Focus of this lecture:

Corporate Governance:
- Defining Corporate Governance
- The Aim of Corporate Governance Rules
- Legal Regulation of Corporate Governance
- Non-legal Regulation
- Law Reform

Directors & Officers
- What or who is an Officer?
- What or who is a Director?
- Qualifications of Company Directors
- How can a Director be removed from Office?

Corporate Governance

Broad notions:
- Impossible to define in a universal manner
  "...the system by which companies are directed and
controlled...board of directors are responsible for
the governance of their companies"
Corporate Governance

Why the need for CG:
- Corporate social responsibility demands accountability and transparency not just to shareholders but to stakeholders of the company, including employee, creditors and the broader community.

Corporate Governance

Broad notions:
- In his final report on collapse of HIH, Royal Commissioner, Justice Owen, said:
  "Corporate governance – describes the framework of rules, relationships, systems and processes within and by which, authority is exercised and controlled in corporations. ...it embraces not only the models and systems themselves but also the practices by which that exercise and control of authority is in fact effected."

Corporate Governance

Broad notions:
- Justice Owen’s description has been adopted by the ASX Corporate Governance Council, which expands to say:
  "...corporate governance influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised."
What is corporate governance (CG)?

- Issues which relate to the management of companies
- The system by which companies are controlled
- Within the company many conflicts can occur:
  - Between members and directors
  - Between directors
  - Between members
- CG is concerned with how companies can resolve these disputes

Corporate Governance (CG)

Q: Should CG provide prescriptive rules to control corporate decision-making?

Alternatively, should the law provide a flexible system where companies can pick and choose their internal rules?

Corporate Governance (CG)

Legal regulation of CG - found in statute and common law which regulates:

- Director’s duties (s 180-184, 588G)
- Members’ remedies (s 232, 236-237)
- Members’ rights (e.g. right to vote)
- Internal corporate organs
- Internal management rules (s140 – statutory contract)
- Market disclosure rules (s 674; s 191)
- Safeguarding the integrity of financial info (Ch 2M)
Corporate Governance (CG)

Non-legal regulation of CG
- Due diligence and compliance systems
- ASX listing rules

Corporate Governance (CG)

Non-legal rule

ASX Listing Rules:
- Stock market acts as a quasi legal method of regulation
- Focus is on licensed public cos listed on ASX (about 1,930 cos)
- ASX Listing Rules (LR) may be enforced by court order under s 793C of CA
- Wide range of CG:
  - periodic and continuous disclosure requirements (ASX LR 3&4)
  - limitations imposed on making structural changes to the co (ASX LR 7 and 11)
  - minimum capital liquidity requirements (ASX LR 12)

Corporate Governance (CG)

Non-legal rule

ASX Listing Rules:
- Corporate Governance Council – formulated 'Principles of Good Corporate Governance and Best Practice Recommendations' (Principles)
- Effect of principles – if did not comply there was an obligation to explain their actions in the annual report to the ASX (LR 4.10), hence quasi legal nature. Cannot be sanctioned for failing to comply
Corporate Governance (CG)

Non-legal rule
ASX Listing Rules:

Some of the principles are...
- Principle 1 - Fundamental to any CG structure is establishing the roles of management and the Board.
- Principle 2 - Balance of skills, experience and independence on board, appropriate to the nature and extent of company's operations.
- Principle 3 - Need for integrity those who influence financial performance and co. strategy. Responsible and ethical decision making.

Law reform

Corporate Law Economic Reform Program (CLERP)

- Took place in 1990s.
- Concerned with reporting obligations, shareholder rights, disclosure, information and developing an effective system of sanctions (through fines and compensation, banning orders and criminal penalties).
- CLERP 9 2004:
  - Increasing disclosure of executive remuneration.
  - Improving disclosure of financial info to shareholders.
  - Providing ASIC with an administrative fining power for continuous disclosure breaches.
  - Protection for corporate whistle blowers.
  - Strengthening auditor independence.

More current reforms – Corporations Legislation Amendment (Simpler Regulatory System) Act 2007:

- Changes to corporate fundraising requirements.
- $5,000 limit for related party transactions that do not require member approval.
- Creating a new general defence.
- Extending current business judgment rule defence to cover other breaches (including insolvent trading).
- Allowing directors to more easily rely on delegates to avoid sanctions.

Commonwealth Treasury Paper – Review of Sanctions in Corporate Law, March 2007:

- Paper suggested substantial alterations to directors’ and officers’ duties including:
  - Creating a new general defence.
  - Extending current business judgment rule defence to cover other breaches (including insolvent trading).
  - Allowing directors to more easily rely on delegates to avoid sanctions.

Regulatory System) Act 2007

Corporations Legislation Amendment (Simpler More current reforms –
Directors and Officers

Officers

What or Who is an officer?
Statutory definition - s 9 – broad definition
- director or secretary of the corporation
- person who participates in making decisions that affect whole or substantial part of business
- person who significantly affects corporations financial standing
- person whose instructions or wishes the directors of the corporation are accustomed to act

Employees
- only refers to senior managers of the co
  Jesserton v Middle East Trading (1994) 13 ACSR 455
- CLERP 9 – 2004; senior mangers:
  - person who participates in making decisions that affect whole or substantial part of business
  - person who significantly affects corporations financial standing
What or Who is an officer?

Executive officers
- Most senior employee and may also be called the CEO/MD
- Relates to persons concerned or take part in the management of the co
- Management refers to central management
- Mere administrative work by co secretary or accountant would not constitute management nor would execution of instructions by an agent

ASIC v Vines (2005) 55 ACSR
- Has capacity as an employee, director and agent (and the relevant duties attached)

What or Who is a Director?

Statute – s 9 of CA – highlights 3 possible categories:
- Officially appointed directors
- Directors acting under a defective appointment (‘de facto’); or
- Person who exercise directorial control but are not officially appointed (‘shadow directors’)

NOT VERY HELPFUL definition!
- But does indicate that the courts will look at the function of the person rather than job title

Company secretaries
- A requirement for every public co under s240A
- Holds a key administrative position – actions could bind the co
  Panorama Developments v Fidelis (1971) 2 QB 711
- Co to have registered office – s 142
- Registered office be open to public – s 145
- Lodgment of financial reports with ASIC (eg. certain resolutions)
- Lodgment of financial reports with ASIC
- Respond to extract of particulars or return of particulars
- Appointed by board of directors
- Can be made liable to cost of court application due to procedural irregularity caused by co sec

Re Wave Capital Ltd (2003) 47 ACSR 418
Directors

Types of Directors and Appointment

Chairman of board
- Appointed by board of directors
- In US common for chair and CEO to be the same person
- Works closely with CEO and co sec in determining agenda of board meetings and preparation of all members meetings
- Has a casting vote if split in voting at a meeting

Managing directors
- Appointed by board of directors
- Control of day to day running of business
- Accountable for board of directors for everyday decisions and being responsible for the executive employees of the co
- Also known as CEO

Executive directors
- Manage a significant part or aspect of the business
- Account for every day management, actions and decision making of the senior management in respect of a particular aspect of business

Non-executive directors
- Appointed to the board with the intent that they will bring an external, independent view to the management of the co
- Large % of board are non-execs
- Required to consider interests of co as a whole and perspectives of shareholders

Nominee directors
- Appointed to represent the needs and interests of a particular stakeholder group
- Eg. Large creditor or JV reps
- Question always arises as to whose interests the nominee director represents?

Walker v Wimboume (1976) 137 CLR
- Paramount interest must be to the co as a whole rather than stakeholder

Alternate directors
- RR 201K(1) – appointed to utilise all or any of the director’s powers when the director is unable to be present
- The exercise of power is as legitimate as if the director had made the exercise

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Directors

Concepts of directors

De facto director

Person acts in the position of a director without proper authority but nonetheless treated by law as being a director of co.

Statutory duties imposed on director by PUSD 1 and s588G will apply.

Corporate Affairs Commission v Drysdale (1976) 141 CLR 236

Can be found as a de facto director even if did not actively consent to act as director, provided actions demonstrate as such.

Forkserve Pty Ltd v Jack (2001) 19 ACLC

The relevant consideration would be whether person acted as if director and person was treated by others as such.

Deputy Commissioner of Taxation v Austin (1998) 28 ACSR 565 - eg. senior person attending all board meetings.

Shadow director

Not formerly appointed as director but able to exert significant influence over decisions by the board of directors.

Key issue: whether board of directors is ‘accustomed to act in accordance with the person’s instructions or wishes’.

Australia securities commission v AS Nominees Ltd (1995) 133 ALR

Emanuel Management Pty Ltd v Foster’s Brewing Group Ltd (2003) 176 FLR 1

Q: Is it possible for a creditor to be a shadow director of its debt co?

Qualifications of company directors

Must satisfy 4 conditions:

- Not disqualified from being a director – s 201B(2)
- At least 18 years of age – s 201B(1)
- Be an individual (rather than a co) – s 201B(1)
- Must agree to the appointment – s 201D

CLERP 9 reforms:

- 2 years must lapse before ex-auditor can become director of co previously audited
- Auditor cannot be a co director of co they are auditing

Removal of director from office

- Removal procedure in the corporate constitution
- Statutory removal (ss 203C and 203D)
- Resignation (s 203A)
- Disqualification (s 206A)
Directors

Removal of director from office

- Remover procedure in the corporate constitution
  - Based on term of director’s life in the constitution
  - Members will decide usually when the director’s period in office should finish and be voted upon again

- Statutory removal
  - Pty: s 203C – ordinary resolution at GM (at least 50% + 1 vote). Convene a general meeting with 21 days notice or at least 5% of members vote to requisition co to call the meeting
  - Public: s 203D – ordinary resolution at GM; 2 months prior notice to director; director has right to defend
  - Difficult to remove public co member – impact on co image (eg. recent Coles, Telstra, NAB) – normally pressured to resign

Directors

Removal of director from office

- Resignation – s 203A
  - Give proper notice to members of co and notice in writing at registered address of co

- Disqualification
  - Automatic disqualification:
    - 1. Convicted persons – s 206B(1)
      - Offence punishable by imprisonment for more than 12 yrs; or
      - Involves dishonesty which is punishable by imprisonment for more than 3 months
      - If convicted but no prison sentence, disqualified for 5 years from date of conviction, otherwise 5 years from release
      - ASIC has power to extend for an additional 15 years with approval from court (s 206B(2))

Directors

Removal of director from office

- Automatic disqualification:
  - 2. Undischarged bankrupts – s 206B(3)
    - Includes one who has undertaken deeds of arrangement under the Bankruptcy Act 1966
  - Must have contravened a civil penalty under CA – s 1317E
  - Must have contravened or obstructed under CA – s 1317E
  - Discretion as to period of disqualification based on relevant contravention
  - Directors or officers who failed to manage co within the last 7 years may be disqualified if fibrum is attributed to them – up to 25 years disqualification (206D)(1)
  - ASIC can apply to court to disqualify repeat contraveners – s 206E(1)

- By court order – s 206C
  - Not automatic:
Directors

Removal of director from office

Disqualification

Not automatic:

4. By ASIC – 206F

- preferred by ASIC as court proceedings require ASIC to carry the burden of proof
- Onus is on director to prove they are an appropriate person

Directors

Director’s application for grant to manage co

- s 206G(1)

- Disqualified person may apply for court grant for leave to manage a particular co or companies
- ASIC before 21 days court is to examine application
- Court can grant full unrestricted access to a particular co or impose conditions on grant

Directors

What is an appropriate disqualification period?

ASIC v Adler (2002) 42 ACSR 80

- disqualified Adler for 20 years for taking unsecured loan from HIH (a co that he was a director and shareholder of) to purchase shares in a co

- Factors court considered:
  - Will the defendant commit another breach in the future?
  - Penalty was harsh enough to discourage other people from doing the same
  - Dishonest conduct would attract longer disqualification period
  - The amount of loss suffered by the co
  - Whether the defendant abused a position of trust
  - Whether the co or defendant has history of breaches
Directors

What is an appropriate disqualification period?

ASIC v Vizard (2005) 145 FCR 57
- fined $390,000 and 10 years disqualification
- Factors court considered:
  - Deliberate breaches of duty
  - Covert means to conceal his illegality
  - Considered his good character to cooperate with authorities and no chance of re-offending
  - Seriousness of breach (could have earned a substantial profit)
  - Warranted a severe penalty to discourage others in such illegal activities (general deterrence)