TRANS-TASMAN REGULATION OF FINANCIAL INVOLVEMENT OF DIRECTORS - The Aftermath of the Corporate Collapse

QUESTIONS AND ANSWERS

Question - Gregory Burton (Barrister-at-Law, Sydney):

If I could ask a question of Mr McKenzie. In clause 136 of the Companies Bill there is the interesting concept of an unreasonable opinion, and I am just wondering if there has any work been done? There seem to be two onuses of proof - one, you have to prove that there are no reasonable grounds and then the onus shifts to the director to show that it was fair. Has any work been done on the difference between what is reasonable and what is fair in that situation? Also, I was wondering if any work - and this is more a general questions - has been done on the application of directors' loans to guarantees or securities given by a subsidiary of a parent's liability, whether that is intended to come within the loans and securities to directors provision because of the enlarged definition of directors? There seems to be an absence of discussion in the text on that and yet a lot of people seem to think that what used to be called the old s230(8) certificate needs to be given in that situation to protect people. I was just wondering if any work has been done on that?

Response - Peter McKenzie (Speaker):

If I could respond to that. The clause that you have referred to is still a clause in a Bill which is before the Select Committee of our Parliament and it has been the subject of course of a good deal of submission and a good deal of debate as well. Certainly the words that you have drawn attention to - "reasonable" and "fair" - have been the subject of some analysis in those submissions. One could draw some conclusions of a tentative kind as to whether they are intended to provide the courts with some objective as well as subjective approach to the situation. Whether the Bill in its final form will retain that wording of course is very much an open question and I do not suppose I could really take the matter much further at this stage. There has been some feeling I think that we need to spell out in rather more detail than the Bill does the sorts of criteria the courts will have to take into account. But the moment you do that you start to close off certain areas and the approach the Law Commission has taken is one where it wants to I think open the door as widely as possible rather than see exceptions created. The second point you raised on loans to subsidiaries, clearly that is an area that will need to be addressed by the clause. You are quite right that as the clause stands at present I think it is a significant area that is arguably not included, unless of course the definition of director brings it in. The importance of some regulation in that area means I think that we have got to look more closely at this.

Comment - Stephen Franks (Chapman Tripp, Wellington):

I am a little puzzled about exactly what is being advanced by Mr Justice Thomas as I have never found it any more difficult to understand the conflict of interest between a nominee director and the conflict of interest that any director faces in juggling the interests of the company and his own interests. That conflict is inherent in any kind of stewardship position, it is obvious, it is very obvious in a nominee appointment position, and it does not seem to me that it is hypocritical to try and resolve an inevitable conflict in a company by imposing on a director an overriding duty to protect the interests of the company irrespective of self-interest or interests of your appointor. It would seem to me that the interests of an appointor are in fact less likely to override your duty than self-interest does. And that is something that company law has grappled with for 150 years. I think it is very relevant that we explore this. The loans to subsidiaries question is related. It seems, if I took the suggestions correctly, that we should recognise there is no real boundary or say there is no real boundary between the interests of the appointing shareholder and the subsidiary or the company on which the nominee sits. Presumably that would mean we would allow transactions to occur which were not, or recognise that they could be validly authorised not in the interests of the subsidiary or associated company. And it seems that we would be very unlikely, whether or not the legislation provided for it, to survive long without having a kind of US deep rock principle, where on any winding up the group would be wound up as a whole, where the status of creditors of each company would be determined by looking not to the assets that they thought they had lent against, but the whole group. Now that may be the way out of an impasse, but it seems to me that that is a very long shot or a very big consequence which we should not lightly invite by relaxing the constraints on nominee or any other directors.

Response - Mr Justice Thomas (Commentator):

I do not think there is really any great value in perpetuating a law which we readily understand simply because it is understandable. The speaker no doubt understands the present law better than I. He no doubt went to university much more recently than I did. But when the chips are down the law relating to the directors' obligations is irreconcilable with the position of a nominee director and it has been for many years. The danger is that, as in Australia and in New Zealand, when the courts come to deal with claims involving nominee directors they will relax the standard for directors generally. And so the relaxation of the duty which the speaker does not want will come about simply because the court has to try and cope with the position of nominee directors in the context of the traditional law. And my thesis is quite simple, as the Law Commission has recognised, nominee directors are in fact irreconcilable with the traditional concept of the corporate entity and the responsibilities of directors. I tend to think that it would be better to take the opportunity that we have recently had, in restructuring our company law, to reconsider the whole position. A far more preferable solution I think could emerge, if we were to sit nominee directors outside the traditional category and direct and remould the law as appropriate to their actual position. It is I think iniquitous that we continue to have nominee directors, thousands of them, serving their companies and every day that they sit at a board table they are to some extent or another in breach of the recognised concepts of a director's responsibility or obligations. I disagree with the speaker. I think we can do better than moving forward on an incremental basis.

Question - Cam Johnston (Blake Dawson Waldron, Melbourne):

It is a constant complaint of companies in Australia that they cannot find sufficient directors of adequate competency to fulfil the role of directorships. Both Mr Farmer and Mr Horsfall Turner referred to this problem and I would be interested in Mr Hartnell's reaction to the situation we seem to be developing in Australia as the "black letter" law is imposing greater and greater obligations and responsibilities on directors. Are we going to end up scaring away anybody who is sufficiently competent to fulfil the role? And perhaps as a supplementary question, do you feel that it is a good idea to have either a balance or a majority of non-executive directors on a board?

Response - Tony Hartnell (Speaker):

I am concerned about the availability of non-executive directors. I have indeed today, but elsewhere as well, advocated that in some areas there has to be a reduction of the duty upon directors and particularly that in relation to potential insolvency situations where the company may be able to trade out of its difficulties. In relation to the trend to "black letter" law, I do not see it as a greater and greater liability. I see it as a greater particularisation of the liability so that directors are able to assess their position more clearly. And I do believe if you rely on general principles to the end of the day you have in a modern and complex corporate world a much more uncertain liability and therefore a much greater basis for taking the position that I frankly am horrified about, namely that no major law firm in London would ever consider having a partner on a board of a company. That is denying to the corporate world a very significant benefit that I think the economy needs. So, I accept the proposition that greater and greater liability will lead to less and less able people performing the task, but I reject the proposition that that is in fact the direction in which we are going. I think the direction we are going is in favour of people knowing their position much more clearly.

With Peter's throw away line about the position of being imputed into liability by being deemed to be a director, that is of course a much more difficult thing to come to grips with than the "black letter" approach of directors' liabilities generally. And in this environment, in this organisation, of course the position of banks exercising rights in relation to their lending or exposure to a group raises quite clearly the question of whether banks are directors and therefore if you are talking about the regulation of financial transactions between directors and companies it leads very clearly into that situation.

Comment - Peter McKenzie (Speaker):

If I could just contribute there, Tom. It does seem to me that there is a measure of agreement here that certainly we do not want to see the law develop in a direction which will discourage competent and able people from serving on boards of directors, with the consequences that Tony Hartnell has adverted to. So there is a balance to be struck there. Whether it is to go in the prescriptive direction and spell out in detail the obligations of directors is still I think for me a question. One would rather see develop from within that sector itself appropriate regulation and rules set out and provide for their own behaviour. We see that in other professional areas. I think we have groped in the area of company boards towards a development of a proper institute or body, within particularly the public sector, that can develop a framework and rules for the guidance of directors themselves. It seems to me that is where the detailed prescription may best come from and which the courts and the legislature can then follow. But I know, at this stage perhaps I am dreaming - we are not there yet - but one would like to encourage development in that area.

Question - John Cadell (Allen, Allen & Hemsley, Sydney):

Could I go back to the judge's comment which I applaud. One of the strategies considered in workouts in Australia in the last couple of years has been that of having the banks go to the directors and suggest that they appoint someone as a director. Very often that would be by way of filling up a board where there was still a vacancy or filling a casual vacancy. As I understood what the judge said, he was saying that if you have shareholders appointing a nominee director then the shareholders cannot escape liability for the director's actions. And if the shareholders are really bad, then they are probably being oppressive, and we all understand oppression. But what is the position of creditors if at the creditors' request a director is appointed to the board and he then as it were looks after the interests of the creditors? Are you saying anything more than that as we all note in a case - and I will say something about this later this afternoon - are you saying anything more than that those creditors might be deemed to be directors?

Response - Mr Justice Thomas (Commentator):

No. We are dealing here specifically, are we not, with a situation where the creditors have appointed a director to the board and not the situation where the directors might owe a general duty to creditors or a duty to creditors generally. I do not see any distinction in confronting the point immediately. The director is quite clearly to my mind a nominee director there for a specific interest. And I see no reason why that should not be recognised. I certainly foresee great difficulties in holding a body of creditors liable for oppressive or unfair conduct compared with a shareholder or a class of shareholders. I cannot really comment sensibly on that at the moment - it is a point I did not embrace in my thoughts or thinking when I prepared the comments.

Comment - Professor Robert Baxt (Trade Practices Commission, Canberra):

I am not sure whether I am making these comments in my private capacity or as Chairman, but as I am out of Australia and I am nearly ***functus officio***, I can say I make it in a private capacity. I would certainly commend the comments made by the judge on the question of the nominee directors. Mr Justice Rogers, the Chief Judge of the Commercial Division of the New South Wales Supreme Court recently threw his hands up in the air and said that we really do need to examine this whole question of a group of companies and the way in which directors' interests operate. He was not adverting to that so much, but I think these words were underlying it in relation to that. I think the time has come for that issue to be looked at. I wanted to mention a case to those of you who are interested in this tension between the development of "black letter" law as against the more traditional approach in dealing with directors' duties in which two members of the court tended to slip into the habit which I think we have been alerted to by the speakers in relation to the clawing back, as it were, clawing away from the reading of the duties strictly, to a more general approach, whilst one judge said that the statute says what it says and the directors are going to have to comply with this strictly, even though that might result in what might appear to be, on the surface, an unnecessary bit of regulation. In ***Woolworths Limited v Kelly*** in the Court of Appeal of New South Wales very recently Mr Justice Kirby, who has been a bit of a champion for the development of stricter rules relating to directors, said that when you have a statutory provision you have got to comply with it strictly, whereas both Mr Justice Samuels and Mr Justice Mahoney tended to look to the rules of equity to say, OK, the statute says that, but really we do not need a strict formal compliance with that because the rules are being complied with in any event. You need to sort of think that through in terms of what that might do in the context of what parliament had intended. I just want

to make one comment - I have made this in relation to Tony Hartnell's approach which I generally applaud in relation to the way in which we need to enforce the law - it relates to the question that we do have in place already a very detailed set of laws in Australia in corporate regulation. I would like to see those laws enforced and tested before we proliferate our statute books with additional laws which will again have to be tested. It seems to me, and I speak here from my position as Chairman of the Trade Practices Commission, that when you have a statute, you have a set of laws, test those laws, see whether they work. If they do not work, then perhaps you need some change in the laws. I just wonder whether we need to proliferate and expand the laws before we have tested all the laws we have already in place.

Comment - Tom Bostock (Chairman):

I think your heart is in the right place Bob!

Question - Rowan Russell (Mallesons Stephen Jaques, Melbourne):

I would like to ask Tony Hartnell, harking back to Cam Johnston's question and concern of scaring away competent business people from the opportunity of acting as non-executive directors, how Mr Hartnell sees that he could achieve the end of encouraging people to take up these positions and his thesis of imposing upon directors an obligation to exercise good commercial judgment - presumably so that liability would attach to a director even though he has acted honestly, even though he has considered all the proper questions, even though he has considered the interests of the company as a whole under all the existing tests - can still be civilly liable and perhaps prosecuted if it is shown in retrospect that that director has made a bad deal or exercised bad commercial judgment? I would have thought, I think as Mr Farmer has said, this type of intrusion by a regulator, the second guessing by regulators and the courts of commercial judgment is something which will inevitably increase the awareness of directors as to the risks and scare away people who can give very good business and sound decision making processes to companies both in Australia and New Zealand, or for that matter anywhere else in the world. I would like perhaps to ask Mr Hartnell to comment as to how he would see this additional test being introduced in a way that would not upset the other objectives.

Response - Tony Hartnell (Speaker):

The comments I was making this morning were directed towards the clear judicial trend not to inquire at all, or not necessarily to inquire deeply, into the considerations of a commercial nature that surrounded a particular transaction. And the formulation of the legal rule that would require greater inquiry may well be, and I have to say I do not have a specific proposal to put before you, may well already be encompassed within the law, although if it is, it is at least in Australian jurisdictions, hidden. The question I guess or the substance of the proposition goes to just how far must a director cause the company to go to study a particular proposition before the director is enabled to take a decision which that director may well have been able to take off the top of his or her head in the first place? Is there some objective standard of study required? It may well be that the law provides at the present time that there is; but we are I guess in the process of adopting the approach of Professor Bob Baxt, and we have a number of transactions which we are currently testing - $100m and more, in fact one of them was a $450m transaction which was entered into without any apparent objective study of the transaction and we will see, I guess, whether there is a need to change the law in that regard.

Comment - Roger Drummond (Bell Gully Buddle Weir, Wellington):

Tom, on behalf of the audience I would like to thank you for chairing this morning's session, which is never an easy task on the first morning of a conference, and also for the contribution which you have made. This morning is an historic occasion in two senses under the theme of CER. Firstly for the Queenslanders who are feeling a little wan this morning after last night's last minute victory - it is the first time that Queensland have been coached by a New Zealander. The second and more important historic event is that this morning is the first time that Tony Hartnell and Peter McKenzie have been on the same panel and the Association is particularly pleased and proud to have achieved that state of affairs, particularly in the CER context and the harmonisation of business laws. I would also like to thank in particular Mr Justice Thomas for making his time available this morning and also to Jim Farmer and Jonathan Horsfall Turner for the contribution which they have made. I would ask you all please to show your appreciation in the normal fashion.