia
- The Law Society of NSW
- Legislation Review Board, Australian Accounting Research Foundation
- Paul Martin
- National Institute of Accountants
- Promina