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Corporate Governance and Company Directors: Are They Alice in Wonderland?

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Abstract

Corporate governance is not a new concept. In fact the last 15 years has seen a surge in academic publications and case law in relation to the lack of corporate governance. Research Gap is that Company Directors are attending a "mad hatters' tea party" when it comes to the implementation of governance codes, with the recent spate of court cases involving breaches of directors fiduciary duties. Methodology used was review of case law using archival data. This research looks at the type of case law issues of corporate governance in Australia and in particular accountability, and relates the case law to the Corporations Act (2001) to find where company directors are getting corporate governance wrong. The findings indicate that perhaps the "if not why not" prescription, should not be an option for corporate governance for some Boards. For some Boards the invitation from Alice to jump down the rabbit hole into creative accounting and bad board behaviour at the "mad hatters' tea party" is just too great an incentive. Implications show that this review of important corporate governance case law will assist Boards to concentrate their efforts on improving the environment they operate in, as good governance equates to good business.

> *"In another moment down went Alice after it, never once considering how in the world she was to get out again." Carroll, Lewis (1865) Alice's Adventures in Wonderland.*

Keywords

corporate governance, accountability, transparency, directors duties

1. Corporate Governance Introduction

Corporate governance refers to the relationship among different participants, and defining the corporation's direction and performance, which includes the CEO, i.e., the management team, the board of directors, and the shareholders (Prasad, 2006). From the agency perspective, corporate

governance is "a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers" (Sifuna & Anazett, 2012). Separation of ownership and control in the modern corporations became an issue by Berle and Means (1932). Recent research shows that there are lots of concentrations of ownership among the largest American companies (Demsetz, 1983; Shleifer & Vishny, 1986; Morck, Shleifer, & Vishny, 1988), and that a relative higher level of ownership concentration exists in other developed and developing countries outside the US (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998).

Corporate governance has been the subject of extensive scrutiny and controversy, particularly after the corporate collapses of the 2000s and the recent global financial crisis. Much of the controversy started in the Western countries, inspired by the early study of Berle and Means (1932). This classic analysis of corporation control call into question the justification for shareholder wealth and raise a problem of social ethics. But Berles' observation shows a lack of empirical justification for the claims held by the shareholders. Fama and Jensen (1983) advocate the financial theory of risk-bearing which hinges on the separation of decision management and residual risk-bearing in the corporation. This separation and specialization of decision management and residual risk-bearing leads to an agency problem between agents and principals (Fama & Jensen, 1983). The governance problem is that those who bear the residual risk have no assurance that the managers will act in the shareholder best interests, and therefore bring in the costs of monitoring and preventing the exercise of such discretion described as agency cost. The pre-occupation for corporate governance then is to mitigate the agency problem and agency cost between shareholders and managers. One of the possibilities is to use corporate governance as the mechanism for governing including boards of directors and to ensure sustainability through the financial structure as proposed by Jensen (1986).

The World Bank defines corporate governance as the set of mechanisms available to shareholders for influencing managers to maximize the value of shareholder's stock and to fixed claimants for controlling the agency costs of equity. The Organisation for Economic Co-operation and Development (OECD) defines corporate governance as a set of relationships among management, company board, its shareholders and other stakeholders. Both of them imply the principal-agent model of the corporation, and emphasise the importance of shareholder interest and company value. Shleifer and Vishny (1997) define corporate governance as a set of mechanisms to assure financiers that they will get a return on their investment. Corporate Governance then is an evolving concept. It dates back to the Code of Hammurabi back in 1800BC when bartering traders agreed to the basic rules of business transactions. The following table shows some of the international corporate governance regimes currently in place.

Table 1. Timeline

Date	Document Name	Date	Document Name
1800 BC	Code of Hammurabi	1999	OECD Principles of Corporate Governance
1991	Bosch Committee – Corporate Practices and Conduct (1995)	2001	Ramsay Report (Australia)
1992	Cadbury Committee Report (UK)	2002	Sarbanes Oxley Act 2002 (US)
1993	Hilmer Report (Australia)	2003	Combined Code Corporate Governance (UK)
1995	Vienot Report (France)	2003	ASX Good Corporate Governance and Best Practice
1995	Toronto Stock Exchange recommendations on Canadian Board practices (Canada)	2003 2004	AS 8000 - 2003 Standards (Australia) CLERP 9 Act 2004 (Australia)
1996	Report on Corporate Governance in Hong Kong	2004	Corporate Governance in New Zealand Principles and Guidelines
1997	King Report (South Africa)	2010	Corporate Governance Principles & Recommendations 2010 Amendments (ASX)
1997	Netherlands Report (Netherlands)	2012	UK Corporate Governance Code
1998	Hampel Report (UK)	2017	Amendments as necessary
1998	Olivencia Report (Spain)	2019	Corporate Governance Principles & Recommendations 2019 Amendments (ASX)

2. Method

This research uses archival data to compare current case law activities to that of the prescribed Corporation Act 2001 and the Corporate Governance recommendations by the ASX (2019). It also uses case studies of each of the case law to develop an in depth analysis of the case to enable the comparison to be made to legal obligations of Corporations Act 2001 and the Corporate Governance recommendations by the ASX (2019), as described by Creswell and Creswell (2018).

Countries that have good corporate governance systems become not only attractive locations for domestic companies to develop and invest (La Porta et al., 1998), but also for foreign investors, and thus promote economic growth (Levine, 1999). However, corporate governance practices are different from country to country. Companies in different countries are operating in different social, cultural, legal and economic environments, as a result, each country has developed its own corporate

governance system that serves its business operations best (La Porta et al., 1998). This paper investigates the most significant cases that have helped to shape the current corporate laws in Australia in relation to corporate governance. It also shows the link between the directors' duties as imposed by law (Corporations Act 2001) and the Australian Securities Exchange corporate governance recommendations (2019) that listed companies must comply with.

> *"How puzzling all these changes are! I'm never sure what I'm going to be, from one minute another." Carroll, Lewis(1865), "Alice's Adventures in Wonderland".*

This leads to the Research Problem of "How have the Corporations Act (2001) for company directors duties and the corporate governance regimes recommended by ASX (2019), been complied with by listed companies in Australia in the last 10 years". Research Question 1: Can the directors duties outlined in the Corporations Act (2001) relate to the Corporate Governance recommendations by the ASX (2019)? Research Question 2: What directors' duties have been breached and resulted in court activity in the last 15 years? To address the research problem, an organised, systematic and logical process of research method, using secondary data will be used. The use of archival data involves the research into case law of court cases involving the Corporations Act (2001) breaches.

3. Results

In order to answer Research Question 1: "*Can directors duties outlined in the Corporations Act (2001) relate to the Corporate Governance recommendations by the ASX (2019)*" directors duties must be investigated in terms of the specific references in the Corporations Act (CA) 2001 legislation. The difference between Common Law duties and Equitable Fiduciary duties must be ascertained, and specifically linked to a section of the act. Directors duties are broken down into Common Law duties and Equitable Fiduciary Duties. Under the Corporations Act (S185), there are specific sections on directors' duties, such as S180 Reasonable care and diligence, S181 Good faith and proper purpose, S182 Conflict of interest, S183 Confidential information, S184 Criminal liability, S588G2/3 Insolvent Trading and Personal liability, and s1043A Insider trading.

Specifically then under common law duties, a breach of section 180 Reasonable Case and Diligence or section 181 Good faith and proper purpose, will result in the use of section of S588G(2) which will result in personally liable penalties. Under the equitable fiduciary duties section of the Corporate Act (2001), section 182 conflict of interest and section 183 confidential information will able be in breach of director duties. Other penalties under the act include Criminal liability (s184), as well and other breaches such as Insolvent trading S588G (3) and Insider Trading (S1043A).

The commonwealth government recognises that all of these laws place a heavy burden on directors, and has encouraged the Council of Australian Governments (COAG) to review these in light of state legislations. Nicholson and Underhill (2012) discuss the "Personal Liability for Corporate Fault Reform Bill" that imposes personal liability on company officers for offences committed by corporations. The reforms came from the 2009 Council of Australian Governments (COAG) which

intends to harmonise corporate wrongs with personal criminal liability. This has been replaced by the Miscellaneous Acts Amendment (Directors' Liability) Act No. 2, 2011 (NSW) (2011 Act) and was subsequently replaced by the Miscellaneous Acts Amendment (Directors' Liability) Act 2012 (NSW) (2012 Act), which commenced on 11th January 2013.

Particularly after the corporate collapse era of 2000s, many countries have adopted some form of governance code such as that of the Corporate Governance Council of Australia, with their Best Practice Recommendations for listed companies on the Australian Securities Exchange (2019). Although these are recommendations only, for listed companies in Australia, listing rule 4.10 dictates that companies must address each of these governance initiatives, and explain if they have not adopted the recommendation (if not why not). In particular for listing companies in Australia it is important to link the Corporate Governance recommendations by the ASX (2019) to that of their Corporations Act (2001) obligations as shown in Table 2.

In order to answer Research Question 1: "*Can directors duties outlined in the Corporations Act (2001) relate to the Corporate Governance recommendations by the ASX (2019)*", Table 2 suggests there is a direct link between the application of the good governance recommendations by the ASX (2010) and the application of the Corporations Act (2001) for any breaches of those recommendations by directors. Directors therefore should be aware that even though the governance recommendations have an "if not why not" regime, that a breach of the recommendation can be directly linked to a breach of the Corporations Act (2001) which could lead to criminal or civil personal liability for Directors actions.

> *"I don't think... "then you shouldn't talk, said the Hatter." Carroll, Lewis (1865) "Alice in Wonderland".*

Table 2. ASX (2019) and CA (2001)

ASX 2019	***Corporations Act 2001***
1: Solid foundations for management & oversight	Reasonable Care and Diligence S180, Good faith and proper purpose S181
2: Structure Board to be effective and add value	Personally Liable S588G(2)
3: Instil a culture of acting lawfully, ethically & responsibly	Criminal Liability S184, Reasonable Care and Diligence S180 Personally Liable S588G (2)
4: Safeguard integrity of corporate reports	Reasonable Care and Diligence S180
5: Make timely and balanced disclosure	Conflict of Interest S182, Confidential Information S183 Reasonable Care and Diligence S180
6: Respect the rights of security holders	Insolvent Trading S588G (3), Insider Trading S1043A Good Faith and Proper Purpose S181

7: Recognise and manage risk	Insolvent Trading S588G (3), Insider Trading S1043A, Good Faith and Proper Purpose S181. Reasonable Care and Due Diligence S180, Conflict of Interest S182, Confidential Information S183
8:Remunerate fairly and responsibly	Reasonable Care and Diligence S180

In order to answer Research Question 2: "*What directors' duties have been breached and resulted in court activity in the last 15 years*?" the following tables have been divided by sections of the Corporations Act in relation to breaches of directors duties, and then linked to the corporate governance recommendations.

Table 3. Personally Liable S588G (2)

Case Name	Breach of Law Companies Act
Commonwealth Bank of Australia v Friedrich 5 ACSR 115: 9 ACLC 946	S588G(2) director found to be personally liable for debts incurred by the company, as the loan was fraudulent and he should not have signed annual report. ASX 2 & 3 breach.
ASIC v Narain FCAFC 120	Misleading information regarding chemicals and claims it could stop spread of disease that was not backed up by medical advice. Managing director held personally liable for the statements 588G(2). ASX 3 breach.

Table 4. Good Faith and Proper Purpose S181

Case Name	Breach of Law Companies Act
R v Byrnes and Hopwood (1995) 183 CLR 501; (1995) 130 ALR 529	Court found that officers could still be in breach of duties even when they thought it would benefit the company, but for an improper purpose S181. ASX 1 & 7 breach.
ASIC v Rich44ACSR 341: 21 ACLC 450-One.Tel	Non-executive chair failed to act with proper case and diligence, it also deals with the business judgement rule S181. ASX 1 & 6 breach.

Table 5. Confidential Information S183/Insider Trading S1043A

Case Name	Breach of Law Companies Act
R v Firns 51 NSWLR 548: 38 ACSR 223	Held that it is was insider trading under s1034A as the information was publically available even if no one had observed it. ASX 6 breach.
ASIC v Southcorp Wines 203 ALR 627: 22 ACLC 1	Contravened continuous disclosure rules by communicating the analysts before notifying ASIC S674(2), S183. ASX 3 breach.
R v Rivkin 198 ALR 400: 45 ACSR 366	Insider trading held s1043A as information that was material and not publically available was used to buy shares. Court imposed detention and a fine. ASX 3 & 7 breach.
ASIC v Wizard 145 FCR 57: 219 ALR 714	Insider trading breach s183, S1043A in that information obtained as a director that was not publically available was used for their own purposes to purchase shares in other companies (even though they made losses). Fined $400,000 and disqualified from being a director for 10 years. ASX 3, 6 & 7 breach.

Table 6. Minority Shareholder Rights S136

Case Name	Finding/Description Breach of Law Companies Act 2001
Gambotto v WCP 182 CLR 432: 127 ALR 4147	Minority shareholder case where a proposed amendment to the constitution and subsequent compulsory acquisition was invalid. To avoid administration and taxation costs was not a valid and proper purpose S136. ASX 6 breach.

Table 7. Reasonable Care and Due Diligence S180

Case Name	Finding/Description Breach of Law Companies Act 2001
AWA Ltd v Daniels t/as Deloitte Haskins and Sells 7 ACSR 759	Problems with delegated authority and incorrect procedures for reporting to a company board. An equal duty of care for both executive and non-executive directors. That all should be familiar with the business of the company. ASX 1 & 7 breach.
Vines v ASIC 55 ACSR 617: 23 ACLC 1387-GIO	Chief Financial Officer (CFO) duties of care and diligence, S180 negligence, and lack of due diligence in forecasting made public. ASX 4 breach.
The Bell Group Ltd (in	Directors duties to consider the interests of creditors in a

liquidation) v Westpac Banking Corporation (No 9) [2008] WASC 239	restructure for corporate debts. Banks were also found to assist in the directors breach of duties and were fined. ASX 3 breach.
ASIC v Narain FCAFC 120	Misleading information regarding chemicals and claims it could stop spread of disease that was not backed up by medical advice. Managing director was held personally liable for making the statements. ASX 7 breach.
Jubliee Mines NL v Riley 253 ALR 673: 69 ACSR 659	Continuous disclosure should be balanced with no misleading or deceptive conduct. Principle of "when in doubt disclose" should be considered carefully as company should not also mislead the market with incomplete information. ASX 5 breach
ASIC v Healy 2011 FCA 717 Centro Case	S180(1) directors breach as inaccurate financial accounts were approved. ASX 4 breach.
ASIC v Fortescue Metals Group Ltd FCAFC 19	Held FMG and Managing director Andrew Forrest breach of continuous disclosure for engaging in misleading or deceptive conduct concerning ASX releases and investor briefings to the signing of framework agreements with Chinese companies. In 2012 this was overturned on appeal. ASX 5 breach.

Table 8. Insolvent Trading S588G(3)

Case Name	Finding/Description Breach of Law Companies Act 2001
Commonwealth Bank of Australia v Friedrich 5 ACSR 115: 9 ACLC 946	S588G(2)/((3) director found to be personally liable for insolvent trading for debts incurred by the company, as the loan was fraudulent and he should not have signed annual reports with assets listed that the business did not own. ASX 1 & 3 breach.
ASIC v Plymin 46 ACSR 126: 21 ACLC 700. Elliott v ASIC 10 VR 369: 205 ALR 594.	Breach of statutory duty to prevent insolvent trading. Under s588G requires individual directors take reasonable steps to prevent a company from incurring a debt. Banned from being a director and fined $25,000 and $15,000 respectively. ASX 4 & 7 breach.

"If everybody minded their own business, the world would go around a great deal faster than it does." Carroll, Lewis (1865) "Alice in Wonderland".

Research Question 1: Can the directors duties outlined in the Corporations Act (2001) relate to the Corporate Governance recommendations by the ASX (2019) are demonstrated by Table 2. The

Research Question 2 of what directors' duties have been breached and resulted in court activity in the last 15 years, has been shown by Tables 3-8.

4. Discussion

Figure 2 is a model based on the interactions between Directors duties as prescribed by Corporations Law (2001) and the ASX Good Governance Recommendations (2019) and court cases from the breaches. Entitled the LAG/LEAD model, it represents how company directors can avoid the court system by instead of being reactive (LAG) they can be proactive (LEAD) by exhibiting good corporate governance and compliance with Corporations law.

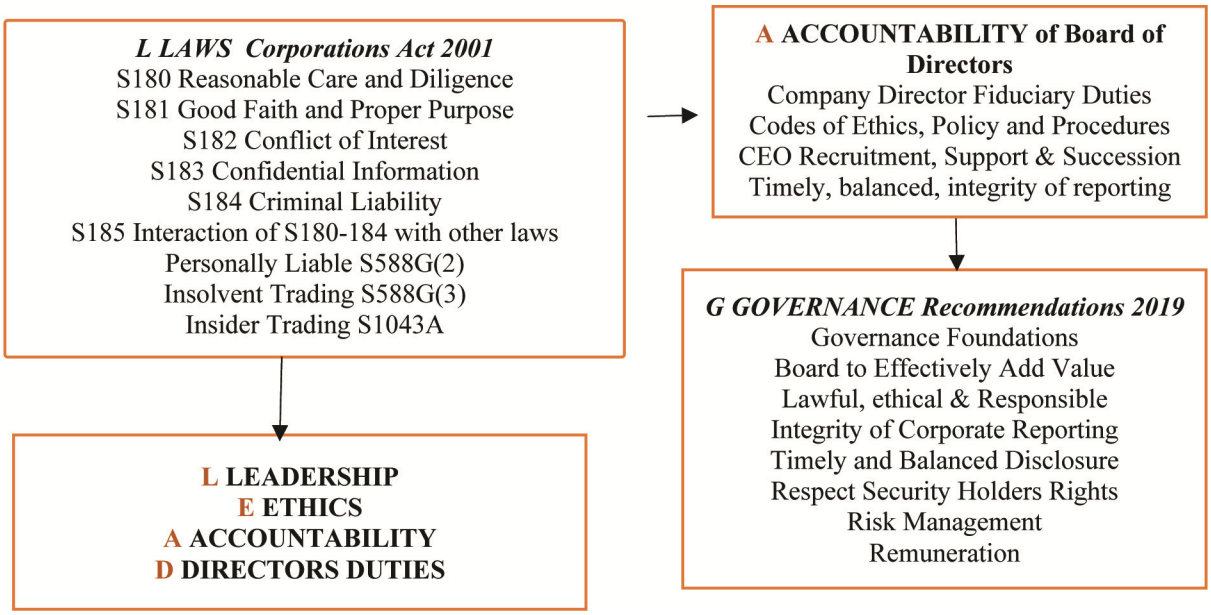

Figure 2. LAG/LEAD Model for Company Directors

The Business Judgement Rule s180(2) states that officers of a company are compliant with S180(1) if they made a judgement in good faith for a proper purpose, they do not have any material personal interest, they inform themselves about the subject matter to a reasonable level and they rationally believe that the judgement is for the best interests of the corporation. Bryans (2011) discusses the James Hardie case in relation to non-executives breaches of care and diligence in relation to ASX announcements that were misleading and failing to request a copy of the announcement. In the Centro case for example, Giordano stated (2011) that the directors failed to exercise their statutory duty of care and diligence in approving inaccurate accounts s180(1), statutory duty of care and diligence, s344(1) (reasonable steps to comply with financial reporting duties) and s601FD(3) in the failure of classifying $1.75 million USD as non-current when in fact they were short-term liabilities. In 2010 Heath in discussing the ASIV v Rich cases (2009) stated that directors are not responsible for unforeseeable

risks, and a mistake or judgement of error does not automatically invoke s180(1) breaches, however Directors still must understand company's financial statements, a responsibility that cannot be avoided.

The answer to the Research Problem of: "How have the Corporations Act (2001) for company directors duties and the corporate governance regimes recommended by ASX (2019), been complied with by listed companies in Australia in the last 10 years?," would be that **every** ASX governance recommendation (2019) and **every** company directors duty imposed by Corporations Law (2001), has in the last 15 years been **breached** resulting in a court case, with either criminal or civil liabilities imposed, so there is a lack of overall compliance by listed companies in Australia.

Directors' duties then are imposed on all Directors of all entities with serious consequences for breaches both on a civil or criminal basis. This research has shown that corporate governance may mean different things to different entities, but the Corporations Act (2001) is applied to ALL directors of ALL entities. Directors should be made aware of these obligations. Adams (2004) describes corporate governance as being not unlike a beauty and a beast, and that Directors who wish to do "good" should carry out diligence, compliance with regulation and adhere to corporate governance recommendations. All these recommendations however only add more to the burden already held by Directors both paid and voluntary. Directors of all Boards then, need to be vigilant, aware of their obligations, fully informed and ethical in all decisions they make for and on behalf of their boards, the last thing they want to see is their company in the courts, and their decision questioned by a judge.

> *"My dear, here we must run as fast as we can, just to stay in place. And if you wish to go anywhere you must run twice as fast as that." Carroll, Lewis (1865)* "*Alice in Wonderland"*.

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