



Expanded Corporate Duties – Proceed with Care

The Federal Government's Corporations and Markets Advisory Committee (CAMAC) is reviewing a number of the key recommendations of the HIH Royal Commission, in particular whether to widen the reach of the Corporations Act. While the recommendations proposing greater protection from improper use of corporate information have merit, those calling for consultants and contractors to be potentially regarded as managers and officers of corporations need more careful consideration.

HIH ROYAL COMMISSION

The HIH Royal Commission, formed to investigate the circumstances surrounding the failure of the insurance company, raised a number of questions about the adequacy of the Corporations Act to deal with what it saw as shortcomings in corporate governance arrangements in Australia.

In his report, delivered in April 2003, the Presiding Commissioner, Mr Justice Neville Owens, made several recommendations for amending the Corporations Act, which he argued would obviate a repeat of the HIH experience.

Key amongst these recommendations was replacing the existing classes of personnel of a company upon whom formal duties are imposed by the Corporations Act based on their legal relationship with the enterprise (e.g. officers and employees), with a definition based on the tasks performed by the relevant person - i.e. a 'functional equivalence' test.

Flowing from this recommendation, Chapter 2D of the Corporations Act (which deals with the duties and powers of directors, other officers and employees) would be amended so the duties imposed upon those persons (directors et al) would also apply to the wider class of persons within a 'functional equivalence' test.

This would, in effect, mean applying the Chapter 2D duties and powers to consultants and contractors who, in functional terms, perform the duties/have the powers, for example, of officers or of senior management.

Furthermore, Mr Justice Owen proposed a parallel extension of the classes of persons prohibited from acting dishonestly under the Corporations Act, to include those covered by his proposed functional equivalence test.

Specifically, it would mean bringing consultants or contractors, where they functionally perform the duties of a director, officer or employee of a company, within Sections 182(1), 183(1) and 184(2) of the Corporations Act.

- Section 182(1) deals with the improper use of position by a director, officer or employee gaining an advantage for themselves or someone else, or causing detriment to the corporation - penalties are civil.
- Section 183(1) deals with improper use of information by a director, officer or employee, who has acquired that information by virtue of that position, gaining an advantage for themselves or someone else, or to causing detriment to the corporation - penalties are civil.
- Section 184(1) deals with the dishonest use of position by a director, officer or employee of a corporation, with the intention of gaining an advantage for themselves or someone else, causing detriment to the corporation, or acting recklessly in this regard - penalties are criminal.

The Royal Commissioner argued these reforms were needed for a number of reasons, most notably that: there is a gap in liability below board level; in larger corporations, significant decisions are made by management without reference to the board; and that it was common for management decisions to be made on a collective or collegiate basis.

He also indicated many of the corporate practices within HIH found to be undesirable were the conduct of middle management, not of directors, and in his view, past legislative changes to the 'act dishonestly' provisions of the Corporations Act had reduced its effectiveness.

CAMAC INQUIRY

The Australian Government has now asked the Corporations and Markets Advisory Committee (CAMAC) to consider a number of the issues raised by Mr Justice Owens in his final report.

The Government released a Discussion Paper on these issues in May 2005 with a closing date for public comment/submissions of late August 2005.

CAMAC's membership is comprised of individuals selected on the basis of their knowledge and/or experience in business, law, corporate governance, accounting, economics or financial markets.

While not a high profile body, CAMAC nevertheless undertakes important reviews into, and provides advice to the Australian Government on, corporations and financial services law and markets.

Key issues before the CAMAC inquiry into corporate duties below board level include whether the:

- duties of good faith and improper purpose (ss 181 and 184(1)) should be extended to cover any person who takes part in, or is concerned with, the management of a corporation;
- duties of care and diligence (s 180(1)) and the business judgement rule (s 180(2)) should be similarly extended;
- improper use of corporation position (ss 182 and 184(2)) and of corporate information (ss 183 and 184(3)) provisions should be extended to any person who performs the functions, or otherwise acts, for and on behalf of that corporation; and
- knowingly providing false and misleading information (s 1309(1)) and misconduct concerning corporate books (s 1307(1)) provisions of the Corporations Act should be similarly extended.

CAMAC has also indicated it is considering whether to create a definition of the term ‘management’, and inserting it into the Corporations Act.

In this regard, ‘management’ could be defined as persons whose activities involve policy and decision making for the company and would have some significant bearing on the financial standing of the corporation or the conduct of its affairs.

It is also examining whether to enlarge the reach of the Corporations Act to include a ‘functional equivalence’ style of test, to cover the conduct of any person who acts for and on behalf of the company, and who participates in the decision-making which has a substantial impact on the corporation.

SPECIFIC ISSUES RAISED BY THE CAMAC REVIEW

The CAMAC review raises a number of important issues for the future of corporate duties below board level, in particular for the management and officers of companies.

These issues include:

- the potential introduction of a ‘functional equivalence’ test, based on the duties performed by a person rather than their formal position within a company;
- extending the existing provisions of the Corporations Act dealing with improper use of position or information; and
- the instatement of a general dishonesty prohibition within the Act.

Functional Equivalence Test

A key recommendation of the HIH Royal Commission, and part of the terms of reference for the CAMAC review, is the potential widening of the class of persons subject to the general duties imposed by Chapter 2D of the Corporations Act.

In particular, whether those duties should be imposed on a ‘functional equivalence’ basis – that is, on persons performing those duties for and on behalf of a corporation, regardless of whether they are directors, officers or employees.

This would mean, in effect, extending the reach of the Corporations Act to embrace consultants and contractors, where they perform equivalent duties to directors, officers or employees.

The HIH Royal Commission proposed such duties “*should be functionally defined. That is because it is increasingly common for a wide range of corporate functions to be performed by consultants or other contractors who are not strictly ‘employees’.*”

“... *it is the performance of the relevant function that should attract legal duty, not the precise legal relationship between the person performing that function and the relevant corporate entity.*”

This proposal ostensibly amounts to codifying recent case law¹ that has recognised what has become known as ‘shadow officers’, being a person in accordance with whose advice or wishes the directors of a corporation are accustomed to act. It would build on amendments made to the Corporations Act in 1999.²

It also takes into account the key findings of a series of court cases arising from the conduct of a person integrally involved in the failure of the HIH Insurance group and subject of the subsequent Royal Commission.

In those cases,³ the Courts held the person to be an officer of a subsidiary of HIH on the basis he participated in decisions that affected the whole of the business of the subsidiary, even though he had not been formally appointed to such a position.

Commerce and industry sees merit in adopting the approach put forward by the CAMAC review, although with some concerns.

Most notably, if there is to be a ‘functional equivalence’ test for persons performing the duties of ‘employees’, then this term will need to be defined in the Corporations Act. While the term ‘employees’ is currently used, it is not defined in the Act.

Second, some consideration may be needed of the reach of the current definition of the term ‘officer.’

Section 9 of the Act defines an ‘officer’ as anyone who makes, or participates in making, decisions that affect the whole or a substantial part of the business of the corporation, or who has a capacity to affect significantly the corporation’s financial standing.

Looked at in a broad frame, the recommendation of the HHH Royal Commission could dramatically widen the reach of the term ‘officer’ to include consultants or contractors whose services would traditionally not be regarded as within the meaning of Section 9.

It could, for example, include: accountants and other financial advisers who, acting as external consultants, provide advice on the restructuring of the corporation; industry association advisers who provide critical input into business plans, such as pursuing new export markets or labour relations contracting; professional management consultants, who provide advice to companies on possible strategic directions; and/ or lawyers in private practice who offer essential advice on a merger or acquisition.

Such persons would be likely to be caught by the terms ‘participating in making decisions’ and ‘has the capacity to affect significantly the corporation’s financial standing’ – that is, such consultants and contractors would be regarded as officers of the relevant corporation.

This could have the potentially undesirable consequence of roping-in consultants and contractors as officers of a corporation.

This would result in the extension of their personal and professional liabilities over an indeterminate time frame – and potentially even after the business relationship had concluded.

A better approach may be to move the focus of attention from ‘officer’ to ‘manager’, and to include ‘ongoing role’ and ‘ordinary person’ tests.

Regrettably, the Corporations Act is deficient in not providing a specific definition of the term ‘manager’ in its general dictionary provision (Section 9), although guidance can be found in *Bracht’s Case*.⁴

ACCI believes that a manager is a person involved in the policy and decision-making of the corporation to the extent such activities have some significant bearing on the financial standing or the conduct of the affairs of the corporation.

This should be complemented by ‘ongoing role’ and ‘ordinary person’ tests – i.e. would a reasonable person regard the consultant or contractor as performing the functions of management on a continuing basis.

Where the consultant or contractor was only providing advice on a discrete short term basis to the board or top management of the corporation, regardless of whether it was policy or significant to the future of the corporation, he/she should not be captured by the proposed functional equivalence, ongoing role and ordinary person tests.

However, if a consultant performed the duties of a manager, with similar appellation, for a sustained period, represented the corporation externally in the standing and style of a manager and would be regarded by an ordinary person as holding such a position, the situation could well be different.

Improper Use of Position or Information

Another key recommendation of the HIH Royal Commission was to extend the reach of the provisions of the Corporations Act dealing with improper use of corporate position or information (ss 182, 183 and 184 (2), (3)) to cover “*all persons performing functions for and on behalf of corporations, whether employees or suppliers of services under contract.*”

The CAMAC review argues this would be consistent with the functional equivalence test proposed by the HIH Royal Commission and a consequential and logical extension of the (proposed) inclusion of that test in the Corporations Act.

Indeed, a sound and rational case can be made, even without accepting the functional equivalence test approach, for such an extension of the improper use of position or information provisions of the Act to cover consultants and contractors.

In the real world of commerce and industry, consultants and contractors often do come into contact with, and possession of, business information that is not generally available or which they could improperly use to their own advantage or that of associates, or to the detriment of the corporation (for example, by on-selling it to competitors or making it publicly known).

Hypothetical examples could include: architects and engineers misusing information about potential property developments; lawyers and litigation under consideration; and management consultants and financial advisors on potential mergers, acquisitions or asset sales.

Given such confidential and inside information is akin to the intellectual property of the company, business should be able to look to the Corporations Act to protect its improper use, especially where this was done in a reckless or dishonest manner.

General Dishonesty Prohibition

The HIH Royal Commission also proposed the reinstatement of a general dishonesty provision into the Corporations Act, presumably beyond Section 1041G, which deals with prohibited conduct related to financial markets and services.

In the Royal Commission’s view, this provision “*would prohibit any person from acting dishonestly in connection with the performance or satisfaction of any obligations imposed upon a corporation under either the Corporations Act or any other written law.*”

While commerce and industry is supportive-in-principle of corporate/ criminal laws which prevent, or failing that deal effectively with, dishonest behaviour within business, the Royal Commission's proposals are deficient in a number of regards.

These shortcomings include: an absence of any substantial argument, let alone compelling evidence, as to why the existing provisions of the Corporations Act dealing with 'acting dishonestly' are inadequate; how a general 'act dishonestly' provision would deal with the perceived problem; and the expansive, indeed, excessive reach of the term 'any other written law'

However, on balance, ACCI would accept the return of a general dishonesty provision along similar lines as that which existed in the Corporations Act until relatively recently.

CONCLUSION

While it is appropriate, in the light of the HIH debacle, to consider the class of persons subject to the general duties imposed by the Corporations Act, policymakers must endeavour to ensure that the Act's provisions do not burden people not directly employed by a company, i.e. contractors and consultants, with unreasonable or unfair responsibilities.

ACCI supports the basic approach of the CAMAC review but believes that the term 'functional equivalence', which relates to the test for persons performing the duties of employees, should be defined in the Act.

The Act should also focus on 'managers' who have an ongoing role in the corporation rather than 'officers' or contractors/consultants.

The relevant test should be if a reasonable person regards the contractor/consultant concerned as performing management functions on a continuing basis.

End Notes:

- ¹ Standard Chartered Bank of Australia Ltd vs Antico (1995) 38 NSWLR 290.
- ² Section 9 (b) (iii).
- ³ Re HIH Insurance Ltd (in prov liq); ASIC vs Adler (2002) 41 ACSR 72 (appeal largely dismissed); Adler vs ASIC (2003) 46 ACSR 504.
- ⁴ Commissioner for Corporate Affairs (Vic) vs Bracht (1989) 14 ACLR 728, per Ormiston J.