

CHAPTER 1

BACKGROUND TO INQUIRY

Terms of reference

1.1 On 26 May 1988, the Senate resolved to refer the following matter to the Standing Committee on Legal and Constitutional Affairs:

the social and fiduciary duties and responsibilities of company directors.¹

1.2 The Committee itself sought this reference from the Senate. It did so because it wanted to examine and consider views that had been expressed, for example, by the Hon Jim Kennan MLC, then Attorney-General for Victoria, that the modern company director should be required to take into account not just the shareholders and, at times, the creditors of the company, but also groups such as consumers and employees, and the environment, when making decisions about the operation of the company.²

1.3 The Committee deliberately sought broad terms of reference. This was to enable interested persons and groups to bring to the Committee's attention areas of particular concern.

Advertising the inquiry

1.4 Advertisements were placed in major national, State and Territory newspapers on 1 June 1988, seeking submissions from interested persons by 19 August 1988. In addition, the Committee

1. *Journals of the Senate, No 79, 26 May 1988, pp 763-4.*

2. See 'Comments on "Directors' Wider Responsibilities - Problems Conceptual, Practical and Procedural"', speech given by the Hon Jim Kennan MLC, at AULSA conference, Monash University, 25 August 1987.

wrote to various individuals and organisations that it considered might be interested in its inquiry. The inquiry also received newspaper and television publicity.

1.5 The Committee received 33 written submissions. The list of people and organisations who made submissions to the Committee is set out in Appendix I to this report.

Focus of the inquiry

1.6 During the course of its inquiry, the Committee was in contact with both the Companies and Securities Law Review Committee and the Law Reform Commission in relation to work being done concerning company directors. The Committee decided not to examine in detail certain issues that were being looked at by other organisations. These areas included, in particular:

- . indemnification of directors (see Companies and Securities Law Review Committee, Discussion Paper No 9, Company Directors and Officers: Indemnification, Relief and Insurance, April 1989);
- . alternate and nominee directors (see Companies and Securities Law Review Committee, Report No 8, Nominee Directors and Alternate Directors, 2 March 1989);³ and
- . a director's role in insolvency (see Law Reform Commission, Report No 45, General Insolvency Inquiry, especially chapter 7⁴).

1.7 The Committee also held a private meeting with

3. Note also other work of the Companies and Securities Law Review Committee, eg, Discussion Paper No 8, Director's Statutory Duty to Disclose Interest (Companies Act s.228) and Loans to Directors (Companies Act s.230), August 1988; A Company's Purchase of its Own Shares, September 1987; and Prescribed Interests, August 1988.

4. AGPS, Canberra, 1988; see also submission from Law Reform Commission.

Professor Robert Austin in Canberra on 9 November 1988 to discuss its terms of reference.

1.8 The Committee decided to focus on the following broad areas in its inquiry:

- . qualifications of directors;
- . multiplicity of directorships;
- . role of directors and composition of the board, including board committees (especially audit committees);
- . the nature of directors' existing duties and responsibilities and the standards required, to whom the duties and responsibilities are owed and whether they should be widened; and
- . the enforcement of the law in so far as it concerns directors.

1.9 The Committee decided that, if particular matters of concern were to emerge from this general inquiry, it would consider seeking further, more specific, terms of reference from the Senate. One such matter that has already been referred to the Committee for investigation and report concerns the shield of the Crown.⁵ In the course of that inquiry, the Committee will consider issues arising in relation to Commonwealth regulatory systems and government companies.

Public hearings

1.10 The Committee held public hearings in the following places on the dates indicated:

5. *Journals of the Senate, No 149, 3 May 1989, p 1578.*

Sydney 15 February 1989
 Canberra 10 March 1989
 Melbourne 22 March 1989

Witnesses who appeared before the Committee at its public hearings are listed in Appendix II to this report.

New corporations legislation

1.11 During the course of the Committee's inquiry, proposed new corporations legislation was referred to a joint select committee of the Parliament for inquiry and report⁶ and was subsequently passed by the Parliament.⁷ The new legislation, subject to a pending High Court challenge, will be implemented over a period of time and will set up a national companies scheme. The Committee has considered it inappropriate to comment in detail on the new scheme at this stage.

1.12 Throughout this report, where references are made to specific sections of the Companies Code, reference is also made to the equivalent provision of the Corporations Act 1989. The Attorney-General's Department has told the Committee that the new Corporations Act does not purport to alter the law relating to directors' duties as currently found in the Companies Code.⁸

Structure of the report

1.13 In this report, the Committee deals first with the duties and responsibilities that company directors have under the law as it is. Chapter 3 considers the so-called traditional duties on directors of care, skill and diligence, and chapter 4

6. *Journals of the Senate, No 100, 17 October 1988, pp 1018-21; House of Representatives, Votes and Proceedings, No 83, 19 October 1988, pp 781-3.*

7. *Journals of the Senate, No 155, 11 May 1989, pp 1641-59; House of Representatives, Votes and Proceedings, No 121, 23 May 1989, pp 1230-4, 1234-43.*

8. *Submission, covering letter.*

the fiduciary duties. These duties are owed to the company.

1.14 The report then deals with the duties directors owe, under company law, to entities outside the company. The case law has, in recent times, imposed a duty on directors to creditors, considered in chapter 5. The basis for this development is the closeness of the relationship between a company, at times of insolvency or near insolvency, and its creditors. Often at these times directors will have dealt with the assets of creditors rather than the assets of the company's owners. The courts have decided that, in those circumstances, directors owe duties to creditors.

1.15 In chapter 6, the Committee considers the interests of entities other than the company, the shareholders and creditors, and the extent to which directors are entitled to take account of extrinsic factors in their decision making. They are entitled to do so to the extent that those interests do not conflict with 'the interests of the company'. In most cases, the Committee has concluded that interests extrinsic to corporations should be promoted and protected, where necessary, in legislation dealing specifically with those extrinsic matters rather than in company law.

1.16 The inter-relationship of the board and the general meeting is discussed in chapter 7. Although the legislature has given shareholders various statutory rights, in reality the conduct of the company's affairs is almost exclusively in the hands of its management and its directors. Shareholders have little to do with the administration of companies which is almost wholly carried out by its management. Chapter 8 examines the role of audit committees. Chapter 9 looks at the qualifications company directors are expected to have and considers whether there should be mandatory qualifications of education, skill or expertise.

1.17 Finally the report deals with enforcement of the law relevant to companies. Chapter 10 considers ethics. The legislature need only provide sanctions when ethical standards are too low or when they are not met. Other enforcement issues dealt with are the remedies available to shareholders to enforce duties owed to them (chapter 11), the extent to which directors should be personally liable for acts of the company (chapter 12), and the kinds of sanctions available against directors who breach their duties (chapter 13).