



Australian Government

**Corporations and Markets
Advisory Committee**

CORPORATE DUTIES BELOW BOARD LEVEL

Discussion Paper

**May
2005**

Corporations and Markets **Advisory**
Committee

Corporate duties below
board level

Discussion Paper

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Introduction

This paper reviews the personal duties and liabilities under the Corporations Act of corporate officers, employees and other individuals below board level. It considers whether the classes of persons subject to these provisions should be broadened, and whether a general dishonesty provision should be introduced.

*The Advisory Committee Discussion Paper on **Personal liability for corporate fault** (May 2005) differs from this paper in focusing on the circumstances in which directors and corporate managers may be criminally liable for corporate misconduct in consequence of their formal position or function in their corporations, without the need to establish any misconduct on their own part.*

0.1 Background

Corporate law has traditionally treated corporate decision making as the preserve of the directors. In some smaller corporations, this may still be the case. 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 corporation. Also, many enterprises are structured as corporate groups (see Advisory Committee *Corporate Groups Final Report* (May 2000) paras 1.1 ff) and are run on a day-to-day basis by centralised executive committees that make many of the operational and management decisions for group companies.

In various areas, 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 the corporation fall within these categories. Some persons who perform functions for a corporation may be contractors, rather than employees, of that corporation or may be employed by another corporation within the same corporate group.

The HIH Royal Commission report *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.

This paper considers whether changes are needed in the current regulation of persons below board level, 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.

0.2 Terms of reference

0.2.1 HIH report

Recommendation 2 of the HIH report proposed changes to the duties and liabilities imposed by the Corporations Act on various individuals. The full text of this recommendation is as follows:

I [Commissioner the Hon Justice Neville Owen] 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 HIH 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 HIH 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 collective or 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 provision relating to ‘dishonesty’ 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 1 to this paper.

0.2.2 Reference from the Government

In May 2004, the then Parliamentary Secretary to the Treasurer, 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 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 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.

0.3 Request for submissions

The Advisory Committee invites submissions on any aspect of the matters referred to in the terms of reference, including the following proposals put forward in Part 2 of this 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 (Proposal 1)

- 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 (Proposal 2)
- as a corollary of Proposal 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 (Proposal 3)
- 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 (Proposal 4)
- 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 (Proposal 5)
- 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 (Proposal 6)
- 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 (Proposal 7).

The Advisory Committee also seeks views on:

- whether the term ‘management’ of the corporation, for the purpose of Proposals 1–3, should be defined. If so, should a 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’ (2.2.1, below)

- 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 that corporation (2.2.3, below)
- whether there is any need to define the term ‘employee’ for the purposes of ss 182–184 or ss 1307 and 1309 if Proposals 4–7 (to expand the categories of persons subject to those provisions) are implemented (2.3, below)
- 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 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 rule defence in s 180(2) and, where the related corporation is a wholly-owned subsidiary, the benefit of s 187) (2.4, below)

- 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
 - obligations under any overseas written laws as well as Australian laws (2.2.4, below)

- whether there are 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 (2.5, below).

0.4 Forwarding submissions

Please send your submission to:

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If you are sending your comments otherwise than by email, please also send, if possible, a computer disk containing your submission, using Microsoft Word for Windows 2000.

If you have any queries, please phone (02) 9911 2950.

Please forward your submissions by **Friday 26 August 2005**.

This Discussion Paper is available under *What's New* and also under *Current Discussion Papers* on the Advisory Committee's Website www.camac.gov.au.

0.5 Functions and membership of the Advisory Committee

The statutory functions and membership of the Advisory Committee are set out in Appendix 3.

Part 1 Current position

This Part sets out some key Corporations Act provisions that impose duties and liabilities on individuals below board level. Reference is also made to some State provisions.

1.1 Relevant Corporations Act terms

Set out below are relevant definitions of corporate participants below board level.

1.1.1 Officer

The definition of ‘officer’ in s 9 includes each ‘director’, as also defined in s 9. In addition, ‘officer’ extends to persons below board level by including:

- (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).

However, this extension below board level 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. It would not apply to any other persons involved in management
- 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 de facto 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’. In 2004, the term ‘executive officer’ was repealed.

1.1.2 Senior manager

‘Senior manager’ in relation to a corporation 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 equivalent tests in the definitions of ‘senior manager’ and ‘officer’ suggests that the current definition of ‘officer’ is intended to be limited to senior managers, and not to cover everyone who is concerned, or takes part, in the management of a corporation.

1.1.3 Other persons

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

1.2 Liability of individuals below board level

The Corporations Act, and other legislation (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’ remain subject to duties that may be imposed under other laws, including the common law: s 179.

1.2.1 Internal management duties

Fiduciary duties

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

- to exercise care and diligence, with a business judgment rule 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 and 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 and s 184(1) — criminal liability).

There are equivalent duties for officers of responsible entities of managed investment schemes, modified, where necessary, to give priority to the interests of members of the scheme rather than the interests of the responsible entity itself (s 601FD). This is a civil penalty provision.

Other fiduciary 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 and 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 and s 184(2) — criminal liability).

There are equivalent duties for officers and employees of responsible entities of managed investment schemes, modified, where necessary, to give priority to the interests of members of the scheme rather than the interests of the responsible entity itself (ss 601FD, 601FE). This is a civil penalty provision.

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. [In contrast, ss 1041F and 1041G define dishonesty 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 below board level may be liable as ‘persons involved in a contravention’ of the legislation 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).

1.2.2 Information disclosure duties

The analysis below excludes the disclosure and other duties and liabilities of individuals in relation to fundraising, continuous disclosure and takeovers. These are part of separate self-contained disclosure and liability regimes, which are not dealt with in this paper.

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).

Officers of the responsible entity of a managed investment scheme must assist the auditor of the compliance plan of the scheme, including by allowing the auditor access to the books of the scheme (s 601HG(6)).

Information in books

Any 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)).

Any 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

Any 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)). Persons 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)). Any 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)).

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

1.2.3 Financial reporting duties

Each 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). The legislation does not define these functional categories.

An officer is also required to provide information to the auditor of the controlling entity, and otherwise assist the auditor in preparing the consolidated financial statements (s 323B). 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).

1.2.4 External administration duties

Duties to assist liquidator

The liquidator may require officers or other stipulated persons to prepare a report on specified matters (s 475(2)).

As soon as practicable after the commencement of a winding up, each officer must deliver to the liquidator all books in that person's possession, other than books to which that person is entitled, and tell the liquidator where any other books are (s 530A(1)). Each officer must also attend on the liquidator and give the liquidator such information as the liquidator reasonably requires (s 530A(2)) and give any other help the liquidator requires (s 530A(3), (4)). Each officer must also 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 guilty of an offence for:

- not disclosing, 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 that the person must not act intentionally or recklessly (s 590(4B)).

Part 2 Issues arising from the HIH report

This Part considers various recommendations in the HIH report to extend the duties and liabilities in the Corporations Act to additional classes of individuals below board level, and also introduce a general dishonesty prohibition.

2.1 Overview

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 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?

2.2 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 2.2.1, 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 2.2.2, 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 2.2.3, below.

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 ss 180–183 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 of ss 181–183, where the relevant fault elements in s 184 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.

Likewise, ss 1307 and 1309 impose criminal liability for breach. The penalties can include up to 2 years imprisonment for breach of s 1307 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 also raises the question of whether there should be a general dishonesty prohibition. This is discussed in 2.2.4, below.

2.2.1 General duties

Summary of 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.

Issues

Should s 181 (the duty of good faith) (and its criminal consequences under s 184(1)) be extended beyond directors and other officers of a corporation to a wider category of persons?

Should s 180(1) (the duty of care and diligence) be extended beyond directors and other officers of a corporation to a wider category of persons? If so, should the business judgment rule (s 180(2)) also be extended to that wider category of persons?

Analysis

Background to s 181

Section 181 imposes duties on directors and other officers 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.

Section 181 was introduced in 2000 to replace the former s 232(2). Prior to that change, the fiduciary duty of honesty in s 232(2) applied, inter alia, to any person who was an ‘executive officer’, namely, anyone ‘who is concerned, or takes part, in the management’ of the company.

Section 181 applies to persons coming within the s 9 definition of ‘officer’, as introduced in 2000. That definition 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.

That definition no longer employs the concept of ‘executive officer’, which was repealed in 2004.

HIH report

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 fiduciary 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.

Comparison of ‘officer’ and ‘executive officer’ tests

The term ‘executive officer’ (repealed in 2004) appeared to include a broader class of persons than the term ‘officer’ under s 9. The definition of ‘officer’ does not contain the broader test of persons included in the definition of ‘executive officer’ (as interpreted by Ormiston J in *Bracht*), namely persons involved in policy and decision making in relation to a corporation that ‘may have some significant bearing on the conduct of its affairs’ (see further Appendix 2 of this paper).

The HIH report recommendation to reinstate the ‘executive officer’ definition in the context of s 181 (and s 184(1)) may go some way towards appropriately broadening the class of corporate personnel who are subject to the fiduciary duties in s 181 to exercise their corporate powers and discharge their corporate duties in good faith and for a proper purpose.

There may also be benefit in clarifying what activities come within the concept of ‘management’ of a corporation in the context of an ‘executive officer’ test. One option would be to define ‘management’ 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.

A definition of this nature would ensure that ‘executive officer’ embraces a considerably broader class of persons engaged in

managerial functions than the definition of ‘officer’. The proposed definition does 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’.

Proposal 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.

For the purpose of Proposal 1 (and Proposals 2 and 3), 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’?

Merits of applying the executive officer test to s 180

Subsection 180(1) imposes a duty on directors and other officers 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 rule defence, as set out in s 180(2).

The clear intention of the current provisions is that the same categories of persons should be subject to the fiduciary 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 (Proposal 1) should also be made to s 180. Likewise, anyone who is subject to the fiduciary duties of care and diligence in s 180(1) should have the benefit of the business judgment rule defence in s 180(2), which applies to those duties.

Proposal 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.

Proposal 3. As a corollary of Proposal 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.

2.2.2 Improper use of corporate position or information

Summary of report

Section 182 prohibits any director, other officer or employee of a corporation from improperly using his or her corporate position. 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. This is a civil penalty provision, with criminal liability arising under s 184(3) if the behaviour is dishonest.

The HIH report recommended that:

The duties imposed by ss 182, 183 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.

Issue

Should the prohibitions on improper use of corporate position (ss 182 and 184(2)) and improper use of corporate information (ss 183 and 184(3)) be extended beyond directors, other officers and employees to a wider category of persons?

Analysis

One option would be to apply the 'executive officer' test in determining what persons are subject to ss 182 and 183. However, this test, even on its broadest interpretation, only extends to persons who are involved in the management of a corporation. It may be too narrow in the context of improper use of corporate position or information, which should extend beyond managerial personnel.

A broader approach would be to apply 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 duties apply to the widest class of persons who have some functional link to the corporation.

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.

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

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

2.2.3 Section 1309

Summary of report

Subsection 1309(1) prohibits an officer or employee of a corporation from knowingly giving certain persons false or misleading information relating to the affairs of that corporation.

Subsection 1309(2) requires an officer or employee of a corporation to take reasonable steps to ensure the accuracy of information relating to the affairs of that corporation that he or she gives to certain persons.

Subsection 1307(1) prohibits any current or former officer, employee or shareholder of a company from concealing, destroying, mutilating or falsifying any books affecting or relating to the affairs of the company.

The HIH report recommended that:

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

that 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.

Issue

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. Should these provisions be extended to a wider category of persons?

Analysis

Persons subject to s 1309(1)

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 any person who performs functions, or otherwise acts, for or on behalf of a corporation.

It may be inappropriate to extend s 1309(1) further to, say, ‘any person’, given that this change would eliminate any requirement that the person be functionally linked to the corporation. Without that link, the section could apply, for instance, to a competitor of a corporation who provides false information concerning that competitor to, say, a director of the corporation. In some cases, that false information could ‘relate to the affairs’ of the deceived corporation, and therefore would come within s 1309(1). A deceived corporation, in those circumstances, could have various common law and other remedies.

Persons subject to s 1309(2)

A related question is 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 they give to various stipulated classes of recipients is not false or misleading.

An argument 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 is

that subsection (2) would be workable if applied 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.

Proposal 6. Subsection 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.

Proposal 7. 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.

Should the categories of persons subject to s 1309(2) (ensuring the veracity of information) 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 that corporation?

2.2.4 General dishonesty prohibition

Summary of 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.

Issue

Should there 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?

Analysis

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.

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 provision if, for instance, their conduct was not fully or appropriately covered under current legislation.

Some possible difficulties in introducing a general dishonesty prohibition are:

- other legislation may already deal with this type of dishonest conduct in particular contexts, thereby raising the matter 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
- 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
- is the reference to ‘any written law’ confined to Australian law? For instance, would the provision apply to an officer of a corporation, either incorporated or conducting business in Australia, who breached an obligation imposed on that corporation by an overseas written law?
- is the reference to ‘any obligation’ confined to specific obligations imposed on corporations 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
- 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.

Consideration would also 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.

Another view is that Proposals 1–7, to reform ss 181–184 and ss 1307 and 1309, together with s 1308, 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 in Proposal 1) who lodged, or arranged for the lodgment, with any regulator of 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.

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

2.3 Employees and others

Terms of reference

The terms of reference pose 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?

Issues

Should the term ‘employee’ for the purpose of the provisions under review in this paper that refer to this term (namely ss 182, 183, 184, 1307 and 1309) be defined in the Corporations Act?

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?

Analysis

Current law

Sections 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 of ‘employee’ means that whether particular persons in a position analogous to that of employees are subject to those provisions can turn on the application of complex and imprecise 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 in a discussion paper by WorkCover NSW *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).

Relevance of other proposals

Proposals 4–7, to extend ss 182–184, 1307 and 1309 to anyone who performs functions, or otherwise acts, for or on behalf of a corporation, appear to 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.

Likewise, any general dishonesty prohibition would apply to *any* person acting dishonestly in connection with any obligation imposed on a corporation by statute. The employment or other relationship of such persons to the corporation would be irrelevant.

Is there any need to define the term ‘employee’ for the purposes of ss 182–184 or ss 1307 and 1309 if Proposals 4–7 are implemented?

2.4 Corporate groups

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?

Summary of report

The HIH report referred to the practice of corporate group executives making decisions 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.

Issue

What, if any, amendments are necessary to ensure that corporate group executives are properly subject to the duties in ss 180–184?

Analysis

Current law

A distinction can be drawn 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 formally appointed as directors of that group company, but who 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), 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/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’ (excluding 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

Proposals 1–7 apply to group executives who make ongoing operational decisions concerning a 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.

Also, any general dishonesty provision would apply to any individual acting dishonestly in connection with any obligation imposed on a corporation by statute. It would not be necessary that the individual be a director, officer or employee of that corporation.

The remaining question is 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.

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.

If this proposal is not supported, what, if any, alternative proposal should be adopted to deal with the concern raised in the HIH report?

2.5 Other behaviour

Part 1 of this paper 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 paper.

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?

Appendix 1 Extract from 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 2 Comparison of the terms 'executive officer' and 'officer'

Executive officer

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

This term was considered in the leading decision of Ormiston J in *Commissioner for Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728. His Honour first sought to define the concept of 'management' and then considered what constitutes 'takes part in' or is 'concerned in' management.

'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 that 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 overall financial health (at 734).

'takes part in'

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.

'concerned in'

According to Ormiston J in *Bracht* (at 735–736), 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.

Subsequent case law

The case law since *Bracht* has tended to adopt a narrower or broader interpretation of the concept of 'taking part or being concerned in' management, depending on the context.

Some cases have given a narrow interpretation to this concept in the context of the former s 556 of the Companies Code, which imposed personal liability for insolvent trading on any director or other ‘person who took part in the management of’ the company. It was held that this expression is limited to persons whose management role in the company 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 insolvent trading provision (s 588G) is confined to directors.

In other contexts, the concept has been given an apparently wider interpretation. For instance, 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’) did take part in the management of the company (*ASIC v Parkes* [2001] NSWSC 377, para 84).

Santow J in *Forkserve Pty Ltd v Jack and Aussie Forklift Repairs Pty Ltd* (2001) 19 ACLC 299 commented that the terms ‘take part in’ and ‘being concerned in’ for the purposes of liability under s 232(2) (prior to its repeal) should be given a wide interpretation:

Those terms include activities involving some responsibility and participation in the decision-making processes of the company but do not extend to routine clerical or administrative duties associated with management (at 312).

In this case, his Honour held that a service manager was an executive officer, and therefore was subject to the fiduciary duty under s 232(2) (since repealed) primarily as he was concerned with the management of staff and involved in the pricing and general ‘management’ side of the business.

Officer

Section 9 of the Corporations Act defines an ‘officer’ to include any 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.

Comparison of 'executive officer' and 'officer'

Both definitions apply to persons who have some involvement in the management of a corporation.

The notion of 'management' has not been defined in the Corporations Act. However, the tests in the definition of 'officer' in s 9 largely adopt the concepts used by Ormiston J in *Bracht* at 733–734 to describe 'management', namely:

- making or participating in making decisions 'that affect the whole or a substantial part of the business of the corporation' (s 9) ['activities which involve policy and decision-making, related to the business affairs of the corporation, affecting the corporation as a whole or a substantial part of that corporation': *Bracht*]
- having a capacity 'to affect significantly the corporation's financial standing' (s 9) ['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': *Bracht*].

The s 9 definition does not contain the additional test of management used by Ormiston J in *Bracht*, namely policy and decision making in relation to a corporation that 'may have some significant bearing on ... the conduct of its affairs'.

Another difference between 'executive officer' and 'officer' is that the former applies to anyone who is 'concerned or takes part' in management, while the latter applies to anyone who 'makes or participates in making' managerial decisions. In view of the lack of any case law on the expression 'makes or participates in making', it is not clear whether this difference is material.

Appendix 3 Functions and membership of the Advisory Committee

Advisory Committee

Functions

The Corporations and Markets Advisory Committee is constituted under Part 9 of the *Australian Securities and Investments Commission Act 2001*.

Section 148 of that Act sets out the functions of the Advisory Committee:

CAMAC's functions are, on its own initiative or when requested by the Minister, to advise the Minister, and to make to the Minister such recommendations as it thinks fit, about any matter connected with:

- (a) a proposal to make corporations legislation, or to make amendments of the corporations legislation (other than the excluded provisions); or
- (b) the operation or administration of the corporations legislation (other than the excluded provisions); or
- (c) law reform in relation to the corporations legislation (other than the excluded provisions); or
- (d) companies or a segment of the financial products and financial services industry; or
- (e) a proposal for improving the efficiency of the financial markets.

Advisory Committee members

The members of the Advisory Committee are selected by the Minister in their personal capacity from throughout Australia 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.

The members of the Advisory Committee during the preparation of this paper were:

- Richard St John (Convenor)—Special Counsel to Johnson Winter & Slattery, former General Counsel of BHP Limited and Secretary to the HIH Royal Commission
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Barbara Bradshaw—Chief Executive Officer, Law Society Northern Territory, Darwin
- Philip Brown—Emeritus Professor, University of Western Australia, Perth
- Berna Collier—Commissioner, Australian Securities and Investments Commission (alternate to Jeffrey Lucy, Chairman, ASIC)
- Greg Hancock—Managing Director, Hancock Corporate Investments Pty Ltd, Perth
- Merran Kelsall—Company Director, Melbourne
- John Maslen—Chief Financial Officer and Company Secretary, Michell Australia Pty Ltd, Adelaide
- Louise McBride—Director, Grant Samuel Corporate Finance, Sydney
- Marian Micalizzi—Chartered Accountant, Brisbane
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, Blake Dawson Waldron, Sydney
- Nerolie Withnall—Company Director, Brisbane.

Legal Committee

The members of the Legal Committee during the preparation of this paper were:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Elspeth Arnold—Partner, Blake Dawson Waldron, Melbourne
- Ashley Black—Partner, Mallesons Stephen Jaques, Sydney
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Suzanne Corcoran—Professor of Law, Flinders University, Adelaide, and Professorial Fellow, Australian National University, Canberra
- 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
- Duncan Maclean—Special Counsel, Minter Ellison, Perth
- Laurie Shervington—Partner, Minter Ellison, Perth
- Gary Watts—Partner, Fisher Jeffries, Adelaide.

Executive

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thamani Parrino—Executive Assistant.