

## Corporate Duties Below Board Level

### Introduction

Developments in the law of corporate governance indicate that middle and senior managers, consultants and corporate advisers could join directors in the firing line when companies collapse.

Spectacular collapses of HIH and One-Tel demonstrated that responsibility for corporate actions should not lie solely with the directors or other officers of a company. People such as divisional heads, senior managers and even contractors who take part in the management of the company may now be at risk of breaching duties in the Corporations Act ('the Act') if recent recommendations made by the Corporations and Market's Advisory Committee<sup>1</sup> ('CAMAC') are adopted.

### Background to the development: the failure of HIH Insurance

After the collapse of HIH, a Royal Commission was formed to investigate the circumstances surrounding the failure of the company. In the Commission's final report, Commissioner Justice Neville Owen commented: '*I have been frustrated by the disinclination of [middle management] to accept responsibility ... The uncertain state of the law in this area has been a source of difficulty in my assessment of those cases...*'.

Justice Owen then made a number of recommendations calling for amendments to the Act. Most notably, he proposed to extend the class of persons subject to statutory duties using a 'functional equivalence' test. Justice Owen said: '*... it is the performance of the relevant function that should attract the legal duty, not the precise legal relationship between the person performing that function and the relevant corporate entity*'. In other words, Justice Owen suggested that managers, consultants and contractors, where they functionally perform the duties of a director or officer of a company, should owe the same legal duties under the law as directors and officers.

### The CAMAC Report: Corporate duties below board level

Following Justice Owen's comments, the Federal Government requested CAMAC to review personal duties and liabilities under the Act for corporate officers and other individuals below board level. CAMAC published its recommendations in a report released in April 2006.

The report discusses whether the Act adequately reflects the commercial practicalities of running a modern corporate enterprise. In particular, it considers:

- whether to expand duties and liabilities in the Act to broader categories of persons;
- whether to introduce a general dishonesty prohibition;
- mechanisms for taking into account roles other than officers and employees, such as consultants and independent contractors, in corporate decision-making; and
- whether other changes are necessary to accommodate the decision-making process within corporate entities.

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<sup>1</sup> The CAMAC advises to the Australian Government on issues that arise in corporations and financial markets law and practice.



The report made the following recommendations to widen the scope of the Act:

- Directors' duties of care, diligence and good faith (ss. 180 and 181) should be extended to 'any other person' who takes part in management of a company. This could include contractors and consultants. The important question is 'whether a person is given some measure of responsibility or some area of discretion, or whether the person's opinion is given some weight in the decision-making processes of management'. If the answer is yes, the person could be exposed to liability under the Act for significant monetary penalties.
- The prohibition on improper use of corporate position or information (ss. 182 and 183) should be extended to 'any other person who performs functions, or otherwise acts, for or on behalf of that corporation'. Even if a person is not technically an officer or an employee of the company, they will be caught 'as long as they have performed acts for or on behalf of the company'. A breach of this prohibition may attract monetary penalties or even criminal liability in serious cases.

The second recommendation has attracted considerable criticism. The Australian Institute of Company Directors has suggested that obligations should only arise for those who have a 'position' within a corporation, because it is unreasonable to expect third parties to have the same understanding as directors and officers of what is in a corporation's best interests.

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The report also contemplated whether there should be a general provision, as recommended in the HIH Report, prohibiting individuals from acting dishonestly in connection with the performance of any statutory obligation imposed on a corporation. Although CAMAC saw some attraction in the proposal, it did not consider such a broad prohibition necessary, concluding that a general dishonesty provision would be difficult to gauge.

## Conclusion

It is questionable whether the proposed changes to the Act would result in better corporate governance or fewer corporate failures. The recommendations do, however, envisage a future where the application of corporate duties is 'functionally' defined.

Even though Government has yet to act on the recommendations made by CAMAC, as a matter of good corporate governance, actions should be taken now by businesses to ensure decision-making protocols are put in place and observed, and that decision-makers receive proper training about their legal rights and responsibilities in the business. Those who are potentially exposed to liabilities (including contractors and consultants) should also make sure they are covered by appropriate insurance. In the future, it may also be necessary to amend your company's Constitution, deeds of indemnity and deeds of access to widen the class of persons to whom indemnities are provided.