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THE DUTIES AND LIABILITIES OF PERSONS BELOW BOARD LEVEL

Abstract

Under recent recommended changes to the Corporations Act 2001 (Cth), managers, consultants and advisers who 'take part in the management of a company' will face a new risk of liability under key statutory duties even though they may not act in any position as a director. The proposals are claimed, in part, to simply correct an oversight in amendments to definitions in the legislation which took effect in 2000. However, this article suggests the implications are much more significant. The class of persons who may be caught under the proposed amendments are very broad and the risk of liability to those persons, because of other ongoing legal developments affecting corporate governance, are much greater than may first appear. Corporate managers, consultants and advisers, even in one-off relationships with corporations, need to be very careful about how their roles may be classified. Particular risks will exist where their work and advice relates to the provision of information and decision making affecting the solvency of the company.

1. Introduction

In April this year, The Corporations and Markets Advisory Committee, recommended that the Corporations Act be amended so that the application of certain duties and liabilities relevant to officers could be extended to include a wider class of persons.¹ This follows the recommendations from the Royal Commission into the collapse of the HIH group of companies.² As a result, some duties and liabilities under the Act will extend to managers, consultants and advisers, who are not directors, but who may take part, or are concerned, in the management of the corporation.³ At least in respect of some of these duties the changes are claimed to merely provide for a return to the position prior to amendments to the definition of "officer" in 2000.⁴ The implications however are much more significant.

It is the opportune time to review how the duties of non-board managers may be assessed and their risk of liability. The law has not stood still during this period when such managers were inadvertently left off the radar. There have been ongoing developments in the manner in which expectations of care, diligence and skill for

¹ Corporations and Markets Advisory Committee, *Corporate Duties Below Board Level: Report*, (April 2006), <http://www.camac.gov.au>.

² The HIH Royal Commission, *The Failure of HIH Insurance*, (April 2003), <http://www.hihroyalcom.gov.au/>.

³ Corporations and Markets Advisory Committee, n 1. The first two recommendations of the Committee at page 35 contain the key amendments that will allow the application of the duties in s180,181 and s184 Corporations Act 2001 (Cth) to "any person who takes part, or is concerned, in the management of that corporation".

⁴ Corporations and Markets Advisory Committee, n 1 at 35-40.

good corporate governance are being applied and these will raise interesting questions about the criteria we would use to test whether this new category of officer live up to their legal duties. The amendments also lead to questions about the relationship between duties to the company and liability for insolvent trading that may be of more general significance. Further, account needs to be taken of the manner in which ASIC may seek to take advantage of the civil penalty provisions.⁵ Recent high profile examples of this highlight the ramifications.⁶ Ultimately it is clear that non-board managers, advisers and consultants should be very wary of their capacity to be caught within the proposed amendments. The risk of liability may be greater than may be appreciated at first glance, particularly where their role relates to matters of finance impacting upon decisions related to the solvency of the company.

2. *From the failure of HIH to the Legislative Review of the Duties of Officers*

The collapse of the HIH Insurance Group in 2001 had far-reaching consequences. It was not just the loss of some billions of dollars that puts it towards the top of the list of spectacular corporate failures. It was spectacular for many reasons. The nature of the industry and the size of the player meant distress was felt not only by those with a direct financial interest but indirectly by many individual policy holders and the community generally. The consequence of the loss of insurance cover for particular industries and the subsequent crisis related to public liability insurance were significant. The government established a Royal Commission to report on the reasons for, and circumstances surrounding, the collapse. This report by the Commissioner, Mr Justice Owen, was delivered in April 2003.⁷ A significant part of the report was devoted to issues of corporate governance. Another feature of the HIH group which was spectacular was its ability to be held up as the antithesis of a role model for good corporate governance.

While there may have been many factors that contributed to the ultimate demise of the HIH group the primary reason for the collapse was found to be the failure to provide adequately for future insurance claims.⁸ The reason for this and the failure to appropriately assess and price the relevant risks was a matter of corporate mismanagement.⁹ While naturally, the report was scathing of the board, the Commissioner emphasised the significant role played by non-board management, consultants and other advisers. One of his key policy recommendations was to broaden the legislative duties and liabilities under the Corporations Act to those performing functions for and on behalf of corporations rather than limiting their application to corporate “officers” as currently defined.¹⁰ The Commissioner was at pains to consider the issue of corporate governance as a holistic process that should consider the function of the participants and not be limited by excluding contributors artificially because of the names and positions used to describe them.

⁵ Pt 9.4B Corporations Act 2001 (Cth).

⁶ Many recent civil penalty actions have involved officers of high profile companies such as HIH, One.Tel and the Water Wheel group of companies. The opportunities for the application of these provisions and the possible outcomes have become more apparent over recent years.

⁷ The HIH Royal Commission, n 2.

⁸ The HIH Royal Commission, n 2, *Volume 1: A Corporate Collapse and its Lessons*, at 12.

⁹ The HIH Royal Commission, n 2, *Volume 1: A Corporate Collapse and its Lessons*, at 12.

¹⁰ The HIH Royal Commission, n 2, *Volume 1: A Corporate Collapse and its Lessons*, at 43.

“Corporate governance – as properly understood – describes the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. Understood in this way, the expression “corporate governance” embraces not only the models or systems themselves but also the practices by which that exercise and control of authority is in fact, effected.”¹¹

According to the Commissioner, the practicalities and realities of the governance of larger corporations is that it is dependent upon personnel involved in management who could otherwise fall outside the obligations and liabilities under the Corporations Act 2001 (Cth) because of their position as “employees”, “consultants”, “advisers” or otherwise. Ultimately the point was that while directors are clearly accountable, those “... at other levels of the decision-making process within companies and on whom the directors rely should also be accountable”.¹² It was this sentiment that led to the final recommendations.

In May 2004 the Parliamentary Secretary to the Treasurer requested that the Corporations and Markets Advisory Committee consider the recommendations in the HIH report relating to the duties and liabilities of non-board personnel who may be involved in the governance of corporations.¹³ In May 2005 the Advisory Committee published a discussion paper on the duties and liabilities under the Corporations Act 2001 (Cth) of corporate officers, employees and other individuals below board level and invited submissions, including responses to particular proposals put forward in the paper.¹⁴

In April 2006 the Corporations and Markets Advisory Committee published its report containing a number of recommendations for amendments to the Corporations Act 2001 (Cth), fundamentally in support of the HIH Report. Essentially, corporate managers, consultants and advisers will have a new potential liability under s180¹⁵ Corporations Act 2001 (Cth) where they ‘take part in the management of a company’ and will have new potential liabilities under s181 to s184¹⁶ where they ‘perform functions, or otherwise act, for or on behalf of the corporation’. Related provisions including ss199A, 199B, 187, 189, 1307 and 1309 Corporations Act 2001 (Cth) are also the subject of change as a consequence.

3. The new liability of non-board managers, consultants and advisers and the resulting questions

The purpose of this paper is to review those final recommendations of the Corporations and Markets Advisory Committee. They have the potential to be implemented without raising too many obvious concerns for corporate managers because at least in the case of the s180, s181 and s184 duties, the recommendations

¹¹ The HIH Royal Commission, n 2, *Volume 1: A Corporate Collapse and its Lessons*, at 23.

¹² The HIH Royal Commission, n 2, *Volume 1: A Corporate Collapse and its Lessons*, at 40.

¹³ Corporations and Markets Advisory Committee, n 1, at 5-6.

¹⁴ Corporations and Markets Advisory Committee, n 1, at 7.

¹⁵ Duties of care and diligence.

¹⁶ Duties of good faith with civil and criminal consequences.

will be achieved by simply returning to a previous definition of company “officer”.¹⁷ However, now that the can of worms has been opened, it is suggested that the following resulting questions deserve further attention at least to assist the targeted managers to assess their risk:

- What are the specific changes in terminology recommended for the Corporations Act, and who will be caught as a consequence? Particularly in respect of s180, the type of officer and position within the company shapes the expectations of the law. Those expectations have been regularly the subject of judicial review and development over recent years and interest lies in how they will be framed for the new category of officer. What will be the standard against which these various types of non-board contributors will be assessed?
- The trigger for re-visiting this issue related to the poor management of financial matters that affected the solvency of the HIH group. To what extent should non-board managers have a responsibility for a company trading while it is insolvent? Should any consideration have also be given to applying this duty to those non-board managers who, it has been demonstrated in the HIH case itself, wield the capacity to significantly impact upon the knowledge of and decisions affecting solvency?
- Will non-board managers, consultants and advisers brought back within the grasp of the core corporate duties, have more to fear than was previously the case? The risk of liability, particularly from s180 related to failed companies has apparently been increasing and this development, in conjunction with the growth of the civil penalty regime as an enforcement tool, may mean non-board managers will feel much more exposed than ever.

4. The specific changes to the Corporations Act 2001 (Cth)

4.1 The HIH recommendations

The Commissioner of the HIH Royal Commission claims to have been frustrated by the disinclination of ‘middle management’ to accept responsibility for undesirable practices that played a significant role in the governance of HIH. He was concerned about the uncertain nature of the application of the legal duties and liabilities to these persons. This was a matter of “...considerable significance, because it is clear that in larger companies many significant decisions are made by management without reference to the board. It follows that any legal regime for the enforcement of corporate governance standards which does not extend to the acts or omissions of at least some levels of management is unlikely to be wholly effective.”¹⁸

“The evidence I have heard also suggests that it is common for management decisions to be made on a collective or collegiate basis, or at least after interaction with other managers. There is therefore an opportunity for the law significantly to influence the

¹⁷ The previous definition is actually made up by the effects of a combination of terms.

¹⁸ The HIH Royal Commission, n 2, Chapter 6 at 15.

mind-set or culture of those managers, and reinforce their obligations to the company and its shareholders.”¹⁹

Ultimately the relevant recommendation from the Commissioner included the following key features:

- That all the general duties imposed by Chapter 2D of the Corporations Act 2001 (Cth) be imposed on directors, secretaries and a wider class of personnel defined by reference to the function they perform rather than by classification of their legal relationship to the corporation;
- That duties imposed by ss.182(1), 183(1) and 184(2) of the Corporations Act 2001 (Cth) should be imposed on all persons performing functions for or on behalf the corporation, whether employees or suppliers of services under contract;
- That s1309 of the Corporations Act (Cth) be imposed on all persons and not be restricted to a limited class of management personnel; and
- That the class of personnel prohibited from acting dishonestly in the performance of any obligation be similarly extended.²⁰

4.2 The response of The Corporations and Markets Advisory Committee: Who will be caught by the “functional” test?

One of the fundamental issues highlighted by the recommendations from the HIH Report is the manner in which the Corporations Act 2001 (Cth) has altered the way it describes officers and others that may have a liability under the Act. Prior to the Corporate Law Economic Reform Program Act 1999 (Cth), the key duty and liability provisions were imposed on “officers”²¹ and this term was defined to include a director, secretary or executive officer”.²² “Executive officer” was defined as “any person, by whatever name called and whether or not he is a director of the corporation, who is concerned, or takes part, in the management of the corporation”.²³ The Corporate Law Economic Reform Program Act 1999 (Cth) inserted a new definition of “officer” which no longer referred to an executive officer. The effect was to exclude anyone simply concerned or taking part in management. Apart from someone appointed as a director it now only extends to include a person:

- “who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- who has the capacity to affect significantly the corporation’s financial standing”²⁴

These amendments became effective in March 2000. The executive officer definition, having lost its connection, was later repealed (2004).²⁵

4.2.1 Concerned or takes part in management?

¹⁹ The HIH Royal Commission, n 2, Chapter 6 at 15.

²⁰ The HIH Royal Commission, n 2, Chapter 1 at 43. This is a summary of the whole of ‘Recommendation 2’ which was the only recommendation affecting these matters.

²¹ Corporations Law (Cth), s232.

²² Corporations Law (Cth), s9, s232 and s82A.

²³ Corporations Law (Cth), s9.

²⁴ Corporations Law (Cth), s9.

²⁵ Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth).

The definitional changes apparently led to an inadvertent reduction in the class of persons affected by the major statutory duties. To overcome this development, and to give effect to the recommendations from the HIH report, the Advisory Committee's first 2 recommendations mean that Sections 180(1), 181 and 184(1) would be extended to apply not only to directors and other officers of a corporation, but to any person who takes part, or is concerned, in the management of the corporation.²⁶ In other words they wish to revert to the old terminology used in the definition of "executive officer" (since repealed). It is argued by the Advisory Committee that these recommendations "seek to put beyond any doubt that those duties do apply to all persons who have some real involvement in corporate management."²⁷ They are confident that the judicial guidance as to the interpretation of the terms used in the recommendation will mean no further legislative elaboration is necessary.²⁸

As a consequence of these changes, the committee made further recommendations to amend other related or dependent provisions in a similar way. That is to extend the application of the following provisions to persons who take part, or are concerned, in the management of the company:

- s199A and s199B (indemnification and insurance) [recommendation 3]²⁹
- s187 (decision making within wholly owned subsidiaries) [recommendation 4]³⁰
- s189 (reliance on information and advice provided by others) [recommendation 5]³¹
- s180(2) (business judgement rule) [recommendation 6]³²

So who will now be caught? What does it mean to be a person "... who takes part, or is concerned in the management of a corporation"? This issue was examined in depth in the Appendix to the Report of The Corporations and Markets Advisory Committee.³³ As explained in that summary, the leading case on the issue is ASIC v Vines³⁴ where a review was undertaken of the relevant authorities. As is discussed later in this article, the predecessor of the current insolvent trading provisions also applied to any person who took part in the management of the company. In this context the courts preferred a narrow interpretation to the concept and likened it closely to the director's role.³⁵ This was apparently because it may have otherwise been unfair to hold a company executive responsible for debts they had no role in incurring.³⁶ For other purposes however (including the duties to be amended) where the issue is to assess the proper discharge of their own responsibilities to the company a wider interpretation is supported. In particular the views of Ormiston J in

²⁶ Corporations and Markets Advisory Committee, n 1, at 35.

²⁷ Corporations and Markets Advisory Committee, n 1, at 35.

²⁸ Corporations and Markets Advisory Committee, n 1, at 35.

²⁹ Corporations and Markets Advisory Committee, n 1, at 40.

³⁰ Corporations and Markets Advisory Committee, n 1, at 41.

³¹ Corporations and Markets Advisory Committee, n 1, at 41.

³² Corporations and Markets Advisory Committee, n 1, at 43.

³³ Corporations and Markets Advisory Committee, n 1, at 83.

³⁴ (2005) 55 ACSR 617 at [1049].

³⁵ *Holpitt Pty Ltd v Swaab* (1992) 6 ACSR 488 at 491, *Sycotex Pty Ltd v Baseler* (1994) 13 ACSR 766 at 782, *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1 at 66.

³⁶ *Holpitt Pty Ltd v Swaab* (1992) 6 ACSR 488 at 491, *Sycotex Pty Ltd v Baseler* (1994) 13 ACSR 766 at 782, *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1 at 66.

Commissioner for Corporate Affairs (Vic) v Bracht³⁷ have received approval in ASIC v Vines.³⁸

The concept of management for Ormiston J “... comprehends activities which involve policy and decision making, related to the business affairs of a corporation, affecting the corporation as a whole or a substantial part of that corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs.”³⁹

Importantly, this concept of management was not confined to central management⁴⁰ and thus could include persons involved in only a segment of the company’s overall business, such as a sales manager.⁴¹ Authority is also given for the view that the terminology would now catch management activities by persons who are not directors and do not even communicate directly with the board.⁴² To be concerned in management could include “... participation at a variety of levels and at differing intensities, some of which may be relatively modest ... It requires activities involving some responsibility, but not necessarily of an ultimate kind whereby control is exercised. Advice given to management, participation in its decision-making processes, and execution of its decisions going beyond mere carrying out of directions as an employee would suffice.”⁴³

The real essence of the question is whether the person involved “... is given some measure of responsibility or some area of discretion, or ... his opinion is given some weight in the decision-making processes of management”.⁴⁴ Clearly this terminology allows for a very broad interpretation to include persons occupying many varied positions under the board level and can certainly catch advisers and consultants who engage in these defined management activities even in a single instance.⁴⁵

While the Committee is obviously confident about the application of the above interpretation those occupying any senior management role or providing advice to management may feel some unrest about the implications.

4.2.2 Perform functions, or otherwise acts for or on behalf of the corporation

The Advisory Committee specifically supported the recommendations in the HIH report to extend the obligations in s182, 183 and 184 to persons who carry out some

³⁷ (1989) 14 ACLR 728.

³⁸ (2005) 55 ACSR 617 at [1049].

³⁹ (1989) 14 ACLR 728 at 733-734.

⁴⁰ This may have been the case with the previous version of the insolvent trading provisions: *Holpitt Pty Ltd v Swaab* (1992) 6 ACSR 488 at 491, *Sycotex Pty Ltd v Baseler* (1994) 13 ACSR 766 at 782, *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1 at 66.

⁴¹ (2005) 55 ACSR 617 at [1049].

⁴² (2005) 55 ACSR 617 at [1051].

⁴³ (2005) 55 ACSR 617 at [1054] in support of the views of Ormiston J in *Commissioner for Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728.

⁴⁴ *Commissioner for Corporate Affairs (Vic) v Bracht* (1989) 14 ACLR 728. This view is supported in *Forge v ASIC* (2004) 52 ACSR 1 at [200] and *ASIC v Vines* (2005) 55 ACSR 617 at [1054].

⁴⁵ *ASIC v Vines* (2005) 55 ACSR 617 at [1052].

role for the company regardless of their status. The desire is to apply the duties by reason of the function performed for the company and therefore it would be inadequate to simply apply the “taking part in management” principle. The recommendations [recommendation 7 and 8] are that s182, 183 and s184(2) and (3) are extended beyond their existing application to apply to “any other person who performs functions, or otherwise acts, for or on behalf of that corporation”.⁴⁶

It has been further recommended that the following provisions be extended with the same terminology:

- s1309(1) (providing information known to be false or misleading) [recommendation 9]⁴⁷
- s1307(1) (misconduct concerning corporate books) [recommendation 10]⁴⁸
- s1309(2) [recommendation 11]⁴⁹

5. *Why not also review the insolvent trading provisions to restore their application to those who ‘take part in management of the corporation’?*

The recommendations discussed above are supporting a return to the situation where some duties applicable to corporate officers include those who “take part in the management of the company”. Neither the HIH Report nor the Corporations and Markets Advisory Committee even considered extending this approach to the insolvent trading provisions. That is, considering whether it would also be appropriate for those who take part in management, other than as directors, to have the express duty to prevent the insolvent trading of the company. This is interesting for two main reasons. Firstly, the Commissioner’s concerns in the case of the HIH group, in respect of the performance and accountability of senior managers and other advisers, related to the manipulation of the supply of information and the provision of poor or misleading information and advice that related directly to the key issue of the solvency of the company. Secondly, like the fundamental duties to the company contained in s180, s181 and s184 that are recommended for change, the insolvent trading provisions also used to extend in its application to those persons who took part in the management of the company. For debts incurred prior to 23 June 1993, any person who was a director or took part in the management of the company could be jointly and severally personally liable, with the company, for the payment of the debt.⁵⁰ This applied of course where there were reasonable grounds to expect that the company would not be able to pay all its debts as and when they became due.⁵¹

So why not also review the application of the now s588G to non-board managers and other advisers, who, as in the case of HIH have been shown to be capable of wielding significant power in influencing the board in its assessment of the solvency of the company? The revision seems particularly worthy given that some of the senior managers involved in the HIH cases were actually directors of subsidiary companies

⁴⁶ Corporations and Markets Advisory Committee, n 1, at 51.

⁴⁷ Corporations and Markets Advisory Committee, n 1, at 58.

⁴⁸ Corporations and Markets Advisory Committee, n 1, at 61.

⁴⁹ Corporations and Markets Advisory Committee, n 1, at 63.

⁵⁰ Corporations Act 1989 (Cth), s592.

⁵¹ Corporations Act 1989 (Cth), s592.

providing information on which to make an assessment as to the financial position of the main entity.

The insolvent trading provisions themselves did undergo significant review in both form and function since the Harmer Report.⁵² It was responsible for changing the focus from providing creditors with another means to recover losses from responsible managers to creating a more positive duty to prevent the incurring of debts by insolvent companies.⁵³ As part of this approach it was recommended that liability should only attach to those who are entrusted with the overall management of the company and this would limit the application to directors.⁵⁴ So the reason s588G only applies to directors was, unlike the unintended shift in the meaning of “officer”, a deliberate act. It was recommended that a duty to prevent insolvent trading could only be owed by those who have the capacity to prevent the incurring of the relevant debts.

In considering this transition however it is curious to review the submissions received as part of the Harmer Report in favour of continuing to make senior executive officers subject to the duty. These arguments could easily be made again today and would have an ironic resonance given the experiences with many recent corporate collapses and with the failure of HIH in particular:

“The argument supporting extension of the duty was that senior managers are in a better position to know the affairs of the company and the directors rely heavily on them for information about those affairs. Furthermore, it is argued that senior managers may not be bringing matters to the attention of the board, or worse could be deliberately misleading the directors and incurring credit without having to worry about personal liability. The Institute of Directors argued that liability for senior managers may prompt more timely reporting to the board of directors and that there should be a provision to enable liability to be apportioned between those culpable by taking into account factors such as the extent of their knowledge, the degree of responsibility for the loss and all other relevant factors.”⁵⁵

The argument is a relatively simple one. Where the information and advice that has been presented to the board is inaccurate or misleading the board may not act appropriately. Board members however are under an obligation to exercise an appropriate level of care, diligence and skill with respect to understanding the financial position of the company. This may mean further investigations and objective assessments on their part prior to accepting or relying on such advice. So even in the unfortunate event of deception from within, directors may still be liable for failing to prevent insolvent trading. Nevertheless as a matter of practicality, there may be circumstances, where non-board managers who may be more culpable, will fall outside the operation of the provisions.

Consider the specific conduct of senior managers, consultants and advisers in the case of HIH itself. Their failings were described in some substantial detail. For the

⁵² Australian Law Reform Commission, Report No. 45 (vol 1), *General Insolvency Inquiry* AGPS, Canberra, 1988 (‘The Harmer Report’).

⁵³ Australian Law Reform Commission, n 52, at para 280.

⁵⁴ Australian Law Reform Commission, n 52, at para 325.

⁵⁵ Australian Law Reform Commission, n 52, at para 324.

purposes of this paper however the following list is a summary, in very general terms, of some of the key issues:

- There were no appropriate limitations on the authority of the chief executive which allowed for abuses of discretion;
- The control of the agenda of the board actually rested in the hands of management as a matter of practice and this power was also abused;
- Management provided information to the board that was misleading;
- Employees who could be described as “middle management” were involved in the manipulation of information, particularly financial information relied upon by the board, auditors and APRA;
- External advisers did not act with the required independence and the relationship between the companies and such parties compromised their role. This was particularly true of the auditors and consulting actuary. In this particular case the quality of their advice was crucial to an accurate understanding of the financial position of the company;
- The role of other advisers in management decisions and processes such as lawyers and financial consultants was questioned and whether an appropriate level of expertise was exercised was put in doubt.⁵⁶

So the identified problems not only related to matters of process which were abused but importantly the provision of information to the board and the manipulation of how that occurred. It was not just that misleading information was presented to the board but that the flow of information generally was controlled and discretions exercised in a way that manipulated the knowledge base of the directors. One consequence of this was the failure to appreciate the real financial position of the company given the way in which their assets and risks had been evaluated.

Given the size of the ultimate losses in the case of HIH it would have been expected that insolvent trading allegations would be canvassed. The Commissioner himself suggested that members of the public may have assumed that insolvent trading was necessarily taking place.⁵⁷ However, as explained by the Commissioner, given the number of difficulties with such an action in these complex circumstances there was no contention that there was a breach of s588G by any of the directors.⁵⁸ The first major hurdle was that the question of the solvency of the company was particularly complex and difficult given the nature of the insurer’s liabilities and that these related to future events subject to contingencies. The second problem was that the incurring of questionable debts was more likely to have been carried out by subsidiary companies and the relationship of officers and companies within the group would make it very difficult to establish the necessary “suspicion” of insolvency.⁵⁹

HIH is simply one example of the significant practical problems that may hamper an insolvent trading action. It demonstrates the difficulties in even identifying when a s588G action may be worthwhile or possible despite exceptional losses as a result of poor management. On this premise non-board managers would be even less

⁵⁶ This is a summary of the findings of the Commissioner: The HIH Royal Commission, n 2, Chapter 1, at 23 to 42.

⁵⁷ The HIH Royal Commission, n 2, Chapter 20 at 12.

⁵⁸ The HIH Royal Commission, n 2, Chapter 20 at 12.

⁵⁹ The HIH Royal Commission, n 2, Chapter 20 at 12,13.

concerned if they were subject to the same principles. Even when the relevant provisions did apply to managers who were not directors (prior to June 1993), there were only ever five (5) actions that involved them.⁶⁰

While the reasons for it may be disputed it seems clear that the number of insolvent trading actions have been reducing.⁶¹ This is apparently at a time when there are a greater number of insolvencies⁶² and some reasons to suspect a greater number of potential cases of insolvent trading, though this is obviously very difficult to evidence.⁶³ While arguably there have been relatively recent successes in high profile cases⁶⁴ the empirical evidence suggests the practical problems of bringing insolvent trading actions continue to be significant.⁶⁵ There have only been 15 decided cases since the end of the 1990s to February 2004.⁶⁶ Even when the actions are taken and end successfully it has been argued it may even act to the disadvantage of creditors.⁶⁷

The difficulties in bringing an insolvent trading action are not new. However, as will be discussed below, where officers of the failed company may be seen to be in breach of s180, civil penalty proceedings to seek compensation orders for the company may arguably achieve similar goals. This may become a significant shift in the focus of officers' duties, particularly where the alleged breach of s180 relates to the failure to exercise the necessary levels of skill to appropriately assess the company's financial status.

⁶⁰ James, P., Ramsay, I., Siva, P., "Insolvent Trading – An Empirical Study" Research Report of Clayton Utz and Centre for Corporate Law and Securities Regulation, The University of Melbourne (2004) at 28-29. In this report only 5 actions were identified as being against "defacto directors". This category included persons who took part in the management of the company and therefore had a potential liability under previous regimes. Accordingly the application to the managers discussed in this paper could have been less than 5 in number.

⁶¹ James, P., et al, n 60.

⁶² This is broadly supported by the statistical figures related to corporate insolvency produced by ASIC: http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/Insolvencies%2C+terminations+%26+new+reg+stats+portal+page?opendocument

⁶³ Parliamentary Joint Committee on Corporations and Financial Services; "Corporate Insolvency Laws: A Stocktake" 2004 Chapter 9: http://www.aph.gov.au/Senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/report/ail.pdf. This report included indicators that there were large numbers of reports from administrators and others of breaches of s588G Corporations Act 2001 (Cth). In the 2002-2003 year there were almost 2,400 such reports however in most cases it was claimed there was a lack of admissible evidence. Apart from insolvent trading actions ASIC has targeted insolvent trading as part of its National Insolvent Trading Program. As part of this program ASIC visited 488 companies suspected of trading while insolvent: Collier, B., "ASIC's increased focus on insolvency" Presentation to Practical Insolvency & Practice Management", 4 August 2005, [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/Insolvency_speech_4_Aug_05.pdf/\\$file/Insolvency_speech_4_Aug_05.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/Insolvency_speech_4_Aug_05.pdf/$file/Insolvency_speech_4_Aug_05.pdf)

⁶⁴ ASIC v Plymin & Ors (No 1) (2003) 21 ACLC 700 where the managing director (Plymin), a non-executive director (Elliott) and the chairman (Harrison) were found liable under civil penalty proceedings relying on s588G Corporations Act 2001 (Cth) as a result of the failure of the Water Wheel group.

⁶⁵ James, P., et al, n 60.

⁶⁶ James, P., et al, n 60, at 2.

⁶⁷ Mitchell, V., "The Water Wheel Case – What do we learn from it?", (2003) 16 Australian Journal of Corporate Law 65. This article identified some of the practical problems that may result from ASIC bringing the action under s588G Corporations Act 2001 (Cth) in high profile cases such as ASIC v Plymin (No 1) (2003) 26 ACSR 126; 21 ACLC 700.

6. *The Liability for Non-board Managers, Consultants and Advisers under s180*

Obviously if the recommendations of the Corporations and Markets Advisory Committee are carried out non-board managers, consultants and advisers may become caught anew within the s180 duty. But it is not a simple case of returning to a previous definition. This gives the impression that little has changed and that non-board managers are no more exposed than was previously the case in the 1990s. However, the interpretation of the relevant legal duties, the use of the enforcement provisions and the expectations on corporate governors have marched on. Non-board managers need to be aware that these amendments will place upon them growing and developing expectations which generally put them at greater risk of personal liability. This may be particularly true when it comes to their role in informing and advising on the financial position of the company.

6.1 *The development of s180 and its relationship with s588G*

In recommending in 1988 that the insolvent trading provisions only apply to directors, Harmer took some comfort from the proposition that other managers who would not be caught under the new provisions may still be liable under the other duties. That is, liability under the equivalent of s180 would still apply (then s229).⁶⁸ At the time the duty did apply to those who took part in management and if the current recommendations proceed, then this will be the same result again. What can that mean in the current climate?

There has always been a strong relationship between the duties of care and diligence under s180 and duty to prevent insolvent trading. It has even been suggested that the latter can be found in the former.⁶⁹ Even if this carries the issue too far it is at least clear that for quite a long time, insolvent trading cases have informed and developed the duty of care and diligence under s180. The courts have relied upon the s180 duty to help it assess whether directors should have reasonably expected that the company was insolvent or would become insolvent for the purposes of s588G.⁷⁰ Under s180, at least for directors, there is a continuing obligation to keep informed about the activities of the corporation and in particular, its financial status.⁷¹ And one is not exonerated from this duty just because you may be entitled to trust your subordinates.⁷² It is an overriding obligation to exercise an objective standard of financial competence and in so doing to make all reasonable enquiries and take all

⁶⁸ Australian Law Reform Commission, n 52, at para 324,325.

⁶⁹ Goldman, D., "Directors beware! Creditor protection from insolvent trading" (2005) 23 Companies and Securities Law Journal 216 at 217 in reference to De Mott, D., "Directors' Duties of Care and the Business Judgment Rule: American Precedents and Australian Choices" (1992) 4 Bond Law Review 133.

⁷⁰ *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405; 8 ACLC 827; [1993] 1 VR 423; (1992) 8 ACSR 305; 10 ACLC 1233; *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115; 9 ACLC 946. The reference to "expectation" is in line with the requirement under the previous version of the insolvent trading provisions.

⁷¹ *ASIC v Adler (No 3)* (2002) 20 ACLC 576; 41 ACSR 72.

⁷² *ASIC v Rich* (2003) 21 ACLC 450 at [467]. This case usefully describes the development of these principles over recent years.

reasonable steps.⁷³ This standard of competency expected regarding financial matters of the company has been growing and developing ever since.⁷⁴

s180 comprises objective and subjective elements. While there would be a minimum standard of care and diligence expected, officers will be assessed against this duty by reference to their particular office and responsibilities.⁷⁵ “The director’s responsibilities would include arrangements flowing from the experience and skills that the director brought to his or her office, and also any arrangements within the board or between the director and executive management affecting the work that the director would be expected to carry out.”⁷⁶ “Responsibilities” in this context “... is a wider concept, referring to the acquisition of responsibilities not only through specific delegation but also through the way in which work is distributed within the corporation in fact, and the expectations placed by those arrangements on the shoulders of the individual director.”⁷⁷ Over time the courts have distinguished between the appropriate varying expectations that should be applicable to executive and non-executive directors,⁷⁸ chairpersons,⁷⁹ and chief financial officers.⁸⁰ While these have been the subject of on-going clarification what will be the approach toward the assessment of non-board managers?

6.2 The consequences for non-board managers, consultants and advisers?

Current cases confirm that the liability of officers under s180 may relate to the provision and interpretation of information that will be critical to the assessment of the solvency of the company and all the consequences this has for creditors and shareholders of the company.⁸¹ It is only logical that the role of non-board managers in the failure to accurately identify and make decisions regarding the possible insolvency of the company may be actionable and the compensation orders possible have been shown to be very significant. While this may have been the desired outcome the extent of the risk may not be as readily apparent to non-board managers.

Consider the actions taken by ASIC as a result of the failure of One.Tel. Although the proceedings are against the founding directors they provide meaningful insight into the use of s180 as a tool to recover losses from a failed company. While the litigation against Rich and Silbermann is ongoing, the matter has been settled for Keeling (Joint Managing Director)⁸² and Greaves (Non-Executive chairman).⁸³ In both cases ASIC

⁷³ Austin, Ford, Ramsay, *Company Directors; Principles of Law and Corporate Governance*, 2005 Lexis Nexis Butterworths Australia, at [6.2] and [6.23].

⁷⁴ *Re New World Alliance Pty Ltd (rec and mgr apptd); Sycotex Pty Ltd v Baseler* (1994) 51 FCR 425; 122 ALR 531; 13 ACSR 766; 12 ACLC 494; *Hawcroft General Trading Co Ltd v Edgar* (1996) 20 ACSR 541; *Metropolitan Fire Systems Pty Ltd v Miller* (1997) 23 ACSR 699; *Credit Corp Australia Pty Ltd v Atkins* (1999) 30 ACSR 727; 17 ACLC 756; *ASIC v Plymin (No 1)* (2003) 175 FLR 124; 46 ACSR 126; 21 ACLC 700.

⁷⁵ s180(1) Corporations Act 2001 (Cth); *ASIC v Rich* (2003) 21 ACLC 450 at [461].

⁷⁶ *ASIC v Rich* (2003) 21 ACLC 450 at [461].

⁷⁷ *ASIC v Rich* (2003) 21 ACLC 450 at [461].

⁷⁸ *AWA Ltd v Daniels (t/as Deloitte Haskins & Sells)* (1992) 7 ACSR 759; 10 ACLC 933; *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395; 11 ACSR 162; 11 ACLC 763.

⁷⁹ *ASIC v Rich* (2003) 21 ACLC 450.

⁸⁰ *ASIC v Vines (No 2)* (2004) 22 ACLC 37; (2003) 48 ACSR 322.

⁸¹ *ASIC v Rich & Ors* (2003) 44 ACSR 682; 21 ACLC 450; *ASIC v Rich & Ors (No 2)* (2004) 22 ACLC 1232; *ASIC v Adler* (2002) 41 ACSR 72; 20 ACLC 576.

⁸² *ASIC v Rich & Ors* (2003) 21 ACLC 672.

were taking civil penalty proceedings and the directors consented to declarations by the court as to a breach of their s180 duty. Orders flowing from the declaration included compensation payments to the company. For Greaves the compensation order was \$20 million and for Keeling it was \$92 million. These cases highlight the ability to use s180 to find officers personally liable where they have failed to take appropriate steps to assess the company's financial position and performance and produce accurate and reliable financial information on which the company can rely. Non-board managers would obviously be assessed against expectations appropriate to their position. Those expectations would obviously not be as great as applied in these cases however the principle is the same. Where non-board managers have failed to provide proper financial information and give appropriate advice (commensurate with their position) regarding the solvency of the company, there would be no reason why similar civil penalty proceedings could not be brought against them. As a consequence compensation orders relative to the consequential losses to the company could be made.

It is also interesting to note that while no insolvent trading actions were brought following the collapse of the HIH group of companies, ASIC certainly did bring a number of civil penalty proceedings for breaches of officers' duties including s180 Corporations Act 2001 (Cth). Messrs Adler, Williams and Fodera were held to be in contravention of s180 and other duties and apart from orders of disqualification, they were subject to compensation and pecuniary penalty orders.⁸⁴ The conduct in question was perhaps a more deliberate abuse of power relating to the funds of the corporation, rather than failing to meet expected standards of financial competency yet the success of the process of obtaining compensation for the failed company is worth assessing.⁸⁵

6.3 *The breach of s180 as a civil penalty provision*

The civil penalty regime contained in Pt 9.4B of the Corporations Act 2001 (Cth) commenced operation in its original form in February 1993. It was a first attempt to deal with apparent problems in the enforcement of the duties applicable to corporate officers.⁸⁶ Its existence arose out of the enquiry into the duties and obligations of company directors by the Senate Standing Committee on Legal and Constitutional Affairs conducted in 1989. In the report of this committee ('The Cooney Report')⁸⁷ a suite of mechanisms was proposed to arm ASIC with the ability to better regulate compliance with the developing duties. The introduction of civil penalties sought to allow for a better balance between punishing the genuinely criminal and enforcing

⁸³ ASIC v Rich & Ors (2004) 22 ACLC 1232.

⁸⁴ ASIC v Adler (No3) (2002) 20 ACLC 576.

⁸⁵ For a comprehensive review of the actions that followed the failure of HIH see du Plessis, J., "Reverberations after the HIH and other recent Australian corporate collapses: The role of ASIC" (2003) 15 Australian Journal of Corporate Law 225.

⁸⁶ These problems related to the difficulties in bringing directors to face criminal prosecution for breaches of directors' duties. The corporate criminal offences were hard to prove and hard to obtain a conviction given their nature: Miller, S., "Corporate Crime, the Excesses of the 80's and Collective Responsibility: an Ethical Perspective" (1995) 5 Australian Journal of Corporate Law 139; Tomasic, R., "Corporate Crime in a Civil Law Culture" (1994) 5(3) Current Issues in Criminal Justice 244.

⁸⁷ Senate Standing Committee on Legal and Constitutional Affairs, "Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors", AGPS, November 1989.

other contraventions as a civil action to promote compliance and improved corporate governance.⁸⁸ It became apparent over time however that ASIC was making very little use of this new weaponry.⁸⁹ While several reasons for this were identified one of the fundamental problems seemed to lay in the competing relationships between the criminal and civil actions.⁹⁰ Civil penalty proceedings were a bar to a criminal action on the same matter and this led to complex procedural issues between the offices of ASIC and the Director of Public Prosecutions.⁹¹

Over the years the application of the regime has been extended to include new sections in the list of civil penalty provisions.⁹² More importantly however the operation of the regime itself was amended more fundamentally by the Corporate Law Economic Reform Program Act 1999 (Cth) which had the effect of inserting an entirely new Pt 9.4B into the Corporations Act 2001 (Cth). This new Part came into effect on 13 March 2000. Effectively the new provisions freed up ASIC to commence any proceedings for a declaration of contravention and penalty, compensation or banning orders. It did not have to be concerned about the impact of these actions on any criminal proceedings.⁹³ The number of these actions is now growing and has been increasingly and successfully⁹⁴ used in recent years in higher profile cases.⁹⁵ Predominantly this use of the civil penalty regime is against directors alleged to have breached their statutory duties.⁹⁶

It is interesting then to consider the implications of the developments of the civil penalty enforcement regime in light of the recommendations to include non-board managers back within the key statutory duties. Prior to the Corporate Law Economic Reform Program Act 1999 (Cth), non-board managers who took part in the management of the company could have been in breach of the statutory duty of care

⁸⁸ Senate Standing Committee on Legal and Constitutional Affairs, n 87, Chapter 13.

⁸⁹ Welsh, M., "Eleven years on – An examination of ASIC's use of an expanding civil penalty regime", (2004) 17 Australian Journal of Corporate Law 175 at 182. In this paper the author examines the actual number of actions prior to and after the 2000 amendments to make comment of the effectiveness of the new civil penalty regime.

⁹⁰ Welsh, M., n 89, at 182. The reasons behind the failings of the original civil penalty regime are explored in depth in this article in reference to the following research: Gilligan, G., Bird, H., Ramsay, I., "Regulating Directors' Duties – How Effective are the Civil Penalty Sanctions in the Australian Corporations Law?", Centre for Corporate Law and Securities Regulation, The University of Melbourne, Melbourne, 1999. See also Comino, V., "High Court relegates strategic regulation and pyramidal enforcement to insignificance" (2005) 18 Australian Journal of Corporate Law 48.

⁹¹ Welsh, M., n 89, at 182; Gilligan, G., et al, n 90; Comino, V., n 90.

⁹² These included duties related to share capital; managed investments and conduct affecting financial markets: Company Law Reform Act 1998 (Cth); Managed Investments Act 1998 (Cth); Financial Services Reform Act 2001 (Cth)

⁹³ s1317P and s1317Q Corporations Act 2001 (Cth). See also Comino, V., n 90, at 54; Welsh, M., n 89, at 183.

⁹⁴ Although there have been many successes concern has been expressed about the recent High Court finding that penalty privilege was available in civil penalty proceedings: *Rich v ASIC* (2004) 78 ALJR 1354; 209 ALR 271. For an analysis of the consequences of this decision on the civil penalty regime refer to Comino, V., n 90.

⁹⁵ Most recently key actions have been taken against directors of failed companies in the Waterwheel group, the HHH group and One.Tel. For an excellent summary of the various actions for pecuniary penalty orders, banning orders and compensation orders refer to: Welsh, M., "Adler, Whitlam, Elliott and others: Judicial Interpretation of the civil penalty provisions of the Corporations Act 2001 (Cth)" (2005) 18 Australian Journal of Corporate Law 243.

⁹⁶ Welsh, M., n 89, at 183. The number and type of civil penalty actions have been carefully recorded in the tables to this paper.

and diligence and subject to the civil penalty provisions. The reality however was that as an enforcement tool, this was not working effectively and such action was unlikely. It is ironic then that the same piece of legislation that removed non-board managers from the application of the relevant statutory duties, also inserted a new Pt 9.4B which greatly improved ASIC's ability to enforce compliance with those very same duties. At the same time that non-board managers dropped off ASIC's radar the regulator was presented with better means of forcing officers to meet the increasing demands of good corporate governance. Non-board managers brought back within the operation of s180 and other statutory duties should now appraise themselves of the greater practical risk under the new and improved enforcement regime.

Although the recent uses of the civil penalty provisions relate to higher profile cases and obviously can not relate to non-board managers at this stage they do give some insight into possible consequences for such managers.

7. Other sources of liability for Non-board Managers, Consultants and Advisers

The duty of care and diligence has been a focus of this paper because, for the reasons explored above, it potentially would provide the greatest risk after amendment. To complete the picture however non-board managers should not lose sight of the effect of some of the other amendments and even the existing means of liability that are not so readily considered.

7.1 Sections 181 to 184 Corporations Act 2001 (Cth)

The other duties affected by the proposed amendments include the duties of good faith (s181 Corporations Act 2001 (Cth)) and the duties not to make improper use of position or information (s182 and s183 Corporations Act 2001 (Cth)).⁹⁷ These will have extended application, under the recommendations, to "any person who performs functions, or otherwise acts, for or on behalf of that corporation".⁹⁸ The purpose, obviously, is to catch anyone acting as agent for the company as a function of what they do regardless of the position they hold.

Unlike the duties of care and diligence, the duties of good faith (s181 Corporations Act 2001 (Cth)) do not involve a subsequent review of your conduct to assess whether you have met standards of behaviour and decision-making set at an objectively appropriate skill level. The duties of good faith relate more to issues of honesty and integrity and therefore are more personally controllable. While it is possible to breach the duties without being reckless or intentionally dishonest⁹⁹ it still involves a knowledge or awareness that what is being done is not in the interests of the company.¹⁰⁰ This is obviously a risk more easily avoidable by scrupulous managers.

⁹⁷ Corporations and Markets Advisory Committee, n 1, Recommendations 7 and 8. Note that these recommendations also affect the equivalent criminal offences in s184 Corporations Act 2001 (Cth).

⁹⁸ Corporations and Markets Advisory Committee, n 1, at page 51.

⁹⁹ Given the terminology of the criminal offence contained in s184 Corporations Act 2001 (Cth).

¹⁰⁰ *Fitzsimmons v R* (1997) 23 ACSR 355; 15 ACLC 666.

The duties not to make improper use of position or information (s182 and s183 Corporations Act 2001 (Cth)) already apply to employees and would be likely to catch non-board managers in any event. Again, the risk to scrupulous persons is no greater.

7.2 Sections 1307 and 1309 Corporations Act 2001 (Cth)

ss.1307 and 1309 Corporations Act 2001 (Cth) will also be extended to catch “any person who performs functions, or otherwise acts, for or on behalf of that corporation”.¹⁰¹ s1307 describes the offence of the falsification of books and s1309 creates the liability in respect of the giving of false information. Again, these provisions already catch employees and non-board managers should already be aware of their significance.

7.3 Ancillary Liability Provisions: s79 Corporations Act 2001 (Cth)

Non-board managers, consultants and advisers should have already been aware that they are subject to liability for a contravention of the Corporations Act generally where they have been “involved in a contravention” for the purposes of s79 Corporations Act 2001 (Cth). s79 is couched in extremely broad terms however the underpinning of its application is that the manager has personally induced the breach or been a party to it with others.

8. Conclusion

At a policy level it has been considered necessary to seek to broaden the application of directors’ duties to catch those who play a role in corporate management yet currently assume little or no risk of liability for their conduct. The goal is arguably to force ‘middle management’ and other non-board managers, consultants and advisers to accept responsibility for their role in the practices and decision making of the company. Leaving aside the question of whether this is appropriate, this paper has reviewed the mechanisms chosen to achieve this goal and suggests that at least two key issues need to be carefully analysed by anyone at risk of falling into this renewed category of officer.

The first matter of concern is the means by which non-board managers will be brought within the operation of the relevant duties. The recommendation is to revert to previous terminology whereby anyone who is “concerned or takes part in the management of the corporation” can be caught. While this has the advantage of bringing with it existing judicial opinion to help with interpretation it is suggested the categorisation provides much less certainty than has been claimed. Even persons in one-off relationships with corporations and engaged in providing services that may not be considered part of central management can still be caught. Such results may assist in the policy goals behind the amendments however from the perspective of the relevant managers careful assessments will need to be undertaken to determine if they are at risk.

¹⁰¹ Corporations and Markets Advisory Committee, n 1, Recommendations 9,10 and 11.

The second major conclusion of the paper is that there may be an undervaluing of risk by those who stand a new chance of being caught within the relevant duties. This is because the amendments do not touch insolvent trading liabilities and extend other duties in rather a simplistic way that has been used before. However, how the new category of manager will be assessed against the standards of good corporate governance that have developed so markedly over recent years, is yet to be seen. This will be a key issue and the risk from s180 in particular deserves attention. Recent cases have highlighted the significance of the civil penalty regime and the possible consequences of a breach of s180 within failed companies. How high would be the confidence of non-board managers, consultants and advisers that they can safely identify the appropriate standards that will be expected of them in applying s180 to their particular role in their particular company?