RECENT DEVELOPMENTS IN AUSTRALIAN CORPORATE GOVERNANCE

The Honourable Justice Berna Collier
Federal Court of Australia
Australia

So far today we have received excellent presentations on the topic of corporate governance from a number of perspectives. Over the next 30 minutes I would like to talk about recent developments in Australian corporate governance, focusing on the following topics:

1. The proposed insolvency reforms permitting a "safe harbour" for directors;
2. The business judgment defence to breach of the duty of care – is it working?;
3. Domestic corporate governance rules and international transactions; and
4. Corporate risks associated with personal relationships within the corporation.

Before turning to these particular issues it may be helpful to set the scene by giving you a very brief and general outline of corporate governance rules in Australia.

A short (and incomplete) summary of Australian corporate governance laws

Under Australian law, the duties of directors and other corporate officers to the company in which they hold office are primarily found in the general law and the *Corporations Act 2001* (Cth). So, company directors in equity owe fiduciary duties to the company including:

- To act bona fide in the best interests of the company[1]
- To exercise power for a proper purpose[2] and
- To avoid conflicts of interest,[3] or profiting from their position.[4]

In addition to these fiduciary duties, directors are subject for example to the tort of negligence, in that directors owe a common law duty of care to the company.[5]

The Corporations Act takes matters considerably further than these equitable and common law principles. In some cases the Act imposes duties not only on directors, but on "other

---

1 As recognised in such cases as *Mills v Mills* (1938) 60 CLR 150 at 185 and *Allen v Gold Reefs of West Africa Limited* [1900] 1 Ch. 656 at 671, and more recently by the High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at [81].

2 As recognised in such cases as *Ngurli v McCann* (1953) 90 CLR 425 at 438, *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 837-838, *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 289-290, *Gambotto v WCP Ltd* (1995) 182 CLR 432 and *SGH Ltd v Commissioner of Taxation* (2002) 210 CLR 51 at [29].

3 As recognised in such cases as *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461 at 471 and *Phipps v Boardman* (1967) 2 AC 46, *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 and *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445.

4 As recognised in such cases as *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n, and more recently in *Ebner v Official Trustee in Bankruptcy* (2000) 205 CLR 337 and *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6

5 *Daniels v Anderson* (1995) 37 NSWLR 438, *Australian Securities and Investments Commission v Flugge* [2016] VSC 779 ("*ASIC v Flugge*").

officers" of corporations, and in some circumstances on employees. "'Officer' of a corporation" is defined by s 9 of the Act as:

> (a) a director or secretary of the corporation; or
>
> (b) a person:
>
> (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
>
> (ii) who has the capacity to affect significantly the corporation's financial standing; or
>
> (iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation); or
>
> (c) a receiver, or receiver and manager, of the property of the corporation; or
>
> (d) an administrator of the corporation; or
>
> (e) an administrator of a deed of company arrangement executed by the corporation; or
>
> (f) a liquidator of the corporation; or
>
> (g) a trustee or other person administering a compromise or arrangement made between the corporation and someone else.

It is important to examine particular statutory duties to identify whether they are owed by directors or a broader range of officers.

Directors alone are subject to s 588G of the Corporations Act, which essentially provides that a director is under a duty to prevent the company trading whilst insolvent. More particularly, the section applies if a person is a director of a company at the time when the company incurs a debt, the company is insolvent at that time, and at the time there are reasonable grounds for suspecting that the company is insolvent or would become insolvent as a result of the incurring of the debt.

Statutory duties to which *directors and corporate officers* are subject include:

- Exercising their powers and discharging their duties with a degree of care and diligence that a reasonable person would exercise (s 180); and
- Exercising their powers and discharging their duties in good faith and for a proper purpose (s 181).

Section 182 applies to *directors, officers and company secretaries and employees*, and proscribes them from improperly using their position to gain an advantage for themselves or someone else, or cause detriment to the corporation.

Section 183 imposes a statutory duty of confidentiality on *directors, officers and employees* of corporations, and proscribes them from improperly using information they have obtained in their position to gain an advantage for themselves or to cause detriment to the corporation.

There are a few points worth noting about these statutory duties.

First, there are escalating burdens of liability depending on the position held in the company. Directors are clearly at the apex of this pyramid of accountability.

Second, as is specifically stated by s 185 of the Corporations Act, these statutory duties supplement, rather than supplant, their equivalent duties in equity and at common law. This means that different remedies can be sought against defendants depending on the nature of the claim. For example, a director in equity can be liable for an account of profits and/or equitable compensation; in tort the director can be liable for damages. In comparison, the monetary remedy for breach of statutory duties is an award of compensation payable to the company (or registered scheme) pursuant to s 1317H of the Corporations Act.[6] Interestingly injunctions are a remedy available both under the general law and under the statute.[7]

Third, ss 180, 181, 182, 183 and 588G of the Corporations Act are "civil penalty provisions". The Australian Law Reform Commission compared civil penalty provisions with criminal penalties in the following terms:

> Civil penalty provisions are founded on the notion of preventing or punishing public harm. The contravention itself may be similar to a criminal offence and may involve the same or similar conduct, and the purpose of imposing a penalty may be to punish the offender, but the procedure by which the offender is sanctioned is based on civil court processes. Civil monetary penalties play a key role in regulation as they may be sufficiently serious to act as a deterrent (if imposed at a high enough level) but do not carry the stigma of a criminal conviction. Civil penalties may be more severe than criminal penalties in many cases.[8]

Where a civil penalty provision is contravened, the Australian Securities and Investments Commission (ASIC) can apply to the Court for a declaration of contravention of the relevant provision, a pecuniary penalty order or a compensation order,[9] and an order for the relevant officer's disqualification from management of any corporation for such period of time the Court considers appropriate.[10] The maximum pecuniary penalty payable to the Commonwealth for breach of these sections is currently $200,000 in the case of individuals and $1 million for a body corporate.[11] A recent example of imposition of a civil penalty and associated orders was in *Australian Securities and Investments Commission v Flugge (No 2)*,[12] where a chairman of a public company was ordered to pay a fine of $50,000 and was disqualified from managing corporations for five years for breach of the statutory duty of care under s 180 (1) (I will be examining the *Flugge* litigation in more detail later in this paper).

Fourth, s 184 of the Corporations Act escalates breach of the statutory duties of good faith, use of position and use of confidential information to criminal offences where the duties have been breached intentionally or recklessly.[13] Section 184 does not treat similarly the duty of care under s 180 (1) Corporations Act.

---

6 See, for example *Mernda Developments Pty Ltd v Rambaldi* [2011] VSCA 392, *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6.
7 Section 1324 Corporations Act.
8 *For Your Information: Australian Privacy Law and Practice* (ALRC Report 108) paragraph 71.85.
9 Section 1317J Corporations Act.
10 Section 206C Corporations Act.
11 Section 1317G Corporations Act.
12 [2017] VSC 117.
13 For a discussion of relevant principles see for example *Kwok v Regina* [2007] NSWCCA 281.

Fifth, the Corporations Act specifically builds in detailed defences against claims of insolvent trading as well as claims of breach of statutory duty of care and diligence.

Section 588H of the Corporations Act contains a defence to insolvent trading under s 588G where, at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time. Section 588H extends the "expectation" of the person to fact situations including where the person relied on a competent and reliable other person to provide financial information (s 588H(3)), where because of illness or other "good reason" the person did not take part in the management of the company (s 588H(4)), or where the person took reasonable steps to prevent the company from incurring the debt including appointing an administrator to the company under Part 5.3A of the Corporations Act (s 588H(5) and (6)).

Subsections 180(2) and (3) of the Corporations Act create a defence for directors and corporate officers both in respect of the statutory duty of care and diligence and for claims under the general law. These subsections provide:

> *Business judgment rule*
>
> (2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment 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.
>
> The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.
>
> Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)—it does not operate in relation to duties under any other provision of this Act or under any other laws.
>
> (3) In this section:
>
> ***business judgment*** means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

Sixth, whereas it may be possible for the constitution of a company to expressly permit directors to enter transactions which would otherwise violate the conflict rule in equity, there is a very real question as to whether such a provision would protect directors from claims for breach of, for example, ss 181 or 182 Corporations Act. Under the Corporations Act however directors can invoke ss 1317S and 1318 which empower the Court, in circumstances where a corporate officer has breached a statutory duty (and contravened a civil penalty provision) to relieve him or her wholly or in part from liability where the Court is satisfied that the person has acted honestly and the person ought fairly to be excused from the contravention. The Court needs to be persuaded of the appropriateness of such relief

however – an absence of dishonesty on the part of the person is not enough to warrant such an order.[14]

Seventh, the Corporations Act imposes similar duties on officers and employees of "responsible entities" under that part of the legislation dealing with managed investments schemes. Managed investment schemes are schemes where, in summary, people contribute money to a pooled fund, which they do not manage, and which money is used produce financial benefits for the contributors. A time share scheme is one type of managed investment scheme. The "responsible entity" is the company named in ASIC's record of the scheme's registration as the responsible entity.

Section 601FD provides that an officer of a responsible entity must:

> (a) act honestly; and
>
> (b) exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position; and
>
> (c) act in the best interests of the members and, if there is a conflict between the members' interests and the interests of the responsible entity, give priority to the members' interests; and
>
> (d) not make use of information acquired through being an officer of the responsible entity in order to:
>
> (i) gain an improper advantage for the officer or another person; or
>
> (ii) cause detriment to the members of the scheme; and
>
> (e) not make improper use of their position as an officer to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme; and
>
> (f) take all steps that a reasonable person would take, if they were in the officer's position, to ensure that the responsible entity complies with:
>
> (i) this Act; and
>
> (ii) any conditions imposed on the responsible entity's Australian financial services licence; and
>
> (iii) the scheme's constitution; and
>
> (iv) the scheme's compliance plan.

Responsibilities of employees of responsible entities are significantly fewer – pursuant to s 601FE:

> (1) An employee of the responsible entity of a registered scheme must not:
>
> (a) make use of information acquired through being an employee of the responsible entity in order to:
>
> (i) gain an improper advantage for the employee or another person; or
>
> (ii) cause detriment to members ofthe scheme; or
>
> (b) make improper use of their position as an employee to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme.

These sections are also civil penalty provisions under the Corporations Act.

Let me now turn to the topics I outlined earlier.

[14] As became apparent recently in *ASIC v Flugge (No 2).*

Safe Harbour

Earlier in this paper I set out the "business judgment rule" which carves out a defence for directors and other officers of corporations to claims of breach of the statutory duties of care and diligence. The business judgment rule is relevant only to directors and officers in respect of claims of contravention of s 180 – not, for example, breach of fiduciary duties, or claims of negligence, or in respect of insolvent trading under s 588G of the Corporations Act.

In 2015 the Australian Productivity Commission produced a report *Business Set-up, Transfer and Closure*,[15] in which it recommended legislation creating a "safe harbour" for directors in defence of insolvent trading provisions under s 588G. At the end of March 2017 the Commonwealth Minister for Revenue and Financial Services released, for consultation, new "safe harbour" proposals to reform the Corporations Act in the context of insolvent trading claims. These reforms propose new protections for company directors from personal liability for insolvent trading in certain cases. The exposure draft bill – the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017* – sets out a new s 588GA of the Corporations Act. In full the proposed section provides:

> **588GA Safe harbour—taking course of action reasonably likely to lead to a better outcome for company and its creditors**
>
> *Safe harbour*
>
> (1) Subsection 588G(2) does not apply in relation to a person and a debt if:
>
> (a) at a particular time after the person starts to suspect the company may become or be insolvent, the person starts taking a course of action that is reasonably likely to lead to a better outcome for the company and the company's creditors; and
>
> (b) the debt is incurred in connection with that course of action during the period starting at that time, and ending at the earliest of any of the following times:
>
> (i) when the person ceases to take that course of action;
>
> (ii) when that course of action ceases to be reasonably likely to lead to a better outcome for the company and the company's creditors;
>
> (iii) when the company becomes a Chapter 5 body corporate.
>
> Note 1: The person bears an evidential burden in relation to the defence in this subsection (see subsection (3)).
>
> Note 2: For this defence to be available, certain matters must be being done to a reasonable standard (see subsection (4)).
>
> *Working out whether a course of action is reasonably likely to lead to a better outcome*
>
> (2) For the purposes of (but without limiting) subsection (1), in working out whether a course of action is reasonably likely to lead to a better outcome for the company and the company's creditors, have regard to whether the person:
>
> (a) is taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts; and
>
> (b) is taking appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company; and

[15] Productivity Commission Inquiry Report No 75 (2015), 30 September 2015.

(c) is obtaining appropriate advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; and

(d) is properly informing himself or herself of the company's financial position; and

(e) is developing or implementing a plan for restructuring the company to improve its financial position.

(3) A person who wishes to rely on subsection (1) in a proceeding for, or relating to, a contravention of subsection 588G(2) bears an evidential burden in relation to that matter.

Matters that must be being done to a reasonable standard

(4) Subsection (1) does not apply if the company is failing to do any of the following to a standard that would reasonably be expected of a company that is not at risk of being wound up in insolvency:

(a) providing for the entitlements of its employees;

(b) giving returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the *Income Tax Assessment Act 1997*).

Note: Employee entitlements are defined in subsection 596AA(2) and 31 include superannuation contributions payable by the company.

Definitions

(5) In this section:

better outcome, for the company and the company's creditors, means an outcome that is better for both:

(a) the company; and

(b) the company's creditors as a whole;

than the outcome of the company becoming a Chapter 5 body corporate.

evidential burden, in relation to a matter, means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist.

In summary, the key aspects of this proposal are as follows:

- A director who has contravened s 588G will not only be liable for a civil penalty, he or she will be personally liable to the company (often, the liquidator) for debts incurred by the company at the relevant time. The proposed reform offers protection to a director from claims of insolvent trading where he or she "starts taking a course of action that is reasonably likely to lead to a better outcome for the company and the company's creditors".
- The proposed protection is not open-ended. The only debts against which the director will be protected are those incurred in connection with the "course of action". The Explanatory Memorandum describes this as circumstances where the company is "undertaking a restructure".
- The protection ends when, for example, the course of action on which the director embarks "ceases to be reasonably likely to lead to a better outcome for the company and the company's creditors", or when the company enters voluntary administration.
- In determining whether the course of action is reasonably likely to lead to a better outcome, the Court will take into account such issues as whether the proper financial

records are being kept by the company, whether the director is receiving proper advice, and whether there is actually a plan to rescue the company from trouble.

- The evidentiary burden is with the director to demonstrate that a course of action was reasonably likely to lead to a better outcome for the company and its creditors. The Explanatory Memorandum describes this as a "low official threshold" for directors to surmount.[16] Once the director has provided this evidence the burden shifts to the liquidator or other claimant alleging contravention of s 588G to establish that the safe harbour does not apply.
- The safe harbour is not to be relied on by directors who seek to abuse it in terms contemplated by proposed subs 588GA(4) – namely where the company has not made provision for employee entitlements, or has not complied with its taxation reporting obligations. A further proposed section I have not reproduced in this paper – s 588GB – disentitles reliance on the safe harbour where the director has concealed, destroyed or removed company books, or generally has not cooperated with the liquidator.

Although not a corporate governance issue, for completeness I note that the predicated safe harbour reforms propose legislation to void "ipso facto" clauses in defined circumstances ("Ipso facto" clauses are clauses in contracts which provide that the contract terminates in the event that the company which is party to the contract experiences an insolvency event).

These proposed reforms introducing a safe harbour for directors have been hailed as positive by industry groups, and it is not difficult to see why. Currently, the prospect of an insolvent trading claim against directors encourages them to place the company into voluntary administration at the first sign of financial trouble. Certainly the possibility that a restructure or bold new trading strategy may lead the company out of its financial woes may not equate to a "reasonable expectation" that the company can pay its debts as they fall due within the meaning of s 588H as it currently stands – this was made clear recently by the Court of Appeal of New South Wales in *Treloar Constructions Pty Ltd v McMillan*.[17]

While there are sound policy reasons for the current approach – an obvious one being to prevent the directors running the company into the ground, and damaging creditors by incurring debts which the company has no hope of repaying – in practice it also stifles initiative and the prospect of the directors steering the company out of trouble by taking measured risks. This issue is recognised in the following passage in the Explanatory Memorandum to the Bill:

> The threat of Australia's insolvent trading laws, combined with uncertainty over the precise moment a company becomes insolvent have long been criticised as driving directors to seek voluntary administration even in circumstances where the company may be viable in the longer term. Concerns over inadvertent breaches of insolvent trading laws are frequently cited as a reason that early stage (angel) investors and professional directors are reluctant to become involved in a start-up.

[16] Paragraph 1.43.

[17] [2017] NSWCA 72. In that case the Court of Appeal at [169]-[170] noted the fundamental difficulty in the proposition that the possibility of future success or business profitably could provide reasonable grounds for a present expectation of solvency at the relevant time. So, performance in the league tables, although potentially indicative of present and future business success, did not establish an expectation of solvency on the part of the director at the relevant times, unless there were other bases upon which that expectation could be based.

It is interesting however to wonder how these reforms, if enacted, will influence directors in circumstances where the company is on the brink of insolvency. In a recent article in the Company and Securities Law Journal,[18] Carmen Boothman speculated that in fact directors in Australia are not particularly in fear of insolvent trading provisions in the Corporations Act, and this lack of fear may be justified in light of the low instance of insolvent trading claims brought by ASIC (being only 103 having been brought between 1961 and 2004)[19] notwithstanding the many thousands of complaints of insolvent trading received by ASIC.

In recent years there have been a number of successful insolvent trading claims for compensation brought against directors in the Federal Court of Australia[20] and the Supreme Court of New South Wales[21], however it is also useful to note that, in the main, these have not been civil penalty proceedings. Certainly civil penalty proceedings in respect of insolvent trading under s 588G have not appeared to feature highly in ASIC's enforcement priorities of late. However recent *criminal* convictions of directors of the Kleenmaid whitegoods group of companies for insolvent trading and fraud offences following action commenced by ASIC more than make up for this absence of civil penalty activity, and are enough to chill the blood of erring directors.[22]

The safe harbour reforms will not protect directors who have criminally contravened the insolvent trading provisions – if enacted they may, however, encourage a more entrepreneurial approach to trading companies out of insolvency than the law currently permits, by providing protection from compensation and civil penalty proceedings against them.

The business judgment defence to breach of the duty of care – is it working?

With the emergence of the "safe harbour" reform proposals offering a defence of the insolvent trading provisions of the Corporations Act, it is useful to note in passing the business judgment rule which was introduced in 2000 into the predecessor legislation to the Corporations Act (that is, the Corporations Law), and at that time was itself deemed a "safe harbour" defence for directors.

Interestingly, unlike in respect of insolvent trading, ASIC has been relatively active in pursuing civil penalty proceedings for breach of the duties of care and diligence – a least five cases decided in the past eighteen months.[23] There have also been a number of cases

[18] "Safe harbour or shipwreck? A critical analysis of the proposed safe harbour for insolvent trading" (2016) 34 *C&SLJ* 520.

[19] *Ibid* at 523.

[20] For *example KMS Imports (Aust) Pty Ltd (In Liq) v Wang* [2016] FCA 1571, *QC Resource Investments Pty Ltd (In Liq) v Mulligan* [2016] FCA 813, *Forgione Family Group Pty Ltd (in liq) v Forgione* [2015] FCA 642, *Smith v Boné* [2015] FCA 319.

[21] For example *In the matter of Swan Services Pty Limited (in liquidation)* [2016] NSWSC 1724 and *Treloar Constructions Pty Ltd v McMillan* [2017] NSWCA 72.

[22] The District Court of Queensland in October 2015 and August 2016 sentenced two directors of Kleenmaid companies to seven years and nine years imprisonment respectively, with the trial of another former director set to commence in the District Court on 21 August 2017. (Report 513 *ASIC enforcement outcomes: July to December 2016* March 2017 page 20 www.asic.gov.au) In the most recent conviction (that of Mr Bradley Young, sentenced on 12 August 2016), the imprisonment term was nine years for the fraud and a total of three and half years for the insolvent trading charges: see http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-257mr-former-kleenmaid-director-sentenced-to-nine-years-imprisonment-for-fraud-and-insolvent-trading/.

[23] See for example *In the matter of Macquarie Investment Management Limited* [2016] NSWSC 1184, *Australian Securities and Investments Commission, in the matter of Sino Australia Oil and Gas Limited (in liq) v Sino Australia Oil and Gas Limited (in liq)* [2016] FCA 934, *Australian Securities and Investments Commission v Cassimatis (No 8)*

where companies have sought relief against corporate officers pursuant to s 180(1), with some success[24] and some failure.[25]

There have been suggestions in scholarly articles that the business judgment rule is, in fact, something of a squib, and that where officers have acted reasonably the defence adds nothing to their prospect of raising an effective defence in any event to a claim of breach of duty.[26] Relatively recently however the first case has been decided where the business judgment rule has been raised, and the defence favourably received. In *Australian Securities and Investments Commission v Mariner Corporation Limited* [2015] FCA 589 ASIC commenced action against Mariner Corporation Limited and three of its directors, claiming among other things that the directors were reckless as to whether the company would be able to perform its obligations relating to a takeover bid of another company (Austock Group Limited) if a substantial proportion of the offers under the bid were accepted. In particular, ASIC asserted that as at the relevant time Mariner did not have the financial resources to fund the bid and had not received relevant assurances from and had no agreements with third parties concerning the provision of such funding, and that the directors had breached their duty under s 180 (1) of the Corporations Act in so committing Mariner to the takeover bid.

On the facts ASIC failed to establish contravention of s 631(2)(b)[27] of the Corporations Act by Mariner or breach of s 180(1) by the directors. In relation to one of the directors, for example, the Court was satisfied that there had been no breach of the duty of care where:

- The director reasonably believed that a third party was interested in purchasing the Austock business once Mariner controlled the shares (such that one of the directors described the acquisition of the shares as a "no-brainer",[28]).
- The director had extensive corporate law experience, and had received detailed legal advice from a major law firm as to the requisite level of funding.
- The director gave uncontested evidence that he reasonably formed the view that Mariner would have no, or little, difficulty in arranging funding of its bid prior to it being required to lodge a bidder's statement.
- The director had formed the view that under the proposed takeover bid (if successful) Mariner stood to make a substantial gain.
- The countervailing benefits to Mariner well exceeded the theoretical risks, and the modest financial consequences of those theoretical risks were well outweighed by the benefits that could be achieved by Mariner.

[2016] FCA 1023, *ASIC v Flugge (No 2)* [2017] VSC 117, *Australian Securities and Investments Commission v Ostrava Equities Pty Ltd* [2016] FCA 1064, contrast unsuccessful proceedings in *Australian Securities and Investments Commission v Drake (No 2)* [2016] FCA 1552.

24 *BCI Finances Pty Limited (in liq) v Binetter (No 4)* [2016] FCA 1351, *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452, *Strategic Management Australia AFL Pty Ltd v Precision Sports & Entertainment Group Pty Ltd* [2016] VSC 303.

25 *In the matter of Toppro Pty Ltd* [2016] NSWSC 1399, *Lewski v Australian Securities & Investments Commission* [2016] FCAFC 96, *In the matter of Centura Global Holdings Pty Ltd* [2015] NSWSC 1744, *In the matter of Ikon Group Limited* [2015] NSWSC 980.

26 See for example the excellent article by J Harris and A Hargovan "Still a sleepy hollow? Directors' liability and the business judgment rule" (2016) 31 *Australian Journal of Corporate Law* 319, P Redmond "Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?" in I Ramsay (ed) *Corporate Governance and Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1997).

27 The section provides that a person must not publicly propose, either alone or with other persons, to make a takeover bid if the person is reckless as to whether they will be able to perform their obligations relating to the takeover bid if a substantial proportion of the offers under the bid are accepted.

28 At [475].

The Judge considered that, although the director did not need to rely on the defence in s 180(2), it was nonetheless available. In summary Justice Beach observed:[29]

- Having regard to the nature of Mariner's business and the evidence concerning the potential benefits to Mariner of attaining control of Austock, the relevant "business judgment" was Mariner's decision to initiate a takeover bid for Austock.
- The second requirement was that the director acted in good faith, and the Court was satisfied that the director decided to support the takeover and make the announcement because of the potential for Mariner to make a significant profit, believing that the decision to make the announcement and pursue a takeover bid for Austock was in the best interests of Mariner.
- The third requirement was satisfied in that the director had no material personal interest in the subject matter of the judgment.
- The fourth requirement was satisfied in that the director considered that he had been provided with sufficient information to make an informed judgment to vote by having various meetings and discussions with relevant parties, and his knowledge of the level of interest in Austock's two businesses.
- Finally, the director rationally believed that the decision was in the best interests of the company.

The Court found that there were similar, and even stronger, reasons upon which the other director was entitled to rely, and that the second director would also have been able to rely on the business judgment rule.

Last year the business judgment rule was invoked by a liquidator in *Asden Developments Pty Ltd (in liq) v Dinoris (No 3)* [2016] FCA 788. In that case however the Judge found that the liquidator had breached his duty of care under s 180 by failing to take into custody property of the company, and that the business judgment rule was not available to a liquidator who had failed in that duty, where there was no aspect of exercise of judgment involved.

A reflection on these cases, and the recent cases in which breach of duty of care has been pleaded, suggest that the detractors of the business judgment rule may have a point. Certainly, in virtually no case in the past two years other than *Mariner* and *Asden* has the business judgment rule been mentioned, much less raised as a defence. This is possibly an oversight by the legal advisers – however it is much more likely to be the result of a judgment on the part of lawyers as to the use of invoking the business judgment rule in the circumstances of their clients' respective cases. The question then arises whether s 180(2) merely is functioning appropriately, or whether there are undue limitations on its operation. It also raises the question whether the experience with s 180(2) will be replicated in the insolvent trading "safe harbour" reforms currently on the legislative drawing board.

[29] At [483]-[495].

Domestic corporate governance rules and international transactions

The recent decision of the Supreme Court of Victoria in *ASIC v Flugge (No 2)*[30] is a not-so-gentle reminder that conduct in other jurisdictions is not necessarily acceptable in your own, and that the role of non-executive chairman of a company can be fraught with risk. This decision was the sequel to *ASIC v Flugge and Geary*,[31] decided by Justice Robson of the Supreme Court of Victoria in 2016, and the final chapter in litigation known in Australia as the "Oil for Food" scandal.

For those of you who may not be familiar with these events, it is worth spending a few minutes elaborating.

A useful starting point is Resolution 661 of the United Nations, made in 1990, where the UN imposed sanctions requiring that all states prevent their nationals making available funds to or trading with the Government of Iraq, or persons or bodies within Iraq. The result was that Iraq was deprived of hard currency, and food became short. In 1995 a new Resolution 986 was adopted by the UN, establishing the Oil-for-Food Programme which permitted Iraq to sell oil under UN-approved contracts provided the proceeds of sale were paid into a UN controlled account, and enterprises in other states to sell goods to Iraq under strictly defined conditions.

As part of this programme in 1996 the Australian Wheat Board ("AWB") commenced selling wheat to Iraq under the Oil-for-Food Programme. This continued a sales relationship between Australia and Iraq in respect of wheat exports which dated back to 1948. AWB's contact in Iraq was the Iraqi Grain Board ("IGB"), an instrumentality of the then-Iraqi government.

The history of AWB was, in summary, as follows:

- AWB was established in 1939 as a government statutory authority to control the domestic and export marketing of Australian wheat. From 1939 to 1989 AWB was the sole marketer of Australian wheat both domestically and for export: it also had other functions under Commonwealth statutes that dealt with wheat marketing.
- The domestic wheat market was deregulated under the *Wheat Marketing Act 1989* (Cth), however AWB retained the sole right to export wheat from Australia. In 1997 and 1998 significant changes were made to the *Wheat Marketing Act 1989* (Cth) so that most of the marketing and financial functions of AWB were transferred to a new grower owned company structure. AWB was the head of that new structure.
- On 1 July 1999, AWB was an unlisted public company. From that time, it was the exclusive manager and marketer of all bulk wheat exports from Australia. This was done though a supply- pooling system known as the Single Desk which was also established by the amendments to the *Wheat Marketing Act 1989* (Cth). All Australian wheat exported in bulk was to be pooled, marketed, sold and exported by a subsidiary of AWB.[32]

AWB was established in 1939, and until 1999 functioned as a statutory body of the Commonwealth of Australia, operating a single desk regime over Australian wheat both domestically and internationally. In 1999 AWB was privatised and in August 2001 it was

[30] [2017] VSC 117.
[31] [2016] VSC 779.
[32] Extracted from Statement of Agreed Facts in *Australian Securities & Investments Commission v Ingleby* [2012] VSC 339.

listed on the Australian Stock Exchange. Until 2005 it was the exclusive manager and marketer of Australian bulk wheat exports.

In June 1999 the IGB introduced a new condition of tender in respect of wheat sales, namely that sales of wheat would be on the following term:

> CIF Free on Truck to the silo at all governorates. Cost of discharge at Umm Qasr and land transport will be USD12.00 per metric tonne. To be paid to the Land Transport Co. for more details contact Iraqi Maritin in Basra.

Previously, the supply of wheat by the AWB was on the basis that delivery was to the Iraqi port of Umm Qasr, after which AWB's contractual obligations ceased.

Representatives of AWB met IGB representatives, and it became clear that the $US12 per tonne was not a genuine payment for transport of wheat – rather it was a payment which would go to the IGB and thence the Iraqi government.

As the subsequent Royal Commission found:

> AWB knew that if it declined to make the payment it would lose its Iraqi trade. Senior management decided to do what was necessary to retain that trade. Mr Officer spoke with Mr Flugge, the Chairman, about the new Iraqi requirement on the basis that:
>
> "There was no option. There was no choice. It was $12 or not; or if you don't make that payment then, of course, there would be no business. That was made very clear. It was in that context that I discussed it with the Chairman, and that was the nature of those discussions."[33]

It was not in dispute that the payment of such sums as sought by the IGB was not only contrary to UN sanctions, they ran counter to Australian government foreign policy. It also appeared that AWB sought to hide the manner in which the payments were made, through intermediaries and co-operative ship-owners, as well as changing the wording of its short-form contract to remove any references to the payment of a US dollar fee for "discharge" costs.

The arrangements between the AWB and the Iraqis were questioned in January 2000 when the Canadian Wheat Board was asked to pay a sum of money into a Jordanian bank account, allegedly to cover transport costs of US$14.00 per tonne for wheat under a proposed contract. When the Canadians refused and did not receive the contract for which they had tendered, they were allegedly told that "similar arrangements had been made with the Australian Wheat Board." The Canadians informed the United Nations.

The United Nations raised the issue whether AWB was engaged in illicit transactions with the Iraqi government, with the Australian Department of Foreign Affairs and Trade. The Department commenced investigation. AWB emphatically denied any irregular payments as alleged.

In February 2000 AWB entered new contracts with the IGB. This time there was no specific mention of the "transport costs" (now of $US15) payable to IGB and the Iraqi government – these fees were included in the contract price. As the Royal Commission report later stated:

> AWB was not responsible for delivering the wheat free in truck to all governorates, as the short-form contract provided; AWB was obliged to pay a fee of US$15.00 per tonne

[33] *Report of the Inquiry into certain Australian companies in relation to UN Oil-for-Food Programme* (the Cole Inquiry) page xiv.

> to an Iraqi entity, a matter not revealed by the contracts; and the fee payable by AWB to the Iraqi entity was included in the contract price, another matter not disclosed.[34]

The Royal Commission found that, by April 2000, AWB was experiencing significant costs because of delays discharging ships at Umm Qasr, which costs it could not recover. When the IGB sought to avoid meetings with AWB representatives to discuss these delays, it appears that the AWB forced meetings by using its knowledge of the illicit transactions concerning the hidden fees of $US15 per tonne.[35]

Further contracts were entered between the IGB and the AWB. By the end of 2000 the "trucking fee" was $US44.50 per tonne.[36]

It is somewhat repetitive to continue to detail the ongoing contractual arrangements entered between AWB and the IGB. Suffice to say that further contracts were entered, and between November 1999 and March 2003 AWB paid "transportation fees" of $US224,128,189.98 in respect of wheat sales to Iraqi government intermediaries. This was in the context of arrangements where:

- AWB was the single largest provider of humanitarian goods under the Oil-for-Food programme between 1997 and 2003;
- During the programme AWB sold 6.8 million tonnes of wheat to Iraq, and was paid in the amount of $US2.8 billion from UN accounts;[37] and
- A UN committee under the chairmanship of Paul Voicker investigating manipulation of the Oil-for-Food programme estimated that AWB accounted for 14% of the illicit payments made to Iraq under that programme.[38]

AWB's conduct came to light in 2004-2005. It was the subject of investigation by the Voicker committee as well as an Australian Royal Commission headed by former Judge Terence Cole.

Relevantly to principles of Australian corporate governance, ASIC sought remedies against the non-executive chairman of the AWB, Mr Trevor Flugge, and other officers of AWB for contraventions of s 180(1) of the Corporations Act. It is clear that after the Oil-for-Food scandal became public, AWB suffered loss of capitalisation and reputation. The Commonwealth government stripped AWB of its monopoly to export wheat.[39] The AWB share price collapsed, it was acquired by Canadian company Agrium Inc in December 2010[40] and subsequently delisted from the Australian Securities Exchange.

---

34 *Ibid* at 25.
35 *Ibid* at 28.
36 *Ibid* at 35.
37 *Independent Inquiry Committee into the United Nations Oil-for-Food Programme: Manipulation of the Oil-for-Food Programme by the Iraqi Regime*, (Paul A Voicker, Richard J Goldstone, Mark Pieth), 27 October 2005, www.iic–offp.org page 311.
38 *Ibid* page 262.
39 http://www.smh.com.au/news/national/scandal-costs-awb-its-monopoly/2006/02/10/1139542402621.html.
40 https://www.agrium.com/en/investors/news-releases/2010/agrium-completes-acquisition-awb.

Interestingly, and despite the facts as found by several inquiries, law enforcement authorities in Australia have had limited success in pursuing corporate officers associated with AWB.

- In August 2009 the Australian Federal Police indicated that it would not prosecute any of the AWB officers.[41]
- ASIC reached a settlement with the former managing director of AWB, Mr Andrew Lindberg whereby Mr Lindberg conceded that he had breached the duty of care he owed to the company pursuant to s 180(1). The parties agreed on the imposition of a pecuniary penalty of $100,000 and a disqualification period expiring on 14 September 2012, and the Supreme Court of Victoria accepted these penalties as appropriate and made orders imposing them.[42]
- Next, ASIC reached a settlement with the former chief financial officer of AWB, Mr Paul Ingleby, whereby Mr Ingleby admitted to breaching s 180(1), and the parties agreed that Mr Ingleby be disqualified from managing a corporation for a period of 15 months and receive a pecuniary penalty of $40,000. Interestingly when the parties took their agreement to the Supreme Court of Victoria the trial Judge reduced the penalty to disqualification from managing corporations for approximately 4½ months and a pecuniary penalty of $10,000 on the basis that his Honour considered the agreed penalty too severe in light of the facts of the case as presented to the Court.[43] The decision of the primary Judge was reversed by the Court of Appeal of Victoria,[44] with strong words from the appellate Judges as to the likely inaccuracy of the Statement of Agreed Facts insofar as it described the role of Mr Ingleby, and the likely inadequacy of the penalties agreed by the parties.[45]
- ASIC had also commenced civil penalty proceedings against Mr Michael Long, the former General Manager of International Sales and Marketing for AWB (2001-2006); and Mr Charles Stott, the former General Manager of International Sales and Marketing for AWB (2000-2001). Those proceedings were discontinued by consent in 2013,with all parties bearing their own costs.[46]
- The Supreme Court of Victoria dismissed the proceedings against the former AWB Group General Manager of Trading, Mr Peter Geary, finding that he did not contravene his duties as an officer in connection with AWB's supply of wheat to Iraq under the United Nations' Oil-for-Food Programme.[47]

In *Australian Securities and Investments Commission v Flugge & Geary* the Supreme Court was not persuaded that the non-executive Chairman, Mr Flugge, knew that the "transport payments" were contrary to the UN sanctions or that it was well known within AWB that the payments were not authorised by the UN. The Court was, however, persuaded that Mr Flugge breached his duty of care to AWB under s 180 (1) Corporations Act. This duty was enlivened by Mr Flugge being present when a complaint was conveyed to the UN that AWB may have been making inappropriate transportation payments to Iraq, in circumstances where Mr Flugge was aware of the payments and the circumstances surrounding the introduction of those payments.

41 http://www.smh.com.au/business/scandalous-that-asic-has-so-little-to-show-despite-millions-spent-on-awb-scandal-20110717-1hk7k.html.
42 *Australian Securities & Investments Commission v Lindberg* [2012] VSC 332.
43 *Australian Securities & Investments Commission v Ingleby* [2012] VSC 339.
44 *Australian Securities & Investments Commission v Ingleby* [2013] VSCA 49.
45 See for example Weinberg JA at [37]-[42] and Harper JA at [96]-[97].
46 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2013-releases/13-363mr-update-on-asics-proceedings-against-former-directors-and-officers-of-awb-limited/.
47 *Australian Securities and Investments Commission v Flugge & Geary* [2016] VSC 779.

In *Australian Securities and Investments Commission v Flugge (No. 2)* ASIC sought a declaration of contravention relating to the breach of duty, the maximum penalty of $200,000, and disqualification of Mr Flugge from managing corporations for a period of 10 years. Mr Flugge applied for relief from liability under ss 1317S and 1318 of the Corporations Act. The primary Judge found that ASIC was entitled to the declaration it sought, that Mr Flugge was not entitled to be exonerated from liability, and that appropriate penalties were a pecuniary penalty of $50,000 and disqualification from management of corporations for five years. In particular, his Honour observed:

> 29. I have found that a director in Mr Flugge's position, knowing what Mr Flugge knew, exercising reasonable care and diligence, would have inquired why the UN was making such an inquiry if the UN was already fully informed that AWB was making such payments to Iraq. I have inferred that Mr Flugge would have understood the inquiry suggested that the UN may not be fully aware of what AWB was doing. A director in Mr Flugge's position, exercising reasonable care and diligence would, in my opinion, have made appropriate inquiries, particularly one with the background knowledge that Mr Flugge had about the introduction of the fee and the consternation that caused within AWB. As stated in my liability judgment, I have found that such inquiries should have been made and that Mr Flugge's failure to do so continued up until he ceased to act as director. As stated in my reasons, I am satisfied adequate inquires would have unearthed the full story, and the conduct in breach of sanctions would have ceased.

I have endeavoured to outline key facts in what is surely a scandalous yet fascinating story. In the annals of corporate governance in Australia I suspect the AWB saga is as interesting for what did not happen, as for what did happen, in the context of law enforcement. So, for example, it is interesting that no criminal proceedings were brought, and that ASIC was successful in Court in a contested case only against the Chairman in respect of his duty of care. It appears that, from the perspective of the Court, the evidence upon which ASIC relied for its broader claims against the Chairman and fellow director Mr Geary simply did not add up. It is also apparent from reading the decision of the trial Judge that his Honour resisted the invitation to make Mr Flugge the scapegoat in circumstances where other officers of AWB would not or could not be held to account. As I indicated earlier in this presentation, *ASIC v Flugge (No 2)* is a reminder that dubious practices abroad can result in significant ramifications under domestic law. It is also another reminder of the risk non-executive Chairs run in respect of companies where they fail to ask the right questions, at the right time.

Corporate governance and personal relationships

This year has seen considerable media attention concerning the manner in which corporate boards deal with scandals involving personal relationships at work. That attention has not been universally flattering, although there have been a number of interesting emergent issues relevant to a discussion of corporate governance.

Without dwelling on the details,[48] in one instance earlier this year the bonus payment to the chief executive officer of insurance company QBE was docked $550,000 by the chairman of the company because "some recent personal decisions by the CEO have been inconsistent with the board's expectations". The "recent personal decisions" concerned the failure of the CEO to notify the board in a timely manner of a relationship between him and

[48] See for example http://www.smh.com.au/business/qbe-chief-john-neals-bonus-cut-by-550000-after-relationship-with-secretary-20170226-gulxq8.html.

his personal assistant. This was considered by the board to constitute a conflict of interest under the company's code of conduct for executives which required employees to disclose to their manager any close personal relationship which could cause a conflict of interest. The code of conduct provided that "conflicts may … arise where an employee has a close personal relationship with another employee (eg direct reporting lines or conflicts in roles and responsibilities)". The docking of the pay was announced in a statement in the company's annual report earlier this year.

In a second case which was ongoing at the time of preparation of this paper, the 2014 bonus of the CEO of the Seven West Media business had been slashed by $100,000, which sum was paid to a female staff member with whom the CEO had apparently been having a relationship. The female staff member subsequently commenced action in the Australian Human Rights Commission and the Courts alleging bullying, victimisation and sexual harassment.[49] Issues of governance arose when the female staff member accused the CEO of, among other things, using company funds to further their relationship and instigating the payment of a bonus to her, however following an investigation the board announced in a statement that it was satisfied the CEO was not responsible for any of those things.

From the perspective of the Court, a private relationship between people who work in the same organisation is a private matter. It is clearly a different issue in the context of ethics and governance standards of individual companies. Issues arise where, in the course of conduct, the corporate officer acts in such a way as to cause detriment to the company. To my knowledge there have been no cases where an action has been brought against a director or corporate officer for breach of duty because of a private relationship between that director or officer and another person. It may, however, be merely a matter of time.

But is this a problem, and if so what is the solution? A recent article by Peter Cabon of the University of Melbourne in the Harvard Business Review[50] suggested that a proactive (or "problem finding") approach to governance by the board could assist in forestalling the types of difficulties that have arisen in QBE and Seven West. Exactly what type of proactivity is either necessary or desirable is, however, a different question. I cannot help wondering whether calling adult employees to account for their personal relationships is the business of the board. Unfortunately it can become the business of the board where the reputation of the company suffers from conduct of its employees after intra-company personal relationships turn sour.

Conclusion

I have endeavoured in my presentation to provide a snapshot of interesting and important corporate governance developments in Australia within the last two years. In doing so, I note that while the safe harbour reforms in insolvent trading have attracted favourable attention, it is the claims of breach of the duty of care of directors and other corporate officers which have predominated in the Courts. This is not to say that there have not been cases where corporate governance claims on other bases have been made.[51] However,

[49] http://www.heraldsun.com.au/entertainment/television/from-family-man-to-executive-affair-seven-media-boss-tim-worners-sordid-slide/news-story/b2575bcb6d0b405e59f8ceaefe7dca8e.

[50] https://hbr.org/2017/01/the-3-company-crises-boards-should-watch-for . See also a further summary of this article in "How 'problem finding' can help corporate boards avoid failures" http://www.abc.net.au/news/2017-02-20/how-corporate-boards-can-avoid-failures/8272500.

[51] See for example *Brentwood Village Limited (in liq) v Terrigal Grosvenor Lodge Pty Limited (No 4)* [2016] FCA 1359 (breaches of ss 181 and 182); *Strategic Management Australia AFL Pty Ltd v Precision Sports & Entertainment Group Pty Ltd* [2016] VSC 303 (breach of section 181), *KQ International Trading Pty Ltd v Yang* [2016] VSC 146 (breaches

allegations of breach of duty of care by corporate officers appear to have been the claim of choice for plaintiff companies and their lawyers in Australia in the corporate governance arena of late, with – on balance – favourable results. It will be interesting to see what trends emerge in the next year or so in Australia, and whether the gloomy predictions of bursting economic (in particular, housing) bubbles in Australia will result in a slew of new litigation against corporate officers.

of sections 181 and 182); *Australian Securities and Investments Commission v Macro Realty Developments Pty Ltd* [2016] FCA 292 (breach of s 181); *Australian Securities and Investments Commission v Planet Platinum* [2015] VSC 682 (breaches of ss 181 and 182).