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Abstract
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Keywords
corporate governance, self regulation, role of judiciary, judges

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CORPORATE GOVERNANCE AND THE JUDGES*

Professor John H. Farrar+

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Introduction

In this article I will first analyse the concept of Corporate Governance and show that it is an increasingly complex amalgam of legal and self regulation. Some reasons for the complexity are that the law has undergone various paradigm shifts over time which have not been adequately noted by commentators and these necessarily impact on the role of the judges. Added to this has been the process of rapid change which has often seemed excessive and even gratuitous. Further, there has been an international movement towards self regulation of this and

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* This article is based on a paper which the author gave to the Queensland Supreme Court Judges' Seminar on 23rd April 2003.

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related areas. Over this now hangs the shadow of recent corporate collapses which casts grave doubts about the ultimate efficacy of self regulation. These developments raise questions about the justiciability of modern corporate governance, whether there are alternatives to conventional adjudication and what the role of the judges should be.

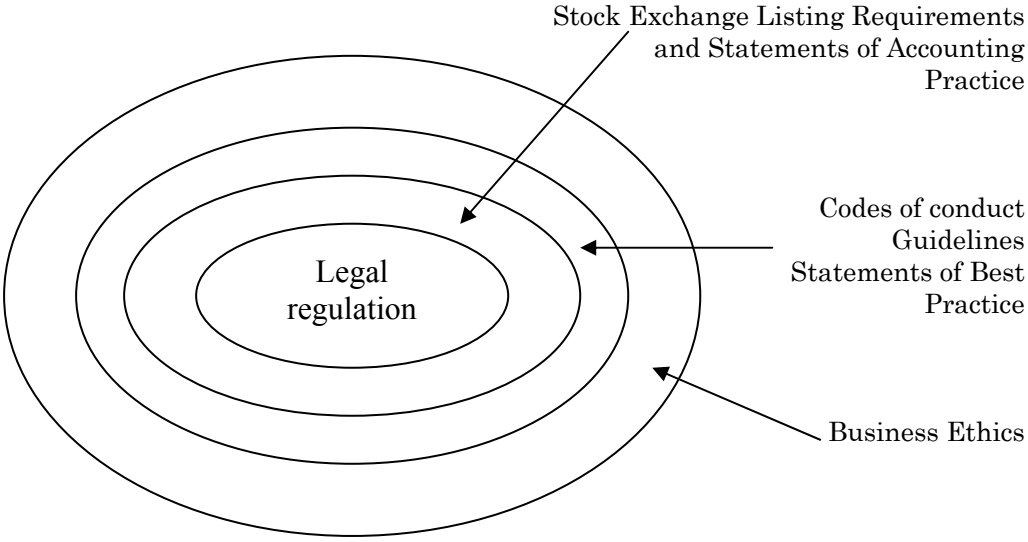
I shall review three recent high profile cases, HIH, NRMA and ONE-TEL where the courts have played a valuable role and shall also review the traditional role of the courts in shareholder disputes which raises questions of case management. I shall then consider whether the courts have a role in enforcing self regulation and what use can be made of self regulation in legal proceedings. Lastly, I shall consider the wisdom of using serving judges for royal commissions in this area in light of the experience in HIH and then attempt some overall conclusions.

The Concept of Corporate Governance

'Corporate Governance' is a term that has been in circulation for the last twenty years and its present use emanates from the USA although it is now truly international.[1] 'Corporate Governance' was used, probably for the first time, in 1962, by Richard Eells of Columbia Business School in his book *The Government of Corporations*.[2] 'The Study of Corporate Governance' was the subject of Chapter 1. Now it is a fashionable concept, and like many fashionable concepts, it is somewhat ambiguous and a bit of a cliché. In its narrower, and most usual, sense it refers to control of corporations and to systems of accountability by those in control. It refers to the companies legislation but it also transcends the law because we are looking not only at legal control but also de facto control of corporations. We are also looking at accountability, not only in terms of legal restraints but also in terms of systems of self-regulation and the norms of so called 'best practice'. Self-regulation starts off as a simple concept but becomes progressively more complex. Added to this we have business ethics. The relationship can be represented as in Figure 1.[3]

1 See JH Farrar, *Corporate Governance in Australia and New Zealand* (2001), 1.
2 Ibid, Chap. 1.
3 Farrar op. cit., 2.

Figure 1
The Structure of Corporate Governance



The subject of corporate governance, therefore, covers the *Corporations Act* 2001 and the case law decided by the courts. It also includes the listing rules of the Australian Stock Exchange (ASX) and Statements of Accounting Practice, which are hybrids or what we can call hard soft law; soft law in the sense of codes such as *Corporate Practices and Conduct*[4], the Guidelines of the Investment and Financial Services Association (IFSA)[5] and *Principles of Good Corporate Governance and Best Practice Recommendations* of the ASX's Corporate Governance Concil; and last we have attempts to formulate business ethics. All of these have some place in an analysis of corporate governance.

The Economic Importance of Corporate Governance

The OECD has recently made the following points about the economic importance of corporate governance:[6]

1. There is the link between corporate governance and investment and economic growth. It is not only the quantity of investment which matters. It is how efficiently this is allocated and monitored. Corporate governance has a crucial impact on all three.

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4 Business Council of Australia (1995).

5 *IFSA, Corporate Governance A Guide for Investment Managers and Corporations* (2002). "The Blue Book".

6 Rainer Geiger, Speech to SE Europe Corporate Governance Roundtable 30-31 May 2002.

2. The law component influences how we mobilize capital by defining property rights and guaranteeing credible information.

3. Corporate governance as a whole is seen as a constituent element of equity risk. Bad corporate governance signals information asymmetry and high probability of expropriation of shareholder value.

4. A McKinsey study of July 2002 showed the average premium that the overwhelming majority of investors will be willing to pay for companies with good corporate governance.

5. The market can only make the best decisions regarding allocation of capital if there is a proper disclosure. Effective monitoring depends on sound procedures, clear lines of authority and incentive schemes.

6. Globalisation affects this because of the:
   - Growing importance of the private sector
   - Growing international institutional investment
   - Growing international interdependence through technology
   - Changing patterns of competition

The Shifting Basis of the Legal Core[7]

Early corporate law was based on the privilege approach[8] which was a public law approach. The granting or recognition of incorporation was a privilege granted by the state on certain conditions which had to be complied with. Public law writs of *Quo Warranto* and *Scire Facias* applied. This was the dominant approach in English corporate law until the nineteenth century when the freedom of contract and utility approach began to be advocated.[9]

The freedom of contract and utility approach is essentially a private law and private ordering approach. The earliest legislation along the freedom of contract and utility lines was the 1844 English Act which was later supplemented by the Limited Liability Act 1855 and superseded by the first modern Companies Act of 1862. This legislation provided a liberal regime based on compliance with certain minimal statutory requirements and registration with a public official. The substance of corporate law made extensive use of equity concepts, especially the trust and fiduciary concept. The fiduciary concept has been interpreted by the law

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7 See J.H. Farrar, 'Fuzzy Law, the Modernization of Corporate Laws, and the Privatization of Takeover Regulation", in Farrar (ed) *Takeovers, Institutional Investors and the Modernization of Corporate Laws* (1993), 3-5; See J. W. Hurst, *The Legitimacy of the Business Corporation* (1970), I.

8 Hurst op. cit.3.

9 Ibid, 47.

and economics movement as an elaborate standard form contract to obviate the necessity for thousands of individual contracts separately negotiated.[10] The use of such concepts enabled the law to cope with the development of company promotion and directors' duties. A combination of these concepts and primitive political concepts of majority rule provided the basis for the law relating to shareholders' rights and company meetings.[11] Traditional corporate law was thus more modern than much recent corporate legislation in the sense that it was simpler and more flexible, and facilitated freedom of contract subject to minimal restraints.

The general trend of corporate law since then has been ever-increasing legislation, particularly regulatory legislation based on the disclosure concept. Nevertheless, a substantial amount of corporate law has remained case law and it can be said that the deep structure of the law has remained an equity-based system built on the ideas of contract, association, and restraint on abuse of power. The increasing tendency, however, has been to gloss or supersede this by statute, and we reach a stage when we have to ask the question of what the price will be as we switch to a substantially statute-based system. Do we cut ourselves adrift from the old equity-based system with its known concepts? What is the deep structure of the new legislation? What are its conceptual underpinnings? Are they changing?

One of the reasons for the modern development has been the growth of regulation. Initially this was the adoption of a simple policy of disclosure which was superimposed on an essentially private law system.[12] Subsequently the system has grown increasingly elaborate and has become a system of administrative regulation and bureaucracy.[13] If one looks at the United States experience, the growth of administrative regulation of securities has gone side by side with the increasing flexibility of the corporate law statutes. The argument is that the subject matter of capital markets and securities requires more complex laws.[14] On the other hand, some writers in the law and economics movement point to the self-interest of politicians and public servants and indeed the corporate bar in pursuing the goal of regulation.[15] Each of these groups has its own self-interest to

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10 See R. Posner, *The Economic Analysis of Law*, 5th ed. (1998), 431.

11 See J. H. Farrar, "Ownership and Control of Listed Public Companies: Revising or Rejecting the Concept of Control", in B. G. Pettet (ed), *Company Law in Change* (1986).

12 See W. Grover and J. Baillie, "Disclosure Requirements", in *Proposals for a Securities Market Law for Canada*, Vol 3, 349 et seq. (1979).

13 See F. Easterbrook and D. Fischel, "Mandatory Disclosure and The Protection of Investors" (1984) 70 Virginia *Law Review* 669.

14 See John C. Coffee Jr, "*Market Failure and the Economic Case for a Mandatory Disclosure System*" (1984) 70 Virginia *Law Review* 717.

15 Easterbrook and Fischel, op. cit.; G. Stigler, "Public Regulation of the Securities Markets", 37 *Journal of Business*. 117 (1964); H. Manne and E. Solomon, *Wall Street in Transition: The Emerging System and its Impact on the Economy* (1974); G. Benston, "The Costs and Benefits of Government Required Disclosure: SEC and FTC

fulfill in the pursuit of regulation. It is arguable in the Australian context that this has led to what one might describe as a dominant paradigm of increasingly complex regulation. This is periodically justified by key buzz words such as 'social responsibility', 'accountability', and 'fairness'. A number of modern commentators, including Professor L.S. Sealy[16] of Cambridge, have pointed to the high cost and low utility of much of modern disclosure requirements. Much work has been done on this topic by people like George Stigler in the USA.[17]

Added to this, in Australia, has been the process of criminalisation of the basic directors' duties which started with the Victoria Companies Act 1958 which formed the basis for the Uniform Companies Acts provisions. These were carried forward into the Companies Code 1981. The courts found these provisions reductionist and hard to interpret.[18] This led to proposals in the Cooney and Lavarch Reports to decriminalise them and this was done in the Corporate Law Reform Act 1992[19] which introduced the concept of civil penalty with complex provisions which have proved counter productive.[20] We still have the most draconian system in the West which is tempered by erratic enforcement.

Recently, we have what Professor Michael Whincop[21] described as the increasing institutionalization of corporate rights in Australia. By this he meant the intervention into private ordering of rights by the State through the Australian Securities and Investments Commission (ASIC) and by the courts through cases such as *Gambotto v WCP Ltd*[22].

A further development has been the supplementing of legal regulation by self regulation which assumes its greatest significance in the case of listed public companies. ASX Listing Rules and the Statements of Accounting Practice are given legal recognition under the Corporations Act. At the individual company level and at the proprietary company level self regulation into business ethics. The efficacy of self regulation has been undermined by recent corporate collapses

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Requirements", in D. DeMott (ed.), *Corporations at the Cross Roads: Government and Reform* 37-69.

16 See *Company Law and Commercial Reality* where he pointed to the high cost and low utility of much modern disclosure requirements. Much work has been done on this topic by people like George Stigler in the USA. Stigler op. cit. (footnote 15).

17 Stigler op. cit. (footnote 15 supra).

18 See for example *Marchesi v Barnes* [1970] V R 434.

19 *Ford's Principles of Corporations Law* 11th ed by HAJ Ford, R Austin and I Ramsay (2003) [2.170].

20 H. Bird "The Problematic Nature of Civil Penalties in the Corporations Law" (1996) 14C & SLJ 405; See G. Gilligan, H. Bird and I. Ramsay "Civil Penalties for Contraventions to Directors' Duties" (1999) 22 *University of New South Wales Law Journal* 417.

21 M. Whincop "The Institutional Politics of Corporate Law in Australia: From Gambotto to DB Management" (2000) 11 *Australian Journal of Corporate Law* 247.

22 (1995) 182 CLR 432.

such as HIH and OneTel in Australia and Enron and Worldcom in the USA. This has led to kneejerk legislation in the USA in the form of the *Sarbanes-Oxley Act* of 2002.[23] We currently await Australia's response.[24]

The Justiciability of Modern Corporate Governance

Is the subject matter of modern corporate governance properly justiciable?

Although as we shall see the matter to some extent can be regarded as a constitutional question, it is probably better to start by considering it from the point of view of principle. The judicial function is definable within limits.

The *Oxford English Dictionary*[25] defines justiciability as 'liable to be tried in a court of justice; subject to jurisdiction'. Not only are these bad definitions, they are manifestly question begging.

The best judicial analysis of justiciability is in the judgement of Kitto J in *The Queen v Trade Practices Tribunal; ex parte Tasmanian Breweries Pty Ltd*[26] where he is talking about the judicial power under the Commonwealth constitution. His Honour said "A judicial power involves, as a general rule, a decision settling for the future, as between defined persons or classes of persons, a question as to the existence of a right or obligation, so that an exercise of the power creates a new charter by reference to which that question is in future to be decided as between those persons or classes of persons. In other words, the process to be followed must generally be an inquiry concerning the law as it is and the facts as they are, followed by an application of the law as determined to the facts as determined; and the end to be reached must be an act which, so long as it stands, entitles and obliges the persons between whom it intervenes, to observance of the rights and obligations that the application of law to facts has shown to exist. It is right, I think to conclude from the cases on the subject that a power which does not involve such a process and lead to such an end needs to possess some special compelling feature if its inclusion in the category of judicial power is to be justified."

This serves as a workable definition for many purposes but the High Court has subsequently acknowledged that it is almost impossible to develop an exhaustive

23 See "Notes. The Good, the Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes-Oxley, and The Problems with Legislating Good Behavior" (2003) 116 Harvard Law Review 2123; LE Ribstein "Market vs Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002" (2002) *The Journal of Corporation Law 1.*

24 See *Ford's Principles of Corporations Law* [70-010] of the Ramsay Report and the discussion of CLERP 9.

25 Vol 5.

26 (1970) 123 CLR 361, 374.

definition. Deane, Dawson, Gaudron and McHugh JJ said in *Brandy v Human Rights and Equal Opportunity Commission*[27] "Difficulty arises in attempting to formulate a comprehensive definition of judicial power not so much because it consists of a number of factors as because the combination is not always the same. It is hard to point to any essential or constant characteristic."

Dr Geoffrey Marshall[28] in the First Series of *Oxford Essays in Jurisprudence* was likewise sceptical. Marshall was a political scientist very interested in law and a good scholar. Marshall argued that as a concept, justiciability is found attached to disputes and sometimes to rules. After a detailed analysis he concluded:[29]

"To sum up: there are two interlocking questions involved in the notion of 'justiciability' when it functions as an appraising term: (1) How far is it possible to make the concept of 'judicial' methods precise? and (2) How far is it possible to specify situations or disputes which are inherently suitable to such methods?
To the first question one answer seems clear: namely that the common law courts have failed to provide us with a single set of reasonably unambiguous criteria for calling a procedure 'judicial'. Moreover, many of the tests historically enunciated by the courts are now insufficiently precise to discriminate within a large *penumbra* of doubtful cases, and too great an element of chance enters into the question of classification where there is no specific guidance by the Legislature. As to judicial methods it is clear that certain (admittedly imprecise) characteristics – for example, objectivity of decision, independence of administrative or popular pressure, and finality of conclusions – have been regarded as necessary ingredients of judicial processes as distinct from discretionary or legislative ones; and there must have been some motives operating upon legislators who have provided for what they intended to be procedures of the first rather than of the second kind. Perhaps, then, the notions and occasions in question may best be made more precise by attempting to specify negatively, and in as neutral a way as possible, circumstances and motives which have led to the deliberate *avoidance* of such adjudicatory procedures and to the description of procedures and issues as involving 'policy' or administrative discretion."

If we turn to corporate governance what we see is that the legal core of corporate governance consisting of statutory rules and caselaw rules and principles has traditionally been regarded as justiciable. Indeed it was left to the courts to fill in the substantial gaps left by the legislation in terms of directors' fiduciary and other duties, and shareholder remedies. The criminalisation of directors' duties was never wholeheartedly endorsed by the courts for good reasons and it has now been left to the courts to deal with the relatively few civil penalty cases which are

27 (1995) 183 CLR 245, 267.
28 "Justiciability" in A. G. Guest ed, *Oxford Essays in Jurisprudence*, 1st series (1961), 265.
29 Ibid 277-8.

brought to court. Court proceedings of any sort are expensive and occasion delay. ASIC prefers to avoid them if possible for these reasons and uses its administrative powers wherever possible[30] and is seeking power to impose its own penalties. The statutory reforms to the Takeovers Panel have taken the jurisdiction in that area away from the courts. This needs to be considered as does the question whether the courts have a role in respect of self regulation. However, before we turn to that, let us briefly consider the constitutional question and how this is related to the question of justiciability.

The Commonwealth and State constitutions are based on the principle of separation of powers.[31] As a side issue to this we currently lack a coherent theoretical explanation of judicial law making as Justice Dyson Heydon[32] has recently pointed out in Quadrant and The Australian Bar Review.

Following from separation of powers is the argument that Parliament must not interfere with the judicial process and the strict view of the types of non judicial functions that may be carried out by persons who are federal judges.[33] This seems to be capable of extension to State judiciary.[34] These arguments hitherto have generally been used to attack proposals to vest adjudicative powers in bodies other than courts, fetter judicial discretion and to cut back on the extra curial activities of judges.[35] I shall return to this theme when I consider the arguments about judges serving on royal commissions.

Three Recent High Profile Cases

Three recent corporate situations highlight the importance of the continuing role of the courts in corporate governance where self regulation fails and in one case the problem of having a Royal Commission running concurrently with legal proceedings in the same matter. The three situations are the HIH and ONE-TEL collapses and the continuing disfunctional governance of NRMA.

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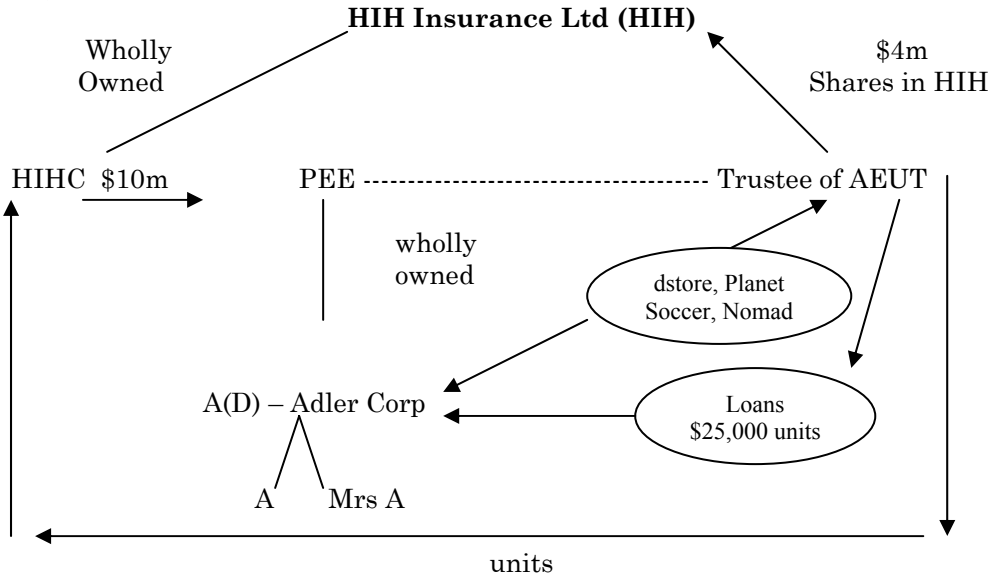
30 See Farrar op. cit (footnote 1).
31 See H. Patapan, *Judging Democracy – The New Politics of the High Court of Australia* (2000), Chap. 6.
32 *Quadrant*, January 2003; "Judicial Activism and the Death of the Rule of Law" (2003) 23 Australian Bar Review 110.
33 See E. Campbell and H.P. Lee, *The Australian Judiciary* (2001), Chap. 7.
34 Ibid 177.
35 Ibid Chap. 7.

HIH[36]

HIH has been the subject of the Royal Commission.[37] It is the largest corporate collapse in Australian history with considerable social impact. The prime cause of HIH's failure was that it did not have adequate reserves against future claims. Its UK branch ran out of control and then it compounded these problems by its takeover of FAI which brought with it a host of further problems. These problems were brought about by arrogance, greed and stupidity and then later panic.

ASIC preempted the Royal Commission's findings by bringing civil penalty proceedings in November 2001 in respect of matters consequent to the FAI takeover and is now pursuing criminal charges in respect of market offences. The facts, which are complex are summarized in the Figure 2 and are taken from the report in 41 ACSR 72.[38]

Figure 2



ASIC sought declarations and civil penalties for breaches of the Corporations Act 2001 against three directors of HIH Insurance Ltd (HIH): Rodney Adler, Raymond Williams and Dominic Fodera. Williams and Fodera were also directors of HIH

36 See M. Westfield, HIH – *The Inside Story of Australia's Biggest Corporate Collapse (2003)* Reviewed by Trevor Sykes in *The Weekend Australian Financial Review*, March 1-2 2003, 44.

37 See HIH Royal Commission website – <www.hihroyalcom.gov.au>.

38 *Re HIH Insurance Ltd (in prov. liq.) and HIH Casualty and General Insurance Ltd (in prov. liq.) ASIC v Adler* (2002) 41 ACSR 72 (hereinafter called *ASIC v Adler*).

Casualty and General Insurance Co Ltd (HIHC), a wholly-owned subsidiary of HIH. The fourth defendant was Adler Corp Pty Ltd (Adler Corp), a company of which Adler was the sole director and Adler and his wife the only shareholders.

The proceedings related to a payment in June 2000 of $10m by HIHC to Pacific Eagle Equity Pty Ltd (PEE) and subsequent investments by PEE using that sum. Adler was the sole director of PEE and Adler Corp the only shareholder. Some three weeks after the payment, the Australian Equities Unit Trust (AEUT) was constituted, with PEE as trustee. HIHC was issued with units in AEUT at an issue price of $10m. Adler Corp was issued with units at an issue price of $25,000. AEUT made the following investments:

- approximately $4m was used to acquire HIH shares (purchased by PEE before the AEUT trust deed was completed or subscribed to by HIHC);
- venture capital unlisted investments (dstore, Planet Soccer and Nomad) were purchased from Adler Corp at the price paid for them by Adler Corp; and;
- loans were made to entities associated with Adler and/or Adler Corp.

The $10m payment to PEE was made in such a way that it would not come to the attention of HIH directors other than Adler, Williams and Fodera. There was no proper documentation in place in relation to the payment at the time that it was made. There was no collective disclosure – either prior to the $10m payment or AEUT making the above investments – to the board of HIH, or to the HIH Investment Committee, which was responsible for overseeing investment decisions of the HIH Group. None of the transactions were approved or ratified by the Investment Committee, nor was AEUT's investment mandate approved, despite this being a requirement of the Investment Committee's guidelines. Self regulation had conspicuously failed when confronted by self interest and increasing panic as the group's affairs declined.

ASIC sought declarations of contravention of the *Corporations Act 2001* and compensation orders, civil penalties and orders for disqualification from acting as a director. The defendants disputed several matters of fact alleged by ASIC, claimed that the contraventions had not been made out and that, among other things, the payment of $10m was from the outset impressed with a trust in favour of HIHC. Each of the defendants also invoked the business judgment rule under s 180(2) in relation to the allegations of breaches of the duty of care under s 180(1).

None of the defendants elected to give evidence, and submitted that the court should decline to draw adverse inferences from such election.
Santow J found contraventions by Adler, Adler Corporation and Williams of s 209(2) of the Corporations Act 2001 (financial benefit to related party) and also s 260D(2) (financial assistance to acquire shares).

He further found that Adler had contravened ss 180(1), 181(1), 182(1) and 183(1) in respect of the payment of $10 million by HIHC to PEE and its use to acquire shares in HIH and shares in dstore, Planet Soccer and Nomad. Williams had contravened ss 180(1) and 182(1) and Adler s 182(2) because he was involved in contravention by Williams. Fodera contravened s 180. The business judgement defence in s 180(2) was not available to the defendants in the circumstances.

In a later judgement his honour dealt in detail with the principles which applied to penalties. He identified propositions[40] which can be derived from the authorities. These are set out in Appendix 1 to this paper.

Adler was disqualified for 20 years and ordered to pay $450,000 penalties. Williams was disqualified for 10 years and ordered to pay $250,000. Fodera was not disqualified but was ordered to pay $5000.

These were important findings and his honour is to be congratulated on his speed and diligence. An appeal was heard in the New South Wales Court of Appeal and in addition Adler has been committed to stand trial for stock market manipulation and false and misleading statements in relation to securities. The appeal was heard before the Royal Commission's Report was completed.

The Court of Appeal[41] upheld Adler's appeal against the finding that he had breached s183 of the Corporations Act (wrongly using information obtained as a company officer) but confirmed all other breaches decided by Santow J against Adler and Williams. The court also upheld the disqualifications, pecuniary penalties and compensation ordered against the defendants, subject to a recalculation of the interest component of the compensation. The court disagreed with Santow J's conclusion that the equitable test of causation applied to compensation orders under section 1317H of the *Corporations Act 2001*. The matter was to be determined by interpretation of the legislation. The Court awarded costs of the appeal to ASIC (which are additional to the approximately $600,000 costs payable to ASIC in relation to the original proceedings).

The Royal Commission's three volume report was published shortly before Easter, 2003. The report shows the effects of mismanagement on a colossal scale unchecked by effective supervision by a board which should have known better. The vanity and folly of former HIH chief executive director Ray Williams and fellow director Rodney Adler should have been monitored more effectively. There was lack of due process, limits on authority, independent critical analysis and management of conflict of interest. There was lack of information to the board and proper accounting.

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40 *ASIC v Adler* (2002) 42 ACSR 80.
41 [2003] NSWCA 131 (8 July 2003).

The social consequences of the failure have been substantial, but so far there has been little political fallout. The Australian Prudential Regulation Authority, while it did not cause or contribute to the HIH collapse, has been shown to be a very ineffective regulator of the insurance sector and has been recast as a regulatory commission. The passive role of ASIC is accepted by the report, although this is debatable. The report says that the role of the minister should be reduced. While it recommends further civil penalty proceedings against a number of officers it also recommends criminal charges against four officers. The firm of Arthur Andersen is criticized for relying too uncritically on HIH management. The report recommends tougher rules on auditor independence, rewriting of relevant accounting standards and auditor staff rotation. Justice Owen thought HIH was not a case where wholesale fraud and embezzlement abounded, but it was mismanaged on a scale that was reprehensible. Gross negligence took place. There was a chronic lack of reserves and poor risk management. Then there were unwise expansions overseas and acquisitions.

From a corporate governance point of view the best parts of the report are the critical assessments at the beginning and parts of Chapters 6, 15 and 23. The first gives the judge's overview, which, in the absence of an executive summary, is particularly useful. Chapter 6 deals with corporate governance in general, Chapter 15 deals specifically with under-provisioning for claims and Chapter 23 with other governance aspects. One very useful point made by Justice Owen is the lack of clarity over the definition of "officer" and the responsibilities of executives.

NRMA

The attempt at demutualisation and subsequent corporate governance of NRMA is a horror story. There have been over 60 directors in 10 years. There was a split on the board over the initial documentation which was held to be misleading and deceptive. This led to professional negligence claims against Dyson Heydon QC as he then was, Allen Allen and Hemsley and Abbotts Tout.[42] At first instance Giles J held them liable in a judgment longer than the average legal text book on Torts.[43] This was the subject of a successful appeal to a Court of Appeal constituted by expert judges from out of state.[44]

Later the chairman, Nick Whitlam, was held liable by Gzell J for civil penalty for breach of duty as director and chairman over the non use of proxies.[45] The Court of Appeal overturned the orders made against Whitlam.[45a] The appeal seemed to turn on the capacity in which Whitlam had acted when he dealt with the proxies.

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42 *NRMA Ltd v Heydon* (1999) 31 ACSR 435.
43 Ibid.
44 *Heydon v NRMA Ltd* (2001) 36 ACSR 462.
45 *ASIC v Whitlam* (2002) 42 ACSR 407.
45a *Whitlam v ASIC* (2003) 46 ACSR 1

The court thought that it was in the role of chair rather than director. This was specifically covered by the Corporations Act and did not fall under the general directors' civil penalty provisions. This seems a very technical distinction out of line with assumptions of the commercial world. ASIC is now applying for leave to appeal to the High Court.

The board last year split into three factions and the NRMA CEO said "the board is working themselves into a position of being irrelevant, frankly."[46] There have since been dramatic board changes after further court involvement at meetings attended by less than 10% of the members. Only about 3% of NRMA's 2 million members voted for or against the resolutions. Another 4% provided undirected proxies to the Chairman. Meetings of members are costing NRMA $8 million each time. The New South Wales judges have made increasingly critical comments about the internecine warfare which now requires legislative intervention to arrest this waste of NRMA's funds.[47] The Australian Shareholders Association has also said that if the skirmishing looks set to continue the Government will need to consider stepping in and seeking the appointment of an administrator.

Now, in a good system of corporate governance dirty washing of this kind would have laundered in the company and not hung out to dry in the courts and in public. Nevertheless the courts performed a valuable role in all three episodes and in resolution of the disputes. Self regulation had conspicuously failed.

ONE-TEL[48]

The collapse of One-Tel is another striking example of the failure of self regulation. The affairs of the group were carried out in a cavalier fashion and important information seems to have been withheld from the board.

This raised, amongst other questions, the role of the chairman. Hitherto the position of chair has been thought of in narrow technical terms about the law of meetings and whether the chairman has any authority to bind the company. In recent years, however, as Sir Adrian Cadbury and Henry Bosch have documented, the role of the chair in listed companies has become more important.

In a recent decision in *ASIC v Rich*,[49] Austin J refused an application by John Greaves, the former Chairman of One-Tel to strike out the claim brought against him by ASIC in civil penalty proceedings. ASIC argued that the chairman had to

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46 Anne Lampe "So over it: NRMA boss eyes off life after board battles" <www.smh.com.au/articles/2002/11/07/1036308424182.html>.

47 See *NRMA Ltd v Snodgrass; NRMA Ltd v Dupree* (2002) 42 ACSR 371; *NRMA Ltd v Bradley* (2002) 42 ACSR 616.

48 See Paul Barry, *Rich Kids* (2002).

49 (2003) 21 ACLC 450. See also Sir Adrian Cadbury, *The Company Chairman* (1990) and H. Bosch, *Conversations Between Chairmen* (1999).

be assessed by a standard of care and diligence which required him to take reasonable steps to ensure the following:

a. *that he and the other members of the board monitored the company so that they detected material adverse developments affecting its financial performance;*

b. *that he and the other members of the board kept themselves informed of material financial information and worked with management to ensure systems were established so that this financial information:*

   – *was accurate and reliable; and*
   – *allowed the board to monitor management, to properly assess the financial position of the company and to promptly detect any material adverse development affecting its financial performance;*

c. *that the company employed a finance director with the qualifications, skills and experience appropriate for a person holding that position;*

d. *that public statements made on behalf of the company did not mislead the ASX or investors;*

e. *that the company maintained cash reserves at a level that ensured that the company was able to pay its debts as and when they fell due; and more generally to make recommendations to the board as to the prudent management of the company, including as to its funding requirements, cessation of its business and/or appointment of an administrator.*[50]

This demonstrates the malleability of negligence and the willingness of the courts to reflect social change. Earlier Lord Denning and the English Court of Appeal in *Panorama Development (Guildford) Ltd v Fidelis Furnishing Ltd*[51] had taken an analogous approach to the question of the authority of a company secretary to bind a company, at least in matters of administration and possibly routine management.

Austin J said that the court's role was to articulate and apply a standard of care which reflected contemporary community expectations. The willingness of Austin J, who came to the Bench after considerable involvement with the Legal Committee of the Australian Institute of Company Directors, to have regard to changing corporate governance practice is interesting and perhaps predictable. It will also be interesting to see if he and his Sydney colleagues recognise similar higher roles and responsibilities for non executive directors who serve on audit

50 See A. Lumsden "A Chairman's Lot is Not a Happy One" *Corrs in Brief* 25 February 2003 for a summary of ASIC's arguments on which this is based.

51 [1971] 2 QB 711.

committees and the like in litigation which will no doubt ensue from the recent failures.

What these situations demonstrate is that self regulation sometimes fails and there is no alternative to court involvement. Self regulation lacks an effective system of sanctions which can only be provided by the courts. In the case of HIH retribution has been swift. There was not time and perhaps inclination for minority shareholders to seek redress. ASIC took prompt action and is engaged in seeking civil and criminal penalties in a pretty clear case. The Royal Commission, if anything, is an expensive side show. In the case of NRMA the courts have been continually involved in sorting out a disfunctional board at great expense to the organisation. This is a different role but made necessary by the common cause, the failure of the self regulatory regime.

The Experience of Takeovers

Whereas HIH, NRMA and One-Tel show the courts performing a valuable role, the history of takeovers demonstrates the contrary. Resort to the courts was an expensive tactic which impeded the speedy resolution of takeovers.

The vesting of powers of investigation and adjudication of unacceptable conduct in a takeover in the NCSC was found to be undesirable. The adjudicative role was then vested in a new Takeover Panel. The matter was further elaborated by the High Court in *Precision Data Holdings Ltd v Wills*[52] when it held that the new Panel was not making binding declarations of existing right but only what rights and obligations should be created. It, therefore, fell outside the judicial power of the Commonwealth under s 71 of the Constitution.

Nevertheless the performance of the panel was regarded as unsatisfactory and it was reconstituted by the Corporate Law Economic Reform Act 1999. Provisions were introduced to prevent court proceedings of most kinds during the period of the bid. The aim was stated in s 659 AA to make the Panel "the main forum for resolving disputes about a takeover bid until the bid period has ended."[53]

The policy is to create a more responsive body that can quickly and efficiently resolve takeover disputes, thereby reducing the costs for the parties involved and ensuring that the outcome of the bid can be decided by the proper arbiters – the shareholders.[54] This policy demonstrates the negative approach to justiciability which Marshall talked about.[55] Takeovers are not inherently non justiciable. It is

52 [1991] 173 CLR 167.
53 See N. Calleja, *The New Takeovers Panel – A Better Way?* (2002), 14.
54 Ibid 28.
55 See above footnote 28.

simply that the legislature thinks that there are policy reasons for treating them as such.

The courts have not been entirely excluded. The Panel itself may refer questions of law to the courts under s.659A. Otherwise there is very limited locus standi to commence proceedings in relation to a bid during a bid.

The provisions, however, are not all that simple. Added to this is the residual risk of a constitutional challenge.[56]

It is interesting to contrast these checkered developments with the long history of successful self regulation in the City of London and the reluctance of the English courts to intervene by way of judicial review except in retrospect in respect of real injustice.[57] This jurisdiction is exercised by declaration to enable the Panel not to repeat any error or to relieve individuals of any disciplinary consequences of an erroneous decision.[58] That system has worked well but perhaps is not for export to Australia because of the more adversarial and litigious local culture here.

It will be interesting to see how long the new system lasts here given this culture.

The Judges' Role in Self Regulation

Takeovers are now substantially dealt with outside the courts unless someone challenges the consitutional basis of the present system.

There is no obvious provision for judicial involvement in the IFSA Blue Book or *Corporate Practices and Conduct*.[59] As we have seen the English courts have exercised some minimalist judicial review of the City of London Takeover Code which exists entirely as self regulation. The English courts have also referred to self regulation to determine the standard of care of auditors and whether conduct in breach of the Takeover Code made it just and equitable to wind up a company.

In *Lloyd Cheynham & Co Ltd v Littlejohn & Co*[60] the plaintiffs alleged that the defendants had negligently audited a company's accounts and they had relied on this and suffered loss. The plaintiffs relied heavily on the statements of Accounting Practice. Woolf J said[61] "While they are not conclusive, so that a departure from their terms necessarily involves a breach of the duty of care, and they are not as the explanatory foreword makes clear, rigid rules, they are very

56 Calleja op. cit. 100 et seq.
57 See Sir H.W.R. Wade & C. F. Forsyth, *Administrative Law* 8th ed. (2000), 629-631.
58 Ibid 629.
59 See footnote 4 above.
60 [1987] BCLC 303.
61 Ibid 313.

strong evidence as to what is the proper standard which should be adopted and unless there is some justification, a departure from this will be regarded as constituting a breach of duty. It appears to me important that this should be the position because third parties in reading the accounts are entitled to assume that they have been drawn up in accordance with the approved practice unless there is some indication in the accounts which clearly states that this is not the case".

In *ASIC v Rich*[62] Austin J had regard to contemporary community expectations in assessing the standard of care of a company chairman.

Re St Piran Ltd [63] was a motion to strike out a petition for winding up on the just and equitable ground on the basis that it was embarrassing, an abuse of the process of the court and disclosed no reasonable ground for relief. The petition had been brought by the Secretary of State for Trade. Dillon J. adjourned the motion to allow amendments to particularize the matters relied on in an Inspectors' Report. A second point concerned the breach by St. Piran of the Takeover Code and directions of the Panel.

Dillon J said:[64] "I turn to the second point which is directed at paragraph 8 of the petition. It is said for St. Piran that the directions of the City Panel have no legislative sanction and that the failure of Mr Raper and Gasco or their associates to make a bid for the entire share capital of St. Piran as directed by the panel was not an act or omission, let alone a default or misconduct, on the part of St. Piran itself or on the part of its management as such. Therefore, it is said, paragraph 8 could never provide grounds for a winding up order and should be struck out. I do not take such a narrow view. The court has jurisdiction to order the winding up of a company on a contributary's petition if it is just and equitable that the company should be wound up. The words "just and equitable" are wide general words to be construed generally and taken at their face value. The provisions of the City code set out a code of conduct which has been laid down by responsible and experienced persons in the City as being fair and reasonable conduct in relation to companies which, like St. Piran, have obtained the benefit of a public quotation on the Stock Exchange. If the directors of a publicly quoted company or the principal shareholders in such a company choose to flout that code of fair and reasonable conduct and to ignore without good reason the consequent directions of the City Panel, and the minority shareholders are injured by the withdrawal of the Stock Exchange quotation for the company's shares, then it seems to me that it could very well be just and equitable in the natural sense of those words that the company should be wound up. Whether in any case a winding up order should be made would depend on a full investigation of the facts of the particular case. That is a matter for the hearing of the petition and not for this motion".

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62 See (2003) 21 ACLC 450 .
63 [1981] 1 WLR 1300.
64 Ibid at 1307 D-G.

In Australia certain types of self regulation are given statutory force which means that they are a kind of hybrid, enforceable in the courts.

Section 793C of the Corporations Act 2001 gives ASIC, a market licensee or an aggrieved person locus standi to apply to the court to enforce the ASX's operating rules. Section 793C(2)(b) expressly empowers the courts to make orders directing directors of listed companies to ensure that their company complies with the Listing Rules. See also the power of the courts to make orders under section 1101B(1) and (4).

What all this amounts to in Australia is probably three things, first an express statutory jurisdiction in certain areas, secondly, a residual role in judicial review[65] of proceedings under the ASX's *Principles of Good Corporate Governance and Best Practice Recommendations*, the IFSA's Blue Book[65a] and *Corporate Practices and Conduct*[66] and thirdly, the reference to self regulation in the assessment of directors' and auditors' duties.

Two other possible developments are the adoption of sentencing guidelines by the judges on the pattern of the US Federal Sentencing Guidelines where the existence of a compliance program is a mitigating factor to be taken into account.[67] It is also likely that in any event this kind of factor will be taken into account in determining whether a company has a "corporate culture" which led to non compliance for the purposes of the Commonwealth Criminal Code Act 1995 which now applies to criminal matters under the Corporations Act 2001.[68]

Shareholder Remedies and the Judges

My colleague Laurence Boulle and I have dealt with this topic in depth elsewhere[69] and I will merely summarize some of our main arguments here.
Just as we have seen that in general there were paradigm shifts from a public law/privilege approach to a private ordering approach and then to a public law/administrative regulatory approach, so too we can identify paradigmatic shifts

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65 See Neat Domestic Trading Pty Ltd v AWB Ltd [2003} HCA35 (19 June 2003).
65a See footnote 5 above.
66 See footnote 4 above.
67 See D. DeMott "Organizational Incentives to Care About the Law" (1997) 60 *Law & Contemporary Problems* 39.
68 See Criminal Code Act 1995 (Cwlth) s12. 3 especially s. 12.3 (6) "corporate culture". See also Commonwealth Attorney-General in association with the Australian Institute of Judicial Administration Inc., *The Commonwealth Criminal Code – A Guide to Practitioners* March 2002, 296 et seq.
69 See J. H. Farrar and L. Boulle "Minority Shareholder Remedies – Shifting Dispute Resolution Paradigms" (2001) 13 *Bond Law Review* 272.

in relation to shareholder remedies. This is not to say that the actual shifts were the same. It is simply the process of change.

The Rule in *Foss v Harbottle*[70] represented a rights based approach by the courts. Normally the rights to seek remedies for wrongs done to the company vested in the company and only exceptionally in the shareholders. The decision of the House of Lords in *Ebrahimi v Westbourne Galleries Ltd*[71] in 1973 represented a new approach which was the beginning of a more interest based approach which arose in that case in interpretation of the just and equitable clause in winding up but was carried over to the reforms of the statutory shareholder remedy, now in section 232 of the Corporations Act 2001. The new basis of intervention was recognised by Sir Ivor Richardson in the New Zealand case of *Re HW Thomas Ltd*[72] which was cited with approval in *Wayde v NSW Rugby League Ltd*[73] and many subsequent Australian cases.

The recent attempt by Lord Hoffmann in the House of Lords to revert to a more rights based approach in *O'Neill v Phillips*[74] is wrong in principle and wrong in policy. Needless to say the Australian and New Zealand cases were not cited. Lord Hoffmann's complaint was primarily against the legal profession and his colleagues. The solution as the English courts have now determined is in an appropriate judicial response to this jurisdiction. This has now been effected by amendment of the Rules of the Supreme Court and the reference of a number of these cases to mediation and other forms of ADR.[75] This obviates the need for prolix pleadings and excessive use of court time, often out of all proportion to the amount in dispute. It is not appropriate for the courts when faced with the interpretation of interest based legislation to seek to interpret it as rights based legislation, simply for convenience.

The Use of Judges as Royal Commissioners[76]

As Justice Owen said at the opening of the HIH Royal Commission "A Royal Commission is an administrative and inquisitional process. It is not a judical

70 [1843] 2 Hare 461.
71 [1973] AC 360
72 [1984] 1 NZLR 686
73 [1985] 180 CLR 459
74 [1999] 1 WLR 1092.
75 See Farrar and Boulle op. cit. 290.
76 See Justice F. G. Brennan, "Limits on the Use of Judges" (1978-9) 9-10 *Federal Law Review 1*; Australian Institute of Judicial Administration; Judges as Royal Commissioners and Chairmen of Non-Judicial Tribunals, (1985); Tom Sherman, "Should Judges Conduct Royal Commissions?" (1997) 8 *Public Law Review 5*; Campbell and Lee op cit (footnote 30), Chap. 7.

proceeding." [77] The terms of reference of the HIH Royal Commission are set out in Appendix 2 to this paper. They are wide ranging and go beyond the province of a judge. They overlap with the investigation by ASIC and there is a risk of duplication and adverse impact on proceedings arising out of ASIC's investigation as the terms of reference themselves recognise. This necessitated a joint Protocol set out in Appendix 3 to this paper.

Should serving judges serve government in this way?

This question was the subject of a very useful publication of the Australian Institute of Judicial Administration, *Judges as Royal Commissioners and Chairmen of Non Judicial Tribunals*[78] in 1985.

The case against was put in considerable detail by the Honourable Sir Murray McInerney QC and Garrie Moloney and the case for was put briefly by DG McGregor QC.

Sir Murray and Moloney raised the following arguments against Judges as Royal Commissioners:[79]

1) the need to protect the reputation of the judiciary
2) the effect on the workload of the courts
3) the executive resort to the prestige of the judiciary for its own purposes
4) the non judicial nature of some of the work
5) the risk of debasement of judicial currency.

They recognised, however, three arguments in favour of judges acting as Royal Commissioners:[80]

1) judicial impartiality and competence
2) a moral duty to assist the executive
3) Parliamentary approval of a particular appointment.

McGregor put forward the following further arguments for the appointment of judges:[81]

a) where the subject matter relates to security issues
b) where it relates to foreign affairs

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77 HIH Royal Commission Website opening remarks from the Commissioner para. 13. <www.hihroyalcom.gov.au/About/index.asp>.
78 Op. cit. (footnote 71 above).
79 Ibid 51 et seq.
80 Ibid 54 et seq.
81 Ibid 96 et seq.

c) *where it relates to high placed people in government (eg. the Profumo inquiry conducted by Lord Denning)*
d) *where it concerns the ramifications of organised crime*
e) *in particular where it relates to criminal matters in an area where there is a national concern.*

As can be seen these arguments are policy arguments which are not necessarily conclusive either way. The practice differs from state to state. The High Court judges do not serve in this way and neither do the Victorian judges except in very exceptional cases.[82]

I have set out in Appendix 4 the Statement by the Council of Chief Justices of Australia and New Zealand on Appointment of Judges to Other Offices by the Executive. This sets out a procedure for consultation with the relevant Chief Justice and members of his or her court.

The experience of former judges in Western Australia and Queensland "conducting inquiries in the midst of political grapeshot"[83] reinforces the wisdom of not appointing serving judges and even of former judges avoiding such appointments.

To me a more relevant question is whether royal commissions serve any useful purpose which justifies the cost (including opportunity cost) of their appointment. This needs to be assessed on a case-by-case basis. The HIH Royal Commission has cost nearly $40 million.

Conclusions

Corporate governance represents a new look at an old area and is a complex amalgam of legal and self-regulation. It is not the only area of law to receive this treatment. Broadcasting, telecommunications, privacy and Trade Practices are other examples. The interface of legal and self-regulation raises new challenges for the courts.

The courts need to be aware of the context in which these developments are taking place. In this area we are seeing major paradigm shifts:

– *first, generally the shift from a public law/privilege approach to a private law ordering approach which has recently been partly superseded by a public law/administrative regulatory approach coupled with increased self regulation.*

82 See Ibid Appendix 1.
83 Sherman op. cit (footnote 76 above), 9. He refers to the Marks inquiry into Carmen Lawrence and the Carruthers inquiry into Premier Borbidge and Minister Cooper.

– *secondly, in the case of shareholder remedies, a shift from a rights based approach to an interests based approach which arguably needs more flexible procedures and more use of Alternative Dispute Resolution.*

The courts need to react constructively to the increased administrative regulatory role of ASIC and systems of self-regulation and to consider the interface with law and what role they can play in ensuring the success of the new regime[84]. Failing this, Parliament might resort to drastic tactics such as shutting out the courts as it has done substantially with Takeovers in the absence of a constitutional challenge.

There is something very striking in the juxtaposition of the speedy adjudication by Santow J of the initial HIH proceedings and the subsequent sentencing, and the laborious processes of the HIH Royal Commission. An obvious concern about the overlap of responsibilities led to the adoption of the Protocol. This is not a very orderly way of running a legal system and by this I am in no way criticizing Justice Owen. He and ASIC tried to make the best of a bad job and he approached his task with diligence and fairness in very difficult circumstances.

On the wisdom of using serving judges on Royal Commissions in the corporate governance area I remain sceptical. There are a number of serious arguments against including a possible constitutional argument and there is the residual question of the wisdom of incurring the immense cost and delay of a Royal Commission such as the HIH Royal Commission[85]. In any event I appreciate that these matters raise questions of broader public policy, which lie outside the province of the judges to decide but on which the judiciary has a legitimate point of view.

84 See *ASIC v DB Management Pty Ltd* (2000) 169 ALR 385 but see the criticism of this decision by Whincop op cit (footnote 21 above). He saw it as an instance of the increasing penetration of public institutions in the working out of corporate governance in Australia. As someone who favoured private ordering he opposed it. My argument is not that but the necessity for greater coherence.

85 For an interesting explanation of how the Royal Commission came about see Andrew Main, *Other People's Money* (2003), 262-3.

APPENDIX 1

JUSTICE SANTOW'S PRINCIPLES

1. Disqualification orders are designed to protect the public from the harmful use of the corporate structure or from use that is contrary to proper commercial standards.
2. The banning order is designed to protect the public by seeking to safeguard the public interest in the transparency and accountability of companies and in the suitability of directors to hold office.
3. Protection of the public also envisages protection of individuals that deal with companies, including consumers, creditors, shareholders and investors.
4. The banning order is protective against present and future misuse of the corporate structure.
5. The order has a motive of personal deterrence, though it is not punitive.
6. The objects of general deterrence are also sought to be achieved.
7. In assessing the fitness of an individual to manage a company, it is necessary that they have an understanding of the proper role of the company director and the duty of due diligence that is owed to the company.
8. Longer periods of disqualification are reserved for cases where contraventions have been a serious nature such as those involving dishonesty.
9. In assessing an appropriate length of prohibition, consideration has been given to the degree of seriousness of the contraventions, the propensity that the defendant may engage in similar conduct in the future and the likely harm that may be caused to the public.
10. It is necessary to balance the personal hardship to the defendant against the public interest and the need for protection of the public from any repeat of the conduct.
11. A mitigating factor in considering a period of disqualification is the likelihood of the defendant reforming.
12. The eight criteria to govern the exercise of the court's powers of disqualification set out in *Commissioner for Corporate Affairs (WA) v Ekamper* (1987) 12 ACLR 519 have been influential.
13. Factors which led to the imposition of the longest periods of disqualification (that is disqualification of 25 years or more) were:
    - large financial losses;
    - high propensity that defendants may engage in similar activities or conduct;

- activities undertaken in fields in which there was potential to do great financial damage such as in management and financial consultancy;
- lack of contrition or remorse;
- disregard for law and compliance with corporate regulations;
- dishonesty and intent to defraud;
- previous convictions and contraventions for similar activities.

It was held that in making such an order it is necessary to assess:

- character of the offenders;
- nature of the breaches;
- structure of the companies and the nature of their business;
- interests of shareholders, creditors and employees;
- risks to others from the continuation of offenders as company directors;
- honesty and competence of offenders;
- hardship to offenders and their personal and commercial interests; and
- offenders' appreciation that future breaches could result in future proceedings.

14. In cases in which the period of disqualification ranged from 7-12 years, the factors evident and which lead to the conclusion that these cases were serious though not "worst cases", included:

- serious incompetence and irresponsibility;
- substantial loss;
- defendants had engaged in deliberate courses of conduct to enrich themselves at others' expense, but with lesser degrees of dishonesty;
- continued, knowing and willful contraventions of the law and disregard for legal obligations;
- lack of contrition or acceptance of responsibility, but as against that, the prospect that the individual may reform.

15. The factors leading to the shortest disqualifications, that is disqualifications for up to 3 years were:

- although the defendants had personally gained from the conduct, they had endeavoured to repay or partially repay the amounts misappropriated;
- the defendants had no immediate or discernible future intention to hold a position as manager of a company;
- in *ASC v Donovan* (1998) 28 ACSR 583 the respondent had expressed remorse and contrition, acted on advice of professionals and had not contested the proceedings.

16. That the object of the disqualification power is the protection of the public, with its corollary of personal deterrence, does not mean that its aim should be punitive although personal deterrence is relevant.

17. The discretion of the court is directed to the nature of the relevant person's conduct in relation to the management, business or property of any corporation. It is also directed more broadly, to any other matters that the court considers appropriate, once the court is satisfied that the disqualification is justified.

18. Lack of contrition has a direct bearing upon disqualification, it favours disqualification and moreover a lengthy period of it. It should not be ignored where a potential for criminal prosecution remains.

19. The public protective purpose must clearly be paramount. That precludes a simple balancing exercise. While a disqualification order should not be disproportionate to the public purpose it is intended to serve, for that indeed would be punitive, it would subvert that public purpose if private interest considerations were to prevail or preclude an order or preclude an order which went further than necessary to serve that public purpose. A lesser period of disqualification than that, designed to serve a private interest consideration, would thus sacrifice the public interest to be protected.

20. There is an absence of any express provision in Section 1317H of the Corporations Act 2001 providing for apportionment of compensation between defendants. Accordingly, the conventional approach as applied to multiple tortfeasors is appropriate and the plaintiff is entitled to recover the whole of the amount of loss against any one defendant but may, of course, only recover in total the full amount of that loss. The court can, however, conclude in relation to a particular defendant that in the circumstances no compensation order should be made.

21. It is well established that the principal purpose of a pecuniary penalty is to act as a personal deterrent to the general public against a repetition of like conduct.

22. As with banning orders there is no simple mechanical process for quantifying the appropriate penalty but guidance can be obtained from the following:

    a) The pecuniary penalty has a punitive character, but it is principally a personal and general deterrent to prevent the corporate structure from being used in a manner contrary to commercial standards. The penalty should be no greater than is necessary to achieve this object.

    b) To determine whether compensation is to be paid and in what amount it is necessary to consider the prospect of the respondent paying such compensation and the hardship to the defendant from such payment. Compensation has been ordered for an amount less than that lost even though there was little prospect of any of it being recovered.

c) The capacity of the defendant to pay is a relevant consideration in determining a pecuniary penalty.

d) In addressing a pecuniary penalty it is important to consider the consequences of an associated disqualification order for the defendant. If the making of such an order has significant consequences, they may operate as a factor in favour of a lesser penalty. Where the disqualification order does not have significant consequences for the defendant, the prohibition order is likely to be only marginally relevant.

e) It is important to assess whether the order will prejudice the rehabilitation of the defendant.

f) The size of the penalty is a question of discretion. The circumstances of one case should not dictate the size of the penalty on another case.

g) Factors leading to the order of a penalty in the range of $20,000-$40,000 included:

- defendant was aware of impropriety of actions;
- no intention to deprive company permanently of funds;
- amount in question not large;
- no deliberate falsification of accounts;
- cases classed as being serious misconduct, but not worst cases.

h) Relevant factors leading to the court to order the lower range penalties in the range of $4000-$5000 included:

- remorse and contrition shown;
- efforts to repay misappropriated funds;
- acted upon the advice of professionals;
- did not contest the proceedings, or sought to save costs in proceedings;
- tended to not involve dishonesty, but negligence or carelessness;
- previous unblemished character;
- further contraventions unlikely.

APPENDIX 2

CONSOLIDATED TERMS OF REFERENCE

[Prepared by the Royal Commission incorporating amendments made on 6 February 2002,2 May 2002 and 23 January 2003 to the Terms of Reference dated 29 August 2001]

ELIZABETH THE SECOND, by the Grace of God Queen of Australia and Her other Realms and Territories, Head of the Commonwealth:

TO the Honorable Justice Neville John Owen

WHEREAS it is desired to have an inquiry into certain matters relating to the failure of HIH Insurance Group ('HIH'):

BY these Letters Patent issued in Our name by Our Governor-General of the Commonwealth of Australia on the advice of the Federal Executive Council and pursuant to the Constitution of the Commonwealth of Australia and the Royal Commissions Act 1902 and other enabling powers, We appoint you to be a Commissioner to inquire into the reasons for and the circumstances surrounding the failure of HIH prior to the appointment of the provisional liquidators on 15 March 2001.

IN particular, We direct that you inquire into:

(a) whether, and f so the extent to which, decisions or actions of HIH, or of any of its directors, officers, employees, auditors, actuaries, advisers, agents, or of any other person:
   (i) contributed to the failure of HIH; or
   (ii) involved or contributed to undesirable corporate governance practices, including any failure to make desirable disclosures regarding the financial position of HIH;
(b) whether those decisions or actions might have constituted a breach of any law of the Commonwealth, a State or a Territory and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency;
(c) the appropriateness of the manner in which powers were exercised and responsibilities and obligations were discharged under Commonwealth laws;
(d) the appropriateness of the manner in which powers were exercised and responsibilities and obligations were discharged under State or Territory laws; and
(e) the adequacy and appropriateness of arrangements for the regulation and prudential supervision of general insurance at Commonwealth, State and Territory levels, taking into account your findings in relation to the matters

referred to in the preceding paragraphs and other relevant matters, including:
(i) Commonwealth arrangements before and after the Financial System Inquiry reforms; and
(ii) different State and Territory statutory insurance and tax regimes.

AND We declare that, in these Letters Patent:

'HIH Insurance Group' means HIH Insurance Ltd and related bodies corporate and related entities, within the meaning of the *Corporations Act 2001*;

A reference to a director, officer, employee, auditor, actuary, adviser or agent includes a reference to a former director, officer, employee, auditor, actuary, adviser or agent;

A reference to a decision or action includes a failure to make a decision or take an action;

A reference to the exercise of a power includes a failure to exercise a power;

A reference to the discharge of a responsibility or obligation includes a failure to discharge a responsibility or obligation;

A reference to related bodies corporate and related entities includes such bodies irrespective of whether they were so related at the time of the matters being inquired into.

AND, noting that the Australian Securities and Investments Commission (ASIC) is also investigating certain matters relating to the failure of HIH, and without limiting in any way the scope of your inquiry, We declare that you should, to the extent practicable, co-operate with ASIC and conduct your inquiry with a view to avoiding:

(a) any duplication of ASIC's investigation; and
(b) any adverse impact on any civil or criminal proceeding arising out of ASIC's investigation.

AND you may choose not to inquire into certain matters otherwise within the scope of these Letters Patent, but any such decision must be yours alone.

AND We declare that you are authorised to conduct your inquiry under these Letters Patent in combination with any inquiry into matters referred to in these Letters Patent that you are directed or authorised to make by any Commission issued, or pursuant to any order or appointment made, by any of the Governors of the States.

AND We declare that the Commission established by these Letters Patent:

(a) is a relevant Commission for the purposes of sections 4 and 5 of the *Royal Commissions Act 1902*; and
(b) is a Commission to which paragraph 16 (4) (k) of the *Income Tax Assessment Act 1936* applies.

AND We require you to begin your inquiry as soon as practicable, to conduct your inquiry as expeditiously as possible and, not later than 4 April 2003, to furnish to Our Governor-General of the Commonwealth of Australia the report of the results of your inquiry and such recommendations as you consider appropriate.

WITNESS the Right Reverend Dr Peter John Hollingworth, Companion of the Order of Australia, Officer of the Most Excellent Order of the British Empire, Governor-General of the Commonwealth of Australia.

APPENDIX 3

PROTOCOL FOR CO-OPERATION BETWEEN THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION (ASIC) AND THE HIH ROYAL COMMISSION (COMMISSION)

Introduction

Commission

1. By Letters Patent dated 29 August 2001, the Commission was established to inquire into the reasons for and the circumstances surrounding the failure of HIH, in particular:

   (a) the conduct of HIH, its directors, officers, employees, auditors, advisors or agents which may have contributed to that failure or which involved undesirable corporate governance practices;
   (b) whether that conduct may have constituted a breach of any Commonwealth, State or Territory law;
   (c) the appropriateness of the manner in which powers were exercised and responsibilities discharged under Commonwealth, State or Territory laws, and
   (d) the adequacy and appropriateness of arrangements for the regulation and prudential supervision of general insurance at Commonwealth, State and Territory levels.

2. The Letters Patent note that ASIC is also investigating certain matters relating to the failure of HIH and declare that, without limiting the scope of the inquiry, the Commission should, to the extent practicable, co-operate with ASIC and conduct its inquiry with a view to avoiding:

   (a) any duplication of ASIC's investigation, and
   (b) any adverse impact on any civil or criminal proceedings arising out of ASIC's investigation.

3. The Commission is authorized, at its discretion, not to inquire into certain matters otherwise within the scope of the Letters Patent.

4. The Commission is required to report on its inquiry not later than 30 June 2002.

5. The initial focus of the Commission's inquiry is directed to the reasons for and circumstances surrounding the failure of HIH.

6. The Commission's inquiry, including by exercise of its statutory powers under the Royal Commissions Act 1902, will provide the Commission with documents and information which could be relevant to ASIC's continuing investigation into possible contraventions of law in connection with the affairs of HIH.

7. Pursuant to section 6P of the Royal Commissions Act 1902, the Commission is empowered, if in its opinion it is appropriate to do so, to communicate to ASIC information that relates or may relate to a contravention of a law or evidence of a contravention of a law for the administration or enforcement of which ASIC is responsible.

ASIC

8. In February 2001, ASIC commenced investigations into the affairs of HIH and certain conduct of its directors, officers, employees, auditors, advisors or agents. The primary focus of ASIC's investigations is to identify and prosecute, by civil or criminal proceedings, contraventions of any Commonwealth, State or Territory law for which ASIC is responsible. ASIC is mindful of the need for its investigations and any actions arising therefrom to be carried out in a timely manner.

9. ASIC's investigations, including by exercise of its statutory powers under Division 2 and Division 3 of Part 3 of the Australian Securities and Investments Commission Act (the ASIC Act), will provide ASIC with documents and information which could be relevant to the Commission's inquiry.

10. Pursuant to section 127 (28) of the ASIC Act, ASIC is authorised to disclose information to a Royal Commission.

Considerations

11. Although ASIC's investigation and the Commission's inquiry are separate independent inquiries with different objectives, ASIC and the Commission recognize the inevitability of some overlap between ASIC's investigation and the Commission's inquiry , and a degree of correspondence between their respective objectives, and are mindful of the need for responsible stewardship of the public resources made available to them.

12. ASIC and the Commission have agreed on the need for a Protocol on co-operation and exchange of information between them in order to assist in the efficient and effective conduct of both the Commission's inquiry and ASIC's continuing investigations and proceedings and to avoid as far as possible:

(a) any duplication of the Commission's inquiry and ASIC's investigations, and
(b) any adverse impact on any civil or criminal proceeding arising out of ASIC's investigations.

13. ASIC and the Commission recognize that it is in the interest of each of them to develop and implement the Protocol in a spirit of good will and mutual co-operation.

Agreed approach

14. ASIC and the Commission agree that, to the extent permitted by law:-

(a) ASIC will provide the Commission with information obtained during the course of its investigations which, in ASIC's view, will assist the Commission to inquire into the matters falling within the scope of the Commission's terms of reference, save that nothing in this Protocol (including, without limitation, Clause 15) imposes any obligation upon ASIC to provide information if ASIC takes the view that:-
(i) disclosure of the information would impact adversely upon ASIC's investigations or on any proceedings arising out of such investigators; or
(ii) the information is subject to a valid claim of legal professional privilege or would, if sought by the Commission by way of summons issued to ASIC, be the subject of a valid claim for public interest immunity; or
(iii) the information has been obtained or derived from documents obtained by ASIC under warrants issued pursuant to the Crimes Act 1914; or
(iv) the information is information that has not been obtained or derived from documents or other material in the possession of both ASIC and the Commission.

(b) The Commission will provide to ASIC any information or evidence which it obtains in the course of its inquiry that relates or may relate to a contravention of a law or evidence of a contravention of a law the administration or enforcement of which ASIC is responsible, if the Commission forms the opinion that it is appropriate so to do, save that if the contravention, if established, would give rise to criminal proceedings, the Commission will consult with ASIC as to whether to communicate the information or furnish the evidence to ASIC or, as the case may be, to the Director of Public Prosecutions.

The information provided by ASIC and the Commission will be provided in writing.

15. Pursuant to Clause 14 and to facilitate the performance of the functions of each of ASIC and the Commission and having regard to the considerations referred to in the Introduction to this Protocol ASIC will, to the extent permitted by law:-
    (a) as soon as practicable after the date of this Protocol inform the Commission of the nature and scope of its investigations up to that date; and
    (b) from time to time inform the Commission of the nature and scope of ASIC's continuing investigations.

ASIC will provide this information to the Commission in writing.

16. Nothing in this Protocol shall prevent representatives of ASIC and the Commission from meeting to discuss the information, which has been provided in writing.

17. The Commission will keep any information supplied by ASIC pursuant to Clauses 14 and 15 confidential to itself, its staff and consultants and will use the information only in the furtherance of its functions.

18. To facilitate the performance of the functions of each of ASIC and the Commission and having regard to the terms of this protocol, the Commission will:-
    (a) provide ASIC with copies of any summons or notice to produce which the Commission has issued or issues in the future to third parties in connection with its inquiry, save that this Protocol will not oblige the Commission to provide ASIC with a copy of any summons relating to a hearing which is to be conducted by the Commission in private;

    (b) inform ASIC of the persons whom the Commission wishes to give evidence before the Commission and the rubric of the evidence-ir1-chief which the Commission desires to lead from such persons; and

    (c) otherwise inform ASIC from time to time of any matters which in the Commission's view will assist ASIC to conduct the investigations described in Clause 8 unless:
        (i) the disclosure is not permitted by law; or
        (ii) the Commission takes the view that the disclosure would impact adversely upon the Commission's inquiry.

19. T o further facilitate the performance of the functions of each of ASIC and the Commission and having regard to the terms of this Protocol:-
    (a) ASIC has produced to the Commission, in answer to summonses addressed to ASIC, documents obtained by ASIC in the course of its investigations to date. ASIC will provide reasonable assistance, to the

extent practicable having regard to the availability of ASIC's resources, to the Commission to identify the documents which in ASIC's view are relevant to the Commission's terms of reference;

(b) ASIC will inform the Commission of any further notices it issues under Division 2 or Division 3 of Part 3 of the ASIC Act.

20. Prior to the issue of any further summons or notice to produce to ASIC, the Commission will provide ASIC with notice of the terms of such proposed summons or notice and will consult with ASIC in good faith with a view to ensuring that any such summons or notice is issued in terms which will best facilitate the performance of the functions of each of ASIC and the Commission.

21. If ASIC forms the view that a document or information sought by the Commission in a summons or notice to produce which the Commission has issued or proposes to issue:-

(a) would, if disclosed, impact adversely upon ASIC's investigations or any proceedings arising out of such investigations; or

(b) is or could be the subject of a valid claim for legal professional privilege or public interest immunity; or

(c) would, if provided to the Commission result in the disclosure of documents or information obtained or derived by ASIC from documents obtained by ASIC under warrants issued pursuant to the *Crimes Act 1914*;

ASIC will promptly advise the Commission of that view and, in so far as is possible without disclosing the information or document in question, the grounds for the formation of that view, following which the Commission and ASIC will consult in good faith with a view to dealing with the documents or information in a way best suited to facilitating the performance of the functions of each of ASIC and the Commission. In the course of such negotiations each party will give all due and appropriate weight to opinions expressed by the other.

22. If the consultations referred to in the preceding paragraph do not result in agreement between ASIC and the Commission either party is at liberty to state publicly its position with respect to the issue.

23. The Secretary to the Commission and the Deputy Chair of ASIC will, as circumstances require, meet to discuss the implementation and operation of this Protocol and will, where appropriate, consult in good faith with respect to any desirable amendment to its terms. ASIC and the Commission will

establish primary points of contact for day to day communication in accordance with this Protocol.

24. Each of ASIC and the Commission will publish this Protocol on their respective websites and will give such further publicity to its terms as may be agreed.

Signed	Signed
for ASIC	for the Commission
.....	.....
Dated:	Dated:

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APPENDIX 4

STATEMENT ON APPOINTMENT OF JUDGES TO OTHER OFFICES BY THE EXECUTIVE

The Council of Chief Justices (of Australia and New Zealand) has adopted the following principles concerning the independence of the judiciary and the integrity of the Courts:

(a) The holder of a judicial office should not, during the term of that office, be appointed by an Executive Government to any other office, including that of a Royal Commissioner, while remaining the holder of his or her judicial office without the prior consent of the judicial head of the relevant court. In the event an Executive Government wishes to appoint the holder of a judicial office to any such other office and requests the head of jurisdiction to make a nomination, any nomination should be made by the head of jurisdiction with the prior consent of the nominee.

(b) In the event that the holder of a judicial office, during the term of that office, is requested by the Executive Government to make himself or herself available for or to accept appointment to any other office, including that of a Royal Commissioner, while remaining the holder of his or her judicial office, the holder should inform the maker of the request that the proper procedure is for the Prime Minister, Premier or Chief Minister (as the case may be) or for the Attorney-General to approach the judicial head, inform the judicial head of the request, and in any event, consult and obtain the consent of the judicial head before acting on such request.

(c) Prior to giving consent to any such appointment the judicial head should consult other members of the court and have regard to the duties of the relevant office or the terms of reference of the relevant Commission, particulars of which should be made available by the Executive Government to the judicial head for that purpose.

(d) These principles apply equally to reappointment as they do to an appointment.

July 1998