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Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?

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Abstract

The conventional view of corporate regulation is that corporations are to be managed for the benefit of their shareholders. The general law and statutory duties of directors and officers reflect this "shareholder primacy norm", with duties formulated to prevent directors acting otherwise than in the interests of shareholders. However, the general law and statutory duties are not identical. The remedies and enforcement mechanisms differ considerably, which raises the question as to whether the public enforcement of statutory duties carries with it a public interest mandate that general law duties do not. This article considers what role the public interest should have in enforcing statutory duties and whether such a role represents a challenge to the dominant shareholder primacy norm of corporate law. This issue is highly topical as recent decisions have suggested that the statutory duties of directors and officers are limited in their scope to protecting the interests of shareholders, even to the detriment of the public interest. We contest that viewpoint and argue that, at least in relation to statutory duties, directors and officers have obligations that extend beyond the narrow conception of the protection of shareholder wealth.

I INTRODUCTION

It is a fundamental principle of company law that directors and officers owe their duties to the company as a whole. The phrase "the company as a whole" is typically interpreted to mean the shareholders as a whole.[1] The consideration of whether directors and officers have complied with their duties will therefore involve a determination of whether the conduct diverged from the interests of the company's shareholders. This "shareholder primacy norm" has been a highly influential analytical model for corporate law, both in Australia and overseas.

Much of the theoretical analysis of modern corporations has focussed on the problem of "agency costs", that is, how to align the interests of directors and officers (who act as notional "agents" of the shareholders) with the interests of shareholders (who are the notional "principal").[2] The use of an agency metaphor to characterise the relationship between directors and shareholders

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[1] *Greenhalgh v Arderne Cinemas* [1951] Ch 286 at 291 per Evershed MR.

[2] See for example, Jensen M and Meckling W, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 Journal of Financial Economics 305; Fama E and Jensen M, "Agency Problems and Residual Claims" (1983) 26 Journal and Law and Economics 327; Fama E and Jensen M, "Separation of Ownership and Control" (1983) 26 Journal and Law and Economics 301. See further Berle A and Means G, *The Modern Corporation and Private Property* (rev ed, Transaction Publishers, 1991).

(as a collective whole rather than individually) has important consequences for ascertaining the scope and purpose of enforcement mechanisms within corporate law. If the directors are the quasi-agents of the shareholders, then the legal and equitable obligations should operate for the benefit of those same shareholders. This perspective relies heavily on the property rights theory of corporations, which obliges the framework of legal regulation to respect and uphold the property rights of the shareholders. According to this view, the beneficiaries of directors' duties are the company's shareholders because the shareholders are the residual owners of the corporation's assets.[3] The enforcement of directors' duties is (and should be according to this influential perspective) for the benefit of the shareholders. When the company seeks to take action against its directors and officers the motivation of the parties is clear. The company (either on its own initiative or under a liquidator initiated action)[4] sets out to prove that the defendant's conduct harmed the interests of the company and thereby the interests of the shareholders.

Where does public enforcement fit within the shareholder primacy norm? Can the rationale used to support the private enforcement of directors' duties also be applied to public enforcement action taken by the Australian Securities and Investments Commission (hereafter 'ASIC')? If ASIC takes action in respect of an alleged breach of directors' statutory duties, is it acting merely to protect the interests of the company's shareholders? Is there no scope for public interest enforcement, outside of shareholder interests? This article will attempt to answer these questions.

Recent decisions have shone the judicial spotlight on the role of directors' statutory duties and their application and relaxation, arguably, in a controversial manner.[5] These decisions have cast doubt upon the relevance of public interest factors in ASIC enforcement actions, particularly where there is a commonality of interest between shareholders and management (i.e. where the shareholders are also the directors). A trend seems to be developing, which, if left unabated, might unduly restrict ASIC's role as corporate regulator acting as guardian of the public interest.

Of particular concern to this article is the NSW Supreme Court decision by Brereton J in *ASIC v Maxwell*.[6] This decision determined that the unity of interests between directors and shareholders could justify a situation where a breach of duty would be not merely forgiven, but removed altogether. This is because the conduct did not sufficiently jeopardize the interests of

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[3] This is explained clearly in Blair M and Stout L, "A Team Production Theory of Corporate Law" (1999) 85 Virginia Law Review 247, 259-265; Stout L, "Bad and Not-So-Bad Arguments for Shareholder Primacy" (2001) 75 Southern California Law Review 1189.

[4] *Corporations Act 2001* (Cth), ss , 477(2), 534. An action may also be commenced in the company's name using a statutory derivative action under *Corporations Act 2001* (Cth), Pt 2F.1A.

[5] Compare *ASIC v Maxwell* (2006) 59 ACSR 373; [2006] NSWSC 1052 (applied in *ASIC v Warrenmang Ltd* (2007) 63 ACSR 623; [2007] FCA 973); *Pascoe Ltd v Lucas* (1998) 27 ACSR 737 with *Angas Law Services Pty Ltd v Carabelas* (2005) 226 CLR 507; [2005] HCA 23; *ASIC v Australian Investors Forum Pty Ltd* (No 2) (2005) 53 ACSR 305; [2005] NSWSC 267; *Forge v ASIC* (2004) 213 ALR 574; [2004] NSWCA 448. See also *Vines v ASIC* (2007) 62 ACSR 1; [2007] NSWCA 75 at [84]-[87] per Spigelman CJ.

[6] (2006) 59 ACSR 373; [2006] NSWSC 1052 (hereinafter *Maxwell*).

shareholders (who had consented to that conduct). This issue raises questions about the scope and role of shareholder ratification, and its impact on the enforcement of statutory directors and officers duties. More importantly, the decision represents a highly restrictive view of the importance of shareholder primacy in interpreting the scope and limits of directors and officers' statutory duties.

The judicial approach adopted in *ASIC v Maxwell* raises a number of basic questions – what is the fundamental purpose and rationale of directors' statutory duties? Are there circumstances in which the content of these duties, as opposed to the general law duties, can legitimately be toned down? What role does the public interest play in the enforcement of these statutory duties? These basal, but rich, policy issues are deserving of further attention and form the focus of this article. These issues are highly topical in light of the recent discussion paper issued by the Commonwealth Treasury regarding the sanctions imposed on directors and officers under the *Corporations Act*.[7]

Before exploring the source, reach and limits (if any) of directors and officers' statutory duties, it pays to examine the source of the recent judicial controversy. The decision in *ASIC v Maxwell* is discussed in Part II with particular reference to judicial comments which suggest that, in certain circumstances, the requirement to prevent self-interested dealing and to constrain management is less acute when enforcing directors' statutory duties. In light of this proposition, Part III of the article critically examines the differences between the general law and statutory duties to assess the scope, if any, of refinements in the obligations of directors. In furtherance of this aim, the article traces the development of directors' statutory duties to assess whether the practical content of those duties can be legitimately affected by shareholder approval and thereby watered down. Significantly, the historical overview highlights the public interest considerations present at the time of the statutory formulation of directors' duties in Victoria. The enforcement role of the corporate regulator, ASIC, is highlighted with reference to its public interest obligations. Against this legal backdrop, the judicial comments of Brereton J in *ASIC v Maxwell* are revisited and, with respect, critiqued in Part IV.

After demonstrating that shareholder primacy considerations, arguably, should not be the sole concern in the enforcement of directors' statutory duties, Part V of the article advocates a greater recognition of the role of public interest in the enforcement of directors' statutory duties. The dominant concept of community expectations,[8] as fashioned by the courts, underscores the need for this legal development.

II *ASIC v MAXWELL*

The issue of enforcement, and modification, to directors' statutory duties arose in *Maxwell* in the context of illegal property financing schemes conducted by Maxwell and seven other company officers who belonged to the Procorp Group and Central Development Group of companies.

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[7] Treasury, *Review of Sanctions in Corporate Law* (5 March 2007), available at www.treasury.gov.au

[8] For examples of judicial reliance on this concept, see *Commonwealth Bank of Australia v Friedrich* (1991) 9 ACLC 946; *ASIC v Rich* (2003) 44 ACSR 341; [2003] NSWSC 85.

Both groups of companies promoted schemes that sought seed capital from investors for property development projects throughout New South Wales. The investments, advertised in local newspapers, promised returns of approximately 30 per cent per annum, and were described as 'secured and guaranteed'. On the contrary, most of the investments were simply unsecured loans.[9] Both groups of companies collapsed and went into liquidation. The Procorp Group had debts of $10.8 million owing to 120 seed capital investors. The Central Development Group left 32 investors facing loses of $3.3 million.

ASIC alleged that the fundraising occurred in breach of the following provisions:

- The disclosure document and advertising provisions (ss 727 and 734) in *Corporations Act 2001* (Cth) Ch 6D
- the misleading or deceptive conduct provisions (s 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) and s 1041H of the *Corporations Act 2001* (Cth))

Furthermore, ASIC sought declarations of contravention, pecuniary penalties (pursuant to s 1317G), injunctive relief (pursuant to s 1324), compensation orders (pursuant to s 1317H) and banning orders (pursuant to ss 206C, 206D and 206E).

Maxwell, the principal promoter for the two corporate groups, was permanently disqualified from managing corporations and from providing financial services and ordered to pay $1.22 million in compensation, penalties and costs. Significantly, ProCorp was found to have contravened s 727(1) on at least 94 occasions.

Of greater significance, for the purposes of this article, were the claims by ASIC against the directors of the failed companies for breach of their statutory duties, arising from the same set of facts. In particular, ASIC alleged that Mr Nahed, a young builder who provided the building and construction expertise for the property developments and was also a director of the Procorp Companies, had breached those duties of care and diligence (s 180), good faith (s 181) and proper use of position (s 182) referred to in the *Corporations Act 2001* (Cth). The allegations were that Mr Nahed had permitted, allowed and participated in Procorp's breaches of the statute, and that such conduct **was itself** a breach of his statutory directors' duties. Thus, ASIC was attempting to tack-on a breach of directors' duties to the breaches of the fundraising and financial services provisions referred to above. Part of the motivation for this may involve the fact that it was only by establishing a breach of directors' duties that ASIC could seek to obtain civil penalty orders.[10]

[9] Parallels may be drawn between this case and the more recent collapses of Westpoint, Fincorp and ACR where similar claims were made. The *Maxwell* decision may cast some doubt on the ability of ASIC or a liquidator to establish a breach of Pt 2D.1 in those cases. Of course, each case turns on its own facts.

[10] Misleading or deceptive conduct, fundraising disclosure and financial services provisions are not listed in s 1317E as being "civil penalty provisions".

After reviewing the legal principles underpinning these provisions, Brereton J held:[11]

> it is a mistake to think that ss 180, 181 and 182 are concerned with any general obligation owed by directors at large to conduct the affairs of the company in accordance with law generally or the Corporations Act in particular; they are not. They are concerned with duties owed to the company ….in my opinion, if a contravention of s 180(1) is to be established, it must founded on jeopardy to the interests of the corporation, and to protection of the interests of potential investors (though the interests of investors may be relevant to the interests of the corporation, as potential creditors).

This view may take support from the comments by Ipp J (as his Honour then was) in *Vrisakis v ASC*,[12] where his Honour held that directors are required to balance the risk of harm on the one hand and the potential benefits to the company on the other.[13]

Based on this line of reasoning, Brereton J concluded that where there is a unity of interest between the directors and the shareholders, so that, in effect, the directors are the shareholders, the requirement to prevent self-interested dealing, constrain management and strengthen shareholder control is much less acute.[14] Relying on the High Court's decision in *Angas Law Services Pty Ltd v Carabelas*,[15] his Honour held:[16]

> Although the shareholders of a company cannot release the directors from their statutory duties … their acquiescence in a course of conduct can affect the practical content of those duties [17]

Thus, his Honour reasoned that as shareholders could cure potential breaches of the general law duties through ratification, the determination that a breach of a statutory duty had occurred would also be affected (although not cured) by shareholder ratification. This was based on the notion that the statutory duties were largely enactments of the general law duties. This line of reasoning is critiqued below.

Applying these principles to the conduct of the Mr Nahed, Justice Brereton held that he did not breach any of the directors' statutory duties as alleged by ASIC. His Honour held that, in the absence of reasons to doubt, Mr Nahed's duty of care and diligence did not require him to do more than he did to ascertain whether the scheme was compliant, given the delegation of responsibility among the directors and the involvement of lawyers and accountants in promoting the scheme. For similar reasons, his Honour

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[11] *ASIC v Maxwell* (2006) 59 ACSR 373 at 399-400; [2006] NSWSC 1052 at [104]-[106].
[12] (1993) 9 WAR 395; 11 ACSR 162.
[13] *Vrisakis v ASC* (1993) 9 WAR 395; 11 ACSR 162 at 213. Ipp J did however note (at 213) that it may be possible for a breach of the statutory duty of care and diligence to occur without any possible damage to the corporation, although such occurrences, noted his Honour, would be rare. Ipp J's approach in *Vrisakis* was applied recently in *Vines v ASIC* (2007) 62 ACSR 1; [2007] NSWSC 75.
[14] *ASIC v Maxwell* (2006) 59 ACSR 373 at 398; [2006] NSWSC 1052 at [103].
[15] (2005) 226 CLR 507; [2005] HCA 23.
[16] *ASIC v Maxwell* (2006) 59 ACSR 373 at 398; [2006] NSWSC 1052 at [103].
[17] What the High Court actually said in *Angas* was: "The shareholders of a company cannot release directors from the statutory duties imposed by [ss 180-183]. In a particular case, their acquiescence in a course of conduct might affect the practical content of those duties. It might, for example, be relevant to a question of impropriety": *Angas Law Services Pty Ltd v Carabelas* (2005) 226 CLR 507 at 523; [2005] HCA 23 at [32] per Gleeson CJ, Heydon J.

concluded the duties in ss 181(1) and 182(1) were not breached by Mr Nahed.[18]

The fact that Mr Nahed was a director and shareholder in a closely held proprietary company, in which the interests of the directors and those of the shareholders were identical, appears to have played a major role in influencing this outcome. The judicial approach adopted by Brereton J seems to relax directors' statutory duties based on (at least partially) the consent of the shareholders, which raises valid policy considerations on the reach and ambit of such duties. Indeed, it demands an answer to the following question: "where the benefits of the directors' conduct to shareholders outstrip the harm to the company in terms of fines and prosecution, can ASIC still prove a breach of statutory duties by relying upon the public interest?" In our view, despite the reasoning of Brereton J, the answer to that question should be "yes".

Before undertaking a critical analysis of this aspect of the case, it is useful to examine the origins and the policy considerations underpinning directors' statutory duties and to contrast the position at general law.

III DIRECTORS' DUTIES

A *Directors Duties under the General Law*

The current duties of directors under the general law emerged from two sources, duties imposed in equity and a duty of care imposed by the common law.

In equity, from at least the middle of the 19th century, directors were taken to be in a fiduciary relationship with the company and accordingly owed it fiduciary duties.[19] This fiduciary relationship between the directors and the company gives rise to duties which can be summarised as follows:[20]

1. a duty to act in good faith in the best interests of the company;
2. a duty to act for proper corporate purposes;
3. a duty to give adequate consideration to matters for decision and to keep discretions unfettered; and
4. a duty to avoid conflicts of interests.

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[18] The director was nonetheless banned for five years under s 206D (for corporate insolvency grounds) and/or s 206E (based on contravention of the fundraising provisions and the misleading and deceptive conduct provisions): *ASIC v Maxwell (No 2)* [2006] NSWSC 1333.

[19] *Re City Equitable Fire Insurance Company Limited* [1925] Ch 407 at 429 per Romer J. It appears that this fiduciary relationship initially arose from the fact that prior to the 1844 most joint stock companies were unincorporated and depended for their validity on a deed of settlement vesting the property of the company in the directors as trustees. Therefore directors were seen to be trustees of the company's money or property. After incorporation courts continued to apply the concept that directors were fiduciaries, despite no longer being trustees of the company property: see Gower L, *Principles of Modern Company Law* (3rd ed, 1969) 515 (repeated in 4th, 5th and 6th editions, not repeated in latest edition (7th)). See also Heydon D, "Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?", in Degeling S and Edelman J, *Equity in Commercial Law* (Thomson, 2005), Ch 9.

[20] Austin R, Ford H and Ramsay I, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005), 211.

The common law duty of care is founded upon the tort of negligence. The duty extends to both executive directors and non-executive directors and is a duty to exercise reasonable care in the performance of their office.[21] A director also owes a duty in equity to exercise care and skill.[22] Although their development can be traced to different sources, the standard of care expected of directors under their equitable duty to exercise care and skill and the common law duty to exercise reasonable care is now the same, as is the standard applied to the equivalent statutory duty referred to below.[23]

B *Statutory Directors Duties*

The principal statutory formulation of the duties of directors and officers is contained in ss 180-184 of the *Corporations Act 2001* (Cth). These are:

1. The duty to act with care and diligence;[24]
2. The duty to act in good faith in the best interests of the corporation and for a proper purpose;[25]
3. The duty not to improperly use their position to gain an advantage for themselves or to cause a detriment to the corporation;[26] and
4. The duty not to improperly use information obtained as a result of their position in the corporation to gain an advantage for themselves or to cause a detriment to the corporation.[27]

Statutory directors' duties were first introduced into Australian in Victoria in 1958.[28] Its statutory formulation was as follows:

> s 107 (1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.
>
> (2) Any officer of a company shall not make use of any information acquired by virtue of his position as an officer to gain an improper advantage for himself or to cause detriment to the company.
>
> (3) Any officer who commits a breach of the foregoing provisions of this section shall be guilty of an offence against this Act and shall be liable to a penalty of not more

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[21] *Daniels (formerly practicing as Deloitte Haskings & Sells) v Anderson* (1995) 37 NSWLR 438 at 506 per Clarke and Sheller JJA.

[22] *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109 at 159 per Ipp J. See further Heydon D, "Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?" in Degeling S and Edelman J, *Equity in Commercial Law* (Thomson, 2005), Ch 9.

[23] *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109 per Ipp J at 160; *Vines v ASIC* (2007) 62 ACSR 1; [2007] NSWSC 75.

[24] *Corporation Act 2001* (Cth), s 180(1). The statutory duty of care and diligence has been held to encompass a standard of skill for executive directors notwithstanding the absence of the word "skill" in the section – see *Daniels (formerly practicing as Deloitte Haskings & Sells) v Anderson* (1995) 37 NSWLR 438; *Vines v ASIC* (2007) 62 ACSR 1; [2007] NSWCA 75. For discussion on 'skill', see further, Hargovan A, "Reformation of Directors' Duties in Australia and New Zealand: A Case of Missed Opportunities for Harmonisation" (1994) 4th National Corporate Law Teachers Conference, University of Technology Sydney Law School, Sydney – cited in Cassidy J, "An evaluation of Corporations Law s 232(4) and the Directors' Duty of Care, Skill and Diligence" (1995) 23 ABLR 184 at 209-210.

[25] *Corporations Act 2001* (Cth), s 181.

[26] *Corporations Act 2001* (Cth), s 182(1).

[27] *Corporations Act 2001* (Cth), s 183(1).

[28] Similar provisions were introduced around Australia shortly thereafter. See *Companies Act 1961* (NSW), s 124 and equivalents in other states. The history of the general law duty of care is considered in *ASIC v Vines* (2003) 48 ACSR 322; [2003] NSWSC 1116 at [12] per Austin J.

than Five hundred pounds and shall in addition be liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach of any of such provisions.

(4) Nothing in this section shall prejudice the operation of any other enactment or rule of law relating to the duty or liability of directors or officers of a company.

This statutory formulation of directors' duties in the Victorian *Companies Act* was the first of its kind in the English speaking world.[29] It was introduced as a direct response to a report of the Victorian Statute Law Revision Committee on Freighters Limited,[30] for reasons discussed next.

Freighters Limited was a public company listed on the Stock Exchange of Melbourne involved in the manufacture of trailer vehicles and associated products. In July 1956 the Attorney General of Victoria appointed an Inspector under the *Companies (Special Investigations) Act 1940* (Vic) to investigate its affairs. In brief, the Inspector identified three main problems. First, in order to raise funds to takeover another company, Australian Machinery Co. Pty Limited, the directors issued new shares in Freighters to themselves at a discount to the then market price and without disclosure to shareholders or providing them with the opportunity to participate in the issue. Second, the directors had an interest in a number of distribution companies which sold products sourced from Freighters. These companies were sold to Freighters for the issue of shares in Freighters to the directors and their associates. Independent valuations were not obtained, nor were the shareholders informed of the directors' interest in the transaction. Third, the directors used an issue of shares for employees to issue further shares to themselves and associates. Again, the shareholders were not informed of the extent and nature of the issue of the shares to the directors.[31]

The Inspector found that no criminal law had been breached and the acquisition of Australian Machinery Co and the distribution companies may have actually been profitable for the company. The Inspector did, however, note that the transactions revealed "a complete lack of appreciation of the standards demanded of and displayed by public company directors."[32]

The Victorian Statute Law Revision Committee was directed to consider the report of the Inspector. In evidence before the Committee it appears clear that the members of the Committee were concerned with the benefits the directors had covertly obtained from the transactions, although noted that some of the transactions may have ultimately advantaged the company. It was recognised that the law was inadequate in dealing with the situation and that it needed to be amended to deter similar behaviour in the future.[33]

The Committee made a number of recommendations including that a section be inserted in the *Companies Act* similar to that of the then s 169 of the

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[29] Brown S, *Company Directors* (2nd ed, Law Book Company, 1965) p 179.
[30] Victorian Parliamentary Debates, 9 September 1958 at 324.
[31] Report of the Inspector Appointed to Investigate the Affairs of Freighters Limited Pursuant to the Provisions of the Companies (Special Investigations) Act 1940, 17 September 1956.
[32] Report of the Inspector Appointed to Investigate the Affairs of Freighters Limited Pursuant to the Provisions of the Companies (Special Investigations) Act 1940, 17 September 1956 at 29.
[33] Minutes of Evidence to Statute Law Revision Committee upon the Provisions of The Companies Acts (re Freighters Limited) at 22.

United Kingdom *Companies Act 1948*. This would allow the Attorney-General, following the report of an inspector, to bring proceedings in the name of the company if appeared to the Attorney that it was in the public interest that such proceedings be brought by such company for the recovery of damages in respect of any fraud misfeasance or other misconduct in connection with the promotion or formation of that company or the management of its affairs or for the recovery of any property of the company which has been misapplied or wrongfully retained.[34]

Whilst Parliament adopted this recommendation,[35] it went further and also introduced s 107 in an attempt to deal with the type of activity uncovered by the report. Although the Explanatory Memorandum to the Act stated that s 107 was to a large extent a declaration of the existing law, it was envisaged that it went further and would:[36]

> free the courts from the technicalities of the existing law in dealing with all forms of dishonesty and impropriety of directors.

Commentators at the time also recognised that the new provision may be interpreted differently from the general law directors' duties.[37]

C *Differences between General Law and Statutory Duties*

It was clear from the express terms of the Victorian provision that it was not intended that statutory directors' duties would replace general law duties. Rather, the statutory duties would operate alongside the general law duties. This coexistence has remained.[38]

What was also clear from the Victorian provision was that, whether or not the courts adopted a similar interpretation to statutory and general law directors' duties, both served different ends. A company could take action against directors for a breach of general law duties which, if successful, would provide the company, and indirectly shareholders, with a remedy. The introduction of statutory duties enhanced shareholder rights but, in addition, provided the State with a remedy to prosecute breaches of directors' duties. By enacting this offence provision, the State could take action against directors in the *public interest* to punish the particular director involved but also with the view to deter similar breaches.

The wider role of the statutory duties is confirmed by the decision in *Castlereagh Motels Ltd v Davies-Roe*,[39] where the purpose of the statutory duties was stated in the following terms:[40]

> It is not the prevention of financial loss to the company which appears to be the main or direct object of the [statutory duties], but the ensuring that companies are benefited by the proper and devoted discharge by directors of their fiduciary duties.

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[34] Report from the Statute Law Revision Committee upon the Provisions of The Companies Acts (re Freighters Limited) at 5. This provision is similar to *Australian Securities and Investments Commissions Act 2001* (Cth) s 50.
[35] Explanatory Memorandum to the Victorian Companies Bill 1958 at 334.
[36] Explanatory Memorandum to the Victorian Companies Bill 1958 at 331.
[37] See Menzies D, "Company Directors" (1959) 33 ALJ 156 at 168-170.
[38] See *Corporations Act 2001* (Cth), s 185.
[39] (1966) 84 WN (Pt 2) (NSW) 182.
[40] Ibid at 184 per Wallace P.

The introduction and development of statutory duties of directors should be viewed in the broader context of the changing community and parliamentary expectations of corporate governance. For example, corporate laws were changed in the 1930's to prevent companies from granting blanket exemptions and indemnifications against breach of directors' duties (the current provision being s 199A). This change was required in order to protect the investing public from abuses by directors.[41]

By a series of legislative amendments since their introduction, statutory directors' duties have diverged from general law duties in a number of respects. For example, a breach of the statutory duty not to make improper use of position or information is now wider than the equivalent fiduciary duty in that it applies to advantages obtained by other persons, rather than just the fiduciary.[42]

Furthermore whereas the company can continue to bring action for breach of general law directors' duties, the role of the State in the enforcement of statutory duties has expanded. A breach of the statutory duties contained in s 180(1) to act with care and diligence is no longer a criminal offence but is a civil penalty provision.[43] Likewise each of the other statutory duties are also civil penalty provisions.[44] However, unlike the duty to act with care and diligence, these other statutory duties can also constitute criminal offences if the additional elements of intention, recklessness or dishonesty set out in s 184 of the Act are established.

When a breach of a civil penalty provision is established the Court can make a declaration of contravention against any person who contravenes the provision or who is involved in the contravention.[45] ASIC can then seek a pecuniary penalty order, a disqualification order or an order for compensation be paid to the company.[46] The company may also seek an order for compensation but cannot seek a pecuniary penalty or disqualification order.[47]

For a breach of the statutory directors duties that are offence provisions, ASIC can commence a prosecution under s 1315 of the *Corporations Act*. Since the time of their introduction the penalties for such offences have increased such they now carry a maximum penalty of five years imprisonment or a fine of $220,000 or both.[48]

In summary, the statutory duties differ from their general law counterparts in terms of enforcement (i.e. statutory duties are also enforceable by ASIC) and in terms of consequences (broader range of sanctions available for statutory

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[41] See further Cranston R, "Limiting Directors' Liability: Ratification, Exemption and Indemnification" [1992] JBL197.

[42] For a discussion on the differences see Austin R, Ford H and Ramsay I, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) p 394.

[43] *Corporations Act 2001* (Cth), s1317E.

[44] Ibid.

[45] *Corporations Act 2001* (Cth), s1317E(1).

[46] *Corporations Act 2001* (Cth), ss 206C, 1317G, and 1317H.

[47] *Corporations Act 2001* (Cth), s 1317J. See further *One.Tel Ltd (in liq) v Rich* (2005) 53 ACSR 623; [2005] NSWSC 226.

[48] *Corporations Act 2001* (Cth), Schedule 3. The definition for a penalty unit is set out in the *Crimes Act 1914* (Cth), s 4AA.

breaches of duty). Lastly, the duty to not act "improperly" (ss 182, 183) is broader in its scope than the general law fiduciary equivalent requirement. In contrast, the standard required to comply with the statutory duties in ss 180(1) and 181 is similar (if not identical) to their general law counterparts.

IV ASIC v MAXWELL: A CRITIQUE

The comments by Brereton J, outlined above in Part II, require a consideration of the purposes of the statutory duties contained in ss 180(1)-183 of the Act. It was those provisions that his Honour found were not contravened by Mr Nahed by allowing Procorp to breach the fundraising, financial services and misleading or deceptive conduct provisions (hereafter "investor protection provisions").

His Honour made several important points which are examined below:

1. The unity of director and shareholder interests may result in an implicit ratification at general law;[49]
2. Such an implicit ratification may be given prospectively or retrospectively and may cover negligence, breach of fiduciary duty or the exercise of directors' powers for an improper purpose;[50]
3. An implicit ratification may "affect the practical content of [directors' statutory duties], including any question of whether directors acted with a reasonable degree of care and diligence, and whether they made improper use of their position";[51] and crucially
4. "It is a mistake to think that ss 180, 181 and 182 are concerned with any general obligation owed by directors at large to conduct the affairs of the company in accordance with law general or the Corporations Act in particular, they are not."[52]

His Honour summed up his view by stating that the Part 2D.1 duties are not directed to "securing compliance with the various requirements of the Corporations Act".[53]

Brereton J's comments grouped together ss 180, 181, and 182, which, in our view, is unfortunate because the duties outlined in those provisions are not identical, and serve different and distinct purposes. Whilst we accept his Honour's view that these provisions are designed primarily to secure the director's attention to benefiting the company, we query whether this guiding principle should be held to prevent ASIC taking action to protect the public interest.

However, before we examine each statutory provision,[54] it is necessary to examine further his Honour's comments regarding the scope, and significance, of shareholder ratification.

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[49] *ASIC v Maxwell* (2006) 59 ACSR 373 at 398-399; [2006] NSWSC 1052 at [103].
[50] Ibid.
[51] Ibid
[52] *ASIC v Maxwell* (2006) 59 ACSR 373 at 399; [2006] NSWSC 1052 at [104].
[53] *ASIC v Maxwell* (2006) 59 ACSR 373 at 400; [2006] NSWSC 1052 at [106].

A *The Scope of Ratification*

The law of ratification is derived largely from principles of equity that allow a principal to ratify breaches of duty by the fiduciary.[55] As noted by the learned authors of *Meagher, Gummow and Lehane*, a person occupying a fiduciary position may avoid liability for conduct that would otherwise breach their duty by obtaining the fully informed consent to the principal.[56] The law of principal and agent also provides for the principal to ratify conduct of the agent that would otherwise be a breach of duty, and thereby extinguish the agent's liability to the principal.[57] There is authority for the view that the principal may ratify the agent's negligence,[58] although perhaps the better view is that ratification of negligent conduct represents a waiver of legal rights.[59]

The rationale for ratification (at least in equity) is that a transaction undertaken in breach of fiduciary duty is not necessarily void, but rather is voidable at the option of the principal.[60] Thus, a principal may choose to forgive a fiduciary for a proposed or actual breach.[61] Clearly then, ratification made be either prospective or retrospective.

Ratification of the directors' conduct by the fully informed consent of the shareholders in a general meeting (by an ordinary resolution) has been accepted in a number of authorities.[62] The shareholders' consent may be express or implied, thus the doctrine of unanimous consent may be used to prove ratification.[63]

There are several limitations on the ability of the shareholders to ratify the conduct of the directors. A shareholders' ratification will not protect a director from a breach of duty where:

- the company is insolvent and the conduct prejudices the company's ability to repay its creditors;[64]

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[54] Section 182 is considered together with s 183, below, as the wordings of those provisions are substantially similar (both involve an improper use of either position or information to gain an advantage or to cause harm to the corporation).

[55] Austin R, Ford H and Ramsay I, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) p 643.

[56] Meagher R, Heydon D and Leeming M, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, LexisNexis Butterworths, 2002), [5-115].

[57] Reynolds R, *Bowstead and Reynolds on Agency* (17th ed, Sweet and Maxwell, 2001) art 14.

[58] *Pavlides v Jensen* [1956] Ch 565 at 576 per Danckwerts J (company shareholders resolved that the company would not sue the directors for negligence).

[59] See further Worthington S, "Corporate Governance: Remedying and Ratifying Directors' Breaches" (2000) 116 LQR 638 at 651-656. It may also be held that the prior informed consent of the principal would enliven a defence of *volenti non fit injuria*.

[60] *Winthrop Investments Ltd v Winns Ltd* [1975] 2 NSWLR 666 at 679 per Samuels JA.

[61] Meagher R, Heydon D and Leeming M, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, LexisNexis Butterworths, 2002), [5-115].

[62] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; [1942] 1 All ER 378; *Winthrop Investments Ltd v Winns Ltd* [1975] 2 NSWLR 666; (1975) 1 ACLR 222.

[63] The doctrine of unanimous consent is recognised by the decision in *Re Duomatic limited* [1969] 2 Ch 365, where it was held that the members had knowledge of the directors' conduct and had implicitly consented to it by approving the company's annual reports which contained information on the transactions by the directors.

[64] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722.

- the ratification would prejudice the rights of third parties;[65]
- the conduct is oppressive;[66]
- the conduct is in breach of a shareholder's personal rights;[67]
- the conduct was a misappropriation of the company's resources;[68] or
- the shareholders' ratification represents a fraud on a power.[69]

Furthermore, the consent of shareholders will not prevent a criminal offence from being committed by the director(s).[70]

Essentially, the ratification acts as a release from liability, or a waiver of rights to enforce compliance with their duties. There is some uncertainty as to whether ratification will necessarily prevent the company from taking any future action.[71] Certainly, the proper ratification by a majority of shareholders prevented the minority from bringing a derivative action at general law, although the statutory derivative action has no similar limitation.[72] Where the control of the company changes (for example under a takeover or during liquidation), it may be that mere shareholder ratification will not prevent the company from enforcing its legal rights.[73] Indeed, the unity between shareholders and directors in *Angas Law Services* did not prevent the liquidator from taking action for breach of directors' duties. Prudent directors should therefore negotiate a deed of release to protect themselves from future action by the company.[74]

There may also be doubts as to whether the shareholders are able to release a director from legal action, given that the decision to sue comes within the managerial prerogative, and the shareholders are not entitled even through a unanimous vote to usurp that managerial prerogative.[75] However, the statutory derivative action may well resolve any doubts on this given that it

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[65] *Forge v ASIC* (2004) 213 ALR 574; [2004] NSWCA 448 at [377] per McColl JA; Baxt R, "Judges in their own case: the ratification of directors' breaches of duty" (1978) 5 Monash University Law Review 16 at 28.

[66] *Ngurli Ltd* v *McCann* (1953) 90 CLR 425; *Hogg v Cramphorn* [1966] 3 All ER 420 at 428 per Buckley J. See further *Corporations Act 2001* (Cth), s 232.

[67] *Residues Treatment and Trading Co Ltd v Southern Resources Ltd* (1988) 51 SASR 177.

[68] *Hurley* v *BGH Nominees Pty Ltd* (1982) 6 ACLR 791; *Re George Newman & Co* [1895] 1 Ch 674 at 685-686 per Lindley LJ.

[69] *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 438 per the Court.

[70] *Macleod v R* (2003) 214 CLR 230 at 240; [2003] HCA 24 at [30] per Gleeson CJ, Gummow and Hayne JJ.

[71] See Cranston R, "Limiting Directors' Liability: Ratification, Exemption and Indemnification" [1992] JBL 197.

[72] *Corporations Act 2001* (Cth), s 239.

[73] The enforcement of equitable rights may be more difficult given the more flexible approach equity takes to the release of equitable rights: Meagher R, Heydon D and Leeming M, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, LexisNexis Butterworths, 2002), Ch 35.

[74] Cranston R, "Limiting Directors' Liability: Ratification, Exemption and Indemnification" [1992] JBL 197, 200

[75] *National Roads & Motorists' Association v Parker* (1986) 6 NSWLR 517 at 521; (1986) 11 ACLR 1 per McLelland J; *Automatic Self-Cleansing Filter Syndicate Company Ltd v Cuninghame* [1906] 2 Ch 34. This assumes of course that there is nothing in the company's constitution to confer specific managerial powers on the general meeting.

clearly envisages the shareholders' limited rights to conduct litigation in the name of the company.

What then of the statutory duties? There is a line of authorities that have determined that the statutory duties cannot be cured by shareholder ratification.[76] Most recently, Gleeson CJ and Heydon J in *Angas Law Services* said:[77]

> The shareholders of a company cannot release directors from the statutory duties imposed by [ss 180-183]. In a particular case, their acquiescence in a course of conduct might affect the practical content of those duties. It might, for example, be relevant to a question of impropriety.

The implications of ratification on the statutory duties are discussed below. However, at this point we might question why there seems to be a blanket refusal to allow ratification to cure what would otherwise be a breach of statutory duty. In our view, the answer is that the statutory duties perform a different (although overlapping) function to the general law duties.

A further consideration that tells against permitting shareholders to forgive statutory breaches is the fact that the civil penalty regime contained in Pt 9.4B specifically provides for the forgiveness of a breach of a civil penalty provision (including directors' statutory duties under ss 181-183) in s 1317S.[78] It could be argued that the civil penalty regime is intended to operate virtually as a complete code for enforcing breaches of the statutory directors' duties,[79] in which case the power to forgive is left solely to the court. Despite the criticism attaching to the complete code thesis propounded by Young J in *Mesenberg*,[80] this line of argument was applied by the NSW Court of Appeal to justify its view that shareholders cannot ratify breaches of the statutory duties.[81] It is submitted that the view that the power to forgive breaches of the statutory duties that are classed as civil penalties (i.e. ss 181-183) should lie exclusively with s 1317S has a much stronger foundation than Young J's broader view that the civil penalty provisions provide an exclusive enforcement code, thereby preventing shareholders from using s 1324.[82]

Having established that shareholder ratification cannot cure a breach of statutory directors' duties, attention is now focussed on how the fact of ratification changes (if at all) the application of the statutory duties.

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[76] *Miller v Miller & Miller* (1995) 16 ACSR 73 at 89 per Santow J; *Forge v ASIC* (2004) 213 ALR 574; [2004] NSWCA 448 at [378]-[384] per McColl JA

[77] *Angas Law Services Pty Ltd v Carabelas* (2005) 226 CLR 507 at 523; [2005] HCA 23 at [32] per Gleeson CJ, Heydon J.

[78] *Forge v ASIC* (2004) 213 ALR 574; [2004] NSWCA 448 at [382] per McColl JA.

[79] *Mesenberg v Cord Industrial Recruiters* (1996) 39 NSWLR 128 at 136-137 per Young J.

[80] See for example: Bird H, "A Spanner in the Works: The Impact of Mesenberg v Cord Industrial Recruiters" (1997) 25 ABLR 179; Bird H, "Problematic Nature of Civil Penalties in the Corporations Law" (1996) 14 C&SLJ 405.

[81] *Forge v ASIC* (2004) 213 ALR 574; [2004] NSWCA 448 at [382] per McColl JA.

[82] See further Austin R, Ford H and Ramsay I, *Company Directors Law and Corporate Governance* (LexisNexis Butterworths, 2005), pp 685-687.

B *The Scope of Statutory Duties*

1 *Section 180(1)*

The original formulation of this statutory duty in the Victorian *Companies Act*, which was adopted by the other Australian states as discussed earlier, required a director to "use reasonable diligence". The requirement that a director also exercise "care" was added with the introduction in *Companies Code* legislation in the Australian states in 1981.[83] As discussed earlier, the original purpose of this statutory duty was to provide for public enforcement which could result in a fine, and/or a statutory right of compensation to the company.[84] Over time, the interpretation of the statutory duty of care and diligence has grown stricter in line with community expectations of corporate managerial behaviour. As Tadgell J noted:[85]

> As the complexity of commerce has gradually intensified (for better or for worse) the community has of necessity come to expect more than formerly from directors whose task it is to govern the affairs of companies to which large sums of money are committed by way of equity capital or loan. In response, the parliaments and the courts have found it necessary in legislation and litigation to refer to the demands made on directors in more exacting terms than formerly; and the standard of capability required of them has correspondingly increased.

It was noted above that shareholders may ratify conduct by the directors that would otherwise be a breach of the director's duty of care,[86] with this shareholder ratification being either express or implied. It was therefore open on the facts in *Maxwell* (i.e. the unity between shareholders and directors) for Justice Brereton to conclude that there had been an implicit ratification of the directors' conduct. Moreover, the unity between shareholders and directors would result in the implicit ratification being prospective. That is, the directors (who were also shareholders) would have known that they consented before they engaged in conduct that ASIC alleged was a breach of s 180(1).

What is the effect of this ratification on the content of s 180(1)? That provision explicitly requires a consideration of the circumstances surrounding the director's conduct. Therefore, the determination of whether a director has breached s 180(1) will require the court to ascertain what a reasonable director would have done in circumstances where the company's shareholders have consented to the conduct.[87] In *Maxwell*, Brereton J accepted that the unity between shareholders and directors was part of the relevant circumstances for the purposes of s 180(1).[88]

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[83] For a history of s 180 of the *Corporations Act 2001* (Cth), see *ASIC v Vines* (2003) 48 ACSR 322; [2003] NSWSC 1116.

[84] See *Castlereagh Motels Ltd v Davies-Roe* (1966) 84 WN (Pt 2) (NSW) 182 at 183 per Wallace P.

[85] *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 126.

[86] Again the terminology here may need clarification. We have used the term ratification to refer to shareholder consent. When dealing with an alleged breach of duty of care the more appropriate term is probably a release or waiver by the company of its rights in law or equity to sue for a failure to comply with this standard.

[87] Of course expert evidence of what directors with similar responsibilities would do in similar circumstances may be used: *ASIC v Vines* (2003) 48 ACSR 322; [2003] NSWSC 1116.

[88] *ASIC v Maxwell* (2006) 59 ACSR 373 at 402; [2006] NSWSC 1052 at [112].

Will shareholder ratification necessarily result in no breach being provable? Brereton J's analysis would seem to accept that even where the shareholders' consent to the conduct, the standard of the reasonable director in those circumstances requires the court to determine whether the director(s) has balanced the potential benefits to the company and the potential harm that may be suffered by the company. As Brereton J noted the statutory duty of care and diligence:[89]

> would be contravened if a director had not exercised a reasonable degree of care and diligence in the exercise of his powers or the discharge of his duties, even if there was no actual damage, that could only be so if it was reasonably foreseeable that the relevant conduct *might harm the interests of the company* - which means the corporate entity itself, the shareholders, and, where the financial position of the company is precarious, the creditors of the company - and, moreover, that in determining whether the relevant duty had been breached, the foreseeable risk of harm must be balanced against the potential benefits which could reasonably be expected to accrue to the company from that conduct. [emphasis in original]

Therefore, it seems that Brereton J recognises that shareholders, even with unanimous informed consent, could not reduce the statutory standard to zero as the directors are still required to engage in a balancing exercise between the benefits and harms that may foreseeably arise from this conduct.

However, if the statutory duties are only owed to the company, and the interests of the company may be completely equated with the interests of the shareholder/directors, why then should directors who are the only shareholders need to balance these interests? Why could the directors not condone even grossly negligent conduct, and by granting a deed of release thereby prevent the company from subsequently taking action. In our view, the reason for the balancing requirement is that the statutory duties perform a higher function than merely serving the interests of the shareholders. The statutory standard of care and diligence performs a public interest function in setting minimum standards of corporate managerial behaviour. These standards are upheld through public enforcement action by ASIC, and through the imposition of quasi-punitive remedies including pecuniary penalties and disqualification orders.

This view is reinforced by the existence of various other actions that may be taken against directors by "interested or aggrieved persons", such as the statutory injunction (under s 1324) and the various orders available under s 1323. These provisions would arguably be rendered nugatory if shareholders could unanimously consent to directors' conduct and thereby prevent a breach of the statutory duties arising.

We are not arguing that shareholders can unanimously consent to cure a breach of statutory duty-such proposals have been rejected on numerous occasions by the court.[90] Rather, we are querying, with respect, Justice Brereton's analysis that "adjusts" the statutory standards to result in no legal breach developing in the first place.

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[89] *ASIC v Maxwell* (2006) 59 ACSR 373 at 397-398; [2006] NSWSC 1052 at [102].

[90] See *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 226 CLR 507 at 523; [2005] HCA 23 at [32] per Gleeson CJ and Heydon J; *Forge v ASIC* (2004) 213 ALR 574; [2004] NSWCA 448 at [378]-[384] per McColl JA.

Brereton J raised another point regarding s 180(1) that warrants examination. As noted earlier, his Honour stated that:[91]

> It is a mistake to think that ss 180, 181 and 182 are concerned with any general obligation owed by directors at large to conduct the affairs of the company in accordance with law general or the Corporations Act in particular, they are not.

We have argued above that the statutory duty of care and diligence under s 180(1) raises public interest considerations through public enforcement and quasi-punitive remedies. In our view, s 180(1) should be interpreted accordingly, so that a director could be negligent by allowing the company to breach its statutory obligations. However, we would caution that merely being a director at the time that the company breaches statutory provisions is insufficient to demonstrate a failure to act with care and diligence. The director may well have acted appropriately given the size and complexity of the company, or other relevant facts, including the possible application of the business judgment rule under s 180(2).

We submit that the express wording of s 180(1), in particular, the phrase "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" (emphasis added) should be interpreted to include the duty to manage (for executive directors) or monitor the management of the company (for non-executive directors) so as to ensure that breaches of the law that are reasonably foreseeable do not occur. Where a director fails to take steps to prevent the company from breaching the law where a reasonable director would have taken such steps, the director has failed to "exercise their powers and discharge their duties" to the reasonable standard required by the community and ultimately enforced by the courts.

It is submitted, with respect, that the difficulty with Brereton J's analysis of s 180(1) is that it arguably allows directors to weigh up the potential benefits that may accrue to the company (in *Maxwell's* case the directors were considering the benefits that would accrue to them as sole shareholders) against the potential fines or reputational damage (i.e. harm in the above negligence calculus). His Honour specifically stated that "in determining whether the relevant duty had been breached, the foreseeable risk of harm must be balanced against the potential benefits which could reasonably be expected to accrue to the company from that conduct".[92] In our view, the conscious balance of financial benefit that may accrue to the company from breaching the law is an inappropriate formulation of directors' duties and runs against the modern trend of increasing standards of corporate governance in Australia.

2 Section 181

Section 181(1) imposes two duties upon company directors and officers, the duty to:

- act in good faith in the best interests of the corporation; and

[91] *ASIC v Maxwell* (2006) 59 ACSR 373 at 399; [2006] NSWSC 1052 at [104].
[92] See further *ASIC v Maxwell* (2006) 59 ACSR 373 at 397-398; [2006] NSWSC 1052 at [110].

- act for a proper purpose.

These duties, similar to s 180(1), arise when directors "exercise their powers and discharge their duties". The significance of this phrase was examined above in relation to s 180(1).

Brereton J found that the "good faith" element of s 181(1)(a) must be more than mere negligence.[93] His Honour stated "in my opinion, s 181 is contravened only where a director engages deliberately in conduct, knowing that it is not in the interests of the company."[94] One may assume that a director who knowingly engages in conduct adverse to the interests of the company would be held to act for an improper purpose and thereby breach s 181(1)(b). In addition, such conduct would also likely breach s 184.

His Honour went on to explain:[95]

> Whether there were in this case breaches of the directors' duties – and, in particular, of their duty of care and diligence - depends upon an analysis of whether and to what extent the corporation's interests were jeopardised, and if they were, whether the risks obviously outweighed any potential countervailing benefits, and whether there were reasonable steps which could have been taken to avoid them.

An initial reading of this passage may suggest that his Honour was concerned only with the duty of care. Indeed, particular mention is made of that duty in the statement. However, his Honour's subsequent analysis and findings address the allegations under ss 180 and 181, 182 using the same balancing standard. When dismissing arguments by ASIC in relation to s 181, Brereton J noted that the duty of good faith (i.e. s 181) "did not require [Nahed] to do more than he did to ascertain whether the scheme was not compliant".[96] That is, Nahed acted in good faith because he considered the potential risk to the company through possible non-compliance and balanced that risk by relying upon the professional expertise of the company's advisors to negate the risk of non-compliance.

It is respectfully submitted that Brereton J's reasoning on the scope of statutory directors' duties, (i.e. that they are not breached as long as the directors have engaged in an appropriate balancing between the likely benefits and harms that may arise out of the transaction), is inherently problematic on both doctrinal and public policy grounds.

Consider, for example, the phrase 'interests of the company' in s 181(1)(a). It is difficult to envisage a situation where exposing the company to a statutory contravention would be in the best interests of the corporation in that it would be exposed to some risk of adverse action be that civil action, prosecution or, at the very least adverse publicity. Justice Brereton's reasoning that "relevant jeopardy to the interests of the company may be found in the actual or potential exposure of the company to civil penalties or other liability under the Act" understates the reality that enviably such actual or potential exposure would not be in the interests of the company. As noted above, any argument that such a balancing exercise may somehow offset potential fines against

[93] *ASIC v Maxwell* (2006) 59 ACSR 373 at 402; [2006] NSWSC 1052 at [109].
[94] *ASIC v Maxwell* (2006) 59 ACSR 373 at 402; [2006] NSWSC 1052 at [109].
[95] *ASIC v Maxwell* (2006) 59 ACSR 373 at 402; [2006] NSWSC 1052 at [110].
[96] *ASIC v Maxwell* (2006) 59 ACSR 373 at 403; [2006] NSWSC 1052 at [114].

benefits to the company (and thereby assert that the illegal conduct was "in the interests of the company") seems inconsistent with the development of directors' duties and enhanced corporate governance standards more generally in recent decades.

In November 1989 the Senate Standing Committee on Legal and Constitutional Affairs, in its report *Company Directors' Duties,* examined whether directors statutory duties should be widened to formally provide that directors could look beyond the 'interests of the company' in the exercise of their duties. It concluded that, apart from the interest of employees, the companies legislation not be amended to take into account such wider interests.[97] In reaching this conclusion the Committee appeared to take comfort from evidence given by company directors who advised that 'traditional' duties owed by directors to the company were sufficient to cover wider responsibilities, for example, to the environment.[98] Prominent company directors gave evidence that directors had regard to wider interests, for example, that a prosecution for a violation of environmental legislation would reflect badly on that particular company.[99]

More recently the Corporations and Markets Advisory Committee in its report *The Social Responsibility of Corporations* (December 2006) examined substantially the same issue and reached a similar conclusion. It found:[100]

> The Committee considers that the current common law and statutory requirements on directors and others to act in the interests of the company… are sufficiently broad to enable corporate decision-makers to take into account the environmental and other social impact of their decisions, including changes in societal expectations about the role of companies and how they should conduct their affairs.

Given their conclusions, both Committees envisaged that courts would continue to interpret directors' duties in line with the shareholder privacy norm such that directors would exercise their duties primarily in the interests of the Company. However these comments recognise that both Committees envisaged that the "interests of the company" encompassed some flexibility and must be considered within the perspective of the wider interests of the community.

Interpreting the interests of the company within the perspective of the wider interests of the community would ensure that actions by directors clearly contrary to the public interest, such as illegal dumping of pollutants, would not be excused as a breach of directors duties just because on one view it was in the interests of the company in making the cost saving of avoiding proper disposal fees. Similarly permitting, allowing or participating in contraventions

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[97] Senate Standing Committee on Legal and Constitutional Affairs *Company Directors Duties* (November 1989) at 99. The Committee did recommend that the companies legislation be amended to make it clear that the interests of the company's employees could be taken into account by directors however this recommendation was not adopted.

[98] Senate Standing Committee on Legal and Constitutional Affairs *Company Directors Duties* (November 1989) at 92.

[99] Senate Standing Committee on Legal and Constitutional Affairs *Company Directors Duties* (November 1989) at 92.

[100] Corporations and Markets Advisory Committee *The Social Responsibility of Corporations* (December 2006) at 111.

of the *Corporations Act 2001* (Cth) or other legislation can hardly be seen as being within the interests of the company.

In addition, consideration of s 181(1)(b) provides support against the view that s 181 cannot be breached where the directors allow the company to breach other statutory provisions. The notion of "acting for a proper purpose" is one with a long-standing heritage in the law. Indeed, the High Court of Australia has considered the requirement on directors to act for a proper purpose on numerous occasions. As Dixon J said in *Mills v Mills*:[101]

> Directors of a company are fiduciary agents, and a power conferred upon them cannot be exercised in order to obtain some private advantage or for any purpose foreign to the power. It is only one application of the general doctrine expressed by Lord Northingtonin *Aleyn v Belchier* [(1758) 1 Eden 132 at 138; 28 ER 634 at 637]: 'No point is better established than that, a person having a power, must execute it bona fide for the end designed, otherwise it is corrupt and void.'

It would seem odd that the powers conferred on corporate directors should be interpreted so that their purpose was to cause the company to breach statutory requirements. If this is accepted, then the deliberate use of corporate power by directors to cause the company to breach the law would by necessity be acting for an improper purpose.

3 *Sections 182 and 183*

These provisions have existed in Australian corporate laws since the introduction of s 107(2) of the *Companies Act 1958* (Vic) (outlined above). There is a strong similarity between these statutory provisions and the scope of the equitable duties owed by company directors. There are, however, notable differences as mentioned above, particularly the fact that the scope of these duties extends to benefits accrued by those apart from the fiduciary (director).

Brereton J stated that: "the duty imposed by s 182[102] is intended to forbid directors from abusing their position for their own advantage or the corporation's detriment, and not with securing compliance with the various requirements of the Corporations Act."[103] In our view, as explained above in relation to s 181, the interpretation of the word "improper" may include the conscious awareness that the company is breaching statutory laws. However, perhaps such deliberate breaches of the law should be put to one side, given that s 184 would render such conduct criminally liable. What of the somewhat lesser conduct of engaging in conduct that the director knows is a breach of their duties (for example taking advantage of a corporate opportunity)? If the directors obtain the informed consent of the shareholders, which would result where there is unity between the shareholders and directors, would the conduct be improper? In our view, the ratification may be capable, subject to limitations, of removing any element of impropriety from the directors' conduct.

Whilst the fact that a company officer acted with the approval of the members does not provide an exoneration of a breach of the statutory duties, the

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[101] (1937) 60 CLR 150 at 185.
[102] This comment would also apply to s 183 given the similar wording of the provisions.
[103] *ASIC v Maxwell* (2006) 59 ACSR 373 at 400; [2006] NSWSC 1052 at [106].

shareholders' approval is a relevant consideration when the court is determining whether the officer acted *improperly*.[104]

Whilst it was recognised by the High Court in *Byrnes* that impropriety may involve an abuse of power or authority,[105] the Court also stated that the concept of impropriety extends beyond merely an abuse of power situation. The majority gave an example of where a director may act improperly because he or she is aware that they are acting without proper authority.[106]

In *Byrnes*, the majority of the High Court stressed that the officer's appreciation of the circumstances was relevant in determining whether they improperly used their position or information. The officer's appreciation of the circumstances is relevant to assessing the propriety of the use made by the officer of his or her position in engaging in that conduct.[107] Therefore, the fact that the members have given express permission for the officer to act in a particular manner, and the officer's awareness of this is relevant to determining whether the director acted "improperly" or not.[108]

C *Ratification vs Relief from Liability*

The members' ratification of directors' conduct may also be relevant for an application by the director to the court seeking relief from liability flowing from the breach of duty. As will be demonstrated below, the ratification may assist in arguing that the director ought reasonably to be excused from liability.

The statutory power of a court to forgive a breach of duty has existed in company law statutes since at least 1907,[109] having been a long-standing element of the law of trusts.[110] If it can be said that the proper assent of the shareholders is capable of rendering a defaulting director's conduct not improper, then this may also mean that the director will be more likely to obtain the forgiveness of the courts under s 1317S or s 1318.[111]

The key issue seems to be whether the members' ratification would necessarily render the officer's resulting conduct "honest". Is acting improperly the same as acting with dishonesty? It could be safely argued that acting in a dishonest manner would bring the conduct within the scope of impropriety, however the same is not necessarily true in the reverse. There may be situations where a director acts improperly without being aware that that they

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[104] *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 226 CLR 507 at 523; [2005] HCA 23 at [32] per Gleeson CJ and Heydon J. This echoes an earlier statement by McPherson J in *Marson Pty Ltd v Pressbank Pty Ltd* (1988) 6 ACLC 338 at 344, and by Santow J in *Miller v Miller & Miller* (1985) 16 ACSR 73 at 89.

[105] *R v Byrnes* (1995) 183 CLR 501 at 512 per Brennan, Deane, Toohey and Gaudron JJ.

[106] *R v Byrnes* (1995) 183 CLR 501 at 515 per Brennan, Deane, Toohey and Gaudron JJ.

[107] *R v Byrnes* (1995) 183 CLR 501 at 512 per Brennan, Deane, Toohey and Gaudron JJ.

[108] *Grove v Flavel* (1986) 4 ACLC 654 at 660 per Jacobs J (in *Grove* the officer knew of the company's financial difficulties).

[109] For a discussion of the historical background to this provision see *Lawson v Mitchell* (1975-1976) CLC ¶40-200; *DCT v Dick* (2007) 64 ACSR 61; [2007] NSWCA 190.

[110] See *Edwards v A-G (NSW)* (2004) 60 NSWLR 667 at 689ff; [2004] NSWCA 272 per Young CJ (in Eq).

[111] In *Re D'Jan of London Ltd* [1994] 1 BCLC 561, Hoffmann LJ considered the UK equivalent of s 1318 and found that the shareholder's assent (the director also held 99% of the shares in the company) was a relevant consideration in determining an application for relief from statutory liability. This decision does not appear to have been considered in Australia.

are misleading the shareholders.[112] The High Court has recognised that honest conduct will not necessary prevent a finding of impropriety.[113]

The considerations that were discussed above in relation to assessing propriety under ss 182, 183 are also relevant for assessing the possibility of statutory forgiveness under either s 1317S (for civil penalties) or s 1318. There are 2 requirements for statutory forgiveness, to which attention is now turned.

1 *Honesty*

The meaning of the phrase "to act honestly" has been considered in many decisions. Decisions concerning the predecessors of s 1318 (which are equally applicable to s 1317S due to the similar wording) state that it is impossible to formulate a general test to prove honesty because it's existence is based on a subjective assessment of the defendant that will differ in each case (which is no doubt why the second requirement (a more objective standard) exists).[114] However, factors such as knowledge of a breach of law, or an intention to deceive or defraud others will be conclusive evidence against proof that the defendant acted honestly.[115] Conduct exhibiting moral turpitude may be said to be dishonest.[116] Consciousness of a breach of law is not however a necessary condition for a finding of a lack of honesty.[117] Furthermore, a failure to declare that a defendant's conduct was dishonest is not sufficient in itself to establish that the defendant acted honestly.[118]

However, there is authority to support the view that knowledge of shareholder consent favours a finding that the conduct by the director(s) was honest.[119] There is some authority for the view that to act honesty means acting bona fide in the interests of the company, including the company's unsecured creditors.[120] Whilst the High Court has made it clear that directors do not owe a direct duty to creditors outside of insolvency,[121] that determination does not mean that the impact of directors' conduct on unsecured creditors cannot be considered in an assessment of whether the director acted honestly (for the purposes of relief). Where the directors knowingly act so as to harm the interests of creditors, the court might refuse to grant relief.

2 *In the circumstances the officer ought fairly be excused from liability*

The notion of forgiveness being "fair" in the circumstances requires consideration of the effect of the conduct in breach for which the forgiveness

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[112] *Corporate Affairs Commission v Papoulias* (1990) 8 ACLC 849 at 850 per Allen J.
[113] *Chew v R* (1992) 173 CLR 626 at 642 per Dawson J, cited with approval in *R v Byrnes* (1995) 183 CLR 501 at 514 per Brennan, Deane, Toohey and Gaudron JJ.
[114] *Re Turner Barker v Ivimey* (1897) 1 Ch D 536, as cited in *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith* (1989) 7 ACLC 1,232 at 1,251 per Olsson J.
[115] *Re Voets Investments Pty Ltd* (1962) 79 WN (NSW) 670 at 677 per Jacobs J.
[116] *Commonwealth Bank of Australia v Friedrich* (1991) 9 ACLC 946 at 1011 per Tadgell J.
[117] *Dominion Insurance Company of Australia Limited (in liq) v Finn* (1989) 7 ACLC 25 at 33-34 per Powell J.
[118] *ASIC v Adler (No 5)* (2002) 20 ACLC 1,146; [2002] NSWSC 483.
[119] *Re Attorney-General's Reference (No 2 of 1982)* [1984] 2 All ER 216 at 224 per Kerr LJ.
[120] *Powell v Fryer* (2001) 37 ACSR 589; [2001] SASC 59 at [111] per Olsson J.
[121] *Spies v R* (2000) 201 CLR 603; [2000] HCA 43. See also Hargovan A, "Directors' Duties to Creditors in Australia after Spies v R: Is the Development of an Independent Fiduciary Duty Dead or Alive?" (2003) 21 C&SLJ 390.

is sought. Obviously the private impact on the company will support forgiveness because the members have considered the conduct to be in their best interests.[122] However, given that the statutory duties are not merely for the private benefit and protection of the company, it is reasonable to argue that there is substantial public interest in publicly condemning proven misconduct (an application for forgiveness is only relevant where the officer's liability is proven) by refusing conduct that clearly breaches the requirements of the law.

There is authority to support the proposition that where the defaulting director acted reasonably this may weigh in favour of granting relief. Reasonableness may be better proved where director has received independent advice before entering the transaction.[123]

Therefore, where the members have ratified the directors breach of statutory duty this will be a relevant consideration in determining whether the directors acted honestly and will be a weighty factor in determining whether the directors "ought fairly to be excused from liability". However, given the public purpose underpinning the statutory duties, the permission of the company will not be a determinative factor in assessing a case under ss 1317S or 1318.

D *Criticism of ASIC's case*

It may be argued that Brereton J's criticisms of the action against Mr Nahed were based upon his Honour's clear disfavour with ASIC's enforcement strategy of seeking civil penalties for engaging in conduct that are otherwise not subject to civil penalties. Essentially, ASIC's case against Mr Nahed was based on the view that his conduct in allowing the company to breach the fundraising rules and financial services provisions was itself a lack of due care and diligence, was furthermore was improper.

It appears that Brereton J felt that there was a lack of specificity in the particulars provided by in ASIC in relation to each of the contraventions which ASIC alleged against Mr Nahed. In providing particulars of each of the failure by Mr Nahed to exercise the requisite standard of care and diligence (s 180(1)), the failure by Mr Nahed to exercise his powers in good faith (s 181(1)) and the failure of Mr Nahed to not improperly use his position (s 182(2)), ASIC merely asserted that he permitted, allowed and participated in the contraventions by ProCorp of the various provisions in the Corporations Act and ASIC Act. No particulars of any detrimental effect to the company were pleaded.

Brereton J gives a 'thinly veiled' criticism of ASIC in the way in which it framed its case against Mr Nahed:[124]

> Generally speaking, therefore, ss 180, 181 and 182 do not provide a *backdoor method* for visiting, on company directors, accessorial civil liability for contraventions of the *Corporations Act* in respect of which provision is not otherwise made. This is all the more

[122] See *Vines v ASIC* (2007) 62 ACSR 1; [2007] NSWCA 126.
[123] *ASIC v Vines* (2005) 56 ACSR 528; [2005] NSWSC 1349.
[124] *ASIC v Maxwell* (2006) 59 ACSR 373 at 402; [2006] NSWSC 1052 at [110].

> so since the *Corporations Act* makes provision for the circumstances in which there is to be accessorial civil liability. [emphasis added]

His Honour was clearly critical of ASIC using these provisions in pursuing Mr Nahed as an alternative to charging him as an accessory to the actual provision contravened by ProCorp.

Even if Brereton's J's comments can be limited to the facts in question, his Honour's discussion of the scope of statutory duties raises doubts about the role (if any) of the public interest in ASIC's enforcement of the statutory duties. The next section advocates for a more secure role for public interest considerations to play in the enforcement of statutory directors duties.

V THE ROLE OF PUBLIC INTEREST IN ASIC ENFORCEMENT ACTIONS

In Australia, ASIC is the body which is responsible for enforcing statutory directors' duties. The objectives of ASIC, set out in s 1(2) of the *Australian Securities and Investments Commission Act 2001* (Cth) include that it must strive to:

> (a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy;
>
> (b) promote the confident and informed participation of investors and consumers in the financial system;
>
> (d) administer the laws that confer functions and powers on it effectively with a minimum of procedural requirements;
>
> (g) take whatever action it can take, and is necessary, in order to enforce and give effect to laws of the Commonwealth that confer functions and powers on it.

As well as being the corporate regulator, ASIC is also the regulator of financial services and markets, including the Australian Securities Exchange. In administering and enforcing the *Corporations Act*, ASIC has stated that it views the goals of protecting investors of equal importance with the goal of and maintaining, facilitating and improving the performance of the financial system and companies with a view to promoting the efficiency and development of the Australian economy.[125]

With limited funds to pursue its goals and objectives, ASIC must and does make choices as to its enforcement priorities and matters it will investigate.[126] For example, under its strategic plan for 2005-2010, ASIC intends to, inter alia, "strengthen the integrity of Australian corporations" and "sustain confidence in out financial markets".[127] ASIC does not act on every complaint but "aims for maximum regulatory impact" and considers:

- what is the extent and nature of the conduct complained about;
- what action can it take give its powers;
- how much evidence is available;

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[125] "ASIC: Facing Regulatory Challenges in 2006" an address by ASIC Chairman J Lucy to the West Australian Events Program: Leadership Matters 5 April 2006 Perth at 3.

[126] See "Significant regulatory issues facing ASIC and Australian business" an address by ASIC Chairman J Lucy to the Australia-Israel Chamber of Commerce 4 August 2004.

[127] "Better Regulation ASIC initiatives" at 6 available from www.asic.gov.au

- how urgent and serious is the matter; and
- whether the action will change how people behave in the future[128]

Given those public statements it could reasonably be expected that in exercising its enforcement powers ASIC will focus on those contraventions which are in the public interest and will have the greatest impact on deterring future contraventions. Accordingly, in considering whether to take action on an alleged contravention of statutory directors duties, ASIC will consider not only the interests of the shareholders in the particular company involved, but the public interest in the enforcement action and the impact that enforcement action will have maintaining proper standards of behaviour by company directors. A recent speech by ASIC's chairman confirms ASIC does take into account the public interest in choosing which cases to pursue:[129]

> From ASIC's perspective, we have run a series of court cases where we have said that it is in the public interest to pursue directors (ie individual liability). Examples are HIH where we were concerned that behaviour fell short of what the law expected. In OneTel, in the Greaves case, to ensure directors were across the company's financial position. In Water Wheel we wanted to send the message that insolvent trading would be treated seriously and directors would be held personally liable.

A *Managing Community Expectations*

It is also clear that in some situations ASIC, in exercising its enforcement powers and deciding which route to take, has to properly manage the community's expectations.[130]

When a company collapses there is usually an expectation that ASIC will take action against those responsible, usually the directors and/or managers.[131] Shareholders often expect ASIC to take action because of the loss of the value of their shares. The performance expectations on ASIC, however, go further as it is usually not just shareholders who expect ASIC to act. Employees, creditors and others in the community often also suffer and have the same expectation.

This is demonstrated in the collapse of the insurance company, HIH Ltd, in 2001. The ramifications went far beyond those to shareholders and, in the

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[128] "ASIC Service Charter An ASIC Better Regulation Initiative" at 10 available from www.asic.gov.au

[129] T D'Aloisio, ASIC Chairman "An Update on ASIC's Priorities for 2007/2008 and how these relate to AICD members", paper presented to the Australian Institute of Company Directors in Sydney on 26 November 2007 at 7.

[130] J Lucy "Directors' Responsibilities: The reality vs the myths" paper delivered to the Australian Institute of Company Directors in Melbourne 17 August 2006.

[131] See for example in relation to the Westpoint collapse Pallisco M, "When big players fold, small players suffer" Sunday Age, 26 August 2007 and Trembath B, "Westpoint investors want action from ASIC", Australian Broadcasting Corporation Transcripts, 5 June 2006; in relation to the collapse of Australian Capital Reserve: West M "In property investing, stuff happens. So do stuff-ups" The Australian, 2 June 2007; in relation to the collapse of Fincorp: Klan A, "Counting the cost of financial scam" The Australian, 16 April 2007 and Alberici E, "Angry Fincorp investors meet in Sydney" Australian Broadcasting Corporation Transcripts, 30 March 2007; and in relation to the problems created by James Hardie: Bartholomeusz S "Watchdog's action against Hardie directors is a case of better late than never" The Age, 16 February 2007.

words of Justice Owen appointed to conduct the Royal Commission into this collapse, "reverberated throughout the community, with consequences of the most serious kind".[132] Persons affected included the hundreds of employees, existing HIH policy holders and business and organisations who were unable to obtain insurance due to the domination of some segments of the insurance market by HIH.[133] The outcome of the collapse was that eventually it impacted on the whole community. The Australian government became HIH's largest creditor as a result of the scheme it set up to assist persons affected by the collapse.[134]

B *The importance of directors' duties in ASIC's enforcement powers*

Unlike many other specific offence provisions in the *Corporations Act 2001* (Cth),[135] directors' statutory duties are broad enough to catch a large range of misconduct by directors and officers. They also attract some of the most significant penalties contained in the Act and offer ASIC the flexibility of taking civil penalty action or criminal prosecution for more serious breaches. Significant penalties have been metered out for contraventions of statutory directors duties in the past and these are used as comparative precedents in setting penalties in future cases.[136] This assists ASIC in being better able to predict outcomes of its enforcement action. In turn, this ensures that ASIC will meet its goals of deterring future contraventions and meeting community expectations. Accordingly statutory directors duties perform a pivotal role in ASIC's enforcement armoury for corporate misconduct.

The importance to ASIC of directors' statutory duties was demonstrated in a 2003 empirical study by Helen Bird, Davin Chow, Jarrod Lenne and Ian Ramsay into court based enforcement activities undertaken by ASIC during 1997 to 1999.[137] This study found that, excluding prosecutions for failures to assist external administrators, prosecutions for breaches of director's duties were the main enforcement action taken by ASIC.[138] Furthermore the most serious penalties were "overwhelmingly" imposed for directors' duties.[139]

If Brereton J in *Maxwell* is correct in his analysis, that in enforcing breaches of statutory directors duties ASIC must establish some harm to the company, this will significantly hamper ASIC's ability to take action for breaches of statutory directors duties. It will not be able to take action against breaches which, although appear to be contrary to the public interest and would deter future breaches, do not detrimentally affect the company involved. This, in turn, must significantly constrain ASIC in its ability to meet its goals and community expectations that errant directors are brought to account.

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[132] "The Failure of HIH Limited" April 2003 Vol 1 at xiii available from: www.hihroyalcom.gov.au.

[133] "The Failure of HIH Limited" April 2003 Vol 1 at xiii available from: www.hihroyalcom.gov.au.

[134] See Transcript of interview with Hon J Hockey MP, Minister for Financial Services and Regulation 2 June 2001 (Cth) available from www.minfsr.treasury.gov.au

[135] For example, *Corporations Act 2001* (Cth), s 588G is confined to personal liability for insolvent trading.

[136] See the summary in *ASIC v Adler [No 5]* (2002) 42 ACSR 80; [2002] NSWSC 483.

[137] Bird H, Chow D, Lenne J and Ramsay I, "ASIC Enforcement Patterns" Centre for Corporate Law and Securities Regulation, University of Melbourne, 2003.

[138] Ibid at 82.

[139] Ibid at 101.

C *Practical effect of the 'interest of the company' constraint*

The practical effect of such a constraint can be seen in the action ASIC has recently commenced against, inter alia, a number of former directors of what was the Australian listed company James Hardie Industries Ltd ("James Hardie").[140] These proceedings followed the Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation by David Jackson Q.C (the "Jackson Inquiry").[141]

In these proceedings ASIC has, inter alia, alleged a number of breaches of s 180(1) against both executive and non-executive directors. In addition it has alleged a number of contraventions of s.181 against two executive directors. Similar to ASIC's case against the defendants in *Maxwell*, many of the alleged breaches of s 180(1) pleaded against the former directors of James Hardie concern allegations that they failed to discharge their duties to the company with the requisite degree of care and diligence in that their action (or inaction) in the particular circumstances exposed the company to a contravention or a risk of contravention of ss 995(2), s 999 of the Act and s 52 of the *Trade Practices Act 1974* (Cth). A number of the alleged contraventions of s 181 by the executive directors are similarly framed, that the actions (or inactions) by the directors were not in good faith in the best interests of the corporation and for a proper purpose in that they exposed the company to contravening or risking the contravention of ss 995(2), 999 and s 52 of the *TPA*.[142] Unlike *Maxwell,* and perhaps to address Brereton J's comments that directors statutory duties are not *"owed by directors at large to conduct the affairs of the company in accordance with law generally or the Corporations Act in particular"* but are only *"owed to the company,"* ASIC has provided further particulars. These include that this exposure or possible exposure to statutory contraventions may have been harmful to the company's reputation and could have jeopardised market perceptions of the company. Accordingly, ASIC is attempting to link back the exposure to these contraventions to some type of harm to the company.

This attempt to do so (i.e. to link back the exposure of these contraventions to some type of harm to James Hardie) seems to somewhat distort what appears to be the real gravamen of the conduct alleged against the directors and revealed as a result of the Jackson Inquiry. The findings of the Jackson Inquiry were, in brief, that conduct of the management of James Hardie was designed to separate the company from its asbestos related liabilities to the detriment of the public and, in particular, existing and potential tort claimants against the company. In having to plead some sort of harm to the James Hardie company by its directors, ASIC has been shackled in its attempt to direct its case to the real harm that was caused by the actions of the directors of James Hardie. If ASIC is successful in its action, the judge imposing

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[140] Media Release. ASIC's Amended Statement of Claim is Attachment 1 to the Media Release dated 15 February 2001 (Cth) available from www.asic.gov.au

[141] D.F Jackson Q.C *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* September 2004.

[142] Section 999 and s 995(2) of the *Corporations Law* have now been repealed and replaced with similar, although not identical, provisions in, respectively, s 1041H and s 1041E of the *Corporations Act 2001* (Cth).

penalties on those involved will be similarly constrained to considering the harm to the company rather than the harm to the asbestos victims.

D *Expanding rights of Shareholders*

In considering whether enforcement of directors' statutory duties should be constrained to protecting the interests of shareholders, it should also be noted that the ability of aggrieved shareholders to bring an action for a breach of directors' duties has considerably expanded over the past 20 years such that now it is a realistic option. The introduction of the statutory derivative action in 2000 has, prima facie, removed the barrier to shareholders presented by the rule in *Foss v Harbottle.*[143] The number of litigation funding companies who are willing to fund class actions by, inter alia, shareholders for a percentage of the damages have been increasing and is likely to continue in light of the the High Court's decision in *Campbells Cash and Carry Pty Limited v Fostif.*[144] The High Court held that there was no rule of public policy against such funding arrangments. These changes significantly reduce the need for ASIC to take action on behalf of shareholders.[145]

This fact was recognised by Deputy Chairman Jeremy Cooper when he stated:

> Where shareholders have suffered loss, ASIC's most direct concern is the regulatory effect on the market and action taken by ASIC is generally geared towards minimising these effects and preventing further occurrences. Most often, ASIC seeks to carry out this role by taking action against the individuals responsible, which sends a strong warning to other market players. However, ASIC acknowledges that the need to protect consumers also plays an integral part in fulfilling its regulatory role in order to promote market confidence and integrity.
>
> ASIC can exercise various powers under the Corporations Act and ASIC Act in order to protect shareholders. At the same time, it needs to be stressed that various provisions in the Corporations Act increasingly empower shareholders to seek their own recourse.[146]

In an environment of expanding shareholder rights, any attempt to constrain directors statutory duties and ASIC's enforcement of these duties, fails to recognise the utility of these provisions in ensuring directors use their, not inconsiderable, powers in accordance with the expectations of the community at large.

VI CONCLUSION

This article has argued that shareholder ratification should not be used to hamper the ability of ASIC to take enforcement action in respect of potential breaches of directors statutory duties. The basis for this objection is because the statutory duties serve different purposes to the general law duties.

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[143] (1843) 2 Hare 461. See further, Ramsay I and Saunders B, "Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action", Centre for Corporate Law and Securities Regulations, University of Melbourne, 2005.

[144] (2006) 229 CLR 386; [2006] HCA 41.

[145] See further, Austin J, "Does the Westpoint litigation signal a revival of the ASIC section 50 class action?" (2008) 22 AJCL 8.

[146] "Corporate wrongdoing: ASIC's enforcement role" Deputy ASIC Chairman J Coopers' address to International Class Actions Conference 2005, Melbourne 2 December 2005 at 4

The directors' statutory duties were originally introduced to protect the public interest, and to establish minimum norms of corporate managerial behaviour through the mechanism of public regulation and enforcement. Whilst the content of the statutory duties will often overlap with the corresponding general law duties, it should not be assumed that the underlying purpose of the duties is the same. As Spigelman CJ said recently in the *Vines* appeal:[147]

> It is clearly the case that the Parliament did have reference to the existence of a duty at common law for purposes of enacting the statutory standard. Nevertheless, when a common law formulation is incorporated as a provision in a statute, its legal nature is altered. The words must now be interpreted as statutory language, albeit having regard, in an appropriate way, to the origins of the statutory formulation. The whole of the law of statutory interpretation must be applied including, relevantly, the statutory context which provides for a structure of sanctions for breach of the statutory standard.

In our view, the decision in *Maxwell* attempts to assimilate the general law and statutory duties in some circumstances that are inappropriate for reasons discussed earlier. Whilst we accept that the content or standards imposed by those duties overlap and are substantially similar, we have argued that the purpose of those duties is distinct. As Spigelman CJ notes in the quote above, the fact that these duties appear in the statute require a consideration of the legislative and policy framework of that statute.

With reference to the *Corporations Act 2001* (Cth), we have demonstrated that the statutory duties serve a public purpose through enforcement by ASIC, through different penalties and sanctions, and through alternative enforcement mechanisms (such as the statutory derivative action). These factors suggest that there are substantial public interest factors at work and that the purpose of statutory duties is not merely to provide for ASIC to protect and enforce the shareholder's rights. ASIC is not charged solely with protecting the company's current shareholders. The statutory duties provide a set of minimum norms of corporate managerial behaviour and thereby serve the interests of the community at large. Being a director, as we are reminded by Justice Kirby in *Rich v ASIC*:[148]

> '[is a] privilege to be earned each day [which] … may be withdrawn for misconduct but also for incompetent, improper or lax activities in the functions of corporate management.'

In our view, the focus on shareholder ratification should legitimately shift to the question of whether that consent should justify relief by the court, and not to the issue of whether statutory breach has been occasioned. A fundamental objection of the latter approach, as adopted in *Maxwell,* is that it pays scant regard to public interest considerations which, as demonstrated earlier, underpinned the evolution of directors' statutory duties.

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[147] *Vines v ASIC* (2007) 62 ACSR 1; [2007] NSWCA 75 at [136].
[148] *Rich v ASIC* (2004) 220 CLR 129 at 171; [2004] HCA 42 at [105].