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# ARTICLES

## REGULATORY ROOMS IN AUSTRALIAN CORPORATE LAW<sup>†</sup>

Joanna Bird\*  
Jennifer Hill\*\*

### I. INTRODUCTION

Regulation, it has been said, occurs "in many rooms."<sup>1</sup> According to some political commentators, there is an international trend in advanced liberal governments to govern, not directly, but rather through the decisions of autonomous agents.<sup>2</sup> This trend blurs the traditional distinction in regulation between government and citizen. It also recognizes the complexities of modern life, in which "market, civil society, citizens . . . have their own internal logics and densities, their own intrinsic mechanisms of self-regulation."<sup>3</sup> The trend as-

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1. See IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 3 (1992) (citing Marc Galanter, *Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law*, 19 J. LEGAL PLURALISM 1 (1981)).

2. See, e.g., Nikolas Rose, *Government, Authority and Expertise in Advanced Liberalism*, 22 ECON. & SOC'Y 283, 298 (1993); Patricia Ewick, *Corporate Cures: The Commodification of Social Control*, 13 STUD. L. POL. & SOC'Y 137, 138-39 (1993); Graham Burchell, *Liberal Government and Techniques of the Self*, 22 ECON. & SOC'Y 267, 276 (1993).

3. Rose, *supra* note 2, at 289. See also Julia Black, *Constitutionalising Self-Regulation*, 59 MOD. L. REV. 24 (1996); Robert J. Bush, *Comment, Stimulating Corporate Self-Regulation—The Corporate Self-Evaluative Privilege: Paradigmatic*

sumes that interconnected and overlapping systems of regulation can be more effective than any single technique.

The message of these political commentators has particular resonance in the arena of Australian corporate law. There has been a well-publicized retreat from direct regulation by the government under Australia's Corporate Law Economic Reform Program (CLERP). This retreat, coupled with the hard lessons of the 1980s for companies, investors and regulators alike,<sup>4</sup> has coincided with the emergence of "corporate governance" as a *fin de siècle* buzz-word.

Although there are a number of definitions of the term "corporate governance," most refer to the systems by which companies are organized, directed and controlled.<sup>5</sup> Corporate governance is therefore essentially about accountability<sup>6</sup> and legitimacy.<sup>7</sup> Although the central focus in a number of international reports on corporate governance tends to be the role and responsibility of managers and directors,<sup>8</sup> it also necessarily involves questions as to the roles of other groups within the

*Preferentialism or Pragmatic Panacea*, 87 NW. U. L. REV. 597 (1993).

4. The interrelation between government regulation and corporate governance was recognized by Sir Adrian Cadbury, in arguing that inadequate enforcement of good governance practices could lead to a renewal of onerous government regulation. See John Holland, *Self Regulation and the Financial Aspects of Corporate Governance*, 1996 J. BUS. L. 127, 131 n.12 (citing Adrian Cadbury, *Reflections on Corporate Governance*, in THE CHARTERED INSTITUTE OF BANKERS (1993)). A number of Australian commentators note the causal connection between the "corporate excesses of the 1980s" and the emergence of the corporate governance debate. See, e.g., Angus Corbett, *A Proposal for a More Responsive Approach to the Regulation of Corporate Governance*, 23 FED. L. REV. 277 (1995); Peter Schelluch & Grant Gay, *Corporate Governance*, 15 COMPANY & SEC. L.J. 235 (1997).

5. See Ian M. Ramsay, *The Corporate Governance Debate and the Role of Directors' Duties*, in CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS 2-3 (Ian M. Ramsay ed., 1997); Stephen Bottomley, *From Contractualism to Constitutionalism: A Framework for Corporate Governance*, 19 SYDNEY L. REV. 277 (1997); Corbett, *supra* note 4; MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RE-THINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 3-4 (1995); Holland, *supra* note 4, at 128-29.

6. See SALEEM SHEIKH & WILLIAM REES, CORPORATE GOVERNANCE & CORPORATE CONTROL v (1995); D.D. Prentice, *Some Aspects of the Corporate Governance Debate*, in CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE 25 (D.D. Prentice & P.R.J. Holland eds., 1993).

7. See Richard M. Buxbaum, *Comparative Aspects of Institutional Investment and Corporate Governance*, in INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE 4-5 (Theodor Baums et al. eds., 1994).

8. See Len Sealy, *Corporate Governance and Directors' Duties*, 1 N.Z. BUS. L. Q. 92 (1995).

corporate enterprise, as a check on managerial power.

The central goal of this article is to examine some of the rooms of regulation in current Australian corporate law, which determine the systems by which Australian companies are organized, directed and controlled today. These regulatory mechanisms include familiar legal duties, such as directors' fiduciary obligations and their enforcement, outlined in Sections Three, Four and Five. The legislative response to uncertainty created by recent judicial decisions is embodied in the Corporate Law Economic Reform Program Bill<sup>9</sup> (CLERP Bill), which is examined in Section Six.

In recent times, the scope of fiduciary and other duties has potentially been extended by important developments in the area of shadow director liability, to encompass a range of third parties closely associated with the corporation. These developments, and their potential impact, are explored in Section Seven.

Contemporary rooms of regulation also include greater involvement in governance by shareholders, discussed in Section Eight, and commercial organizations, discussed in Section Nine. This involvement includes guidelines emanating from the Investment and Financial Services Association (IFSA)<sup>10</sup> and the Australian Stock Exchange (ASX), discussed in Section Ten, as well as informal pressure and monitoring through institutional investor activism. A number of corporate governance practices concerning the structure of boards and disclosure are derived from these sources.<sup>11</sup> The Australian Corporations Law<sup>12</sup> (Corporations Law) and the Australian Stock Exchange Listing Rules<sup>13</sup> also use shareholder consent as a regulatory technique for a range of corporate transactions.<sup>14</sup> Reforms to the law relating to company meetings under the

9. Corporate Law Economic Reform Program Bill, 1998, (Austl.) [hereinafter CLERP Bill].

10. This association was previously named the Australian Investment Managers' Association (AIMA).

11. See, e.g., IFSA Guidance Note No. 2.00, CORPORATE GOVERNANCE: A GUIDE FOR INVESTMENT MANAGERS AND CORPORATIONS (1999).

12. Corporations Law, (Austl.).

13. *Guide to Listing on ASX*, § 4 (visited Sept. 26, 1999) <<http://www.asx.com.au/SB1500.htm>> [hereinafter ASX Listing Rules].

14. See COMPANIES AND SECURITIES ADVISORY COMMITTEE, SHAREHOLDER PARTICIPATION IN THE MODERN LISTED COMPANY, DISCUSSION PAPER 8 n.7 (1999).

recently enacted Company Law Review Act<sup>15</sup> may also facilitate greater shareholder involvement in governance issues.

Finally, Section Eleven addresses the significant developments in the area of market-based regulation and commercial practice. Proposed changes to Australia's takeover regime under the CLERP Bill, for example, are designed to reactivate takeovers as a disciplinary technique for under-performing corporate managers.<sup>16</sup> Section Eleven also examines a commercial development designed to ensure managerial accountability to shareholders, namely, the rise of performance-based remuneration for executives and directors.

## II. WHO IS GOVERNING AUSTRALIAN COMPANIES AND HOW ARE THEY DOING IT?

A recent report by Korn/Ferry International<sup>17</sup> gives a snapshot of board composition and governance structures today in Australasia.<sup>18</sup> Significant aspects of the profile of boards are as follows:

- Boards of public companies typically comprise eight directors, including two executive and six non-executive. Boards of private companies are generally smaller (six directors), with equal numbers of executive and non-executive directors, and government boards have only one executive director. Australian boards tend to be smaller than their counterparts in the U.S.<sup>19</sup>

- Over 55% of Australian directors are aged between 51 and 55 and the median age of executive directors is five years less than that of non-executive directors.<sup>20</sup>

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15. Company Law Review Act, 1998, ch. 2G (Austl.).

16. See CLERP, COMMENTARY ON DRAFT PROVISIONS 93 (1998).

17. KORN/FERRY INTERNATIONAL, BOARDS OF DIRECTORS IN AUSTRALIA AND NEW ZEALAND 1998 (1998) [hereinafter KORN/FERRY].

18. The Korn/Ferry survey covered 172 organizations in Australia and New Zealand, including over 35 companies with assets in excess of \$1.5 billion. See *id.* at 4.

19. *Id.* at 6. In contrast to Australian boards, U.S. boards typically are comprised of eleven directors, including two executive and nine outside directors. Even this figure represents a shift in the U.S. towards "smaller, more independent and more accountable boards." See Korn/Ferry's *New Study Tracks 25 Years of Change in America's Corporate Boardrooms*, BUS. WIRE, Sept. 24, 1998.

20. KORN/FERRY, *supra* note 17, at 7.

- Of non-executive directors surveyed in Australia, 15% were current CEOs of other companies, 22% were retired CEOs of other companies and 2% were retired CEOs of the company on whose board they sat. Multiple directorships were held by 46%. The dominant professional backgrounds of non-executive directors were: accounting (17%), commercial banking (11%), legal (9%) and agri-business (8%).<sup>21</sup>

- Women comprised 9.7% of non-executive directors in Australian companies surveyed, and 1.3% of executive directors.<sup>22</sup>

- In contrast to corporate practice in the U.S., Australian governance best practice clearly separates the roles of CEO and chairperson of the board, to provide structural checks and balances to the CEO's powers. Of all companies surveyed, 92% separated these roles.<sup>23</sup>

- There is an entrenched committee structure in Australia, with 85% of companies, and all listed public companies, surveyed operating through a range of committees. These included audit committees (85% of all companies surveyed and 99% of public listed companies), compensation committees (56% of all companies surveyed), nomination committees (22% of all companies surveyed), compliance committees (16% of all companies surveyed) and risk management committees (13% of all companies surveyed).<sup>24</sup>

- The main mechanisms for appointing the CEO in Australian

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21. *Id.* at 8. It has been said that, for historical and cultural reasons, "Australia's leading companies operate under a tangle of cross-directorships," with twenty-two directors serving on the boards of three or more of Australia's top 50 companies. Andrew Cornell, *The Cabal That Runs Australia's Companies*, AUSTL. FIN. REV., June 6, 1998, at 21. See Parliamentary Joint Committee on Corporations and Securities, *Report on the Corporate Law Economic Reform Program Bill 1998* (May 1999), para. 2.4 (expressing concern about the concentration of directorships in Australia and adopting the view that the increase in levels of share ownership in Australia should be matched by an expansion in the pool from which company directors can be chosen).

22. KORN/FERRY, *supra* note 17, at 9.

23. *Id.* at 6. Only 6% of U.S. companies surveyed in 1997 had an independent non-executive chairperson. See *id.* See also Korn/Ferry's *New Study Tracks 25 Years of Change in America's Corporate Boardrooms*, *supra* note 19.

24. KORN/FERRY, *supra* note 17, at 18-20.

companies were internal appointment (46%) and executive search (35%). Shareholder nomination led to 10% of CEO appointments. On the other hand, recommendation by major shareholders was an important source of new non-executive directors, accounting for 29% of appointments.<sup>25</sup>

•The report found that there is regular formal and informal contact with institutional investors at both board and executive level in Australasian public companies.<sup>26</sup>

•Sixty percent of companies surveyed had a code of ethics, with formal written codes being more common in publicly listed companies.<sup>27</sup>

### III. DIRECTORS' DUTIES IN AUSTRALIA—A REGULATORY MAP

Australian directors are subject to a multitude of overlapping duties. The case law requires that directors avoid conflicts of interest, not fetter their discretion, act with due care, and exercise their powers in good faith for the benefit of the company and for a proper purpose.<sup>28</sup> These broad common law duties are to a large extent duplicated by statutory duties. The *Corporations Law* prohibits improper use of information<sup>29</sup> and position.<sup>30</sup> These two conflict avoidance duties are supplemented by provisions preventing directors of public companies voting on, or being present for discussion of, any matter in which they have a material personal interest<sup>31</sup> and requiring directors of proprietary companies to declare their conflicts of interest to fellow board members.<sup>32</sup> In addition, there is a complex statutory regime prohibiting related party transactions.<sup>33</sup>

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25. *Id.* at 11, 15.

26. *Id.* at 21-22.

27. *Id.* at 21.

28. See FORD ET AL., *FORD'S PRINCIPLES OF CORPORATIONS LAW* para. 8.010 (1999).

29. *Corporations Law*, § 232(5) (Austl.). Note that if the CLERP Bill is enacted, many of the legislative provisions referred to in section III will be renumbered and rewritten. Their substantive effect will not be greatly altered.

30. *Id.* § 232(6).

31. See *id.* § 232A.

32. See *id.* § 231.

33. See *id.* at ch. 2E.

The case law duty of care is replicated by a statutory duty to exercise "care and diligence"<sup>34</sup> and the statutory duty to "act honestly"<sup>35</sup> has been interpreted as a legislative enactment of the duty to act in good faith for the benefit of the company and for a proper purpose.<sup>36</sup> Finally, the *Corporations Law* imposes a number of more specific duties on directors. These include duties in relation to corporate accounts<sup>37</sup> and insolvent trading.<sup>38</sup>

Of this panoply of duties, it is the duty of care that, in recent years, has been most controversial, attracting attention from the legislature, the courts, academics, legal practitioners and directors. The article, therefore, focuses on this duty.

#### IV. HISTORY OF THE DUTY OF CARE (OR HOW LOW CAN YOU GO?)

Until the early 1990s there were, in fact, very few Australian cases dealing with the duty of care. Possibly this was because the standard of care required of directors was both settled and extraordinarily undemanding. The English cases of the late 19th and early 20th century held that directors were liable for "gross negligence" only<sup>39</sup> and this standard was adopted in Australian law. The judgment of Romer J. in the key English case of *In re City Equitable Fire Insurance Co.*<sup>40</sup> was treated as the definitive exposition of the duty of care

34. *Id.* § 232(4).

35. *Id.* § 232(2).

36. There has been debate as to whether the statutory duty is an exact duplication of the case law duty to act in good faith for the benefit of the company and for a proper purpose. In particular, there is uncertainty as to whether section 232(2) of the *Corporations Law*, like the case law duty, prohibits an exercise of power which the director, subjectively, thinks is in the interests of the company but which is nonetheless for an improper purpose. See *Marchesi v. Barnes* [1970] V.R. 434; *Australian Growth Resources Corp. Pty v. Van Reesema* (1988) 13 A.C.L.R. 261. As part of the CLERP reforms, section 232(2) will be amended so that it clearly mirrors the case law duty. See CLERP Bill, *supra* note 9, § 181, sched. 1.

37. See *Corporations Law*, § 344 (Austl.).

38. See *id.* § 588G.

39. See *Overend & Gurney Co. v. Gibb* 5 L.R.-E. & I. App. 480, 486-87 (1872) (Eng.); *Lagunas Nitrate Co. v. Lagunas Syndicate* 2 L.R.-Ch. 392, 418 (1899) (Eng.); *In re Brazilian Rubber Plantations & Estates, Ltd.* 1 L.R.-Ch. 425, 436 (1911) (Eng.); *In re City Equitable Fire Ins. Co.* 1 L.R.-Ch. 407, 427 (1925) (Eng.).

40. 1 L.R.-Ch. 407 (1925) (Eng.).



imposed on Australian directors.<sup>41</sup> In that case Romer J. held that a director is required to exercise "the care an ordinary man might be expected to take in the circumstances on his own behalf."<sup>42</sup> Even this statement of the duty was immediately undermined by Romer J.'s approval of the proposition that directors are liable only if they "were cognisant of circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men with any ordinary degree of prudence, acting on their own behalf, would have entered into such a transaction as they entered into."<sup>43</sup> Romer J.'s further elucidation of the duty confirmed that minimal care, skill and diligence were expected of directors and that the courts would tolerate substantial delegation by directors of their duties.<sup>44</sup>

The first judicial indication that more would be expected of directors came a decade ago in the context of insolvent trading cases. In *Statewide Tobacco Services, Ltd. v. Morley*<sup>45</sup> and *Commonwealth Bank of Australia v. Friedrich*<sup>46</sup> the court asserted that changes to the corporations legislation and increasing community expectations showed that more was now required of directors.<sup>47</sup> Whilst Ormiston J. acknowledged that "there is still a place for part-time and advisory directors,"<sup>48</sup> both he and Tadgell J. insisted the law would no longer tolerate the passive or incompetent director.<sup>49</sup> Their judgments es-

41. See Douglas Menzies, *Company Directors*, 33 AUSTL. L.J. 156, 163 (1959).

42. 1 L.R.-Ch. 407, 428 (1925) (Eng.).

43. *Id.* (quoting *Overend & Gurney Co. v. Gibb* (1872) 5 L.R.-E. & I. App. 480, 487 (Eng.)).

44. *Id.* at 428-29. Romer J. said:

(1) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience . . . . (2) A director is not bound to give continuous attention to the affairs of his company . . . . (3) In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly:

*Id.*

45. (1990) 2 A.C.S.R. 405 (*aff'd* by the Full Court of the Supreme Court of Victoria in *Morley v. Statewide Tobacco Serv., Ltd.* (1992) 8 A.C.S.R. 305).

46. (1991) 5 A.C.S.R. 115.

47. See *Statewide Tobacco v. Morley* (1990) 2 A.C.S.R. 405, 412-13; *Commonwealth Bank v. Friedrich* (1991) 5 A.C.S.R. 115, 126. See also *Morley v. Statewide Tobacco* (1992) 8 A.C.S.R. 305, 320; *Metal Mfrs. Pty, Ltd. v. Lewis* (1988) 13 N.S.W.L.R. 315, 318-19.

48. *Statewide Tobacco v. Morley* (1990) 2 A.C.S.R. 405, 431.

49. See *id.* at 412-13; *Commonwealth Bank v. Friedrich* (1991) 5 A.C.S.R. 115,

established that directors must display a level of financial competence and knowledge of the company's affairs sufficient to enable them to reach an informed opinion as to the company's financial capacity.<sup>50</sup>

These cases were followed by a spate of litigation against directors alleging that they had breached their duty of care.<sup>51</sup> In a number of these cases the courts stated, frequently by reference to the insolvent trading cases, that the standard of care expected of directors had risen since the cases decided in the late 19th and early 20th century.<sup>52</sup> Nevertheless, most judgments, especially those from the Western Australian Supreme Court dealing with the aftermath of the notorious corporate collapses of the late 1980s, continued to rely heavily on *In re City Equitable* and other English cases of that era.<sup>53</sup> There is little in these judgments, and that of Rogers C.J. in the key New South Wales case of *AWA v. Daniels*,<sup>54</sup> which should strike fear into the hearts of directors. In fact, whilst during this period there was a significant number of civil and criminal actions, it is difficult to find a case in which judgment was entered against a director, who was not also tainted by breaches of other duties.<sup>55</sup> However, *AWA v. Daniels* was widely ac-

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126.

50. See *Statewide Tobacco v. Morley* (1990) 2 A.C.S.R. 405, 412-13; *Commonwealth Bank v. Friedrich* (1991) 5 A.C.S.R. 115, 126.

51. See, e.g., *AWA, Ltd. v. Daniels* (1992) 7 A.C.S.R. 759; *Cummings v. Claremont Petroleum NL* (1992) 9 A.C.S.R. 583; *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395; *McQuestin v. Austl. Sec. Comm'n* (1993) 12 A.C.S.R. 279; *Biala Pty, Ltd. v. Mallina Holdings, Ltd.* (1993) 11 A.C.S.R. 785; *Permanent Bldg. Soc'y (in liq) v. Wheeler* (1994) 14 A.C.S.R. 109; *NCSC v. Hurley* (1995) 13 A.C.L.C. 1635; *Daniels v. Anderson* (1995) 16 A.C.S.R. 607 [hereinafter *AWA Appeal*]; *In re Property Force Consultants Pty, Ltd.* (1995) 13 A.C.L.C. 1051; *S. Austl. v. Marcus Clark* (1996) 19 A.C.S.R. 606; *Mistmorn Pty, Ltd. v. Yasseen* (1996) 21 A.C.S.R. 173; *Gamble v. Hoffmann* (1997) 24 A.C.S.R. 369; *Austl. Sec. Comm'n v. Donovan* (1998) 28 A.C.S.R. 583.

52. See *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 864-65; *Vrisakis v. ASC* (1993) 9 W.A.R. 395, 405; *AWA Appeal*, (1995) 16 A.C.S.R. 607, 661-64; *S. Austl. v. Marcus Clark* (1996) 19 A.C.S.R. 606, 627-28.

53. 1 L.R.-Ch. 407 (1925) (Eng.). See *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395; *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43; *Permanent Bldg. Soc'y v. Wheeler* (1994) 14 A.C.S.R. 109; *NCSC v. Hurley* (1995) 13 A.C.L.C. 1635.

54. (1992) 7 A.C.S.R. 759.

55. There are some cases in which judgment was entered against a director for breach of the duty of care but in most of these the director was also in a position of conflict or had breached other duties. See, e.g., *Cummings v. Claremont*

knowledge as laying down a commercially realistic duty of care.<sup>56</sup> The commercial acceptance of the judicial interpretation of the duty evaporated when the Court of Appeal delivered its judgment in the appeal from *AWA v. Daniels*.<sup>57</sup> In some quarters, at least, this judgment was criticized as imposing too onerous and unrealistic a duty on directors.<sup>58</sup>

The statutory expression of the duty of care was also amended in the early 1990s. Although the *Explanatory Memorandum* asserts that the amended section does no more than re-state the case law duty of care,<sup>59</sup> it is clear that the impetus for the amendment was a perception that, prior to the 1990s, the duty of care required of directors was unacceptably low.<sup>60</sup> However, by the time the legislation was introduced into Parliament, cases such as *Commonwealth Bank of Australia v. Friedrich*<sup>61</sup> and *AWA v. Daniels*, enabled the government to claim that the amendment did "not change the law."<sup>62</sup>

It is against this case law and legislative background that the current Federal Government has proposed a number of reforms to the duty of care as part of CLERP. In particular, it proposes the introduction of a statutory business judgment rule, explicit recognition of a director's right to delegate to and rely on others, and further amendment of the statutory duty of

Petroleum (1992) 9 A.C.S.R. 583; *S. Austl. v. Marcus Clark* (1996) 19 A.C.S.R. 606; *Mistmorn v. Yasseen* (1996) 21 A.C.S.R. 173; *Gamble v. Hoffmann* (1997) 24 A.C.S.R. 369. In other cases in which the court held that a director had breached the duty of care, no judgment was entered against the director. See, e.g., *Permanent Bldg. Soc'y (in liq) v. Wheeler* (1994) 14 A.C.S.R. 109; *AWA Appeal* (1995) 16 A.C.S.R. 607; *McQuestin v. Austl. Sec. Comm'n* (1993) 12 A.C.S.R. 279. In most cases directors were exonerated.

56. See A.S. Sievers, *Directors' Duty of Care: What is the New Standard?*, 15 COMPANY & SEC. L.J. 392 (1997).

57. *AWA Appeal* (1995) 16 A.C.S.R. 607.

58. See Robert Baxt, *One 'AWA Case' is Not Enough: The Turning of the Screws for Directors*, 13 COMPANY & SEC. L.J. 414 (1995); Australian Institute of Company Directors, *Duty of Care and the Business Judgment Rule: Submission to Department of Treasury/CLERP*, June 1997, at 2. CLERP appears to blame the judgment for much of the uncertainty about the duty of care. See CLERP, *Directors' Duties and Corporate Governance: Proposals For Reform: Paper No. 3* (1997), at 22 [hereinafter *CLERP Proposal*].

59. *Corporate Law Reform Bill 1992, Explanatory Memorandum*, at 83 [hereinafter *CLRB Explanatory Memo*].

60. See Senate Standing Committee on Constitutional and Legal Affairs, *Report on the Social and Fiduciary Duties and Obligations of Company Directors*, Nov. 1989, ch. 3 [hereinafter *Cooney Report*].

61. (1991) 5 A.C.S.R. 115.

62. *CLRB Explanatory Memo*, *supra* note 59, para. 83.

care.

## V. THE CURRENT DUTY OF CARE (OR DRAGGING DIRECTORS INTO THE 20TH CENTURY)

### A. *An Objective Duty with Subjective Elements*

The duty is generally considered to be an objective one.<sup>63</sup> A director must exercise reasonable care or, to put it another way, the director's conduct will be measured by reference to the conduct of a reasonable person in the position of the director. This, however, does not mean that the same standard of care, skill and diligence will be expected of all directors. The duty is objective and thus constant, but the conduct required to satisfy the duty varies depending on a number of circumstances.<sup>64</sup> The courts do not treat directors as professionals who are expected to meet a uniform standard of conduct. It has been recognized repeatedly that the nature of companies, the role of directors within those companies and the experience and skill of persons who become directors may legitimately vary to such an extent that it is impossible to lay down a uniform set of norms by which to judge a director's behavior.<sup>65</sup> Thus, it is accepted that when determining what constitutes reasonable care the courts must take into account a number of features of the particular fact situation before them. In this way the duty sometimes appears to operate much like a subjective one, which the incompetent who plays a minor role in the company is less likely to breach than the highly skilled chief executive officer.

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63. See *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43, 53; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 451; *Permanent Bldg. Soc'y (in liq) v. Wheeler* (1994) 14 A.C.S.R. 109, 159; *NCSC v. Hurley* (1995) 13 A.C.L.C. 1635 1641; *AWA Appeal* (1995) 16 A.C.S.R. 607, 666. The statutory duty provides that:

In the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances.

Corporations Law, § 232(4) (Austl.).

64. See *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 404, 451; *AWA Appeal* (1995) 16 A.C.S.R. 607, 668.

65. *In re City Equitable Fire Ins. Co.* 1 L.R.-Ch. 407, 426 (1925) (Eng.); *Commonwealth Bank of Australia v. Friedrich* (1991) 5 A.C.S.R. 115, 125; *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 865; *AWA Appeal* (1995) 16 A.C.S.R. 607, 664, 668.

*B. Variation of the Standard of Conduct Required of Directors*

When determining what conduct will satisfy the duty of care, the courts regard a number of factors. In particular, the court will consider: (1) the type of company and its particular circumstances; (2) the distribution of functions within the corporation; and (3) the personal traits or idiosyncrasies of the director involved.<sup>66</sup> The relevance and scope of the first two factors is uncontroversial. The third is more problematic.

As early as *In re City Equitable* it was recognized that the tasks of directors depend on the nature of the business conducted by the company and the size of that business.<sup>67</sup> The modern cases particularly stress the relevance of size.<sup>68</sup> They acknowledge that in modern conglomerates it is impossible for directors to have a detailed knowledge of the business and its day-to-day concerns.<sup>69</sup> Thus, the larger the corporation, the less involvement in the affairs of the company that can be demanded of directors and the more they are allowed to delegate the types of tasks that would ordinarily be the province of the board.<sup>70</sup> The modern statutory requirement also qualifies the duty by reference to the "corporation's circumstances" so as to allow consideration of "the state of the corporation's financial affairs, the size and nature of the corporation, [and] the urgency and magnitude of any problem."<sup>71</sup>

Provided that there are no limitations in the company's constitution, the company has considerable freedom to divide management functions, within the board and between the board and management, in any way it considers appropriate.<sup>72</sup> The court takes into account the distribution adopted when determining whether a director's conduct satisfies the duty of care.<sup>73</sup> In *AWA v. Daniels*, Rogers C.J. drew a clear, and much

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66. See discussion *infra* Part V.B.

67. 1 L.R.-Ch. 407, 426 (1925) (Eng.). See also *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 864, 866; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 451.

68. See, e.g., *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 865-66.

69. See *id.*

70. See *id.*

71. *CLRB Explanatory Memo*, *supra* note 59, para. 86.

72. See *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 865-68. However, it appears that functions can no longer be divided in such a way as to give a director an entirely passive role. All directors are now required to perform certain minimum functions. See discussion *infra* note 90 and accompanying text.

73. See *CLRB Explanatory Memo*, *supra* note 59, para. 39, 85; *In re City Equitable Fire Ins. Co.*, 1 L.R.-Ch. 407, 426-27 (1925) (Eng.); *AWA v. Daniels*

supported,<sup>74</sup> distinction between the roles of executive and non-executive directors, stating that the latter are expected merely to guide and monitor the company and give intermittent attention to its affairs.<sup>75</sup> The majority in the *AWA Appeal* appeared to cast doubt on the relevance of this distinction.<sup>76</sup> However, it is likely that they merely wished to stress that all directors, regardless of the division of functions within the board, must perform certain minimum functions, and that it is no longer acceptable for non-executive directors to be appointed solely for "perceived commercial advantage such as attracting customers or adding to the prestige and status of the company."<sup>77</sup> In any case, the importance of the division drawn by Rogers C.J. in *AWA v. Daniels* has been endorsed by courts in other Australian jurisdictions.<sup>78</sup>

As stated above, the relevance of the directors' personal traits or idiosyncrasies to the determination of what is required to satisfy the duty is problematic. It has frequently been said that "[w]hat constitutes proper performance of the duties of a director of a particular company is considered to be dependant ... upon the actual knowledge and experience of the individual director."<sup>79</sup> Moreover, it is clear that if a director has particular expertise, skill or experience, he or she will be expected to display it and, thus, a higher standard of care is required of such a director.<sup>80</sup>

However, the issue of whether the standard can be adjusted downwards by reference to a director's lack of expertise, skills, experience or, even, intelligence is controversial. It is

(1992) 7 A.C.S.R. 759, 864; *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43, 53; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 451.

74. See, e.g., Alex Chernov, *The Role of Corporate Governance Practices in the Development of Legal Principles Relating to Directors*, in *CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS*, *supra* note 5, at 33, 37; Baxt, *supra* note 58, at 421.

75. *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 866-67.

76. *AWA Appeal* (1995) 16 A.C.S.R. 607, 664.

77. *Id.*

78. See *Biala v. Mallina* (1993) 11 A.C.S.R. 785, 857; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 451-52.

79. *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 864 (*approved in Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 451). The *CLRB Explanatory Memo*, *supra* note 59, para. 39, 85, states that the phrase "in a like position" in § 232(4) enables the court to take into account the director's special expertise, background and qualifications.

80. See *In re City Equitable Fire Ins. Co.*, 1 L.R.-Ch. 407, 428 (1925) (Eng.).

strongly arguable that, in the *AWA Appeal*, Clarke and Sheller J.J.A. held that such personal deficiencies should not be taken into account in determining what is required to satisfy the duty.<sup>81</sup> In *Gamble v. Hoffman*, Carr J., by reference to the *AWA Appeal*, doubted whether the fact that the director "left school at the age of 14 years, has no tertiary qualifications and has spent his life '... essentially as a fruit and vegetable market gardener'" justified a lower standard.<sup>82</sup> The great difficulty with the contrary view, that personal factors such as lack of expertise, skill, experience and intelligence lower the standard of conduct required of directors, is that, if accepted, the duty ceases to be objective in any meaningful sense.<sup>83</sup>

### C. What is the Director's Role?

Although a corporation has considerable freedom to divide management functions within the corporation in any way it considers appropriate,<sup>84</sup> in most corporations management powers are specifically vested in the board.<sup>85</sup> However, the board may delegate these management powers.<sup>86</sup> In practice, the extent of delegation, especially in large corporations, is such that directors become monitors, rather than managers.<sup>87</sup>

The most notable feature of the 1990s cases on the duty of care is that they place a limitation on the freedom of the board

81. See *AWA Appeal* (1995) 16 A.C.S.R. 607, 666; *Gamble v. Hoffman* (1997) 24 A.C.S.R. 369, 373; G. P. Stapledon, *The CLERP Proposal in Relation to Section 232(4): The Duty of Care and Diligence*, 16 COMPANY & SEC. L.J. 144 (1998).

82. *Gamble v. Hoffmann* (1997) 24 A.C.S.R. 369, 373. It is interesting to note that in an earlier draft of the CLERP Bill, the statutory duty read: "A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: . . . (c) had the director or other officer's experience." CLERP, *Draft Legislative Provisions*, 1998, pt. 2, § 2(1). This appeared to require consideration of personal factors such as lack of expertise and skills and, yet, it was claimed that the amendment was consistent with *AWA Appeal* (1995) 16 A.C.S.R. 607. See *CLERP Proposal*, *supra* note 58, at 45. Both this claim and the merits of this amendment were severely criticized. See Stapledon, *supra* note 81. Paragraph (c) was omitted from the CLERP Bill when it was presented to Parliament.

83. See *AWA Appeal* (1995) 16 A.C.S.R. 607, 666; *Gamble v. Hoffman* (1997) 24 A.C.S.R. 369, 373.

84. See *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 865.

85. See Corporations Law, § 226A (Austl.).

86. The power to delegate is implicit in section 226A. See *id.* It will be explicitly outlined in the Corporations Law if the CLERP Bill is passed. See CLERP Bill, § 198D, sched. 1. See also Corporations Law, §§ 226C, 226D.

87. See *CLERP Proposal*, *supra* note 58, at 22.

to delegate.<sup>88</sup> They stress that all directors must perform certain minimum management tasks.<sup>89</sup> In other words, a corporation cannot distribute management functions so that all or any of its directors are nothing more than figure-heads: "the days of the sleeping, or passive, director are well and truly over."<sup>90</sup> This is the major difference between the current duty of care and that expounded in the late 19th and early 20th century. In 1911, Neville J. said a director "is not ... bound to take any definite part in the conduct of the company's business."<sup>91</sup> In contrast, in 1995 Clarke and Sheller J.J.A. confidently asserted "the courts ... have recognised that at law more is required of a director than supine indifference. The legislature requires both diligence and action."<sup>92</sup> Thus, regardless of the distribution of functions within the corporation, the size and nature of the corporation's business and the director's knowledge, skill and experience, a director's role now has a minimum content.<sup>93</sup>

It is not easy to describe this minimum content. There is no dispute that all directors must read and understand the corporation's financial reports. The insolvent trading cases established that a director is required to have "sufficient

88. See, e.g., *AWA Appeal* (1995) 16 A.C.S.R. 607, 663, 668; *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43, 54-55; *In re Property Force Consultants Pty, Ltd.* (1995) 13 A.C.L.C. 1051, 1061.

89. See *AWA Appeal* (1995) 16 A.C.S.R. 607, 663, 668; *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43, 54-55; *In re Property Force Consultants Pty, Ltd.* (1995) 13 A.C.L.C. 1051, 1061.

90. *Naffai v. Haines*, Nov. 26, 1991, NSW (CA), unreported. See also, *AWA Appeal* (1995) 16 A.C.S.R. 607, 663, 668. Cf. *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43, 54-55. The court distanced itself from the magistrate's assertion that the director's function was no more than "flag waving." Justice Pidgeon asserted that the director still had certain responsibilities within the corporation. Nevertheless, the director escaped liability because it was reasonable for him to rely on the other directors who had more experience in banking, the business of the company.

91. *In re Brazilian Rubber Plantations & Estates, Ltd.*, 1 L.R.-Ch. 425, 437 (1911) (Eng.). See, e.g., *In re Denham*, 25 Ch. D. 752 (1883) (Eng.), where a 'country gentleman' was held not to have breached his duty even though he had not attended any board meetings for four years and, therefore, did not notice that the chairman was falsifying the company's accounts.

92. *AWA Appeal* (1995) 16 A.C.S.R. 607, 657.

93. A court would presumably respect a provision in a corporate constitution which specifically stated that a director, or directors, are not required to perform any functions. Such a provision would be unusual but, nevertheless, it seems unlikely that a director protected by such a provision would be held to have breached the duty of care because of his or her passivity.



knowledge and understanding of the company's affairs and its financial records" to enable him or her to form an annual opinion as to the solvency of the company.<sup>94</sup> Beyond this task, the extent of the director's minimum role is not clear. In *AWA v. Daniels*, Rogers C.J. said a director must guide and monitor the management of the company.<sup>95</sup> In particular, he described the director's role as:

- (1) to set goals for the corporation;
- (2) to appoint the corporation's chief executive;
- (3) to oversee the plans of managers for the acquisition and organization of financial and human resources towards attainment of the corporation's goals; and
- (4) to review, at reasonable intervals, the corporation's progress towards attaining its goals.<sup>96</sup>

In performing these functions, a director is not required to become involved in the day-to-day management of the corporation, nor is he or she required to have a detailed knowledge of the business.<sup>97</sup> In essence, it appears that Rogers C.J. conceived of a director as a person whose only essential contribution to the corporation is on matters of high policy.<sup>98</sup> The majority in the *AWA Appeal* also described the director's role as guiding and monitoring management.<sup>99</sup> However, it appears that they considered that this role involves more direct involvement in the affairs of the company than Rogers C.J. thought practicable.<sup>100</sup> In their view, all directors must understand the business of the company and how it is run, be informed about the activities of the corporation, regularly review the company's financial reports and ensure that the board is in a position to audit management.<sup>101</sup>

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94. *Statewide Tobacco v. Morley* (1990) 2 A.C.S.R. 405, 412-13; *Commonwealth Bank v. Friedrich* (1991) 5 A.C.S.R. 115, 125-26.

95. *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 864.

96. *Id.* at 865-66.

97. *See id.*

98. *See John Farrar, Corporate Governance, Business Judgment and the Professionalism of Directors*, 6 CORP. & BUS. L.J. 1, 8 (1993).

99. *AWA Appeal* (1995) 16 A.C.S.R. 607, 664.

100. *Compare AWA v. Daniels* (1992) 7 A.C.S.R. 759, 865-69, with *AWA Appeal* (1995) 16 A.C.S.R. 607, 664-68.

101. *See AWA Appeal* (1995) 16 A.C.S.R. 607, 664.

*D. Should a Director be Skillful and Diligent?*

Traditionally, a director who possessed special skills was required to display them,<sup>102</sup> but a director was not required to possess any skills.<sup>103</sup> However, as stated above, the law now requires that all directors fulfill a minimum role.<sup>104</sup> Consequently, all directors must now possess the degree of skill necessary to fulfill this role. That is, at minimum, directors must be able to read and understand the company's accounts, evaluate the financial position of the company and understand the company's business.<sup>105</sup> A person who is incapable of performing this minimum role should not accept the position of director.<sup>106</sup>

This new approach may mean that the company is unable to access certain specialist skills or perspectives at board level. For example, neither a specialist geologist, nor an employee representative, may sit on the board of a mining company unless he or she is capable of understanding the company's financial accounts.<sup>107</sup> The majority in the *AWA Appeal* acknowledged and accepted this price, stating that "a director, whatever his or her background, has a duty greater than that of simply representing a particular field of experience."<sup>108</sup> In any case, this may not be a high price to pay. A corporation can easily access specialist skills through consultancies, rather than directorships. Consultancies are less likely to be used by a board to provide different perspectives, such as those of employees or consumers. However, the fact that diverse perspectives are not represented at board level is consistent with the Australian shareholder-centered model of the corporation.<sup>109</sup>

102. See *In re Brazilian Rubber Plantation & Estates, Ltd.*, 1 L.R.-Ch. 425, 437 (1911) (Eng.); R. Macfarlan, *Directors' Duties After the National Safety Council Case: Directors' Duty of Care*, 9 AUST. BAR REV. 269, 275 (1992).

103. See *In re Brazilian Rubber Plantation & Estates, Ltd.*, 1 L.R.-Ch. 425, 437 (1911) (Eng.); *In re City Equitable Fire Ins. Co.*, 1 L.R.-Ch. 407, 428 (1925) (Eng.).

104. See discussion *supra* note 93 and accompanying text.

105. See Julie Cassidy, *An Evaluation of Section 232(4) of the Corporations Law and the Directors' Duty of Due Care, Skill and Diligence*, 23 AUSTL. BUS. L. REV. 184, 187 (1995).

106. See *AWA Appeal* (1995) 16 A.C.S.R. 607, 666 (citing *Francis v. United Jersey Bank*, 432 A.2d 814 (1981)).

107. Cf. M.J. Trebilcock, *The Liability of Company Directors for Negligence*, 32 MOD. L. REV. 499, 509-10 (1969).

108. *AWA Appeal* (1995) 16 A.C.S.R. 607, 664.

109. See *CLERP Proposal*, *supra* note 58, at 60.

In line with the rejection of passive or sleeping directors, the law now requires diligent attendance at meetings. A director is required to attend all board meetings and all meetings of committees on which he or she sits "unless exceptional circumstances, such as illness or absence from the State prevent him or her from doing so."<sup>110</sup> Moreover, the director must actually participate in the meetings; he or she must bring an informed mind to the meetings and exercise an independent judgment.<sup>111</sup>

The more difficult issue is how frequently the board or committees should meet. It is accepted that a non-executive director is not required to devote full-time attention to the corporation.<sup>112</sup> Beyond this there is a difference of approach, at least in the *AWA Cases*.<sup>113</sup> Rogers C.J.'s approach is to limit the extent of the non-executive's role by reference to the fact the board only meets periodically.<sup>114</sup> The Court of Appeal, on the other hand, approached the issue from the other end. The majority defined the extent of diligence required by reference to the director's role and, thus, said that the board should meet as often as is necessary to fulfill its role.<sup>115</sup> The latter approach increases the possibility of a breach of duty by a board that does not meet sufficiently frequently.

#### *E. Passing the Buck—Delegation and Reliance on Others*

It is clear that directors are entitled to delegate the bulk of their management functions and to rely on their delegates to perform their functions properly. There are numerous cases in which the directors have escaped liability because they had relied on other directors,<sup>116</sup> management<sup>117</sup> or auditors<sup>118</sup>

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110. *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 405.

111. *See AWA v. Daniels* (1992) 7 A.C.S.R. 759, 864-65.

112. *See id.* at 867; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 405; *AWA Appeal* (1995) 16 A.C.S.R. 607, 657.

113. *See AWA v. Daniels* (1992) 7 A.C.S.R. 759; *AWA Appeal* (1995) 16 A.C.S.R. 607.

114. *See AWA v. Daniels* (1992) 7 A.C.S.R. 759, 867.

115. *AWA Appeal* (1995) 16 A.C.S.R. 607, 664.

116. *See, e.g., Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43; *Biala v. Mallina* (1993) 11 A.C.S.R. 785.

117. *See AWA v. Daniels* (1992) 7 A.C.S.R. 759; *AWA Appeal* (1995) 16 A.C.S.R. 607.

118. *See AWA v. Daniels* (1992) 7 A.C.S.R. 759; *AWA Appeal* (1995) 16 A.C.S.R. 607; *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395.

to perform their management functions.

Nevertheless, there are limitations on the extent of permissible delegation. Directors cannot delegate to such an extent that they abdicate all responsibility; that is, all directors must fulfill the minimum role. Additionally, the circumstances of the particular case may be such that the director must personally perform far more than these minimal tasks. For example, in *Permanent Building Society v. Wheeler*,<sup>119</sup> the Full Court of the Supreme Court of Western Australia held that a director who abstained from voting because of a conflict of interest had breached his duty of care. The fact that the director was the chief executive and managing director of the company and that the transaction being considered was extremely risky and one in which the remainder of the board had no expertise, meant that the director could not delegate his obligation to review the transaction. The court held that regardless of his conflict of interest, the director should have personally ensured that the other directors appreciated the harm inherent in the transaction, pointed out ways in which that harm could be reduced, and ensured the company would be provided with adequate security.

The final limitation on the extent of permissible delegation is that directors are not entitled to rely on a delegate if they are aware that the delegate is not properly performing the delegated task.<sup>120</sup> The degree of notice that renders reliance improper is another point of difference between the courts in the *AWA Cases*. According to Rogers C.J., reliance upon management or others is only improper if the director has unambiguous notice that the persons so entrusted are not properly performing their delegated tasks. He stated that:

Reliance would only be unreasonable where the director was aware of circumstances of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence, acting on his behalf, would have relied on the particular judgment information and advice of the officers.<sup>121</sup>

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119. (1994) 14 A.C.S.R. 109. Note this case has been criticized as imposing too onerous a duty on directors. See Baxt, *supra* note 58, at 428-30.

120. See *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 868; *AWA Appeal* (1995) 16 A.C.S.R. 607, 666.

121. *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 868.

This approach is even more indulgent of directors than that in *In re City Equitable Fire Insurance Co.*,<sup>122</sup> and was specifically rejected by the majority judges in the Court of Appeal.<sup>123</sup> They clearly expected more diligent monitoring of delegates. Thus, they held that delegation ceases to be permissible if directors "know, or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put a prudent man on his guard."<sup>124</sup>

## VI. THE CLERP REFORMS—BACK TO THE FUTURE

Dissatisfaction with the more onerous duty, and the uncertainty created by the judicial contributions of the past decade, prompted the government to propose a number of duty of care reforms as part of CLERP. These reforms, which are now embodied in the CLERP Bill, are examined in this section.

### A. *Business Judgment Rule*

Section 180(2), schedule 1 of the CLERP Bill provides that directors, who make a business judgment, will be taken to have complied with the duty of care, if they:

- (a) make the judgment in good faith for a proper purpose; and
- (b) do not have a material personal interest in the subject matter of the judgment; and
- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationally believe that the judgment is in the best interests of the corporation.<sup>125</sup>

The legislature intends that this rule will operate, like its American counterpart, as a presumption in favor of directors,

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122. 1 L.R.-Ch. 407 (1925) (Eng.). See Paul Redmond, *Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?*, in CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS, *supra* note 5, at 185, 187.

123. See *AWA Appeal* (1995) 16 A.C.S.R. 607, 665.

124. *Id.* at 666 (citing *Rankin v. Cooper*, 149 F. 1010, 1013 (1907)). For a comparative discussion of the duty of oversight under U.S. and Australian law, see Jennifer Hill, *Deconstructing Sunbeam—Contemporary Issues in Corporate Governance*, 67 U. CIN. L. REV. 1099 (1999).

125. CLERP Bill, *supra* note 9, § 180(2), sched. 1.

with the onus on the plaintiff to prove that the director did not satisfy the five criteria in the rule.<sup>126</sup> That is, it is intended that the plaintiff must show that the director did not make a business judgment<sup>127</sup> or that he or she did not comply with paragraphs (a) to (d). A plaintiff who manages to do this must then establish that the director has breached the duty of care.

It is highly unlikely that this import<sup>128</sup> into Australian law will affect the outcome of litigation. As stated above, in spite of the large number of recent cases, only a handful of directors have been held to have breached their duty of care, and even fewer have had judgments entered against them.<sup>129</sup> Generally, judgments were only entered against directors who, in addition to breaching the duty of care, had a conflict of interest or breached their duty to act bona fide for the benefit of the company and for a proper purpose.<sup>130</sup> The business judgment rule would not have protected these directors.<sup>131</sup> Directors who have a material personal interest in the subject matter of a decision are prevented from entering the business judgment safe harbor by paragraph (b) and those who have breached the duty to act bona fide for the benefit of the compa-

126. See *Corporate Law Economic Reform Program Bill 1998, Explanatory Memorandum*, at 18 [hereinafter *CLERP Bill Explanatory Memo*]. Compare Deborah A. DeMott, *Legislating Business Judgment—A Comment from the United States*, 16 *COMPANY & SEC. L.J.* 575, 576 (1998), in which it is argued that the “language [of the rule] appears more apt to place the onus on the director.” See also G.F.K. Santow, *Codification of Directors’ Duties*, 73 *AUST. L.J.* 336, 348-49 (1999).

127. See *CLERP Bill*, *supra* note 9, § 180(2), sched. 1. This requirement is derived from the opening words of the rule which refer to a “director or other officer of a corporation who makes a business judgment.” *Id.* § 180(3), sched. 1. “Business judgment” is defined as “any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.” *Id.* § 180(3), sched. 1. The U.S. business judgment rule also only protects directors’ decisions. Omissions or failures of oversight are not covered by the rule. See Charles Hansen, *The Duty of Care, the Business Judgment Rule, and The American Law Institute Corporate Governance Project*, 48 *BUS. LAW.* 1355, 1356-60 (1993). It has been suggested that the proposed Australian rule covers a narrower range of directorial conduct than the U.S. business judgment rule, because its protection is confined, by section 180(3), sched. 1, to business judgments which are “relevant to business operations.” DeMott, *supra* note 126, at 577.

128. The business judgment rule in the *CLERP Bill* is closely modelled on the American Law Institute’s business judgment rule. See *AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE* § 4.01(c) (1994).

129. See discussion *supra* note 55.

130. See *id.*

131. See Larelle Law, *The Business Judgment Rule in Australia: A Reappraisal Since the AWA Case*, 15 *COMPANY & SEC. L.J.* 174, 188 (1997).

ny and for a proper purpose will not satisfy the preconditions to protection in paragraphs (a) and (d).

Likewise, paragraph (c) is unlikely to affect the development of the law. Under the current duty of care a director may, in theory, be liable if either the decision-making processes or decisions fail to meet the requisite standard of care. The effect of paragraph (c) is to shift the focus of the duty away from the merits of decisions and on to one aspect of the decision-making process, that is, the informational base on which decisions are made. Failure to gather the requisite information, rather than poor decisions, will attract liability.<sup>132</sup> However, the impact of this shift in focus will be largely symbolic. Under the current law, the prospect of liability attaching to poor decisions is remote. Judges are extremely reluctant to review the merits of business decisions.<sup>133</sup> On the other hand, even in the late 19th century cases, the courts were prepared to take some notice of defects in the decision-making process<sup>134</sup> and the recent cases stress the importance of being informed.<sup>135</sup> In other words, emphasis on the review of the decision-making process, rather than the actual decision, is implicit in the current law.

Finally, the requirement that directors actually make a business decision or judgment means that a significant range of conduct will be denied the protection of the business judgment rule. Failures to respond to business crises or failures to monitor or review the conduct of delegates and subordinates will still be judged by the standards laid down in cases such as the *AWA Appeal*. Again, this refusal to allow those who fail to make a decision to enter the safe harbor provided by the business judgment rule reinforces, rather than alters, the current law. In practice, it is those who fail to take part in the decision-making process, not those who make decisions, that are

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132. The U.S. business judgment rule also means that "due care examination has focused on a board's *decisionmaking process*." See *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66 (Del. 1989).

133. See, e.g., *Harlowe's Nominees Pty, Ltd. v. Woodside (Lakes Entrance) Oil Co.* (1968) 121 C.L.R. 483, 493; *Howard Smith, Ltd. v. Ampol Petroleum, Ltd.* (1974) A.C. 821, 835; *Turquand v. Marshall*, 4 L.R.-Ch. App. 376, 386 (1869) (Eng.).

134. See JOHN E. PARKINSON, *CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW* 110-11 (1993).

135. See *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 864-65; *Austl. Sec. Comm'n v. Gallagher* (1993) 10 A.C.S.R. 43, 53.

currently caught by the duty of care. Judges may be reluctant to review the merits of business decisions<sup>136</sup> but, as the insolvent trading cases and dicta in the *AWA Appeal* show,<sup>137</sup> they are willing to punish passivity.

Thus, the business judgment rule will not give directors greater or lesser protection than they currently enjoy. Directors who can satisfy the five criteria of the rule will not be judged by the statutory or case law duty of care. However, in all probability, they would be able to satisfy that duty if it were applied to them. On the other hand, directors who fail to satisfy one of the five criteria will still be subject to the existing duty of care.

The fact that the business judgment rule is unlikely to affect the outcome of litigation raises questions about its utility. In *Directors' Duties and Corporate Governance: Proposals for Reform: Paper No. 3 (CLERP Proposal)*, the rule is justified on the basis that it will encourage entrepreneurial risk-taking and, therefore, enhance shareholder wealth.<sup>138</sup> The need to encourage risk-taking has already shaped both the common law and statutory duty of care.<sup>139</sup> Judges are clearly cognizant of the need to avoid applying the duty of care in a way which will "dampen business enterprise and penalise legitimate but unsuccessful entrepreneurial activity."<sup>140</sup> However, in spite of this judicial sensitivity to the risk-taking role of directors, the uncertainty of the current duty of care has, according to the *CLERP Proposal*, caused directors to engage in

136. See, e.g., *Harlowe's Nominees Pty, Ltd. v. Woodside (Lakes Entrance) Oil Co.* (1968) 121 C.L.R. 483, 493; *Howard Smith, Ltd. v. Ampol Petroleum, Ltd.* (1974) A.C. 821, 835; *Turquand v. Marshall*, 4 L.R.-Ch. App. 376, 386 (1869) (Eng.).

137. *AWA Appeal* (1995) 16 A.C.S.R. 607, 657, 661-664, 668. See also *Statewide Tobacco v. Morley* (1990) 2 A.C.S.R. 405; *Commonwealth Bank of Austl. v. Friedrich* (1991) 5 A.C.S.R. 115; *Morley v. Statewide Tobacco Servs., Ltd.* (1992) 8 A.C.S.R. 305.

138. See *CLERP Proposal*, *supra* note 58, at 22-23. See also, Alan Cameron, *The Perspective of the Australian Securities Commission on the Enforcement of Directors' Duties and the Role of the Courts: A Comment*, in *CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS*, *supra* note 5, at 205, 205-06; Australian Institute of Company Directors, *Duty of Care and the Business Judgment Rule: Submission to Department of Treasury/CLERP*, June 1997, at 3.

139. See, e.g., *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 449-50; *AWA Appeal* (1995) 16 A.C.S.R. 607, 664; *Permanent Bldg. Soc'y v. Wheeler* (1994) 14 A.C.S.R. 109, 159; *CLRB Explanatory Memo*, *supra* note 59, para. 87.

140. *Vrisakis v. Austl. Sec. Comm'n* (1993) 9 W.A.R. 395, 449.



conservative, risk-averse behavior.<sup>141</sup> The *CLERP Proposal* paints a picture of directors who are so paralysed by judge-made confusion that they are unable to fulfill their task of generating wealth for shareholders and the society in general.<sup>142</sup>

There are, undoubtedly, areas of uncertainty in the current law but an analysis of all recent cases, rather than just the two *AWA Cases*, shows that some clear and settled principles have developed.<sup>143</sup> In any case, there are many unknowns surrounding the business judgment rule in the CLERP Bill. It involves a number of concepts untested in Australian courts and, thus, it will be some time before lawyers can confidently advise directors on its meaning. In spite of its similarity to the American Law Institute's business judgment rule,<sup>144</sup> American jurisprudence may well be of limited assistance in interpreting the Australian rule. The restrictive definition of "business judgment" in the CLERP Bill is likely to confine the area of operation of the Australian rule compared to its American counterpart.<sup>145</sup> Moreover, it is difficult to predict how judges will interpret even those parts of the rule which rely on concepts already familiar to Australian corporate lawyers. The notion of "material personal interest," found in paragraph (b) of the rule, is used elsewhere in the legislation but there is no real guidance as to its meaning in either the legislation or the case law.<sup>146</sup> Paragraphs (a) and (d) almost mirror the duty to act bona fide for the benefit of the company and for a proper purpose.<sup>147</sup> However, the body of case law on this duty is not noted for its clarity.

Having said this, it is the perception of certainty, rather than certainty itself, which is required to pacify directors and liberate their entrepreneurial spirit. The business judgment rule may create sufficient illusion of certainty as to free direc-

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141. *CLERP Proposal*, *supra* note 58, at 22-23.

142. *Id.*

143. *See* Sievers, *supra* note 56, at 408.

144. *See* discussion *supra* note 128.

145. *See* discussion *supra* note 127.

146. *See* FORD ET AL., *supra* note 28, para. 9.150.

147. Paragraph (d) requires that the director "rationally" believe that his or her judgment is in the best interests of the corporation. The existing law merely requires a subjective belief. *See* *Smith & Fawcett, Ltd*, Ch. 304, 306 (1942) (Eng.). The inconsistency, however, is unlikely to cause difficulty.

tors from the paralysis that is allegedly caused by the current law. It provides a "checklist" against which directors can measure their decisions, rather than an open-ended test. It should be easier for directors to satisfy themselves that they have complied with the checklist, than it is for them to assure themselves that their actual decision is one that a reasonable director in a similar position and in a similar corporation would make. The brevity of the list is also an advantage. Under the current law it would be almost impossible to provide directors with a hundred word description of what they must do to satisfy their duty.

Thus, the business judgment rule in the CLERP Bill is unlikely to have a great impact on the development of the law. It will not substantially affect the outcome of litigation. However, it may give directors sufficient peace of mind and free them to take risks. That is, its greatest effect is likely to be psychological. The situation has been neatly summarized by a member of the Business Regulation Advisory Group, which advised the government on the proposed reform. He said that the business judgment rule "does no more than codify what the law is at the moment. But you do need something to stop directors spending 95 per cent of their time making sure their back-sides are covered. It's a shocking waste."<sup>148</sup>

### *B. Statutory Recognition of the Right to Delegate*

The CLERP Bill attempts to proscribe the limits of directors' rights to delegate their functions and to rely on advice and information provided by employees, professional advisers, experts, officers and other directors.<sup>149</sup> This attempt was prompted by uncertainty about the extent of permissible delegation, created by the difference of approach to this issue in the two *AWA Cases*.<sup>150</sup> Again, it is feared that this uncertainty "could lead to an overly conservative approach to management and could impede the decision-making processes within a company."<sup>151</sup>

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148. Trevor Sykes, *Why the Minimalist Model May Harm Investors*, AUSTL. FIN. REV., Mar. 19, 1998, at 15 (quoting Leigh Hall).

149. CLERP Bill, *supra* note 9, §§ 189, 190, sched. 1.

150. See *supra* note 121 and accompanying text.

151. CLERP Bill Explanatory Memo, *supra* note 126, at 29.

Section 198D, schedule 1 of the CLERP Bill specifically recognizes directors' right to delegate any of their powers to a single director, a committee of directors, an employee or any other person, unless the company's constitution provides otherwise.<sup>152</sup> Section 190(2), schedule 1 of the Bill provides that a director is not responsible for the delegate's exercise of power provided:

- (a) the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by this Law and the company's constitution (if any); and
- (b) the director believed:
  - (i) on reasonable grounds; and
  - (ii) in good faith; and
  - (iii) after making proper inquiry if the circumstances indicated the need for inquiry; that the delegate was reliable and competent in relation to the power-delegated.<sup>153</sup>

Section 189, schedule 1, provides that in an action for breach of duty, a director's reliance on information or advice provided by an employee, professional adviser, expert, officer, director, or a committee of directors will be presumed to be reasonable, provided certain conditions are met.<sup>154</sup> First, the director must believe, on reasonable grounds, that the employee is reliable and competent in relation to matters relied upon or that the advice is within the professional adviser's or expert's area of competence.<sup>155</sup> Alternatively, if the director has relied upon information from an officer, director or committee of directors, those persons must be acting within authority in providing that information.<sup>156</sup> Second, the director's reliance on the information or advice must be in good faith.<sup>157</sup> Finally, the reliance must be made "after making proper inquiry if the circumstances indicated the need for inquiry."<sup>158</sup> Even if these conditions are satisfied, the presumption of rea-

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152. CLERP Bill, *supra* note 9, § 198D, sched. 1.

153. *Id.* § 190(2), sched. 1.

154. *See id.* § 189, sched. 1.

155. *See id.* § 189(a)(i)(ii), sched. 1.

156. *See id.* § 189(a)(iii)(iv), sched. 1.

157. *See id.* § 189(b)(i), sched. 1.

158. *See id.* § 189(b)(ii), sched. 1.

sonable reliance can be rebutted.<sup>159</sup>

The weakness of these provisions is that they do little to resolve the uncertainty created by the difference of opinion in the *AWA Cases*. The most significant dispute between Rogers C.J. and the majority of the Court of Appeal was the issue of when circumstances indicate that the directors should make further inquiry before relying on actions of or information provided by delegates.<sup>160</sup> The sections do not resolve this dispute; they merely state that a director is only entitled to protection if he or she made proper inquiry when "the circumstances indicated the need for inquiry."<sup>161</sup> Section 190 also leaves open the question of when a director has "reasonable grounds" to believe that a delegate will exercise the power in conformity with the director's duties. If the courts interpret the provision in conformity with the decision of Rogers C.J., the director's belief may be reasonable unless he or she has unambiguous notice of a failure to comply with relevant standards imposed on directors.<sup>162</sup> Alternatively, the courts could interpret the section in accordance with the sentiments expressed in the *AWA Appeal*. This would lead to the conclusion that a director's belief is not reasonable, if the director "know[s], or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put a prudent man on his guard."<sup>163</sup> The latter interpretation is more consistent with the usual construction of "reasonable person" tests. Similar uncertainty exists about what will constitute belief on reasonable grounds that an employee or delegate is reliable and competent.<sup>164</sup> Given that the onus is on the director to prove that he or she has satisfied the many conditions in these sections, the uncertainty should be a matter of considerable concern for directors.

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159. See *CLERP Bill Explanatory Memo*, *supra* note 126, at 29.

160. See *supra* note 121 and accompanying text.

161. *CLERP Bill*, *supra* note 9, §§ 189(b)(ii), 190(2)(b)(iii), sched. 1.

162. See *AWA v. Daniels* (1992) 7 A.C.S.R. 759, 868.

163. *AWA Appeal* (1995) 16 A.C.S.R. 607, 666 (quoting *Rankin v. Cooper*, 149 F. 1010, 1013 (1907)).

164. See *CLERP Bill*, *supra* note 9, §§ 189(a)(i), 190(2)(b), sched. 1. See David Goddard, *Company Law Reform—Lessons from the New Zealand Experience*, 16 COMPANY & SEC. L.J. 236, 246-47 (1998).

### C. *Amendment of the Statutory Duty of Care*

In an earlier draft of the CLERP Bill the statutory duty of care was amended to make it more subjective. Courts were directed to consider directors' experience, as well as their position in the corporation and the corporation's circumstances, when determining the standard of care required of directors.<sup>165</sup> This amendment was abandoned and the statutory duty of care in the Bill presented to Parliament merely alters the wording, but not the meaning, of the current statutory duty of care. It provides:

A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- (a) were a director or officer of a corporation in the corporation's circumstances; and
- (b) occupied the office held by, and had the same responsibility within the corporation, as the director or officer.<sup>166</sup>

## VII. THE SPECTER OF SHAREHOLDER LIABILITY

Traditional liability principles in Australian corporate law assumed a division between ownership and control. Fiduciary and statutory duties were restricted to directors of the company, since managerial power was generally exclusively vested in the board of directors under corporate constitutions,<sup>167</sup> with shareholders essentially viewed as "innocent bystanders." Both the responsibility and the accountability of shareholders were limited under this model. Shareholders owed no fiduciary duties, and received the protection of limited liability. Shareholders, and other groups such as creditors, were also usually protected from liability, such as tortious liability for the acts of the corporation, by strict adherence to the separate entity doctrine, which has been upheld by the Australian High Court in a number of cases.<sup>168</sup>

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165. See discussion *supra* note 82.

166. CLERP Bill, *supra* note 9, § 180(1), sched. 1.

167. See Corporations Law, § 226A (Austl.).

168. See *Walker v. Wimborne* (1976) 137 C.L.R. 1; *Industrial Equity, Ltd. v. Blackburn* (1977) 137 C.L.R. 567.

Recent developments in the area of shadow director liability, however, have extended potential liability to other persons closely associated with the corporate enterprise and created incursions into the separate entity doctrine.<sup>169</sup> Those who are at risk of liability under these developments<sup>170</sup> include: holding companies and controlling shareholders, directors of holding companies, banks and other financial institutions,<sup>171</sup> and professional advisers and experts.<sup>172</sup> A number of recent cases have focused specifically on the issue of liability of a holding company for the actions of its subsidiary.

A basic principle under Australian and New Zealand law is that complete control of the board of a subsidiary by its parent is regarded as insufficient to disregard the corporate veil.<sup>173</sup> In *Briggs v. James Hardie & Co. Pty.*,<sup>174</sup> Rogers A.J.A. stated that were this not so, the corporate veil could be discarded in virtually every holding company and wholly-owned subsidiary scenario.<sup>175</sup> This approach was upheld in the 1995 New Zealand decision, *Dairy Containers, Ltd. v. NZI Bank, Ltd.*,<sup>176</sup> where the court rejected an argument that, because the New Zealand Dairy Board (NZDB) had the ability to exercise almost complete control over its wholly-owned sub-

169. See generally, Jennifer Hill, *Corporate Groups, Creditor Protection and Cross Guarantees: Australian Perspectives*, 24 CANADIAN BUS. L.J. 321, 334 ff (1995); 38 CORP. PRAC. COMMENTATOR 381, 394 ff (1996).

170. See Robyn Carroll, *Shadow Director and Other Third Party Liability for Corporate Activity*, in CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS, *supra* note 5, at 162, 163; Pearlie M. C. Koh, *Shadow Director, Shadow Director, Who Art Thou?*, 14 COMPANY & SEC. L.J. 340, 342-43 (1996).

171. See generally the discussion on the blurring of the boundary between debt and equity in Jennifer Hill, *Public Beginnings, Private Ends—Should Corporate Law Privilege the Interests of Shareholders?*, 9 AUSTL. J. CORP. L. 21, 24 (1998). See also Koh, *supra* note 170, at 348-49; Stephen Girvin, *Statutory Liability of Shadow Directors*, 1995 JURID. REV. 414, 422. Cf. Campbell, *Liability as a Shadow Director*, 1994 JBL 609, 614. In the U.S. context, see Stuart C. Gilson & Michael R. Vetsuypens, *Creditor Control in Financially Distressed Firms: Empirical Evidence*, 72 WASH. U. L.Q. 1005, 1014 (1994), suggesting that one reason why U.S. banks are reluctant to acquire board seats is the increased risk of liability.

172. An exception exists under section 60(2) for persons acting in a business capacity or according to a business relationship, however it has been said that "the fine line which divides an adviser and a shadow director can be difficult to draw." Carroll, *supra* note 170, at 162, 163 n.7.

173. See *Briggs v. James Hardie & Co. Pty* (1989) 7 A.C.L.C. 841.

174. *Id.*

175. *Id.*

176. (1995) 13 A.C.L.C. 3211.

sidiary Dairy Containers Ltd. (DCL) through nominee directors, the parent therefore owed a duty of care to the subsidiary. According to the judge, the existence of such a duty of care would impose a positive monitoring function on the parent company, which according to Thomas J. was "going too far."<sup>177</sup> Nonetheless, where the control of the parent company shifts beyond "general or usual control"<sup>178</sup> over its subsidiary, particularly where it involves actual interference, the parent company may be held accountable on a range of grounds.<sup>179</sup>

One possible basis of liability, which was rejected by the Privy Council in *Kuwait Asia Bank EC v. National Mutual Life Nominees, Ltd.*,<sup>180</sup> but given support in obiter comments in *Dairy Containers, Ltd. v. NZI Bank, Ltd.*,<sup>181</sup> is that the parent company may be vicariously liable for the acts of its employees, who sit as nominee directors on the subsidiary company's board.<sup>182</sup> Although in Australia, there is one decision adopting a strict principle that a nominee director has an overwhelming duty to the company and not to an appointor,<sup>183</sup> there are a number of decisions where the courts have taken a more pragmatic and commercial approach to nominee directors, declining to intervene even though a director has clearly given overriding consideration to, or acted solely in the interests of, an appointor.<sup>184</sup>

In the *Dairy Containers* case, Thomas J. used this latter

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177. "[B]ut it is going too far to suggest that [NZDB] must undertake the monitoring functions reposed in the directors of DCL which it has appointed to look after its interests." *Dairy Containers v. NZI Bank* (1995) 13 A.C.L.C. 3211, 3237 (per Thomas J.). On this issue, see also Prentice, *supra* note 6, at 25, 26, who asks whether the concept of managerial accountability implies the imposition of some corollary obligation on shareholders.

178. *Dairy Containers v. NZI Bank* (1995) 13 A.C.L.C. 3211, 3237.

179. *See id.*

180. 3 All E.R. 404 (1990) (Eng.).

181. (1995) 13 A.C.L.C. 3211, 3244. *See also* E. W. Thomas, *The Role of Nominee Directors and the Liability of their Appointors*, in *CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS*, *supra* note 5, at 148, 156-60.

182. *See generally* Carroll, *supra* note 170, at 167-69. As Carroll points out, since Australian courts are not bound by Privy Council decisions, it is not clear whether they will adopt the *Kuwait Asia Bank* approach or that of Thomas J. in the *Dairy Containers* case on the issue of vicarious liability. *Id.* at 168.

183. *See* Bennetts v. Bd. of Fire Comm'rs of NSW (1967) 87 W.N. (Pt 1) (NSW) 307. *See also* *Kuwait Asia Bank EC v. Nat'l Mut. Life Nominees, Ltd.*, 3 All E.R. 404, 424 (1990) (Eng.), for dicta supporting this strict position.

184. *See, e.g.,* Levin v. Clark [1962] N.S.W.R. 686; *In re Broadcasting Station 2GB Pty, Ltd.* [1964-65] N.S.W.R. 1648.

group of cases in support of recognition of potential vicarious liability for the negligent acts of a holding company's employees appointed to the board of a subsidiary company. The judge stated that "[r]ecognising the economic reality of employee-directors and their employers requires that those who employ employees as directors to represent their interests accept responsibility for their resulting conduct."<sup>185</sup> As a matter of principle, the judge could see no reason why the relationship between employer and employee-directors should fall outside the ambit of the general doctrine of vicarious liability.<sup>186</sup> The approach advocated by Thomas J. echoes concerns of corporate theorists that a central problem in corporate groups is a disjunction, whereby action, but not responsibility, may be collectivized within group structures.<sup>187</sup>

A proposed reform under the CLERP Bill will adjust the traditional fiduciary duties of nominee directors of a wholly-owned subsidiary company, by expressly authorizing them to act solely in the best interests of the parent company in certain circumstances.<sup>188</sup> It will be interesting to see whether the implementation of this reform provides further support for Thomas J.'s approach in seeking the expansion of liability for ap-

185. *Dairy Containers v. NZI Bank* (1995) 13 A.C.L.C. 3211, 3244.

186. *See id.*

187. *See, e.g.,* PHILLIP I. BLUMBERG, *THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS* 1-25 (1983); Hugh Collins, *Ascription of Legal Responsibility to Groups in Complex Patterns of Economic Integration*, 53 MOD. L. REV. 731 (1990); Gunther Teubner, *Beyond Contract And Organization? The External Liability of Franchising Systems in German Law*, in *FRANCHISING AND THE LAW: THEORETICAL AND COMPARATIVE APPROACHES IN EUROPE AND THE UNITED STATES* 105 (Christian Joerges ed., 1991); Gunther Teubner, *Unitas Multiplex: Corporate Governance in Group Enterprises*, in *REGULATING CORPORATE GROUPS IN EUROPE* 67 (David Sugarman & Gunther Teubner eds., 1990).

188. Under CLERP Bill, *supra* note 9, § 187, sched. 1, a director of a wholly-owned subsidiary will be taken to have acted in good faith in the best interests of the subsidiary if:

- (a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and
- (b) the director acts in good faith in the best interests of the holding company; and
- (c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

*Id.*



pointers as the flip-side to recognition of commercial control.<sup>189</sup>

Another important basis on which liability may be imposed on a shareholder and/or third party is as a "shadow director." Under section 60(1) of the *Corporations Law*, there is an extended definition of the term "director" to include "a person in accordance with whose directions or instructions the directors of the body are accustomed to act."<sup>190</sup> Although a corporation cannot be formally appointed as a director under Australian law,<sup>191</sup> it may nonetheless qualify as a shadow director. The extended definition of director in section 60(1) presents particular dangers to third parties when it is conjoined with the duty of directors to prevent insolvent trading under section 588G of the *Corporations Law*.

The decision in *Standard Chartered Bank of Australia, Ltd. v. Antico*<sup>192</sup> provides a good example of shadow director liability. A claim was brought against Pioneer International Ltd. under the insolvent trading provision.<sup>193</sup> A key issue in the case was whether Pioneer International Ltd., which owned 42% of Giant Resources Ltd. and had appointed three nominee directors to the board of Giant, was a shadow director of Giant. Although, in accordance with standard entity principles, the size of its stake in Giant and representation on Giant's board were insufficient to render Pioneer a shadow director, additional features of the case reversed this position.<sup>194</sup> Not only did Pioneer have effective control of Giant, through wide dispersal of other shares in the company, but evidence showed that it interfered in, and usurped, major strategic decisions of Giant on a number of occasions, and that it imposed Pioneer group financial reporting requirements on Giant.<sup>195</sup> Furthermore, an agreement by Pioneer to provide funding to Giant contained preconditions, such as a requirement that no new financial arrangements be entered into without Pioneer's approval and

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189. See Thomas, *supra* note 181, at 148.

190. Corporations Law, § 60(1)(b) (Austl.).

191. See *id.* § 221(3).

192. (1995) 13 A.C.L.C. 1381.

193. See *id.* The relevant provision was then section 556 of the *Companies Code*, and is now *Corporations Law*, § 588G (Austl.).

194. See *Standard Chartered Bank v. Antico* (1995) 13 A.C.L.C. 1381, 1436 *ff.*

195. See *id.* at 1437

that all payments be approved by Pioneer.<sup>196</sup> The judge accepted that these factors showed not only a willingness to control, but actuality of control sufficient to render Pioneer a shadow director of Giant.<sup>197</sup>

Again, under shadow director principles, it appears that the law is attempting to bypass the separate entity principle and create greater congruence between control and accountability. As Finn J. has stated, the central concern under section 60(1)(b) is "[w]here, for some or all purposes, is the locus of effective decision making?"<sup>198</sup> This underlying principle may be useful in determining a number of issues in shadow director liability which are yet to be resolved satisfactorily, such as whether there is any requirement that formal directions and instructions must be issued; whether directions or instructions must be given to, and followed by, all members of the board or only a majority of them; under what circumstances directors of a parent company may be liable as shadow directors of a subsidiary; and what level of consistency is required to show that the directors are "accustomed to act" in accordance with another person's directions.<sup>199</sup>

Another statutory path by which liability may be attributed to a parent company is under section 588V of the *Corporations Law*.<sup>200</sup> This provision, which was introduced in 1992, provides a relatively direct form of liability in a parent company where there has been insolvent trading by the subsidiary.<sup>201</sup> The element of control or domination, which is central to establishing that a parent company is a shadow director, is not a prerequisite to liability under section 588V.<sup>202</sup> Finally, the oppression provision, section 246AA of the *Corporations*

196. See *id.* at 1438.

197. See *id.* at 1440.

198. Austl. Sec. Comm'n v. AS Nominees, Ltd. (1995) 13 A.C.L.C. 1822, 1838.

199. See Koh, *supra* note 170, at 343-47; Carroll, *supra* note 170, at 181-83; Girvin, *supra* note 171, at 415; Campbell, *supra* note 171, at 609.

200. Corporations Law, § 588V (Austl.).

201. Under section 588V, a parent company may become liable for debts incurred by a subsidiary if, at the time the debt is incurred the holding company or its directors were aware of reasonable grounds for suspecting that the subsidiary was, or would become, insolvent, or should have been so aware given the "nature and extent" of the parent company's control over the subsidiary. *Id.*

202. See generally Ian M. Ramsay, *Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective*, 17 U.N.S.W.L.R. 520 (1994).

Law, is very flexible and has been used in the context of corporate groups<sup>203</sup> to prevent unfair domination by parent companies and their nominees.<sup>204</sup> These diverse developments represent an interesting retreat by the law from the consequences of a paradigm of the shareholder as "innocent bystander," when such a characterization clearly fails to reflect commercial reality.

#### VIII. PARTICIPATORY RIGHTS FOR SHAREHOLDERS IN CORPORATE GOVERNANCE—SHAREHOLDERS AS CORPORATE MONITORS

There is a tension in contemporary Australian law as to the appropriate role of shareholders in corporate governance and what participatory rights they should possess.<sup>205</sup> Some reforms, such as those relating to company meetings and the proposed introduction of a statutory derivative suit, are designed to give shareholders a greater role in corporate governance, particularly in monitoring managerial conduct.<sup>206</sup> Nonetheless, other reforms are clearly designed to confer far greater autonomy on directors in exercising their powers.<sup>207</sup>

Australian corporate law has traditionally restricted the participatory role of shareholders in corporate governance.<sup>208</sup> For example, when managerial powers are vested in the directors under the company's constitution, the general meeting is powerless to override decisions of the board,<sup>209</sup> even by unanimous shareholder agreement.

The technical rules on company meetings also reflected management's central role in corporate governance, and the peripheral one occupied by shareholders.<sup>210</sup> Decisions such as

203. See, e.g., *In re Spargos Mining NL* (1990) 8 A.C.L.C. 1218, 1253.

204. See generally Jennifer Hill, *Protecting Minority Shareholders and Reasonable Expectations*, 10 COMPANY & SEC. L.J. 86 (1992).

205. See generally Jennifer Hill, *Changes in the Role of the Shareholder*, in CORPORATE PERSONALITY IN THE 20TH CENTURY 175 (Charles E.F. Rickett & Ross B. Grantham eds., 1998).

206. See, e.g., *Company Law Review Bill*, 1997, *Explanatory Memorandum*, para. 10.1, ff.

207. See generally *id.* para. 12.1, ff.

208. See generally Hill, *supra* note 205, at 182 ff.

209. This was in accordance with the English decision in *Automatic Self-Cleansing Filter Syndicate Co. v. Cuningham*, 2 Ch. 34 (1906) (Eng.).

210. On the status of shareholders as "bystanders," see generally Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CAL. L.

*NRMA, Ltd. v. Parker*<sup>211</sup> made it clear that not only were shareholders in general meetings excluded from making managerial decisions, but they did not even have the power to communicate their views and opinions on management matters to the board.<sup>212</sup> Furthermore, in one Australian case, *LC O'Neil Enterprises Pty, Ltd. v. Toxic Treatments, Ltd.*,<sup>213</sup> the court severely restricted the circumstances in which shareholders could themselves convene, and therefore have access, to the general meeting.<sup>214</sup>

Many of the changes relating to general meetings under Chapter 2G, schedule 1 of the *Company Law Review Act 1998*<sup>215</sup> will facilitate greater shareholder involvement and "voice" in corporate governance, and it has been suggested that the reforms will accelerate shareholder activism in Australia.<sup>216</sup> One important reform under the Act is that, under section 249F, members holding at least 5% of votes in the company will have an *absolute* right to convene a general meeting directly.<sup>217</sup> This reverses the previous restrictive position taken by the court in *LC O'Neil Enterprises Pty, Ltd. v. Toxic Treatments, Ltd.*, where such a right could be ousted by the company's constitution.<sup>218</sup> Section 249F of the Act will im-

REV. 1671 (1985).

211. (1986) 4 A.C.L.C. 609. In the United States, compare SEC Rule 14a-8, which was regarded by the court in *Medical Committee for Human Rights v. SEC*, 432 F.2d 659, 680-81 (D.C. Cir. 1970), as critical in ensuring shareholder participation in matters concerning their investment, although the boundaries of shareholder involvement have been shifting as a result of fluctuating interpretations of the "ordinary business" exception to the shareholder proposal rule. See generally Daniel E. Lazaroff, *Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals*, 50 RUTGERS L. REV. 33 (1997); Michelle J. McCann, *Shareholder Proposal Rule: Cracker Barrel in Light of Texaco*, 39 B.C. L. REV. 965, 973 (1998); Beth-ann Roth, *Proactive Corporate-Shareholder Relations: Filling the Communications Void*, 48 CATH. U. L. REV. 101 (1998).

212. (1986) 4 A.C.L.C. 609, 614.

213. (1986) 4 A.C.L.C. 178.

214. See *id.* at 180.

215. The *Company Law Review Act*, 1998, (Austl.), commenced on July 1, 1998. All amendments in the Act are now consolidated in the *Corporations Law*, (Austl.). Further proposals to increase effective shareholder participation in corporate governance via greater use of "virtual meeting" technology are found in the recent report of the *Companies and Securities Advisory Committee*, *supra* note 14.

216. See James MacDonald, *Major Reform of Company Law Rules*, 72 L. INST. J. 54 (1988).

217. *Company Law Review Act*, 1998, § 249F (Austl.).

218. (1976) 4 A.C.L.C. 178.

plement the policy behind Kirby P.'s dissenting judgment in the *LC O'Neil Enterprises* decision, that the right of shareholders to convene a general meeting should be a "fail-safe" protection granted to members, to enable them to act swiftly and independently of the directors.<sup>219</sup>

Sections 250S and 250T, schedule 1 of the *Company Law Review Act* 1998<sup>220</sup> may increase shareholder involvement at annual general meetings. Section 250S requires the chairperson of an annual general meeting to allow the members as a whole a reasonable opportunity to ask questions or make comments on the management of the company.<sup>221</sup> This is in contrast to *NRMA, Ltd. v. Parker*, which took the view that this was outside the role and function of shareholders.<sup>222</sup> Section 250T gives a similar statutory right to shareholders to question the company's auditor, or the auditor's representative, if present at the annual general meeting.<sup>223</sup>

These provisions have caused a considerable amount of angst in Australian boardrooms, with concerns that the annual general meetings of Australian companies will in the future be disrupted by small numbers of vocal shareholders.<sup>224</sup> Nonetheless, sections 250S and 250T are relatively tame. Although there is a right for members to ask questions, there is no corresponding duty for the directors or auditor to answer questions.<sup>225</sup> In the case of section 250T, the right is conditional on the presence of the auditor or representative at the meeting, and such presence is not mandatory.<sup>226</sup> The language of sections 250S and 250T, particularly the references to "a reasonable opportunity"<sup>227</sup> and "the members as a whole,"<sup>228</sup> is

219. *Id.* at 180.

220. *Company Law Review Act*, 1998, §§ 250S, 250T (Austl.).

221. *Id.* § 250S.

222. (1986) 4 A.C.L.C. 609.

223. *Company Law Review Act*, 1998, § 250T (Austl.).

224. For a fascinating account of genuine problems in this regard in Japan, where for some time professional agitators, "the Sokaiya," were so disruptive at annual general meetings that they were paid by management not to attend, see JONATHAN P. CHARKHAM, *KEEPING GOOD COMPANY: A STUDY OF CORPORATE GOVERNANCE IN FIVE COUNTRIES* 79 (1994).

225. See Parliamentary Joint Committee on Corporations and Securities, *Report on the Draft Second Corporate Law Simplification Bill* 1996, para. 2.54.

226. Compare Parliamentary Joint Committee on Corporations and Securities, *supra* note 225, at recommendation 5(a), with *Government Response to the Report of the Parliamentary Joint Committee on Corporations and Securities on the Draft Second Corporate Law Simplification Bill* (1997), at 9.

227. *Company Law Review Act*, 1998, §§ 250S, 250T (Austl.).

vague and ambiguous. The chairperson of meetings will still have significant discretion in the way that the meetings are conducted and will certainly not need to ensure that each member who wishes to speak has an opportunity to do so.<sup>229</sup>

The proposed introduction of a statutory derivative action under the CLERP Bill is also designed to enhance managerial accountability, by enabling an individual shareholder to bring private actions for breach of directors' duties.<sup>230</sup> Since duty-based controls on managerial misconduct, such as fiduciary duties, depend upon judicial monitoring to ensure compliance,<sup>231</sup> standing to sue is an important issue. One of the goals of the statutory derivative suit is to abolish the famously restrictive rule in *Foss v. Harbottle*,<sup>232</sup> under which the company is prima facie the proper plaintiff in an action for breach of duty by directors.<sup>233</sup> At general law, an individual member would not have standing to sue, unless able to satisfy the stringent requirements for a derivative action.<sup>234</sup>

In the past, these restrictions on standing could be bypassed in Australia under section 1324 of the *Corporations Law*, which allows any "person whose interests have been, are or would be affected by" conduct contravening the *Corporations Law* to apply for injunctive relief and damages.<sup>235</sup> Nonetheless, a number of recent cases have interpreted section 1324 itself in a very narrow way, to prevent it undermining the rule in *Foss v. Harbottle*.<sup>236</sup>

The introduction of a statutory derivative action in Austra-

228. See *id.*

229. See *Company Law Review Bill*, 1997, *Explanatory Memorandum*, *supra* note 206, para. 10.78.

230. See CLERP Bill, *supra* note 9, pt. 2F.1A, sched. 1.

231. See PARKINSON, *supra* note 134, at 73-74.

232. 2 Hare 461 (1843) (Eng.). For a comparative discussion of Anglo-Australian and U.S. law in this area, see Deborah A. DeMott, *Shareholder Litigation in Australia and the United States: Common Problems, Uncommon Solutions*, 11 SYD. L. REV. 259 (1987).

233. *Foss*, 2 Hare 461 (1843) (Eng.).

234. The two preconditions to establishing a derivative action at general law are that the wrongdoers' actions constitute a fraud on the minority and that the wrongdoers are in control. See FORD ET AL., *supra* note 28, para. 11.270.

235. See Robert Baxt, *Will Section 574 of the Companies Code Please Stand Up! (And Will Section 1323 of the Corporations Act Follow Suit)*, 7 COMPANY & SEC. L.J. 388 (1989).

236. See, e.g., *Mesenberg v. Cord Indus. Recruiters Pty, Ltd.* (1996) 19 A.C.S.R. 483, 488-89.

lia under the CLERP Bill<sup>237</sup> will implement the recommendations of a number of reports in Australia over the last decade that have advocated the enactment of a statutory derivative action.<sup>238</sup> These reports have generally supported the introduction of a statutory derivation action on the basis that current standing rules unduly inhibit shareholders in commencing legal proceedings on behalf of the company and thereby acting as an independent regulatory mechanism.<sup>239</sup>

Central elements of the proposed statutory derivative action are as follows. First, a range of persons associated with the company may apply for leave to bring proceedings on behalf of the company.<sup>240</sup> Eligible persons include a member or former member of the company or a related body corporate, and past and present directors and officers of the company.<sup>241</sup> Excluded from the list of persons is the Australian Securities and Investments Commission (ASIC).<sup>242</sup> According to the *Explanatory Memorandum*, this is deliberate, since the action is designed as a self-help measure for investors, with "the potential to remove some of the regulatory burden from ASIC by making it easier for investors themselves to protect the interests of a company."<sup>243</sup>

Second, the court acts as a filter in the process, determining, at the time when an application is made, whether or not the action should proceed. The court must, however, grant the

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237. See CLERP Bill, *supra* note 9, pt. 2F.1A, sched. 1.

238. See COMPANY AND SECURITIES LAW REVIEW COMMITTEE, ENFORCEMENT OF THE DUTIES OF DIRECTORS AND OFFICERS OF A COMPANY BY MEANS OF A STATUTORY DERIVATIVE ACTION, REPORT NO. 12 (1990); Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders*, Recommendation 26 (1991); Companies and Securities Advisory Committee, *Report on a Statutory Derivative Action* (1993). The Parliamentary Joint Committee on Corporations and Securities has recently added its support for the introduction of the proposed statutory derivative action, on the basis that it will clarify and add certainty to the law. Parliamentary Joint Committee on Corporations and Securities, *supra* note 21, para. 2.11.

239. See CLERP Bill *Explanatory Memo*, *supra* note 126, at 19. The Australian Stock Exchange, however, raised objections that the proposed form of the statutory derivative suit could lead to vexatious actions. See Parliamentary Joint Committee on Corporations and Securities, *supra* note 21, para. 2.9.

240. See CLERP Bill, *supra* note 9, § 236, sched. 1.

241. See *id.*

242. See *id.*

243. CLERP Bill *Explanatory Memo*, *supra* note 126, at 21. The concept of private litigation as an independent mechanism to ensure compliance with the law has long been accepted in the United States. See DeMott, *supra* note 232, at 283.

application, if it is satisfied of certain statutory criteria.<sup>244</sup> Third, one of the central problems with the common law derivative suit was the fact that no action could generally be taken with respect to a breach of duty that was ratifiable by the general meeting.<sup>245</sup> This was exacerbated by the fact that the courts have, in recent years, characterized a wider range of breaches of duty as ratifiable.<sup>246</sup> Under the proposed reform, however, the court will have greater discretion where there has been general meeting ratification. While ratification will not prevent the bringing of a statutory derivative action, the court may nonetheless take the ratification (including the extent to which ratifying members were well-informed about the relevant conduct and were acting for proper purposes) into account in its determination.<sup>247</sup> Finally, and perhaps most importantly, the court has broad discretion concerning costs in relation to proceedings brought under a statutory derivative action, and can make "any orders it considers appropriate."<sup>248</sup> Where the court considers proceedings to be in the company's best interests, it will therefore be possible for the court to indemnify an applicant shareholder from company funds.

In contrast to these developments, there are a number of reforms under the *Company Law Review Act 1998*, which confer greater discretion and flexibility on directors in relation to a range of share capital transactions. For example, in the case of capital reductions, court approval will no longer be necessary.<sup>249</sup> Also, under the revised provisions dealing with a company providing financial assistance for the purchase of its

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244. Under section 237(2), the criteria are that: (a) it is probable that the company will not itself bring the action; (b) the applicant is acting in good faith; (c) the action is in the best interests of the company; (d) there is a serious question to be tried; (e) the applicant gave at least 14 days written notice to the company of the intention to apply for leave and reasons for so doing or it is appropriate for the court to grant leave even though the notice requirement has not been satisfied. See CLERP Bill, *supra* note 9, § 237(2), sched. 1.

245. See FORD ET AL., *supra* note 28, para. 11.270.

246. See, e.g., *Winthrop Invs., Ltd. v. Winns, Ltd.* [1975] N.S.W.L.R. 666. Compare, however, *Residues Treatment & Trading Co. v. Southern Resources, Ltd.* (No. 4) (1988) 6 A.C.L.C. 1160.

247. See CLERP Bill, *supra* note 9, § 239, sched. 1. The court also has very broad discretionary powers under section 241, including the power to appoint an independent person to report on the affairs of the company. *Id.* § 241, sched. 1.

248. *Id.* § 242, sched. 1.

249. See *Company Law Review Act, 1998*, § 256B(1), sched. 5 (Austl.).



own shares, the need for shareholder consent as a monitoring and legitimating technique is significantly reduced.<sup>250</sup> Directors will, under the new provisions, generally have greater autonomy in implementing corporate restructurings, so long as the transactions do not materially prejudice the company and its ability to pay creditors.<sup>251</sup>

#### IX. INSTITUTIONAL INVESTORS IN AUSTRALIA

Australia is currently experiencing two major trends, which have reshaped shareownership. The most recent of these trends is a jump in the number of individual Australians holding shares, as a result of a series of major privatizations and demutualizations in recent times.<sup>252</sup> Recent figures show that, following the partial float of Telstra<sup>253</sup> in November 1997, share ownership in Australia surged to 40.4% of adults, with 28.5% of all adult Australians having direct share ownership.<sup>254</sup> Over 1.8 million Australians, of which 559,000 were first time shareowners, invested in the Telstra float, comprising 4.3 billion shares.<sup>255</sup>

The second trend relates to the dramatic rise in institutional investment.<sup>256</sup> It has been estimated, for example, that institutional investors now hold approximately 65% of available capital of companies listed in Australia.<sup>257</sup> There is no doubt that institutional investors in Australia have the potential to play an important role in corporate governance, as a self-regulatory mechanism.<sup>258</sup> Just as the proposed statutory

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250. See *Company Law Review Bill, 1997, Explanatory Memorandum*, *supra* note 206, para. 12.75 to 12.76; Corporations Law, pt. 2J.3 (Austl.).

251. See *Company Law Review Act, 1998*, pt. 2J.1, sched. 5 (Austl.).

252. See *ASX 1998 Shareownership Update* (visited Nov. 10, 1999) <<http://www.asx.com.au>>.

253. The Australian Senate has recently decided to sell another 16.6% tranche of Telstra. See *Selling Telstra Benefits Users*, AUSTRALIAN BUS. INTELLIGENCE, July 6, 1999, at 63; Richard Alston & John Fahey, *Passage of Telstra Legislation*, MEDIA RELEASE, July 8, 1999.

254. See Alston & Fahey, *supra* note 253.

255. See *id.*

256. See generally IAN M. RAMSAY ET AL., INSTITUTIONAL INVESTORS' VIEWS ON CORPORATE GOVERNANCE (1998); G. P. STAPLEDON, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE (1996); Jennifer Hill, *Institutional Investors and Corporate Governance in Australia*, in INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE, *supra* note 7, at 583.

257. See AIMA, CORPORATE GOVERNANCE: A GUIDE FOR INVESTMENT MANAGERS AND CORPORATIONS 13 (2d ed., July 1997).

258. Nonetheless, there exist some obstacles to institutional investors adopting

derivative action is designed to encourage private enforcement of directors' duties, so institutional investors are seen as potential monitors.<sup>259</sup>

So far institutional investor involvement has primarily manifested itself in two distinct ways. The first of these has involved institutional investor pressure at a procedural level. The leading institutional investor group, IFSA, publishes an influential guide of recommended corporate practice.<sup>260</sup> The principles of good corporate governance contained in the guide are very detailed, relating to matters such as composition of boards, appointment of non-executive directors, board committees and performance evaluation.

Institutional investors have also lobbied strongly for certain legislative changes. Recently, they lobbied for the introduction of more rigorous disclosure standards for director and executive remuneration in publicly listed companies, on the basis that the existing provisions were "incomplete, piecemeal and unclear in their reach."<sup>261</sup> Additionally, they contended that the Australian disclosure regime lagged far behind requirements in a number of other countries and international statements of best practice.<sup>262</sup> The reforms sought by the institutional investors were included at the eleventh hour when the *Company Law Review Act* was passed in the Senate.<sup>263</sup>

The second way in which Australian institutional investors have affected corporate governance has been through activism. Institutional investors have been instrumental in a number of boardroom coups in Australia,<sup>264</sup> in which the institutions were by no means universally applauded for their stance.<sup>265</sup>

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this role. See G. P. Stapledon, *Disincentives to Activism by Institutional Investors in Listed Australian Companies*, 18 SYDNEY L. REV. 152 (1996). In the U.K. context, see Holland, *supra* note 4, at 127.

259. See RAMSAY ET AL., *supra* note 256.

260. See IFSA Guidance Note No. 2.00, *supra* note 11.

261. Jennifer Hill, "What Reward Have Ye?" *Disclosure of Director and Executive Remuneration in Australia*, 14 COMPANY & SEC. L.J. 232, 232 (1996).

262. See *id.*

263. *Company Law Review Act*, 1998, § 300A (Austl.). See Hans Van Leeuwen, *Corporate Crackdown: Executives Forced to Reveal Their Salaries*, AUSTL. FIN. REV., June 26, 1998, at 1.

264. Two notable examples related to the companies, Goodman Fielder and Coles Myer. See generally Jennifer Hill, *supra* note 205, at 202.

265. In the controversial Coles Myer dispute, the Prime Minister at the time, Paul Keating, entered the fray, referring to the institutional investors as "don-

Although the institutions have often cited governance issues as a key reason for their interference, it is generally recognized that financial underperformance is the real trigger in most cases.<sup>266</sup>

The most recent high-profile example of activism has been at BHP Ltd., a blue-chip corporate icon in Australia,<sup>267</sup> in which institutions own more than 60% of all shares. In March 1998, BHP's chief executive, John Prescott was forced to resign, following pressure from institutional investors and non-executive directors.<sup>268</sup> The company clearly fell within the category of underperformance. BHP announced a full-year net loss of \$1.47 billion and asset writedowns of more than \$3 billion, in the wake of lower commodity prices, the Asian economic downturn,<sup>269</sup> and a series of disastrous acquisitions and investment projects undertaken by the company.<sup>270</sup>

Anecdotal evidence suggests that institutional investors are clearly playing a greater role, not only in the removal of CEOs, but also in the appointment process.<sup>271</sup> Echoing John Pound's model of shared governance by institutional investors and the board,<sup>272</sup> one fund manager was reported as saying

keys." See Shires, *PM Blasts "Donkey" Funds Managers: The Coles Myer Affair*, AUSTL. FIN. REV., Oct. 20, 1995, at 14.

266. See Crispin Wood, *Corporate Australia: Who's in Charge?*, BUS. REV. WEEKLY, June 1, 1998, at 62; KORN/FERRY INTERNATIONAL, BOARD MEETING IN SESSION: BOARDS OF DIRECTORS IN AUSTRALASIA 19-20 (1997).

267. The 113 year old company goes under the sobriquet, "The Big Australian."

268. See Ivor Riés, *Behind Prescott's Early Exit*, AUSTL. FIN. REV., Mar. 8, 1998, at 48. John Prescott subsequently received a golden handshake of \$11.1 million. See John Hurst & Christine Lacy, *BHP Execs Get Pay Rise as Prescott Gets Paid Out*, AUSTL. FIN. REV., Aug. 22, 1998, at 11.

269. See Kate Askew, *BHP Down . . . And Still Out*, SYDNEY MORNING HERALD, June 27, 1998, at 93.

270. See Glenn Burge, *Growth Binge Delivers Failure*, SYDNEY MORNING HERALD, June 27, 1998, at 93; Kate Askew, *Magma Copper Flows \$1.78bn Into The Red*, SYDNEY MORNING HERALD, June 27, 1998, at 94; Trevor Sykes, *BHP's Top-heavy Troubles*, AUSTL. FIN. REV., June 27, 1998, at 56. According to one commentator, "BHP has become the first industrial company in Australian history to have blown more than \$5 billion of shareholder funds in less than a decade." Ivor Riés, *BHP: Jerry Ellis's Last Stand*, AUSTL. FIN. REV., June 30, 1998, at 52. Following these financial revelations, a number of large and small BHP shareholders engaged in a new round of activism, successfully putting pressure on Ellis to leave the position of company chairman early. See Ian Howard & Christine Lacy, *Investors Demand Ellis's Head*, AUSTL. FIN. REV., June 30, 1998, at 1.

271. See Wood, *supra* note 266, at 62.

272. See John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control*, 68 N.Y.U. L. REV. 1003 (1993); John Pound, *The Promise*

that it is common for the board to consult with institutions about "what qualities shareholders want to see in the new managing director."<sup>273</sup> BHP spent seven months seeking a replacement for its former CEO, during which time there was overt tension between the board of directors<sup>274</sup> and institutional investors, who demanded an outside appointment.<sup>275</sup> BHP initially responded to institutional investor pressure by announcing that the selection of the new CEO would be made by a board committee with a majority of non-executive directors, who, according to one commentator, were "outside the club."<sup>276</sup> Ultimately, in spite of strong suggestions that BHP's management and board favored an internal appointment, the company announced that an American, who was currently president and CEO of Duke Energy Corp, would become BHP's next chief executive officer.<sup>277</sup>

#### X. CORPORATE GOVERNANCE AND THE AUSTRALIAN STOCK EXCHANGE

The Australian Stock Exchange (ASX) has assumed a more prominent role in corporate regulation. Senator Gibson, for example, has stated that:

In Australia, we have . . . a regulatory framework, whereby the regulator has developed an effective partnership with the Stock Exchange. The importance of self-regulatory organisations should not be underestimated. A self-regulatory

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*of the Governed Corporation*, HARV. BUS. REV., Jan-Feb. 1995, at 89.

273. Wood, *supra* note 266, at 62.

274. See Alan Kohler, *Alarm Over BHP's Top Job*, AUSTL. FIN. REV., May 2, 1998, at 60; Stephen Bartholomeusz, *Who Can Lead BHP Out Of The Mire?*, AGE, May 16, 1998, at 1.

275. See Alan Kohler, *Yanking BHP Into Global Practice*, AUSTL. FIN. REV., May 19, 1998, at 21; Kate Askew, *Nasser Touted As Head For BHP*, SYDNEY MORNING HERALD, May 26, 1998, at 25. See also Alan Kohler, *Alarm Over BHP's Top Job*, AUSTL. FIN. REV., May 2, 1998, at 60, who states, "[w]ell, here is a news flash: revolution is coming to BHP whether they like it or not. If an internal candidate gets the job and the board tries to get by with only incremental change, then the stockmarket will savage the company."

276. Elisabeth Sexton, *Responsibility And Accountability Are Now The Bywords*, SYDNEY MORNING HERALD, June 27, 1998, at 93.

277. See Alan Kohler, *Smorgon Steeled For BHP*, AUSTL. FIN. REV., Oct. 10, 1998, at 64; *BHP Reportedly Pressured By Institutional Investors To Name New CEO*, AFX NEWS: WORLD REPORTER, Oct. 27, 1998; *Australia's BHP Taps Duke Energy Official To Become Its CEO*, WALL ST. J., Nov. 2, 1998, at B16.

organisation has the ability to impose rules for market conduct which are acceptable to market participants.<sup>278</sup>

ASX Listing Rules are a potent source of regulation, since listed companies are obliged by the *Corporations Law* to comply with the rules and the obligation can be enforced by the courts.<sup>279</sup> Nonetheless, there are indications that the ASX, which recently demutualized and listed its own shares on its Exchange on October 14, 1998, will adopt a far less prescriptive and interventionist approach to matters of corporate governance than has, for example, the London Stock Exchange in recent years. In its submission to a Senate Commission inquiry on the *Company Law Review Bill* 1997, the ASX strongly opposed a prescriptive and interventionist approach to corporate governance, on the basis that it was impossible to devise governance standards appropriate for the whole corporate spectrum and that any attempt to do so would interfere with the ability of Australian companies to follow world best practice.<sup>280</sup>

There has been a clear tension between the ASX's approach and that of IFSA, which has favored a more detailed and prescriptive approach to corporate governance matters.<sup>281</sup> Listing Rule 4.10.3, which came into operation on June 30, 1996 and requires listed companies to disclose their main corporate governance practices in annual reports,<sup>282</sup> provides a good example of this tension.

In 1994, the ASX announced that it wished to take "a leadership role" in promoting corporate governance standards for listed companies.<sup>283</sup> According to the ASX, there were two main reasons justifying the introduction of rules relating to corporate governance. First, investor confidence in Australian

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278. Senator Gibson, Address at 15th East Asian & Oceanic Stock Exchange Federation General Assembly (May 27, 1996). Compare, however, the admonition of Earl Latham that the checks and balances operating to control corporate power should not be "entrusted to the subjective bias of the hierarchies within." Earl Latham, *The Body Politic of the Corporation*, in *THE CORPORATION IN MODERN SOCIETY* 218, 228 (Edward S. Mason ed., 1960).

279. *Corporations Law*, § 777 (Austl.).

280. See Parliamentary Joint Committee on Corporations and Securities, *Report on Company Law Review Bill*, 1997, Mar. 1998, para. 1.35.

281. See *id.* para. 1.36.

282. See *ASX Listing Rules*, *supra* note 13, § 14.10.

283. See AUSTRALIAN STOCK EXCHANGE, *DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES BY LISTED COMPANIES* 1 (Sept. 1994).

equity markets might be undermined unless companies were seen to be adopting good corporate governance principles.<sup>284</sup> Second, a number of international stock exchanges had introduced, or proposed to introduce, rules which gave guidance on appropriate standards of corporate governance, requiring companies to disclose whether they met those standards.<sup>285</sup>

There was an earlier attempt to formulate principles of good governance for companies in 1991, when a Working Group, with representatives from the ASX and a number of private sector organizations, released a guide on *Corporate Practices and Conduct*.<sup>286</sup> The Guide proposed that companies' annual reports should contain a statement supporting the governance principles set out in the Guide and explain departures from the principles.<sup>287</sup> According to the ASX, however, this Guide had been less than successful, with evidence suggesting that a large proportion of listed companies did not follow the principles or make any reference to them in their annual reports.<sup>288</sup>

The introduction in 1996 of the new listing rule was widely heralded as a major advance in corporate governance practices. Yet, in fact the final version<sup>289</sup> of ASX Listing Rule 4.10.3 was relatively innocuous, avoiding any prescriptive rules as to the appropriate content of corporate governance practices. This followed strong opposition in the business community to the original proposal to introduce a checklist of best corporate governance practices, together with a requirement that companies explain any deviation from this list. Therefore, under the

284. *See id.*

285. Exchanges which were regarded as particularly influential in this regard were the London Stock Exchange, Toronto Stock Exchange and New York Stock Exchange. *See id.* at 6-8.

286. Working Group on Corporate Practices and Conduct, *Corporate Practices and Conduct* (Information Australia, 1991) (the Bosch Committee Report).

287. *See id.*

288. *See* AUSTRALIAN STOCK EXCHANGE, *supra* note 283, at 6.

289. This is less stringent than an earlier proposal that the ASX should adopt a listing rule, similar to that of the London Stock Exchange, which would have required listed companies to include in their annual reports:

[A] statement as to whether the company has followed throughout the reporting period the practices set out in the Schedule of the Corporate Governance Practices. A company that has not followed all of the practices . . . must identify those practices not followed and give reasons for not following them.

*Id.* at 2.

final version of ASX Listing Rule 4.10.3, "[n]o benchmark levels are set, there are no areas of compulsory disclosure, and there is no minimum level of disclosure."<sup>290</sup> Rather, compliance simply requires that companies disclose their main corporate governance practices, if any.

An indicative, rather than prescriptive, list of corporate governance matters that a company may take into account in preparing its statement of practices is found in Appendix 4A to the Listing Rules. Relevant factors covered in Appendix 4A include matters such as board composition and review; appointment and retirement of non-executive directors; independent advice for directors; remuneration practices; audit arrangements; business risk strategies; and ethical standards.

There has been controversy about the effectiveness of the operation of ASX Listing Rule 4.10.3.<sup>291</sup> While the ASX considered that there had been total compliance with the new governance rule, IFSA took a less sanguine view, suggesting that the governance statements of only a small percentage (10%) of the Top 100 companies reviewed provided useful information and demonstrated an understanding of the rationale and purpose of the statement.<sup>292</sup> Other reports on the operation of the new disclosure rule have concluded that, although there is scope for considerable improvement in disclosure of corporate governance practices, Listing Rule 4.10.3 has encouraged many companies, particularly larger companies, to make detailed disclosure of governance practices.<sup>293</sup>

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290. IAN M. RAMSAY & RICHARD HOAD, DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES BY AUSTRALIAN COMPANIES 5 (1997).

291. See Ian M. Ramsay, *Models of Corporate Regulation: the Mandatory/Enabling Debate*, in CORPORATE PERSONALITY IN THE 20TH CENTURY, *supra* note 205, at 215, 247-49.

292. See AIMA, CORPORATE GOVERNANCE STATEMENTS BY MAJOR ASX LISTED COMPANIES (Mar. 1997).

293. See Ian M. Ramsay & Richard Hoad, *Disclosure of Corporate Governance Practices by Australian Companies*, 15 COMPANY & SEC. L.J. 454 (1997); *Disclosures! Corporate Governance in Practice*, COMPANY DIRECTOR, Mar. 1998, at 11. See also G. P. STAPLEDON & JEFFREY LAWRENCE, CORPORATE GOVERNANCE IN THE TOP 100: AN EMPIRICAL STUDY OF THE TOP 100 COMPANIES' BOARDS OF DIRECTORS (1996). In a 1998 study of disclosure of corporate governance in the Top 100 companies by IFSA, it was suggested that in spite of general improvements, "too many companies are still treating disclosure as a compliance task rather than an opportunity to communicate with shareholders in a meaningful way." IFSA Media Release, Sept. 3, 1998.

# XI. OTHER COMMERCIAL CONSTRAINTS ON MANAGEMENT: PERFORMANCE-BASED REMUNERATION AND TAKEOVERS

One commercial development that is particularly worthy of note is performance-based pay for executives and directors. Even more than institutional investor activism, this practice can guarantee that managers pay undivided attention to the goal of profit maximization for shareholders. It is no surprise that in both the U.S. and Australia institutional investors have agitated strongly for performance-based pay.<sup>294</sup>

Pay for performance comes in many guises, and essentially ties a substantial portion of executive remuneration to corporate performance. This trend has been widely hailed as a governance technique in itself, which can ensure accountability of directors and managers by aligning their interests with those of shareholders. Ever since Jensen and Murphy made their famous pronouncement, "CEO Incentives—It's Not How Much You Pay, But How,"<sup>295</sup> pay for performance schemes have flourished.<sup>296</sup>

In Australia, performance-based pay is now a major trend both in the private sector and in the public service.<sup>297</sup> A recent survey on pay for performance<sup>298</sup> has shown that there has been a significant increase in executive option plans approved in Australia.<sup>299</sup> Performance hurdles were included in 90% of these executive option plans.<sup>300</sup> In spite of the general enthusiasm for performance-based pay, not everyone regards it

294. See Charles M. Yablon, *Overcompensating: The Corporate Lawyer and Executive Pay*, 92 COLUM. L. REV. 1867, 1889-90 (1992) (book review).

295. Michael C. Jensen & Kevin J. Murphy, *CEO Incentives—It's Not How Much You Pay, But How*, HARV. BUS. REV., May-June 1990, at 138.

296. In the U.K., the Greenbury Committee, reporting in 1995, thought that performance-related remuneration was very effective in aligning shareholder and management interests. See *Directors' Remuneration*, Report of a Study Group chaired by Sir Richard Greenbury, July 1995, para. 6.16.

297. So successful has the concept of performance-related pay been in the public sector, that it seems that even bureaucrats are no longer paid like bureaucrats. See Clare, *Pay Reforms and the Performance Culture in the Public Sector*, 78 CANBERRA BULL. PUB. ADMIN. 82 (1995).

298. Equity Strategies Report, *Pay for Performance—1997 Executive Share Plans: Australia Top 150 Companies, New Zealand Top 14 Companies* (June 1998).

299. The survey sample comprised 122 companies out of Australia's top 150 companies by market capitalization. See *id.* In 1997, executive option plans had been approved in 43% of the sample companies, in contrast to 17% in 1996. See *id.*

300. See *id.* at 2.



as a panacea to corporate governance problems.<sup>301</sup> For example, it can be argued that alignment of shareholder and management interests is not all that counts in governance. A number of scholars assert that the fundamental objectives of corporate governance systems must be the long-term health of the corporate enterprise and that to achieve this, corporate law needs to seek to align, not just the interests of managers and shareholders, but also the interests of a range of other groups, such as employees, suppliers and creditors.<sup>302</sup>

Performance-based pay therefore has the capacity to privilege shareholder interests at the expense of other groups in the company.<sup>303</sup> At a commercial level, it has effectively "collectivized" the interests of shareholders and managers, at a time when there has been a shift in Australia toward "decollectivization" of labor interests through enterprise bargaining systems.<sup>304</sup> Pay for performance can present dangers to employees and indeed the long-term interests of the enterprise itself. As one Australian commentator has stated "Institutional investors—themselves under pressure to perform—are obsessed with maintaining growth of 15 per cent per annum. When GDP is growing by 3% and consumer prices by about half that rate, the only way to achieve 10 per cent plus profit growth is by taking out costs."<sup>305</sup> Also, pay for performance, designed as a governance technique, can itself, particularly

301. See generally Hill, *supra* note 171, at 21, 33-36.

302. See, e.g., BLAIR, *supra* note 5, at 202-34; Martin Lipton et al., *Book Review: Corporate Governance in the Era of Institutional Ownership*, 70 N.Y.U. L. REV. 1144, 1153 (1995).

303. See generally Hill, *supra* note 205, at 193-95.

304. See Ron McCallum, *Crafting a New Collective Labour Law for Australia*, 39 J. IND. REL. 405 (1997); Jennifer Hill, *At the Frontiers of Labour Law and Corporate Law: Enterprise Bargaining, Corporations and Employees*, 23 FED. L. REV. 204 (1995). In the U.S. context, Professor Gordon has noted that while corporate profits increased by 250% between 1980 and 1995, the average wages for all workers, except those in the top quintile of wage distribution, declined in real terms, creating "circumstances in which shareholders are gaining and workers are not." Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1534 (1997).

305. Kohler, *supra* note 275, at 21. For some of the dangers of this increasing focus on "economic competitiveness and bottom line returns," see Eric W. Orts, *The Future of Enterprise Organization*, 96 MICH. L. REV. 1947, 1966 (1998). Also, in the leaner 1990s, costs are not always the root cause of poor performance. See, e.g., Joann S. Lublin & Martha Brannigan, *Sunbeam Names Albert Dunlap As Chief, Betting He Can Pull Off a Turnaround*, WALL ST. J., July 19, 1996, at B2; *Exit Bad Guy*, ECONOMIST, June 20-26, 1998, at 70.

when coupled with stock options, create a range of new governance problems, including dangers in relation to timing of disclosure of corporate information, where exercise of options is linked to share price.<sup>306</sup>

A fundamental and fascinating question in the remuneration debate in corporate governance is whether there is a causal link between pay structures and firm performance. Recent special reports in the United States by *Business Week*<sup>307</sup> suggest that the connection is tenuous at best in practice.<sup>308</sup> The 1999 report also revealed that, largely as a result of pay for performance, the average American CEO, whose pay has increased 442% from its 1990 level, now earns 419 times the wage of an average blue-collar worker.<sup>309</sup>

A final reform proposal, designed to improve managerial accountability, involves radical changes to Australia's takeover regime, which will be rewritten under the CLERP Bill.<sup>310</sup> Mirroring international trends, there has been a marked decline in takeovers in Australia in the 1990s.<sup>311</sup> The stated aim of the proposed reforms to the takeover regulation is to

306. See Joshua A. Kreinberg, Note, *Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive*, 45 DUKE L.J. 138 (1995); Hill, *supra* note 124.

307. See *Compensation Scoreboard Glossary*, BUS. WK., Apr. 19, 1999, at 90; *Special Report: Executive Pay*, BUS. WK., Apr. 19, 1999, at 72; *Special Report: Executive Pay*, BUS. WK., Apr. 20, 1998, at 2.

308. According to the 1998 *Business Week*:

Good, bad, or indifferent, virtually anyone who spent time in the corner office of a large public company in 1997 saw his or her net worth rise by at least several million. Thanks to an exploding stock market, CEOs were more handsomely rewarded than ever before . . . But for many CEOs, those gains bore little relation to how well their companies—or investors—did. In the pay-for-performance sweepstakes, the “performance” half of the equation increasingly fell by the wayside.

*Special Report: Executive Pay*, BUS. WK., Apr. 20, 1998, *supra* note 307, at 2. See also Fredrick Hilmer & Philip Stern, *Hurdles Don't Test Executives*, AUSTL. FIN. REV., Aug. 5, 1998; Adam Bryant, *Executive Cash Machine*, N.Y. TIMES, Nov. 8, 1998, at C1.

309. See *Special Report: Executive Pay*, BUS. WK., Apr. 19, 1999, *supra* note 307, at 72.

310. See generally BLACK ET AL., CLERP AND THE NEW CORPORATIONS LAW ch. 3 (1998).

311. See Jennifer Hill & Ian M. Ramsay, *Institutional Investment in Australia: Theory and Evidence*, in SECURITIES REGULATION IN AUSTRALIA AND NEW ZEALAND 289, 295-96 (Walker & Fisse eds., 1994); John Green, *Make Takeover Law Discipline Managers*, AUSTL. FIN. REV., Nov. 10, 1997, at 17.

"facilitate a more competitive market for corporate control."<sup>312</sup> The underlying premises to this change are that Australia's current laws "unduly restrict takeover activity"<sup>313</sup> and that this is undesirable since the market for corporate control constitutes a crucial monitoring device.<sup>314</sup>

Australia's takeover regime is founded on four key principles, known as the "Eggleston principles." Under these principles, it is necessary to ensure that shareholders:

- know the identity of the buyer;
- have sufficient time to assess the bid;
- have adequate information on all matters relevant to the bid;
- have an equal opportunity to share in the benefits.<sup>315</sup>

Current rules *prima facie* prohibit a bidder acquiring more than 20% of a target's shares,<sup>316</sup> unless it is via a permitted acquisition method under the *Corporations Law*.<sup>317</sup> This process will often give rise to a contested auction. One highly controversial reform proposal under the CLERP Bill, which would, if accepted, modify this regulatory regime, is the "mandatory bid" or "follow-on" rule.<sup>318</sup> Under the proposed mandatory bid rule, a bidder will be able to proceed in an acquisition over the 20% threshold, provided that immediately after the acquisition occurs, an unconditional bid is made to other shareholders at the highest price paid in the preceding four months by the bidder for shares in the target company.<sup>319</sup> The effect of the rule will be to enable bidders to acquire a controlling stake in a company more easily and with greater certainty

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312. *CLERP Bill Explanatory Memo*, *supra* note 126, at 36.

313. Green, *supra* note 311, at 17.

314. This has, however, become a controversial issue in recent years. Critics have queried both the efficacy of takeovers and the efficient capital market hypothesis. See generally Arthur R. Pinto, *Corporate Governance: Monitoring the Board of Directors in American Corporations*, 46 AM. J. COMP. L. 317, 338 n.109 (1998). See also Prentice, *supra* note 6, at 25, 36-38.

315. These principles are currently reflected, for example, in *Corporations Law*, §§ 732, 733 (Austl.).

316. See *id.* § 615.

317. Under the current regime, the Part A bid is the most important of the permitted pathways for acquisitions over 20%. Other permitted pathways include: on-market bids by takeover announcement on the ASX (Part C bid), and creeping acquisitions of not more than 3% of shares every 6 months.

318. CLERP Bill, *supra* note 9, §§ 611, 614, sched. 1.

319. See *id.*

through a pre-bid deal, than is possible under the current regime. Under the proposed rule, control of a company may already have effectively passed to a bidder before the mandatory bid is made.

The mandatory bid element preserves the "equality of opportunity" principle under the Eggleston rules.<sup>320</sup> Nonetheless, there has been concern that the ability of a bidder to bypass a contested auction under the mandatory bid rule may prejudice other shareholders.<sup>321</sup> Indeed, it has been suggested that the effect of the mandatory bid rule will be to enable the initial bidder "to storm, as it were, the commanding heights over the 20% ceiling,"<sup>322</sup> which far from upholding the reformist aim of facilitating a more competitive market for corporate control, will actually subvert it.<sup>323</sup> While the mandatory bid rule assumes that minority shareholders are protected from receiving inadequate compensation by the self-interest of the controlling and institutional investors in extracting an appropriate premium for their controlling block of shares, this may not be the case where a vendor is forced to sell a controlling parcel due to financial distress.<sup>324</sup>

The takeover reforms will also reconstitute Australia's takeover panel, the Corporations and Securities Panel,<sup>325</sup> in the image of the UK Panel on Takeovers and Mergers.<sup>326</sup> It is intended that the new-look Panel should become the primary forum for resolving takeover disputes in Australia, rather than the courts or Administrative Appeals Tribunal.<sup>327</sup> The main

320. See, e.g., Parliamentary Joint Committee on Corporations and Securities, *supra* note 21, para. 3.14.

321. See Frith, *Costello Follow-On Folly a Regressive Takeover Reform*, AUSTRALIAN, Mar. 18, 1998, at 24.

322. BLACK ET AL., *supra* note 310, at 81.

323. See *id.* The government has undertaken to review the operation of the mandatory bid rule two years after commencement, to ensure that its policy goals are being met by the reform.

324. See *id.* at 80-81.

325. The Corporations and Securities Panel is created by Australian Securities and Investments Commission Act, 1989, § 171 (Austl.).

326. For influential articles on the need for reform to rescue Australia's Corporations and Securities Panel from "dormancy," see Santow & Williams, *Taking The Legalism Out of Takeovers*, 71 A.L.J. 749 (1997), and John M. Green & Stephen Brent, *Takeovers: Breathing More Life Into the Corporations and Securities Panel*, 15 COMPANY & SEC. L.J. 319 (1997).

327. See generally BLACK ET AL., *supra* note 310, at 109-20; Parliamentary Joint Committee on Corporations and Securities, *supra* note 21, para. 3.52 to 3.55.

goals of this reform are to ensure that takeover disputes are resolved with greater speed, specialized expertise and informality, and to reduce the incidence of anti-takeover tactics.<sup>328</sup>

## XII. CONCLUSION

It has been said that corporate governance involves the interface between two competing cultural values—"dynamism of enterprise and accountability under the law."<sup>329</sup> The developments under contemporary Australian corporate law demonstrate this tension well. They also indicate a new regulatory eclecticism in corporate law,<sup>330</sup> in which the possibility of different combinations and interactions of governance techniques will continue to foster both diversity in organizational structure,<sup>331</sup> and comparative study in the field of corporate governance.

## POSTSCRIPT

The CLERP Bill was passed by the Senate of the Australian Federal Parliament on October 18, 1999 and by the House of Representatives on October 20, 1999.<sup>332</sup> It is expected that the Bill will commence operation on March 13, 2000.<sup>333</sup>

As a result of pressure by the Australian Democrats, who hold the balance of power in the Senate, a number of changes were made to the CLERP Bill at the last minute.<sup>334</sup> The most notable of these changes was removal of the mandatory bid rule.<sup>335</sup>

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328. For some doubts on the ability of the reforms to achieve these goals, see Dyer, *A Revitalised Panel?*, 16 *COMPANY & SEC. L.J.* 261 (1998).

329. Sealy, *supra* note 8, at 92, 93.

330. See Hill & Ramsay, *supra* note 311, at 289-90.

331. See Orts, *supra* note 305, at 1947.

332. See 23 *BUTTERWORTHS CORPORATE LAW BULLETIN* para. 370 (1999).

333. See *id.*

334. See *id.*; Corporate Law Economic Reform Program Bill 1998 Schedule of Amendments made by the Senate (visited Nov. 10, 1999) <<http://www.aph.gov.au/parlinfo/billsnet/s-amend.htm>>.

335. See *BUTTERWORTHS CORPORATE LAW BULLETIN*, *supra* note 332, para. 370; Corporate Law Economic Reform Program Bill 1998 Schedule of Amendments made by the Senate, *supra* note 334.