SUPREME COURT OF NEW SOUTH WALES

ANNUAL CORPORATE LAW CONFERENCE

Directors' Duties, Corporate Culture and Corporate Governance

2018 Conference

Tuesday, 20 November 2018 at 1.30pm

Banco Court, Supreme Court of New South Wales, Level 13, Queen's Square, Sydney
DR AUSTIN: Ladies and gentlemen, I am Bob Austin and it is my function to call this meeting to order and then get out of the way. Welcome everyone to this the 13th in the series of Supreme Court conferences which started in 2006 and we have our best attendance ever so far, so we appreciate the support. It is my privilege to call upon the Chief Justice to be welcomed to the conference and then we will move immediately to the first session which will be a paper by Professor Harris. Chief Justice, thank you.

THE HON CHIEF JUSTICE TF BATHURST: Thank you and good afternoon. There has probably never been a more exciting time to be a corporate lawyer. That might be because there never before has been an exciting time to be one, but I think the times have changed. If a commercial barrister has a standing hashtag on Twitter, by which I am of course referring to #docotor, there must be something going on.

Now, in these exciting times this conference is a welcome opportunity I think though to sit back and reflect more deeply, absent the media hype, on the issues surrounding directors’ duties, corporate culture and corporate governance.

On that note, it is my great pleasure to welcome you to the 2018 Supreme Court Annual Corporate and Commercial Law Conference. I would like to begin by acknowledging the traditional owners of the land on which we meet, the Gadigal people of the Eora Nation and pay my respects to their elders past, present and emerging and my respects to all other indigenous people who may be here today.

I will keep my remarks very brief so as not to encroach on the program which I know we are all looking forward to. Thanks as always are due to the Law Society of New South Wales, the Ross Parson Centre for Commercial, Corporate and Taxation Law at the University of Sydney and the Law Society for their generous sponsorship of this event and they are actually coordinating and ensuring the seamless running of the conference.

I have also, of course, to acknowledge Bob Austin for his tireless efforts over the years in putting this conference together and his never ending patience in dealing with me. He has once again arranged a topical and thought provoking program. It brings together practitioners, academics and the judiciary to discuss their
different perspectives on the difficult legal and social issues presently at the forefront of the commercial world.

Thanks also must go to Professor Barbara McDonald of the Ross Parson Centre who has been involved in organisation this year and also the President of the Law Society, Doug Humphreys.

These are exciting times but they are also quite turbulent. In fact, "exciting" is probably just a politician's positive spin on turbulence. The revelations from the Hayne Commission have caused I think significant soul-searching, particularly in the financial services industry, and a re-evaluation of the legal framework around corporate governance.

I think two major themes have emerged. The first relates to whether the traditional view that directors' duties are owed to the company come with a consideration of the primacy of shareholders still holds water or perhaps is going to continue to hold water. Put another way, it can be asked whether the so-called social licence to operate extends to taking action which on its face may be seen to be contrary to the financial interests of shareholders.

Social licence to operate, as most of you know, isn't new. It used to be called corporate social responsibility before it was forgotten for about I think 15 years or thereabouts, coinciding with the 2007 financial crisis.

Second is the question of how we regulate. Is it a principles based approach, such as it seems to be favoured by Commissioner Hayne in his Interim Report, or should it be what could be described as prescriptive or more pejoratively, in the words of its distractors, tick-a-box regulation.

For what it is worth, which is probably not much, I don't think either extreme is appropriate. The broad principles based approach may give rise to too much uncertainty whilst prescriptive regulation can lead at best to mechanical compliance without thought as to the underlying outcomes that are sought and at worst, a strategic compliance designed to avoid the intended outcomes of a regulatory regime.

Many of us, looking back, may have from time to time
advised on what is euphemistically called
"strategic compliance", but this year we are privileged to
have four distinguished speakers to consider these topical
issues bringing their particular perspectives to the table.

Our first speaker is Associate Professor Jason Harris.
Congratulations are in order as he will from 2019 be taking
a position as Professor of Corporate Law at the University
of Sydney, a very well deserved appointment. He will also
as a result have to have much more to do with this
conference than previously.

Professor Harris will be discussing shareholder
primacy in these changing times, examining the ongoing
debate as to what exactly the best interests of the
corporation are. He will also touch on the question of
stakeholder interests and the desirability of legislative
recognition of these interests, such as, of course,
section 172 of the United Kingdom's Companies Act.

As you would all know, this was answered in the
negative by the Corporate and Markets Advisory Committee in
2006, was reconsidered again by the Governance Institute in
2014 and probably will be rehashed yet again in the
aftermath of the Hayne Commission. This paper and session
certainly adds a measured and considered perspective to the
bourgeoning debate.

You will then hear from Professor Dimity Kingsford
Smith from the University of New South Wales who will be
considering the question of whether directors' duties are
public duties. That was the question that Edelman J
considered in some detail in ASIC v Cassimatis, the
Storm Financial case. This paper, however, takes the
question one step further and asks what it actually means
practically to say that directors' duties have a public
quality. This is certainly the question that has vexed me
both in considering Cassimatis and the academic debate over
the years.

Following afternoon tea we move from the academics to
the practitioners, hearing from Shannon Finch who most of
you know is a partner at King & Wood Mallesons and a chair
of the Law Council's Corporations Committee. Her topic is
regulators and the ASX and her paper considers the
regulation of corporate culture. These issues have - I am
perhaps exaggerating a bit - blown up recently in the

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reactions to the proposed changes to Principle 3 of the
ASX Corporate Government Principles and Recommendations
from its current form which requires that a listed entity
act ethically and responsibly to requiring that a board -
and I quote - "have regard to the views and interests of
stakeholders, including employees, customers, suppliers,
regulators and the local community." It may be put in
fairly short form, have regard to everyone but I shouldn't
express views.

Among other submissions critical of the proposed
change, the business law section of the Law Council has
firmly stated its opposition. It submitted that the
efforts of the board must ultimately be directed towards
the financial wellbeing of the shareholders as a general
body, that being the fundamental raison d'être of all
listed entities. You can see how it relates back to
Associate Professor Harris's paper and as I think that
points out, the competing views are underlain by
fundamental differences as to the purposes of corporations,
whether they are in fact simply devices used by law to
support the proper exploitation of private property, or
whether they are public entities that not only exist for
the financial wellbeing of shareholders but also for the
benefit of society. It may be that the two positions can
never be reconciled and we simply end up with laws that
seek to find a balance between both those views.

These conceptions of a corporation I think are often
influenced directly or indirectly by public opinion,
resulting in swings back and forth in regulation reflecting
the two underlying ideologies. As I said, you only have to
look at 2007 when everyone thought that the most important
thing to do was to protect the banks, to the reaction to
the banks these days. It shows how public opinion can
really affect these issues.

A more immediate question is whether a body like the
ASX Corporate Governance Council is the appropriate body to
be setting these sorts of legal norms or whether this is
something which should be left to parliament. Of necessity
I have to take a neutral position but let me say this, that
those supporting the view that it be left to parliament
would generally support the proposition that directors
should be free to act in what they perceive to be in the
best interests of the corporation, subject to such duties
imposed by parliament or by the general law.
The alternative view is that bodies such as the ASX council, which is made up of listed entity representatives as well as shareholder and industry groups, is well placed to set legal norms apart from whatever parliament deems appropriate. Whichever view a person holds is probably underpinned to a large extent on whether they support simply broad principle based regulation or whether it is preferable at the present time to expand on these principles by the imposition of guidelines such as those amendments proposed by the ASX council or, for example, by those found in the Banking Code of Conduct.

In addition to these issues, Shannon's paper addresses the views expressed in the Interim Report of the Royal Commission about the appropriate role for ASIC and particularly that in all cases ASIC's first question should be "Why not litigate?" It is interesting to reflect I think that in virtually every other sphere of litigation the approach of governments and the courts has been to encourage parties to settle and come to an agreement wherever possible. It is unsurprising in those circumstances that aspects of that approach have infused the work of the corporate regulator.

In Commissioner Hayne's interim view, however, considering how misconduct can be resolved by agreement cannot be the starting point for a conduct regulator. However, Sharon's paper issues a word of caution as to whether this new approach to enforcement will actually discourage compliance. Once again, it may be we end up somewhere between an overly risk averse approach to enforcement and the extreme of litigating each and every case of non-compliance. I certainly hope that we do.

In this context it will be interesting to see whether the proposed deferred prosecution scheme for Australia will go ahead. The bill establishing that scheme has been before the Senate for some time now and it would appear that the preventative justice methodologies which underlie such agreements are somewhat at odds with ASIC's new stated approach to enforcement or should I say more accurately, the approach to enforcement it is suggested that ASIC should adopt.

We are very lucky today because we will have the expert opinion of Kevin McCann who will take us through the
implications arising from corporate governance from the Hayne Interim Report. It might be called a right of reply. A number of quite strong views to enforcement and changes to the law, or otherwise, have been expressed by the Commissioner and I certainly look forward to hearing Kevin's views on those and other issues.

The conference will conclude with a panel comprised of all of the speakers - and I have to disclose in advance my arm has been twisted to join that panel - chaired by Dr Bob Austin and it will be followed by post-conference drinks.

So without further ado, let me start the proceedings by introducing our speaker for the first session which I have the honour of chairing. As I have already mentioned, Jason has been appointed as a professor of corporate law at the University of Sydney from 2019. He is currently an associate professor at the University of Technology where he has taught in the areas of corporate law, securities law, secured transactions and corporate insolvency. He has been around, so to speak, previously teaching at the University of New South Wales and the ANU, acting as a visiting scholar in Canada and the UK and an adjunct professor in Delaware. Prior to this, he worked as a lawyer for the Australian Government Solicitor. Please join me in welcoming Professor Harris.

ASSOCIATE PROFESSOR HARRIS: Thank you very much, Chief Justice for that introduction. Thanks also to the conference organisers for asking me to come and speak with you today about a topic that really is a core controversy in our corporate law, the topic of shareholder primacy.

The title of my paper, which is in your materials, is "Shareholder Primacy in Changing Times", and that title points to the longstanding nature of the debate about the extent to which shareholder primacy should form part of our corporate law. But it also points to the question of whether our changing times - and we have already had reference to that in the Royal Commission - warrant further law reform, and these are themes that I develop in the paper - that is, the question is being asked about whether the conduct of seemingly many small and large companies in Australia has focused too much on generating profits for shareholders and has disregarded community concerns. But my paper is focused on the legal issues, particularly a director's duty to act in good faith in the best interests
of the company.

A particular focus of my paper is the legal status of the English Court of Appeal decision in Greenhalgh v Arderne Cinemas. This debate about shareholder primacy and what are the interests of the company goes to the heart of what a company is in our system of law and, therefore, how it should be regulated. The Chief Justice has already touched on some of those issues, and the next presenter will also discuss the public and private debate.

Really, this is posing the question of in whose interests should companies be managed and are companies anything more than simply the aggregation of their shareholders' economic interests? In my view, they are.

To cut to the conclusion in my paper, in my view, law reform is not needed to deal with these changing times, and that is because our current law, as I attempt to argue in the paper, is sufficiently flexible to allow directors to take into account a wide variety of interests, not just shareholder interests, and that is because the duty, of course, is owed to the company and not to the shareholders.

So what I have here are a number of attempts to define shareholder primacy. I am not going to read through the quotes, but there is a common theme there, and the theme is that shareholders should be viewed as the ultimate beneficiaries of management decision-making. This is based on the view, to use the language of shareholder primacy's proponents, because shareholders are the ultimate owners of the company. That is one view.

The first quote there from Professor Berle is that, of course, management powers are only to be exercised for the rateable benefit of all shareholders. That seems like a relatively straightforward statement, but it actually draws out a number of important legal, commercial and practical questions: are shareholder interests the only interests that need to be considered? If other interests are to be considered in addition to shareholders', how are they to be balanced? Must shareholder interests always take precedence? And what about community expectations; what happens if there is a potential conflict between community expectations and shareholder expectations? These are issues that I develop through the paper.
So, as I said at the start, the debate about shareholder primacy is a longstanding one in our company law and we can go back to the academic debate between Professor Adolf Berle and Professor Merrick Dodd, and this was back during the time of the Great Depression.

Now, this debate is actually still relevant for us today. The themes that they were discussing at that time in a series of articles published in the Harvard Law Review still resonate with us today and still connect to some of the issues that we are dealing with today.

Professor Berle, of course, is most famous for his seminal book "The Modern Corporation and Private Property", which he published in 1932 with economist Gardiner Means. In that book they looked at the capital structure of large publicly listed companies in the United States and they found what we know today, which is that a large number of companies have a lot of very small shareholders; they are dispersed shareholder bases.

Berle and Means were concerned about the challenge that this reality posed for keeping managers accountable: how could directors and their managers be accountable to a dispersed shareholder base? So he wrote in a series of articles during the Great Depression about the need for director powers to be tied directly to shareholder interests, and he went so far, as I put on the last slide, to say that that is the only purpose that they should be exercised for.

Now, Dodd responded to this by saying that the problem with viewing director powers as linked only to shareholder profit is that, of course, corporations play an important role in our society. They affect many stakeholders. Dodd argued that the role that corporations play in society gave rise to legitimate community expectations and that these should also be taken into account. But both scholars here are really arguing about what is the corporation and how do we keep directors accountable? So on the one hand Berle is concerned about protecting the private property of shareholders who have invested in these companies, and if the shareholder base is too dispersed, then how do we keep managers accountable? Whereas Dodd is really arguing about the public nature of companies and the need to serve that public purpose.
Now, the public versus private debate I will leave to our next presenter, Professor Kingsford Smith, but suffice it to say, of course, in these changing times these issues are still highly relevant.

So I will focus for a moment just on the economic perspective, and really what we have here are competing conceptions about what a corporation is, as the Chief Justice mentioned in his introductory remarks. Economic perspectives - and I won't turn this into a corporate law lecture, don't worry - in short, take the view of the corporation as not a real thing. It is a nexus of contractual relationships - that is, it acts as a forum recognised by law to facilitate and assist the relationship between the owners of capital, the shareholders, and the managers of that capital.

Central to that idea is that of shareholders as the residual risk bearers. Shareholders are the last in the queue to get paid, as it were. As the residual risk bearers they should, in theory, have the appropriate economic incentives to effectively monitor corporate management, to hold directors accountable, again reflecting on Professor Berle's experience in writing that book in 1932 and the dangers that having a dispersed shareholder base posed.

On the other hand, stakeholder perspectives take a different view. They disagree with the view that shareholders are the only residual risk bearers in the corporation. Again they argue, as Professor Dodd did, that there are a variety of stakeholders who have legitimate interest in the corporation's activity.

Some stakeholder theorists go so far as to criticise economic perspectives on the basis that they are too narrow in their focus, that they look for only things that can be easily measured in economic terms. Whereas the life of corporations and the relationship that corporations have with their stakeholders, of course, is more than simply those economic values and includes things such as mutual trust and confidence, interdependence with stakeholders and the company, vulnerability and the legitimate interests of the community. Stakeholder theory therefore rejects this idea of shareholders as the residual risk bearers, and this is something I am going to come back to. Employees, customers, creditors, shareholders and the community all
share the risk of corporate failure.

So if this debate has been going on for so long, why are we still talking about it today? As was discussed at the start, these are issues that are coming out in the Royal Commission. We are seeing these sorts of headlines, which I have taken from various newspaper reports this year, and they really show that this debate about the public purpose versus the private purpose of corporations is still very relevant, and the question of in whose interests the corporation should be managed is still highly relevant.

But where does the law fit in? As I said, I am going to focus on the legal issues.

I do not need to explain to this audience the nature of directors' duties or where they come from. As I said, I am focused on specifically the duty of directors to act in good faith in the best interests of the company. The leading statement that seems to explain that duty is up there on the slide, from Smith & Fawcett in the English Court of Appeal. The key point to note from that is that somewhat similar comments had been made in various earlier cases, including by the High Court in Ure's case some 30 years earlier.

The main point to take from both of those quotes is that the law allows directors considerable discretion in exercising their management power and it leaves the decision of what are the interests of the company to the directors. It is not for the court to determine what those interests are. This is sometimes explained as being a form of general law business judgment rule, that we allow directors to make what they believe are decisions in the best interests of the company.

Now, the Hutton v West Cork Railway case, of course, noted that there has to be some limit to this. It cannot simply be an honest attempt to benefit the company, otherwise, as the court there said, you could have the honest lunatic running companies.

That case tried to draw an important line that the decisions that directors were exercising in good faith had to have some connection to the business of the company, and of course gives us the often-cited quote of:
The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.

So what do we take from this? How do we define what are the interests of the company? We can go back to the case of Allen v Gold Reefs, which is sometimes said to be the origin of this particular phrase, "bona fide for the benefit of the company as a whole", although, as I was researching for this paper, McPherson J, in an article written in the Australian Law Journal about 40 years ago, went back much further than that to trace the origins of that phrase.

That particular phrase, of course, as we know, is no longer the test for assessing the validity of changes to a company's constitution, at least not in Australia since the High Court's Gambotto decision. But the meaning of that term, "the company as a whole", was sought to be explained in the Court of Appeal decision in Greenhalgh v Arderne Cinemas. I won't read through the entirety of that quote.

Clearly, what the Master of the Rolls is saying there in that quote in Greenhalgh's case is that we cannot just focus on the commercial interests of the company as a separate entity, but it has to mean something more than that, and in his Honour's view means the interests of the shareholders as a whole, or the corporators, as he mentioned.

Now, that particular formulation has been applied by the High Court in a directors' duties case in Ngurli v McCann.

In the paper I trace through the lines of authority that have applied the Greenhalgh formulation, and there are a number of cases that have applied that. I also go through and map a number of significant appellate cases that recognise that there is a distinction, and there has to be a distinction, between the interests of the company and the interests of shareholders, that they are not the same.

So, for example, there are cases such as Reid v Baggot
Well Pastoral Company, International Swimwear Logistics, and Idylic Solutions here in New South Wales that apply that Greenhalgh formulation. There are other cases that make it very clear that, even though they are not applying the Greenhalgh case, they are equating the interests of the company with the interests of shareholders, including in Isaac J's decision in the Ure case in 1923, Dixon J's reasons in Peters American Delicacy, those of King CJ in Australian Growth Resources and Kirby P here in New South Wales in Darvall v North Sydney Brick. So there is clearly a long line of cases that supports the view that "the interests of the company" means the interests of shareholders.

But for an alternate view, if we look, for example, to the reasons of the plurality in the High Court's decision in Pilmer v Duke Group, we see the court discussing that when directors determine what the interests of the company as a whole are, the directors will usually have close regard to how the decision will affect shareholders. They are clearly drawing a distinction between the interests of the company and the interests of shareholders. They are not the same, even if they may well overlap.

Indeed, in just the last 12 months we have seen a first-instance decision in the Victorian Supreme Court in the case of United Petroleum that has gone so far as to call into question the continuing relevance of the Greenhalgh formulation about the interests of the company as a whole, where the court said:

In more recent times, the view has been expressed that the general body of shareholders does not always, and for all purposes, embody "the company as a whole".

But perhaps the clearest expression of this idea that the interests of the company are separate from the interests of the shareholders as a whole comes from Owen J at first instance in the Bell case, and there is a brief quote there where he draws that distinction. They may well overlap, but they are not the same.

There is a longer quote on the next slide which makes the same point but also very strongly states that simply equating the interests of the company to be the interests of shareholders, and vice versa, is, in fact, an error. So
Owen J in that case favoured the approach of balancing those various interests.

Now, of course, that case was about the duty to consider creditor interests when the company nears insolvency, and that is not an issue that I am going to discuss in any detail. It is a well-worn topic.

So what, then, can we make of the Greenhalgh case and its continuing relevance in Australian corporate law? The first point to note, as I have mentioned already, is that Greenhalgh was not a case involving directors' duties; it was a case applying the Allen v Gold Reefs test about how we assess the validity of resolutions to change the constitution. But it is a case that has been applied by the High Court in directors' duties, and that is Ngurli v McCann.

I will also note that the Master of the Rolls in Greenhalgh made it quite clear that he was stating a formulation for cases about changing the constitution, because with the relevant quote that I had up earlier on the slide, and also in the paper before you, he makes the clear statement, "at least in a case such as the present"; he is limiting it to decisions to change the constitution.

But there are broader issues at play here. The assimilation in the Greenhalgh case of the interests of the company with interests of shareholders is really reminiscent of the earlier quotes that I had on the second slide with the idea that shareholders are the ultimate beneficiaries, and that is because they are seen to be the ultimate owners of the company.

But shareholders do not have all the hallmarks of owning the company. The company is a separate legal entity. Directors may well be accountable to shareholders, but that is because of the very practical issue that if the directors do not do what the shareholders like, or at least sufficient majority of the shareholders, then they can be voted out.

Directors do not derive their power from a delegation from the shareholders. The directors are not the agents of the shareholders. The shareholders do not control the directors' exercise of managerial power and, indeed, cases such as Automatic Self-Cleansing Filter v Cunninghame
recognise that the directors are not bound to follow the
wishes of the members.

So it seems odd that shareholders are seen to be the
owners of the company. In fact, even if directors were
directly accountable to the actual shareholder interests,
they would find that identifying the nature of those
interests would be difficult, if not impossible. There are
simply too many differences between the interests of
shareholders, for example within the same class, where we
have shareholders who are investing for the long term
versus shareholders investing in the short term;
differences between classes, for example holders of
preference shares versus holders of ordinary shares or
holders of non-voting shares and holders of voting shares;
and also inter-temporal problems, differences between the
current shareholders and also the future shareholders.

So the Greenhalgh test is limited in its practical
capacity to actually help directors.

Now, the Master of the Rolls was aware of these
problems of conflicting interests within the shareholder
body, because his Honour actually proposed a solution, and
it is in the quote that I have included there on the slide.
It is the idea that it is not the actual shareholders that
he is talking about, it is some sort of hypothetical
shareholder who acts in the medium to long-term interests
of the company. But as one noted commentator wrote in the
Modern Law Review many years ago, this risks substituting
one legal quagmire for another, the idea of the
hypothetical shareholder.

This is not a new issue in company law and this is an
issue that has been addressed by the High Court in Mills v
Mills, where Latham CJ recognised that in these
circumstances where there are inherent conflicts between
shareholder groups, what is it the directors are expected
to do; they are expected to act fairly between those
competing groups.

So we end up in the situation where company law allows
the directors to make the management decisions, confers
a great deal of discretion on them, does not require them
to focus on the actual interests of shareholders and
creates a hypothetical shareholder who is actually divorced
from the actual shareholders and their actual interests.
Well, it must be seriously asked, if shareholder primacy bears no resemblance to the actual shareholders and their actual interests, what use is it? If the law is glossing over the actual shareholders in favour of maintaining strong managerial discretion in the board room, it is no wonder that some scholars go so far as to say it is not, in fact, shareholder primacy; it is director primacy.

It is submitted here that part of the problem is seeing shareholders as the owners of the company, which I mentioned earlier. Clearly, they are not, either as a matter of law or as a matter of practice. Shareholders own shares in the company. The arguments that shareholders are owners of the company in some way really harks back to an older notion of joint-stock companies that were based on partnerships, and the merchants would combine their resources and that would form the basis of the company's joint stock as it went overseas to conduct its trading operations.

The shares that those shareholders had represented a percentage of that joint stock. But that time is long gone. Shares are themselves personal property now, and shareholders do not own, through their shareholdings, any interest in the company's property. Why? Because the company is, of course, separate.

Once we recognise that principle, that the company is separate from its shareholders, the shareholder interests are not the same as the company's interests or not necessarily the same - they are certainly not equivalent in all circumstances - it makes it much easier for us to accept the central consequence of the Salomon case; and you cannot give a talk on company law without mentioning Salomon's case.

Of course, the consequence of Salomon's case is that the company is a separate entity. But the further consequence, in some ways the whole point of Salomon's case, is that it should not matter who the shareholders are, because the company is separate from the shareholders.

Now, the suggestion has been made that directors might not be able to consider non-shareholder interests as a matter of law. I would dispute that, and as the Chief Justice mentioned, that has also been disputed by CAMAC.
There are a number of cases that recognise that directors can and do take into account non-shareholder interests when making decisions. Of course, the statement there from the High Court's decision in *Harlowe's Nominees* makes that very clear, that there are wide interests that can be considered. That formulation is also commonly recognised as a form of general business law - a business judgment rule at general law, that is, that the courts are reluctant to interfere in good faith commercial decision-making.

The statement from the Canadian case in *Teck Corp* that I have included there, and which is also included in the paper, is even more explicit of the need and the reality of directors taking into account a variety of interests when making decisions. That particular statement was approved by the Privy Council in the *Howard Smith v Ampol* case and was also approved by Wilson J in *Whitehouse v Carlton* here in the High Court. So, as a matter of law, directors can take into account wider interests than merely the shareholder interests.

It has been suggested that we might need law reform to deal with these changing times and that if we had, perhaps, some further statutory clarification that directors are permitted to take into account non-shareholder interests when they are acting in the best interests of the company, that would provide for more acceptable corporate conduct.

One way of doing this would be to enact a so-called constituency statute, which has been undertaken in more than 40 states in America. But all those statutes do is give directors the permission, not the imperative, to include non-shareholder interests.

The Chief Justice earlier referred to section 172 of the UK Companies Act. That provides that directors "shall" consider a variety of interests, some of which are then listed there, but it is important to note that that is a non-exhaustive list. The directors are able to choose which interests they will take into account, and section 172 is not a serious challenge to the shareholder primacy norm, because that is actually a duty to promote the success of the company for the interests of the members as a whole.
So to come to the conclusion of my argument, do we need law reform to provide directors with the capacity to take into account broader considerations or are they bound by law to only consider shareholder primacy, the interests of shareholders? In my answer, no, we do not need law reform. The law is sufficiently flexible as it is to allow directors to take into account a broad variety of concerns. And while there may be calls from bodies such as the ASX Corporate Governance Council for listed corporate boards to take into account broader stakeholder interests and to maintain the company's licence, whatever it is that that may mean, I would argue that law reform is not needed. Our existing law is sufficient to deal with these problems.

Of course, that accords both with legal principle, as I have mentioned earlier, but also with the reality of board room decisions. Boards have to take into account a broad range of interests, as Professor Gower mentioned many years ago.

So, in short, we need to recognise that there is a limit here to what company law can do. Changing the Corporations Act is very much a blunt instrument, and if we are concerned about directors making decisions that do not accord with so-called community expectations, then we need to be looking more at what motivates, what drives, both individual and corporate behaviour. The law is only one factor in that equation and I would argue it is not even the most important factor. Trying to obtain a commercial benefit for the company and all of its stakeholders is what drives board behaviour.

So, in conclusion, shareholder primacy, in my view, is not under serious threat by these changing times, because it has only ever been one part of the story.

And if I can finish with a cartoon from Dilbert, who is always my guiding light on corporate behaviour - actually, that is quite big, you should all be able to read that, but if anyone is unable to read that, essentially, Dilbert goes to his manager and says, "Look, I have found a way to save a million dollars by spending only 10,000." The manager responds, "Well, that 10,000 would come out of my budget, but the benefit would go to somebody else's budget, so I don't think that's feasible." Dilbert replies, "Well I think our shareholders would disagree", and his manager says, "And that's why they are not invited
to the meeting." Thank you.

THE HON CHIEF JUSTICE TF BATHURST: Thank you, Jason. One thing I think you must have regard to in this area is the evolution of the law to take account of changing conditions and circumstances. I think it was Milton Friedman in 1970 who said that the only object of a corporation was to make money, and lots of it, for its shareholders. Shareholders might agree. That was shot down fairly quickly thereafter by Sir Anthony Mason in *Walker v Wimborne*, and since then there has been a move that directors, as part of their duties, have to take into account the interests of creditors near insolvency and, I think, take steps, obviously, to comply with existing laws and regulations because the company is a legal entity.

Now, that may or may not make good Jason's thesis as to whether the blunt instrument of changing the Corporations Law is necessary, but it certainly shows, I think, irrespective of that, the law will evolve to take account of changing circumstances and, indeed, changing social mores.

With that homily, can I throw it open for questions. Could I ask you, please, to wait for the microphone and identify yourself. Are there any questions?

MS SHARMA: Good evening, everyone, my name is Apurva. I am a researcher and I have come from RMIT University, Melbourne. I've read a lot and it is an honour to be here and listening to you. I actually think that if you could reflect on the new laws that have come out in the USA recently of benefit corporation legislation being adopted by 33 states already, what would you think about that, a structure like that? I don't pitch that a new corporate form should be enacted here, but indeed changing or taking the three main features of that law reform in that respect. Thank you so much.

ASSOCIATE PROFESSOR HARRIS: Thank you for question. I will defer perhaps to Professor Gower, even though he wrote this almost 50 years ago. In my personal view, I haven't looked too much into benefit corporations. I think they get a lot of publicity and in particular there are certain companies that promote their status as B corps. There is clearly some money to be made there.
The idea that I am arguing for in the paper is that at the end of the day it comes down to the sustainability of the company as a commercial entity and that will require a variety of stakeholders to be taken into account.

If you want to set up some form of commercial activity and say, "Well, we're not here to make a profit, we're here to serve the interests of broad stakeholders", there is already a capacity to do that. You can set up a company limited by guarantee. You can set up a company even if it's limited by shares and include a provision in your constitution saying "This is what we're trying to achieve".

My argument is more that shareholder primacy is an incomplete picture of what happens inside boardrooms. While it provides a seemingly clear object that boards can focus on - is this going to help the shareholders - what the cases show is that really we are arguing about what happens in the longer term. Are the decisions going to promote the longer-term success of the company? If they do then each of the stakeholders should get some benefit out of that. Shareholders, of course, can't receive dividends until the company makes a profit. It is only making a profit if the other stakeholders receive their benefit.

I personally don't see a need for B corps here in Australia. I think we can already achieve that, but as I say I haven't looked into that in great detail. Thank you for your question.

THE HON CHIEF JUSTICE TF BATHURST: We have 14 more minutes.

MATT McGIRR: Thanks, Professor. I am Matt McGirr from the Australian Institute of Company Directors. I just wanted to follow on from something that the Chief Justice said about this, but before I do, I personally agree with your paper. It is not the position of the AICD necessarily but I agree with what you are saying. I am interested in this question. There seem to be a number of competing regulatory demands, if you like, on the boardroom now. So you have this overarching principle which stands, but then you have, take financial services law, a number of obligations imposed on the board now through things like the BEAR management which in some ways runs counter to it, or at least there is a tension point between this overarching obligation and some of the more individual
sorts of discrete obligations that are now imposed on boards.

I guess what I am asking is this - and this is a really important question to this debate going forward - are we at the point where there is now a misalignment between our overarching obligation imposed on directors and what they are actually being asked to do in practice and that is to be stakeholder managers. The reason I think it is important is that there is an element of truth - and I think Kevin McCann might have more to say on this - to the proposition that directors are no longer necessarily in any given instance asking the question "Is this for the benefit of shareholders?", but asking the question "Is this in compliance with the law that I am considering at any given moment in the particular circumstance that I find myself?". We might not have an answer now but it is the difficulty we face. Thanks.

THE HON CHIEF JUSTICE TF BATHURST: Jason has passed it to me, I'm not quite sure why.

ASSOCIATE PROFESSOR HARRIS: I always defer to you, Chief Justice.

THE HON CHIEF JUSTICE TF BATHURST: I don't think there is a misalignment. I am seriously reluctant to express too much of a personal view on it, but there is inevitably a danger that if a board is swamped by regulation they will move from a position where they're able to - again using a colloquialism - steer the company because they're too involved with risk management advisers telling them what the latest piece of regulation can or cannot do. That is not to say that some regulation is not necessary or shouldn't respond to significant matters that arise, but if at all possible it should be relatively simple and not over technical or over prescriptive. That is about the best answer I think I can give you.

ASSOCIATE PROFESSOR HARRIS: I would like to add a few comments to that. I would actually take a slightly different view, although I am hesitant, which is that I think there is a misalignment. I think what we are seeing is a continual piling on of - it is essentially addressing the squeaky wheel. A problem presents itself: "Well, let's draft a law to try and deal with that problem." Who is the person that we can make accountable?
We are being tough on companies and tough on boards and so it is continually piling on.

What we are not seeing is policy that is sitting back and saying, "Actually, what are we trying to achieve here?" Rather than just dealing with that squeaky wheel problem, let's think carefully about actually how companies operate, how we want them to operate and how we think what role the law should play in that, but that's a hard task. It is much easier to say, "Well, here's a rule that will deal with that problem that was reported in the press", rather than, "Let's actually undertake a holistic review of our corporate legislation", which in many respects is still buried in the 19th century, and actually ask the hard question of what is it that we should be asking directors to do and what can they actually do? I am not sure that just piling on more and more and more regulation is actually getting us anywhere.

To a similar extent saying, "Well, let's increase the regulation, let's just give ASIC more powers and give ASIC more responsibility", I am not sure that that's the appropriate approach either. If we were to start again would we have the system that we have now? I don't think so.

THE HON CHIEF JUSTICE TF BATHURST: Anyone else?

JOHN MORGAN: John Morgan from Allens and UNSW. Jason, it is interesting in the Royal Commission at the moment there has been a lot of commentary upon remuneration and the fact that institutional shareholders and proxy advisers are very influential in relation to how shareholders vote in relation to the approval of remuneration of executives and that remuneration structure seems to have some alignment with the problems that occur, that is, the disregarding of the customer interest or the community interest and the greater regard of the shareholder and profit interest.

Do you think that that law needs to be revisited so that there needs to be some countervail to having regard properly to the other stakeholder interests and not just the shareholder interests in how remuneration is actually approved and structured?

ASSOCIATE PROFESSOR HARRIS: Thank you for your question, John. There's an awful lot in that. On one level I would
agree that the current - and I am not holding myself out as an executive remuneration expert by any means, but it seems to me that the current law on executive remuneration is too complex. It doesn't make sense to me, just as an ordinary investor, that we have companies that are spending dozens and dozens of pages explaining the detail of remuneration and not as much time actually explaining how they run their business. I think there is a problem with that.

However, you also mentioned in your question about whether there is a link between so-called shareholder primacy and these particular remuneration structures. I think the problem I have tried to highlight in my paper is that it is not necessarily actually shareholder primacy, it is not actually what the shareholders want necessarily that we are focused on here. It is an idealised notion of supposedly what we think they want, so I am not sure that the way remuneration structures tend to be set up is necessarily the same thing as what shareholders would actually want.

We assume that they want, for example, ever increasing share prices if you invest in a publicly listed company, but the diversity of shareholders' interests would suggest that maybe there are other things that they would value as well, perhaps to draw back to the earlier question about B corps. So yes, I think there is a problem, but I don't have the confidence of the law to fix it. I am not sure that saying, "Okay. Well, you must not do this now", or, "You must include this further disclosure now", or, "There must be these further hurdles now", I am not sure that that's going to fix it. I would far favour saying this is one area where we need to be looking at big picture wholesale reform, like England did with the Companies Act, take 10, 15 years and go through and try and work out what we think a more appropriate system for company law is and remuneration would certainly be part of that.

THE HON CHIEF JUSTICE TF BATHURST: Could I just add this. There is a lot of talk about executive remuneration, variable remuneration, bonuses, et cetera, but one of the real difficulties in generalising is that for each company there is a different means, a different structure, a different way of doing so and different reasons to incentivise or pay people in that way. It is a very difficult area to generalise about, I think.
KAYLEEN MANWARING: Kayleen Manwaring from the UNSW. This is a very pragmatic question, it's quite a simple question and I am sure you have an answer for it. You have argued quite convincingly - I haven't read your paper but I am sure it will back everything up - that the law is sufficiently flexible to extend outside the guardianship of the regulator. The very fact that you have been asked to come here, my question to you is is the law sufficiently clear? The law shouldn't just act on stuff that has already happened. There should be a guide to conduct in some of the law.

I suppose my question is about two things. What is wrong with regulatory clarity? You are saying we don't need reform, but what's wrong with clearing up the obvious discontent, misunderstandings, or things like that, with the current law?

ASSOCIATE PROFESSOR HARRIS: Thank you, Kayleen, that is a great question. To a certain extent, essentially, that is where the UK has ended up. One of the narratives around section 172 is does it really change anything? Even if the answer is no, I have read some commentary that suggests that there's still a benefit because it tries to make it even clearer to corporate boards that yes, you can take into account these sorts of things.

I am not sure that changing the law is the best way to do that, though. We have a variety of regulatory tools and certainly government, through its infrastructure and procurement processes and the like, has a variety of things that it can do to try and make that message clearer. The concern that I have about changing the law, just adding little bits to try and deal with one perceived problem, is that it can create unintended consequences.

As I argue in the paper, I don't think we need a 172 here in Australia. I think the existing law covers it. As you are suggesting and others are suggesting, if we are still not getting the results that we want, I think there's a bigger problem there. I don't see the problem as being section 181.

THE HON CHIEF JUSTICE TF BATHURST: We have time I think for one more question. Professor Austin?

DR AUSTIN: Jason, is there any situation you can envisage
where the interests of the group of shareholders and the
interests of other recognised stakeholder groups, such as
consumers, will necessarily conflict and if so what does
the law tell us about that? What is the purpose of the
directors' conduct?

ASSOCIATE PROFESSOR HARRIS: That is an excellent question
and yes, I absolutely can. We have seen this in a number
of product liability examples where companies become aware
that their products may well be dangerous and might be
harming people, so there's a clear conflict there.

My first response would be to say - and I also argue
this in the paper - that I think we need to recognise
company law has a limit, that company law is not about
regulating everything that companies do or everyone that
companies affect. My first response would be yes, that's a
very big problem and that's what consumer law is about,
that there should be a legislative response to that. But
to bring it back within company law, again, if we think
about the interests of the company as being the long-term
sustainability of the company, then actually I'd go back to
what Professor Dodd was arguing at the start, that if there
is a dissonance between how companies are being run and
what the community demands, regulation will come and
directors have to respond to that.

Drawing on that, I would suggest that - and as a
lead-in to Professor Kingsford Smith's paper - directors
need to be thinking about that regulatory risk. If they're
doing things that they know are going to harm people then
they're going to get regulated in the future and they will
need to adjust their conduct.

DR AUSTIN: Just a slight further proposition. Do you
think that it would be right to tell directors who are in
that sort of quandary, where there seems to be a conflict
between shareholder interests and other stakeholder
interests, that their objective is to act in good faith to
promote the success of the company for the benefit of
shareholders in the longer term?

ASSOCIATE PROFESSOR HARRIS: Yes.

DR AUSTIN: In which case, we do have a modified
shareholder primacy goal underlying it all.
ASSOCIATE PROFESSOR HARRIS: Yes, I would agree with that because if we accept that when we say the interests of shareholders, particularly in the long-term, does not have to relate to what the actual shareholders want right now, then really we're talking about the success of the company as an entity, so I would agree with that.

THE HON CHIEF JUSTICE TF BATHURST: On that note, can I ask you all to thank Jason in the usual way.

DR AUSTIN: We will reorganise the bench and I would ask Justice Beazley, the President of the Court of Appeal, to move up to chair the session with Professor Dimity Kingsford Smith.

THE HON JUSTICE M BEAZLEY: It is my pleasure to introduce Dimity Kingsford Smith, Professor of Law at the University of New South Wales. You will already have some of her biographical details in the paper, but I think it is important to focus on what she does rather than the post-nominals.

Professor Kingsford Smith's scholarship covers a number of specialties, financial services regulation, corporate governance, online investing, but perhaps more importantly and more relevantly for this paper, the theory and practice of regulation and civil society forms of governance in the financial sector and I think Jason was correct when he said the questions which came out of the last paper are a very interesting segue into Dimity's work that she is going to present now.

Perhaps I should only add in terms of her qualifications and activities that in addition to her position at University of New South Wales, she is a member of ASIC's external advisory panel and she has written many research reports for ASIC, so she has very much a hands-on feel for the types of issues that we are discussing this afternoon. Thank you.

PROFESSOR KINGSFORD SMITH: Thank you very much, a very generous and kind introduction. I am delighted to be here and I thank the Chief Justice for the invitation to present in this lovely courtroom, to Justice Beazley for agreeing to chair and also to Bob Austin with whom I have a long association in corporate law and whose lectures at the University of Sydney I think sparked my interest in company
law a long time ago now.

Moral revolutions happen. The philosopher Anthony Appiah observes that, "At the end of [a] moral revolution, as at the end of a scientific revolution, things look new. Looking back, even over a single generation, people ask, 'What were they thinking? How did we did that for all those years?'"

Rather than a revolution my argument here is that there is a bit of an evolution underway in the way we think about directors' duties. The law now recognises in various ways that interests greater than those of the commercial entity of a company may be considered in advance by boards. This is instead of directors' decisions turning exclusively on private corporate interests, primarily those of the shareholders as Professor Harris has indicated. Indeed, the law has recognised the public content of directors' duties for a long time.

In the community I think there's something more of a revolution going on. In organised society and in some parts of the business world it is expected that directors may and even should take wider interests into account in the management of corporations. This expectation continues as a term of reference and prominent theme of the Royal Commission and it is also obvious in quasi-legal ideas such as the social licence to operate and in the codes of corporate social responsibility.

The moral change can also be observed in a recent statement by Catherine Livingston, the chair of the CBA. She said: "Too often, a focus on profitability disadvantaged some of our customers. We agree that this balance is not acceptable." And she went on to say that the board's strategy is to become "a simpler, better bank that delivers balanced and sustainable outcomes for our customers, community, our people", and the last on her list is the shareholders.

This wider moral revolution is I think feeding a longstanding legal evolution but giving it a real move along. Directors are still required to weigh the interests that relate to the private nature of the corporation, but increasingly they must do so by taking account of wider moral goods and I would argue that these are goods of a public character.
As legally this area is truly one of evolution, many of the instances I hope to enliven this argument with are well known and my aim is to draw them together in the hope of showing how far towards having a public character directors' duties have already progressed.

The titular question of this paper has actually done some shape-shifting since I first proposed it and instead of debating the unarguable existence in Australian law of public elements or aspects of directors' duties, here I concentrate on what I hope is a more trenchant question, that is, what does it mean to say that directors' duties have a public quality? And in doing so I concentrate on two core issues which are up on the slide there. What is the nature and effect of the public character in directors' duties, and secondly, to whom do directors owe their duties in this public character?

I would like to start with thinking about what it means to say that something might be public. There are a variety of responses to the very idea that it is useful to reason about the categories of public and private. Karl Llewellyn and the realists attack the distinction as legally unsophisticated to draw attention to the widespread perception that so-called private institutions were acquiring the coercive power that had previously only been in the hands of government. Christopher Stone - not Julius Stone - writing about corporations is more realistic about the unstable nature of the distinction and sees it as a barometer of how social choices about rules change the autonomy of decision makers over time.

My argument is that the lines between public and private, always very changeable and back and forth, have created hybrid directors' duties and that it is important to understand the public side as well as we understand the private.

The distinction between public and private is open-textured, but the general trend in processes and sometimes in substantive standards is for traditionally private bodies, even business corporations, to bear the obligations once associated almost exclusively with governments.

While public values manifest differently, the overall
effect is to diminish an entity's internal decision-making independence and to narrow the space in which an actor can be arbitrary, capricious and prejudiced. Instead of the non-interventionist approach explicit in the internal management rule of companies, directors and boards find themselves required to consider wider interests or community standards than those recognised by traditional private duties.

Critics of this imperialism of the public sphere, such as Professor Hilmer, say that rather than encouraging performance this imposes conformance, stifling to management decision making and damaging to companies. Like Llewellyn and the realists, those who support a greater influence of public values see those as a way to temper power and to protect the interests of those whom private power affects.

What might be the signposts of this publicness? The first one I think that is relevant to our argument here is that when government steps into a traditionally private law domain, it often concentrates on increasing accountability and responsibility of decision makers and often does that through improvements or changes to enforcement.

The empowerment and funding of a regulator to supervise, detect, investigate and take action against deficient decision makers is the kind of thing I have in mind, so a first sign or value of the conception of publicness is a consequent increase in accountability and responsibility of decision makers, in this case directors.

A second sign of publicness is a greater opportunity for those affected by the resolutions or determinations of decision makers to participate in and have their interests considered in the process of decision making. This may be through greater disclosure to them, it may be through an opportunity to put forward their interest and the consequences for them of the options before the decision maker.

Publicness may be conceived of, therefore, as taking account of the interests of others affected by a decision and an example of this is the requirement of directors to consider the interests of creditors in board decisions in certain circumstances, although people might suggest that that is a rather tame version of the kind of voice of
interested participants that are seen in other circumstances.

Wider purposes and scope of the benefit to be weighed in the exercise of a power by a decision maker is a third marker of publicness. This is the idea where we encounter the idea of public harm and parallel public duty. If we consider the careless management of companies to be a public harm, then the legislature may impose a public duty to mitigate the occurrence of the harm and it is arguable that purposes of section 180 are directed in that way.

In this way regulation adopts wider purposes and distributes to a wider group of beneficiaries the goods of publicly mandated processes and standards of conduct. With a public duty the fact that the regulated conduct may harm particular individuals is of secondary, if any, importance and private loss and damage to an individual or entity need not be shown to establish liability. Of course, the same facts which enliven a breach of public duty may also establish a private right of action.

There are many emblems in the public domain, but a fourth and the last considered here is a more demanding requirement of reasonableness and rationality. One of the changes to section 180, particularly in the CLERP reforms enacted in 1999, was from a subjective standard of directors' conduct to one to be judged objectively, taking account of accepted practice of the kind of company and the responsibilities of the person in question.

Rationality in director decision making is evidenced in procedural requirements in decision making. These involve appropriate information seeking and other steps to develop a belief in the interests of the company that only a reasonable person in their position could hold about the subject matter of their decision.

This greater procedural rationality, as Whincop and Keyes argued 20 years ago, draws implicitly from public law norms and concepts and this is in contrast with the relative freedom of action accorded by the principles permitting director autonomy in internal management.

Now I am going to proceed to what is basically part 3 of that schema up there for the rest of my talk and to look at some areas in which I think directors' duties have
evolved towards some of these conceptions of publicness.

In his observations about moral revolutions Appiah also says that arguments against each of the practices that changed were well known and clearly made a good deal before the moral revolution occurred. It wasn't that people were bowled over by new moral arguments. I think it would be clear from the rest of what I have to say that publicness in Australian directors' duties is not recent.

Let's start with public enforcement. Public enforcement of directors' duties, including the duty of care, began early in Australia and as Langford, Ramsay and Welsh point out, public enforcement of this duty began with the introduction of an offence in 1958 providing for prosecution of a duty which in its original form had entered the statutory law in 1896.

Justice Nettle observes it was from 1958 that directors' duties were thought of and enforced as part of the public law and not just part of the private obligations.

Public prosecution of directors' duties, though since 1999 not of the duty of care, continues today. The introduction in 1993 of ASIC powers for civil enforcement of directors' duties, including the duty of care, is the most obvious and unique feature of the evolving publicness of Australian directors' duties.

In the comparable jurisdictions of the US and the UK while directors' duties are prosecuted, there are fewer avenues for public civil enforcement and these are generally privately enforced. Empowerment of ASIC as a plaintiff makes available public resources for civil enforcement and this is particularly salient for the statutory duty of care which is at the heart of company management and absent a prosecution power.

In the ensuing 25 years, public enforcement of the statutory duty of care has been an important influence on Australian corporate governance.

There are important sanctions which accompany the change to civil penalties. The public character of civil regulatory enforcement of the statutory duty of care is deepened by the nature of these civil sanctions that ASIC
may apply for. All of the directors' duties, including the
duty of care, are civil penalties. Civil penalty actions
may result in sanctions which are personal and share some
of the qualities of criminal sanctions. For example, the
making of a declaration of contravention shares aspects of
the public denunciation inherent in a finding of guilt in
criminal proceedings. It requires specification of the
person who contravened the provision and particulars of the
conduct constituting the contravention.

Likewise, a pecuniary penalty order shares aspects of
fines as criminal sanctions. While disqualification
consequent upon a finding of breach of a civil penalty
provision does not involve a custodial sentence, it is
considered penal in part. They share a purpose, in effect,
of protecting the public from further damage by removing
the liable director from the management of companies.

Further emphasising the public nature of civil penalty
enforcement against directors, only ASIC has standing to
apply for civil penalty orders consequent upon
a declaration of contravention.

In director disqualification it has been held that the
class of persons whom disqualification is to protect is
wider than shareholders and, at the very least, includes
creditors and potential creditors. Protection for the
public also includes consumers and individuals who deal
with a company, such as suppliers or employees. It is not
to be limited to the commercially unsophisticated nor
limited to public companies. The interest of protecting
the public should be paramount and outweighs the hardship
to the disqualified director. The more serious the
contravention, the longer the term of disqualification and
the greater the weight to be given to the risk of return to
old practices.

Now I would like to advance to talking about public
harms and the purposes of the public interest in protecting
individuals and other interests from those harms, and to do
so I am going to spend a minute tracing the pre-legislative
statements of parliaments in relation to the enactment of
earlier versions of section 180 and then very quickly go
through the statements of judicial officers and the ASIC
enforcement discretion, and then move on to think about the
statutory duty and its public features.
Since its original enactment in 1896, the directors' statutory duty of care has addressed a potentially wide public harm being the misuse of the corporate form. The public purpose of responding to this public harm has sharpened with the introduction of civil penalties and accompanying statements in pre-enactment sources about the wide public interest in better enforcement.

Both the 1896 and the subsequent 1958 versions of the statutory duty of care were responses to corporate frauds. In both cases, those supporting enactments thought "something must be done to protect the public" and that setting out clearly the principles to govern directors' duties in the provisions would be "a deterrent to misconduct by directors and officers", an inference being that such deterrence would be for the benefit of the public.

The 1958 text was re-enacted a number of times as Australia tried to create a national system of company registration. In 1992 two recommendations to amend the statutory duty of care by a senate committee were amongst those adopted by the government. One recommendation enacted provided that the statutory duty of care should be objective. The other was the introduction of the civil penalty provisions.

In adopting the senate's recommendation for the introduction of the civil penalty sanctions, the government said, "the government's view is that the enforcement of duties of directors is important because a breach of these provisions could have adverse consequences for many stakeholders, including shareholders, other directors, creditors, employees and the general community."

With civil penalties in place, the issue of removing criminal prosecution for breach of the duty of care remained on the legislative agenda, and in 1999 criminal penalties for a contravention of the duty of care were finally removed and, in the same enactment, a business judgment rule was introduced.

This express tour of the legislative history is to point out the nature of the harms that section 180 is intended to address and the remedial purposes of the various enacting parliaments.
That Australian directors' duties serve public purposes which may address public harms has also been observed by the courts, though this has been expressed in differing ways. I am going to be very synoptic here because "time's winged chariot is hurrying near".

Sometimes the public interest is found in the proper management of companies. At other times, the courts have found that the public interest in directors' compliance with their duties is identified as a delivery of accurate information to the market and the public. In other times, a wider and more variegated version of the public interest in the duties of directors is identified by the courts, saying, "The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors." At other times, the courts identify a public interest in the proper enforcement of sanctions against errant directors, primarily through the civil penalty provisions.

The law is also concerned with public protection more widely, including of individuals that deal with companies in a wide way, as many of these descriptions have already captured. In ASIC v Adler, Santow J conducted a wide-ranging review of the mix of public interests involved in directors' duties, including those protected by the civil penalty provisions.

ASIC's enforcement discretion also sets out the nature of the interests it wishes to protect. For ASIC, a leading consideration is the nature of the conduct and extent of the harm or loss caused by the suspected breach and whether it impacts on market integrity and the confidence of investors and financial consumers. To ASIC, the amount of money lost and the impact of that loss on the people affected is very important in deciding what to do about enforcement. Here, the interest is in a safe and orderly market and in mitigating the human impact of large financial losses on a wide range of participants.

This all contrasts sharply with the singularity of the interest in private enforcement of directors' duties.

Now I am going to turn to the text of the directors' statutory duty of care and make a few remarks about the differences between it in its public version and its private operation.
The statutory text of section 180 imposing a duty of care on Australian directors contains elements and concepts different to those in the general law duty. Judicial interpretation of the text of the statutory duty has identified how these elements and concepts differ from those in the general law. The discussion of the public character of directors' duties, and specifically the duty of care, has been elevated since the Federal Court decision in ASIC v Cassimatis in 2016. There, it was noted that:

Private wrongdoing is relational. It involves a breach of duty in relation to another person...This principle of private law does not apply to public duties. A public duty to take care can often and does arise without being in relation to a person. There are few, if any, places in the world where a person who drives at 200km per hour on a public road does not seriously breach a legislated public duty.

I am longing to know what sort of car Edelman J has, because 200 kilometres an hour is very fast:

If no person is damaged then no private duty to a person is breached. But the public duty is breached.

Consideration of the text of section 180 reveals that the duty of a director of an Australian corporation to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise is open and general. The duty is nowhere expressed to be in relation to any beneficiary or owed to any entity. In particular, the text of the section does not expressly state that the duty of care is owed to the company. Nor does the statutory text restrict the powers to be exercised and the duties to be discharged by directors to the private kind derived from a corporate constitution. The text leaves open and general the possibility, indeed, the modern reality, that directors will be required to exercise powers and discharge duties under general and statute law derived otherwise than from the corporation. This, of course, includes powers and duties other than that from the Corporations Act. Many of these general powers and duties will be public in nature and owed to the public or sections
of it, such as employees of or investors in the

corporation.

Also distinctive about the text of section 180, though
by omission, is the absence of a requirement to show loss
to the corporation to constitute a breach of the public
duty when ASIC is the plaintiff. This was observed in
Vrisakis v Australian Securities Commission about
a predecessor to section 180, that unlike in private tort,
liability could be found without any damage having been
sustained. Rather, it is only necessary to show
a foreseeable likelihood of loss from the balance of the
risk of harm and potential benefit potentially arising from
a director's decision or action. Instead, the public duty
is argued to be a norm of conduct which may require
consideration of the public interest possibly separate from
the interests of the corporation.

The clearest examples are judgments of liability for
failure by directors to carefully and diligently monitor
arrangements for corporate compliance with statutory
provisions revealed by instances of corporate illegality.
The absence of a requirement to show loss in the text of
the civil penalty section is both a departure from the
private law elements of tort and, more significantly for
directors, a signpost suggesting a departure from the
relational private law setting where directors owe their
duty only to the company.

I will move on now to ask this blockbuster question,
to which I have a really tame response: to whom might the
public duty of care be owed?

If we are to conclude, as I think we must, that
section 180 is a public duty, then to whom is that public
duty owed? Private law directors' duties are owed to the
company and in Australian law, aside from the liberty to
consider the interests of creditors, only the shareholders'
interests are required to be considered.

This paper is about legal evolution and slow changes
in the legal system effected through the public sphere in
response to changes in community standards. There is no
need to see or predict a dramatic break from the current
legal position that directors' duties are owed to the
company both at general law and in relation to statutory
duties. There are, however, two theatres of contemporary
Australian corporate law from which it is credible to suggest that changes will develop. The first is in changes which may emerge from the increase in parties with standing to sue for breach of statutory duties. The second is in the ratification of statutory directors' duties or, to be more precise, the possibilities that remain for general law ratification of those duties which may alter the standard of care that directors must discharge.

A public duty is owed to the world at large or, as put in Cassimatis, "often does arise without being in relation to a person" in any way nominated. Taking further Edelman J's example of a breach of public duty in driving at 200 kilometres an hour, does that mean that anyone in the world catching a driver in the act can enforce such a public duty? How would it play out if we followed this logic of public duties to the full in relation to section 180? A public duty may have normative but little practical effect unless it is grounded in a right such as standing. Unless it is accompanied by standing rights, a public duty such as section 180 remains a duty of imperfect obligation. Imperfect because, though a positive norm of conduct, there is no legal means to compel it.

The section 180 duty when enforced by ASIC is partially perfected and, importantly, wider and different public interests are protected as well. When a company applies for compensation for breach of section 180 the duty is further perfected in a fashion and measure similar but not identical to the general law. And the same is the case where shareholders and others named as potential derivative applicants successfully obtain leave to sue on section 180 for statutory compensation as derivative plaintiffs.

If a plaintiff is a person whose interests have been or would be affected by conduct constituting a contravention of the Corporations Act, including section 180, then they may apply for an injunction. Standing under section 1324 is generally given a broad and remedial interpretation consistent with the objects of the legislation in protecting the public in respect of the commercial interests of corporations. Standing to apply for injunctions responding to breaches of directors' duties have been granted to shareholders and to creditors. There are practical obstacles and controversial limits to this remedy, but the cases indicate the court should consider the public interest in curtailing contraventions in
deciding to grant an injunction.

For other potential plaintiffs the section 180 duty remains one of imperfect obligation. One way to vindicate section 180 as a public duty more widely is to assert that it implies a private right of action against a breaching director. Speaking practically, this would likely only occur when someone had suffered a loss or damage, though, legally, no proof of that is required. Speaking theoretically, this could perfect the directors' public duty by conferring on any individual or entity a right of action for breach of statutory duty.

Theoretical is, however, the state in which standing of those in the general public is likely to remain. In a recent review of the state of Australian authorities for implying a private right to sue for the tort of breach of statutory duty owed to the world at large, Foster concludes:

> It is true to say that in recent years the action for breach of statutory duty has more often been denied than accepted in areas outside workplace safety...more recently the presumption now usually applied is the opposite one, at least where a penalty is prescribed by the statute: that the criminal penalty alone is deemed to be the main means of enforcement of the statutory right, unless there are good reasons...otherwise.

Generally, the court finds that the implication of what parliament has enacted is that parliament intended to legislate for the protection of a class of persons which includes the claimant. One important piece of evidence tending to show that parliament intended such protection is that the legislation makes further and better provision for protection of an already recognised common law right.

As we have been discussing, standing to sue in common or general law is limited to the company or derivatively to shareholders and has never been available to the general public.

In short, since 1958, standing to enforce directors' duties has increased from solely the company to include the
Director of Public Prosecutions and a number of other plaintiffs that we have mentioned. This experience of 60 years suggests the practical likelihood of the public duty in section 180 bringing on a deluge of actions is remote. However, it is also the case that over 60 years the combination of statutory public duties and wider standing rights have slowly transformed our understanding of what is required of directors to include the public interest and, in some circumstances, to consider the interests of third parties as creditors. My guess is that opportunities to be heard that this wider standing affords, and the greater accountability and responsibility exacted by public plaintiffs such as ASIC, will continue this slow evolution of the interests to be considered and even the recognition of new beneficiaries of the statutory duty in the decisions of company directors.

Greater standing to vindicate a public duty is one vector towards recognition of wider interests but says nothing directly about to whom the duty is owed. The 1896 version of the statutory duty expressly provided that every director shall be under an obligation to the company to use reasonable care and prudence and did, in fact, replicate the general law in having the duty expressly owed to the company. This conclusion was confirmed by the accompanying grant of standing to the company to seek compensation. None of the subsequent versions of the statutory duty replicated this express statement that the directors' duty was owed to the company. However, all of them, alongside a provision for an offence or civil penalties, include a mechanism for the company to seek compensation. Given this hybridity and that the directors' statutory duty has not been expressed as owing to the company since 1910, can we still say that the duty is owed to the company? I think we must, though I think it is a point of departure and not a destination.

The cases on ratification of breaches of the statutory directors' duties by the shareholders in general meetings show us how the evolution of the statutory public duty might, over time, change our conception. One reason ratification is provoking about the beneficiary of the statutory duty of care is that it involves a direct engagement between public and private interests. On one hand, the review of pre-legislative materials and judicial decisions shows a surprisingly wide roundup of interests external to the company mentioned as relevant to, if not
the beneficiaries of, statutory directors' duties. On the
other hand, corporations law is strongly conceptualised as
involving private property, contractual rights and liberal
autonomy of action by directors in the private sphere.

The weight of authority on ratification of statutory
duty denies directors a release from the consequences of
breach of statutory conduct standards. Some decisions
indicate the types of interests the statutory duties seek
to protect and which cannot be derogated from by a vote of
the shareholders in general meeting.

Ratification of the statutory duty has been denied
when it would damage the rights of third parties
transacting with a company, in part because the duty
involves public rights. Ratifications also consider, and
still only as obiter, but in the High Court, whether
a resolution of the shareholders can alter - usually
diminish - the strictness of the statutory standards of
conduct required of directors. This is an even more
trenchant question for the distinction between the public
and the private law of companies and the question of to
whom directors owe their statutory duties. In Carabelas,
the liquidator on behalf of the company argued that any
appropriation of company property by a director would be in
breach of the statutory conduct standards of propriety.
Two justices of the High Court disagreed, saying:

This proposition concerning "appropriation"
is too broad. It insufficiently allows for
the significance from case to case of the
commercial context, and assumes a standard
of conduct that is inflexible. The
starting point must be the general duty of
a director to act in the best interests of
the company. The best interests of the
company will depend on various factors
including solvency.

Less emphatically, two other members of the court seem to
agree:

In a particular case, their [the
shareholders'] acquiescence in a course of
conduct might affect the practical content
of those [directors'] duties. It might,
for example, be relevant to a question of
impropriety.

Turning back now to the statutory duty of care, the High Court's obiter view is also relevant to whether the general meeting can prospectively alter the content of statutory duties in relation to a transaction, especially one involving parties external to the company. At general law it is argued shareholders of a solvent company have wide freedom to take honest but stupid business risks in authorising or ratifying acts of directors provided the acts are not fraudulent - Professor Harris's amiable lunatic.

If shareholders can prospectively release directors to act on the company's behalf in such a way, then, as one commentator has put it, there is a risk that standards of company management set by the legislature may be avoided by the back door.

These matters point up the dance which continues between the private law origins of corporate law and the public interest of the state in standards for companies' proper management. Sometimes, the public duty in section 180 is treated as if it is the private law general duty with additional standing and sanctions. At other times it is described, and sometimes acted on, as a general conduct standard intended to protect substantially wider interests than only those of the company. It seems likely that, incrementally, rules granting wider standing will bring forward new constituencies and new types of claims to be treated with care and diligence in competition with the interests of shareholders. With a greater number of claims it also seems plausible that over time the elements of the public duty will develop interpretatively and diverge from the private law version. Perhaps this development will eventually incorporate other interests alongside the company as the beneficiaries of the statutory directors' duty of care, and it is in this characteristically common law fashion that it is possible to imagine the evolution of legal change to a duty of company directors owed more widely than to their company: in short, a duty with a more public character.

I think I might leave it there and thank you very much.

THE HON JUSTICE M BEAZLEY: We have a few minutes for
questions. It is a very stimulating paper and in some ways perhaps a little controversial, so your questions and comments I'm sure will be appreciated.

Perhaps if I could just start off with this question: really underlying your paper, I think, is a vote for the regulatory model, if I can put it in those terms. Is that correct? And if that is so, is the reverse side of the publicness of Corporations Law, as you have put it, a challenge to a stifling of corporate activity?

PROFESSOR KINGSFORD SMITH: Yes, as you can see, I am sitting carefully on the fence here. There is a lot to be said for Professor Hilmer's view of leaving autonomy and, as Professor Harris has discussed, leaving the decision about what the best interests of the company is to the directors. If they are stewards of the company in the long term, then they will be considering the kinds of interests that the public duty of care has brought up to the surface.

However, the empirical fact of the matter is that though companies do a lot of good, some of them do harm, and, in fact, it seems from what we see from the Royal Commission that some of our largest and most respected companies do harm as well, and so we have, going back to the Chief Justice's earlier remarks about balance, a need to give directors, who know their company and their company's business best, the room to make determinations about how to promote the success of that company, but at the same time to find some kind of legal mechanism or, as Professor Harris suggests, extra-legal means, to bring the legitimate public interest in a wider group of interests into the board room and to have those interests weighed in a proper way in directors' decision-making.

I think the change in insight and outlook from that quote that I read from Catherine Livingstone is a very good example of how the to and fro of public and private from time to time brings into account different interests as you deal, as a director, with the circumstances of the company before you.

I have a great deal of respect, as my work with ASIC would suggest, for the need to regulate. I think we have to deal with the bad byproducts of good activity which most companies provide. So I think there is no clear answer to the question of how much public and how much private, but
we need to have both, and one of the things that I think
we, having been - most of us - trained in a private and
politically liberal mindset about how to think about
companies sometimes overlook is the quite developed public
aspect that is already in the Australian law of companies
and thinking about what the future is for that particular
component of thinking about companies.

THE HON JUSTICE M BEAZLEY: Would anyone like to make
a very quick comment on that? Pauline, thank you. We
might have to make that the only one.

MS WRIGHT: Does the trend towards short-term appointments
of directors in the interests of refreshment and keeping
a board new and fresh have an adverse impact on the ability
of the board to consider the long-term public interest of
its activities?

PROFESSOR KINGSFORD SMITH: Losing your institutional
memory is I think one of the things that short-term board
appointments can bring on, and one of the things about
regulatory interaction, of whatever sort, is that it is
hoped that companies learn from regulatory interaction and
take that back into the organisation - into training, into
recruitment, into the kinds of corporate purposes or the
way those corporate purposes are realised. If you have
short-term turnover, I think one of the things you lose is
the impact of those lessons that come from regulatory
interaction. And that regulatory interaction does not have
to be your own regulatory interaction, it can be watching
somebody who is a competitor get an enforceable
undertaking, for example, or civil penalty action being
taken against members of a board in a competitor company.
You can learn a lot, and we know that people do learn
a lot, from watching that happening. But too short
a period I think - you know, too long a period, of course,
people do not bring anything new to the corporation and the
 corporation's circumstances can change. But I think
institutional memory is really important.

THE HON JUSTICE M BEAZLEY: Thank you. I think with that,
then, I would ask you to thank Professor Kingsford Smith in
the usual way.

DR AUSTIN: Ladies and gentlemen, it is now afternoon tea
time out in the foyer there. We will resume at 4 o'clock
sharp, please.
SHORT ADJOURNMENT

DR AUSTIN: Ladies and gentlemen, can I call the meeting to order again. I will ask Mr Justice Gleeson of the Court of Appeal and of the Corporations List to chair this session with Shannon Finch.

THE HON JUSTICE F GLEESON: Thank you, Bob. Welcome back to our third session of today's conference. I trust you enjoyed the opportunity to speak with your colleagues.

Our speaker this afternoon, Shannon Finch, will be directing us on two related and highly topical issues which the Chief Justice mentioned earlier this afternoon. One concerns proposals to regulate corporate culture and the particular focus of Shannon's presentation will be draft proposed Principle 3 of the ASX Corporate Governance Principles. The other is the other obviously highly topical issue, particularly arising out of the Banking Royal Commission Interim Recommendations, what type of enforcement strategies adopted by regulators might impact governance and culture.

Shannon's background and experience is detailed in the brochure in your conference booklet. She is a senior partner in the mergers and acquisition teams of King & Wood Mallesons and she is the national chair of the corporations committee of the business law section of the Law Council of Australia. She has a wealth of practical experience on the topic and I expect you will find her presentation informative, balanced and insightful. Welcome Shannon.

MS FINCH: As some of you who know me well may know, I am a passionate fan of Bell Shakespeare and as I was gathering my thoughts for this paper I had attended the opening night of 'Julius Caesar'. It may have shaped my views. Today perhaps I fear I come to bury Caesar, not to praise him, but it does seem to me that there is some balance to be brought to current discussions about our key corporate regulators and their proper roles, including their role in relation to matters of corporate governance.

It must be an interesting time to be a regulator. They have been under intense review and scrutiny over the past fives years, whether directly or indirectly, and in saying that it's not to suggest that this scrutiny or
reflection only commenced with the 2013 Senate inquiry into
the performance of the Australian Securities and
Investments Commission. Simply, that it must seem to have
been unrelenting in one form or another since that time,
but it has been a valuable and timely period of reflection.

The Senate's inquiry into ASIC's performance was
undertaken in close proximity to the financial system
inquiry which in turn reflected on the earlier work of the
Wallis inquiry and the Campbell inquiry and was followed by
the ASIC Enforcement Review and a contemporaneous House of
Representatives review into the four major banks. Then
most recently of course the Royal Commission and its
Interim Report combined with the release of APRA's report
into CBA, its prudential inquiry final report.

In the midst of all of this activity important reforms
have been proposed and are in the course of being
implemented, reforms to introduce design and distribution
obligations and product intervention powers for ASIC, the
introduction of the Banking Executive Accountability
Regime, tellingly known as the BEAR reforms, substantial
reforms to corporate penalties and sanctions following the
ASIC Enforcement Review, and of course revisions to the
corporate governance principles and recommendations of the
ASX Corporate Governance Council proposed for its fourth
edition.

Out of those various inquiries, reviews and reports
emerged some consistent and not terribly surprising themes.
Firstly, that for law to be effective it must be seen to be
enforced, that enforcement is not simply about consequences
for the entity or person who has contravened the law, but
an important deterrent and motivator of corporate conduct
and that enforcement will not be an effective deterrent if
the sanctions are not meaningful. These are not new
observations but their examination has raised questions as
to whether our various regulators have been doing enough of
the right kind of things in the right way.

Further themes have emerged that have really
captivated the legal community this year, that where
sanctions have not been meaningful and where regulators may
have been too comfortable with or close to the entities
that they regulate, compliance with the law or lack thereof
may be treated as a cost of doing business; sometimes,
controversially, the relevance or otherwise from a
regulatory or governance perspective of the social licence and values or culture of regulated entities; and finally, the roles of core corporate regulators that appear to be shifting and changing, including an expanded role for APRA, suites of new powers and increased sanctions at the fingertips of ASIC, but a looming threat perhaps to the scope of ASIC's remit.

These themes have offered too generous a supply of material, so for today's purposes I propose to explore only a couple of aspects in particular.

Firstly, regulating culture. To reflect on the proposal to incorporate social licence and cultural issues in the draft governance principles in light of the APRA report and the Royal Commission's Interim Report and the effectiveness of different regulatory strategies for engaging on culture, and secondly, to consider the comments in the Interim Report on enforcement strategies by regulators and the way that this may impact governance and compliance.

To turn first to the social licence and the regulation of culture, in 2016 the then Chairman of ASIC waxed lyrical on a few occasions on the importance of corporate culture and companies' awareness of their need for a social licence to operate to maintain the trust and confidence of the community over and above their legal licence. Greg Medcraft was careful, however, to emphasise that ASIC was examining culture to identify early warning signs of misconduct, not seeking to regulate culture.

There was an echo of this concept of the social licence in the articulated focus of the Royal Commission, being not only on conduct that had breached the law but also on conduct that had fallen below community expectations and standards. It was initially unclear whether this suggested that the Royal Commission would seek to hold financial institutions to community standards that went beyond the black letter law.

Against this backdrop and amidst the media frenzy that surrounds each day's commentary of case studies being examined by the Royal Commission, there were two fascinating developments: the release of the APRA report on 1 May and the release of the consultation draft of the revised corporate governance principles by the
ASX Corporate Governance Council on 2 May. Each of these
cultural factors with governance and
accountability.

The APRA report highlighted concerns with culture in a
number of respects. A certain complacency and
overconfidence buoyed by financial success, a reactive
attitude to risks, particularly non-financial risks, and a
slow and legalistic and at times dismissive culture in
dealings with regulators, insularity, a failure to listen
to external voices and community expectations of fair
treatment and a degree of collegiality and trust in the
good intent of peers that impeded accountability and
healthy challenge within the organisation.

The APRA report made a range of recommendations to
strengthen governance, accountability and culture which
included cultivation of a DNA deep culture of asking
"Should we?" rather than "Can we?" in its dealings with
customers. The APRA report did, in effect, touch on social
licence issues, but it connected them strongly with
traditional governance obligations and compliance with law.

At the risk of leaping ahead to my next theme,
I believe the APRA report is an interesting demonstration
of how a regulator can have a profound effect on the
conduct of those who believe themselves to be good or at
the very least well intentioned actors without resorting to
prosecution. This report did not purport to be a set of
guidelines for all companies, yet it contained simple
messages that appear to have resonated strongly with
boards. It has been discussed and debated in boardrooms
within and far beyond the financial sector, often with
boards asking "What can we learn from this?"

Part of the value of the report, in my opinion, is
that it examines cultural factors as they connect with
governance and compliance issues in the specific context of
a large and complex business and it acknowledges both
strengths and weaknesses. As a result, it provides
flashpoints of recognition for other entities.

The release of the consultation draft of the corporate
governance principles at around the same time provided an
interesting contrast to the APRA report. It too was a
thoughtful document that sought to engage with the links
between culture and governance. It too was released
against a backdrop of stories from the Royal Commission
that were highlighting cultural governance and compliance
concerns.

Amongst a range of other changes, the draft proposed
that Principle 3, currently to act responsibly and
ethically, be substantially revised as follows:

> to instill and continually reinforce a
> culture across the organisation of acting
> lawfully, ethically and in a socially
> responsible manner.

This principle was then voiced in a number of
recommendations. Listed entities must report the extent to
which they have chosen to follow recommendations on an
"if not, why not" basis. As members of the ASX Corporate
Governance Council are at pains to point out, it is not a
binding code other than in a few respects for larger listed
entities.

The additions to the recommendations included that the
entities should articulate and disclose its core values and
there's also a suggestion, which entities need not strictly
respond to, that this could be included in its code of
conduct and that this should include a requirement not to
act in an unethically or socially irresponsible manner.

Further, that there should be reporting to the board
on material breaches of the code of conduct, presumably
including core values, by directors or senior executives,
and any other material breaches of the code that called
into question the culture of the organisation. Then
followed on that whistleblowing regimes should encourage
reporting of concerns that the entity is not acting
lawfully, ethically or in a socially responsible manner and
that the board should be informed of material concerns
raised under whistleblowing policies that called into
question the culture of the organisation.

Many submissions acknowledge the importance of values
and the culture of organisations. However, this
formulation of Principle 3 and its recommendations
encountered significant resistance from the industry and
the legal community and objections included comments to the
effect that it went beyond the obligations of the black
letter law to act in the best interests of the company and
comply with the law, that it could expand the scope for potential liability for companies and their directors, and that the recommendations, while not binding per se, operate as a soft code that has the potential to creep into hard law.

The concepts of values, culture and more particularly acting in a socially responsible manner were nebulous and problematic and that finally it represents an attempt to regulate culture, which is not the proper role of regulators.

The final fourth edition is expected to be released in the near future and there has been speculation that some aspects of these recommendations may be reconsidered in light of the heat of the debate.

I have found the vehemence of some of the reactions to the proposed Principle 3 and its recommendations curious when contrasted to the reaction to the APRA report. It struck me that the APRA report could be said, without any great stretch of the imagination, to be seeking to influence and engage on matters of culture and values more directly, effectively regulating culture.

APRA provided a simple but effective answer as to why a prudential regulator commissioned the report in the first place and why these matters fall within its remit. Culture governance and accountability go to risk and that is fundamental to stability. Nonetheless, the commissioning and publication of a report of this kind was a new approach for APRA.

Perhaps the difference in the reactions to these two documents lies in part in the way that people respond to and derive significance from them, in particular, the way they respond to specific narratives and storytelling. The governance principles necessarily are expressed at a general level and it is acknowledged that governance practices can be adapted to different organisations in light of their scale and complexity.

However, while they are not a code they do purport to articulate a contemporary view of appropriate corporate government standards and reflect the reasonable expectations of investors and that suggests they have the potential to influence interpretation of directors' duties.
and could expand those duties. That may also go some way to explaining the reaction.

The APRA report is obviously a very different kind of document. It grounds the specific cultural issues that it identified in compliance, oversight and accountability outcomes and matters that have had a demonstrated relevance to the existing law and to shareholder value. It acknowledges strengths but it explains how weaknesses have arisen from those strengths and in that way it is vivid and it is relatable.

There may be some scientific backing to the difference in the reaction. The APRA report has both a sense of immediacy and salience. It was produced swiftly, it is contemporary to events and its observations are compelling. When I was reflecting on this it struck a chord with an early piece of work by behavioural scientists Professors Cass Sunstein, Christine Jolls and Richard Thaler. Richard Thaler, as you might recall, won the Nobel Prize for Economics last year for his work in the field.

They have examined the way that laws influence the behaviour of individuals and in particular the way that an individual's behaviour will be likely not to conform to economically rational behaviour. I am about to dramatically oversimplify, so for anyone who is a devotee of this subject you're about to be annoyed.

Part of the gist of their thesis relates to the availability heuristic which they say seems to shape regulation. That is, troubling conduct that is both salient - so it is vivid, it is noticeable - and recent influences perceptions of the probability that it is going to happen again, and therefore the importance of addressing it. It is more likely as a result to provoke both a community reaction and a regulatory reaction, but it also means that this heuristic can be used by regulators to influence people's behaviour.

Could that help to explain why the APRA report has had such an influence beyond the entity that it related to? Perhaps there is a powerful lesson here as to how culture can in fact be shaped.

The later work of Professors Thaler and Sunstein is in
their acclaimed and very accessible, I might add, work "Nudge", and it highlights some of the successes of public disclosure and transparency by regulators in motivating improved behaviour on the part of regulated entities even if consumers themselves do not always read it. And that was sort of an "Aha!" moment for me because we have all seen the comments from regulators that disclosure regulation is failing us, it's not working, but perhaps Sunstein and Thaler have pointed to a role where disclosure may still have an important influence.

Both the APRA report and the draft governance principles could be said to have pre-empted matters that were within the remit of the Royal Commission. After all, the Royal Commission had specifically inquired into conduct that fell below community expectations. To my mind the Interim Report grounds matters of social licence and cultural concerns again firmly within compliance with the law, often in a failure to meet a standard of honestly, efficiently and fairly that is required of legally licensed entities and failures in oversight.

The Commission's observations regarding the role of regulators do not suggest to me that it believes that regulators need more powers to regulate culture. Rather, it asserts that they should have responded more firmly to breach reports and should have made more use of traditional forms of enforcement.

The Interim Report may as a result have quieted some initial concerns that the Royal Commission will call for the law on directors' duties to be dramatically rewritten and we will wait to see what emerges from the ASX Corporate Governance Council in their fourth edition of governance principles. However, in the meantime we should not forget the powerful nudge that came from the APRA report and the impact that it has had. Regulating culture by any other name.

Which brings me around to my second theme which is examining the role of the regulators and some of the critique by the Royal Commission in its Interim Report and the impact that this could have on the way that regulators interact with regulated entities and vice versa.

The Interim Report seeks submissions as to whether ASIC and APRA, in particular, need greater powers and
whether their enforcement strategies are effective. However, the Commission's interim views with respect to ASIC in particular do tend to leap off the page. The Interim Report suggested ASIC has responded to misconduct in the banking sector by focussing on infringement notices made on a no-admissions basis and negotiated enforceable undertakings which set relatively low financial payments.

It also suggests that ASIC does have a track record of successful prosecutions but notes that on closer scrutiny these reveal an apparent emphasis on prosecutions in the small business compliance and deterrence team, in many cases prosecuting strict liability offences, and it also suggests that ASIC has a risk averse approach to litigation. Those observations no doubt all have some validity to them.

The Royal Commission does recognise that ASIC will be delivered an additional suite of powers and that Corporations Act contraventions will carry significantly increased sanctions, a broader ability to seek civil penalties and infringement notices under the Enforcement Review bill and further powers under the Product Design and Intervention reforms.

However, it remains highly critical of ASIC's attitude to enforcement and appears to advocate for more of a "litigate first, negotiate later" approach. The temptation to say they were recommending a little less conversation, a little more action was quite powerful, although it may be some form of heresy to introduce Elvis when I started with Shakespeare.

It gives the example - presumably intended as a favourable comparison - of the ACCC conducting unsuccessful litigation in order to demonstrate that regulatory reform was needed, but how does all that stack up against theories of effective regulation?

The Interim Report makes reference to the enforcement pyramid from the work done on responsive regulation by Professors John Braithwaite and Ian Ayres and that pyramid is often presented, particularly in a corporate law context, in a relatively simple form drawn from their 1992 work, with regulatory responses starting at the base of the pyramid with persuasion, and perhaps education, escalating to warning letters, then to civil penalties, then to
criminal penalties, then to licence suspension and ultimately, licence revocation.

They indicate that the vast majority of enforcement activity should be concentrated in the lower three levels of the pyramid, so that’s down with persuasion, education, perhaps warning letters as a form of deterrence and then perhaps progressing to civil penalties.

More recent versions of the enforcement pyramid show the now familiar tiers of regulatory responses with some variations, noting that some tiers are suited to different categories of actors. Activities around education and persuasion are helpful, for instance, where people may be compliant and you wish to engage and stimulate responses or changes in direction, they’re helpful where people may be confused and they remain helpful even when people are perhaps careless, so perhaps well intentioned but dropping the ball occasionally.

On later versions of the pyramid this still remains within the remit of education, persuasion and then drifting towards subtle acts of deterrence. As conduct becomes a little more reckless then sanctions should increase. So for people who are inclined to gamble, to take chances with compliance, at that point you move towards increased sanctions, stricter forms of enforcement and you reserve the full force of the law and prosecutions for truly criminal behaviour. The idea is that you start at the lower levels of the pyramid, signalling an intention to move up if there is not compliance, but you only move up if compliance is not procured.

There have also been more recent versions of the pyramid that refer also to complementary pyramids of support, so while you have escalating forms of sanctions, you also have escalating forms of recognition and benefit coming to those people who demonstrate compliance. At the upper reaches you may in fact have champions of compliance where you recognise and reward good behaviour. Braithwaite now indicates that it is the combination of the two that is more effective.

The Interim Report accurately observes that the Braithwaite thesis is that enforcement strategies should start at the lower level of the pyramid and escalate from there, but it rapidly goes on to observe that ASIC should
be more inclined to pursue litigation and negotiate with regulated entities in the context of that litigation. It cautions that a regulator speaking softly will rarely be effective unless the regulator carries a big stick.

It suggests that persuasion cannot be the starting point for a conduct regulator, that ASIC must always ask why would it not be in the public interest to bring proceedings to penalise the breach? Hasn't that turned Braithwaite's pyramid on its head or at least sideways?

Surely the course that ASIC has pursued is consistent with the Braithwaite model even though it may be criticised for setting financial payments at too low a level. Is there not a valid case to be made that court enforced undertakings with outcomes made publicly known are not capable of being highly effective regulatory tools if they are set at levels that are perceived to properly reflect the severity of the contravention?

It is also interesting that examples of the Braithwaite pyramid of enforcement and support drawn from other industries include in their pyramid a stage between education and persuasion and sanctions to deter an additional layer, which is shaming for inaction.

We typically refer to the famous quote from the former Supreme Court Justice Louis Brandeis - I should say US Supreme Court, given my location - that "Sunlight is the best disinfectant". We traditionally refer to that in the context of disclosure regulation, but perhaps it is also apt in this context. The impact of the APRA report on not only its subject but also on other companies across the market, is a case in point.

That brings me back to behavioural science. In addition to the availability heuristic, which is the effect of vivid recent examples on the assessment of significance of a risk and the need to respond, Professors Sunstein, Jolls and Thaler identified other behavioural biases and heuristics. One was that perceptions of fairness powerfully influence the way that people respond, but they are impacted by self-interest and in particular people tend to be concerned for others and they are inclined to be cooperative in the interests of fairness sometimes, to the astonishment of economists, against their own material self-interest.
Conversely, they may act spitefully even against their own self interest where there is perceived unfairness. In addition, over-optimism affects both perceptions of relativities of conduct and individual responses to regulation. People tend to be overly-optimistic about their own standards of behaviour relative to others. In effect, they tend to believe that they are good actors. They believe that their own risk of a negative outcome is lower than other people's.

Hindsight bias has a striking effect on the assessment of past conduct, namely, that the outcomes of actions that would have been fundamentally uncertain or unpredictable at the time look far more predictable after the outcomes are known. Finally, hyperbolic discounting is the tendency of people - other than economists and perhaps lawyers - to discount costs or consequences that occur over time at an inconsistent rate. As a result, this means impatience for near term rewards tends to be very high, aversion to immediate sanctions tends to be very high. However, this sharply declines the further out those rewards or sanctions may apply.

For some time many regulators across the world, including ASIC, have acknowledged the importance of behavioural science to understanding how consumers and investors make decisions and also to understanding how to procure better compliance by companies.

In Nudge, the later work by Professors Thaler and Sunstein, there are observations in that context which relate, amongst other things, to conduct in the financial sector. Their work continues to be influential in regulatory design, particularly where there is a need to change people's minds or their behaviour or both.

Behavioural science tends to suggest that increasing the size of the big stick that regulators carry does not always have a corresponding influence on behaviour. For instance, people who are genuinely well intentioned, albeit perhaps not effective, will tend to see themselves as good actors so they can't imagine that the stick would actually be applied to them. People who are not well intentioned may either be delusional about their compliance or overly optimistic that they will be able to avoid detection.

Moving straight to litigation more often by itself may
not necessarily be effective to persuade the mainstream business community that their conduct or their attitudes need to change. They may think that other people's conduct and attitudes need to change, but they think their own is actually okay, for the most part.

In addition, while increasing applicable penalties is very important so that there is an appropriate sanction available in the worst of circumstances, if those penalties can only be obtained through traditional litigation, then the delay in securing an outcome may cause the regulated community to discount the effect of it as a deterrent and reduce the impact of it on the community as a vivid and proximate response. It does not take advantage of the availability heuristic.

Now, if Braithwaite's model is valid, then responsive regulation can justify dialogue with the regulated community and seeking to secure their cooperation before escalating to more severe sanctions. If examples of regulatory responses are heavily weighted towards litigation and formal sanctions, then will that, in fact, deter cooperation that is valuable for enforcement outcomes?

If there is not perceived proportionality in regulatory responses and applicable sanctions, both for wilful and serious misconduct but also for lower-order regulatory compliance failures, then that can impact on perceived fairness which behavioural science suggests will impact on willingness to cooperate in those lower-order cases?

In addition, if laws are so torturous, or so broad and uncertain, that perfect compliance is virtually impossible or seems meaningless, does that not also have an impact on perceived fairness?

Understandably, ASIC has responded to the anticipated and received criticism. It has announced a greater emphasis on civil and criminal litigation, it has appointed an experienced senior counsel as its deputy chairman, it proposes to put supervisors into major banks and use public denunciation of the banks to drive change, and it has secured increased funding for these purposes.

However, I would urge that these responses be tempered
and applied with proportionality and an appreciation of the way that human behaviour can be shaped. Our goal is not simply to see more prosecutions; it is to drive change in human behaviour.

ASIC has also demonstrated many strengths as a regulator. For instance, it has been effective in improving standards and conduct in the securities markets; it has followed a process of well-publicised scrutiny and information gathering, followed by publication of reports and detailed guidance that shines a light on problematic conduct, with a warning of enforcement following publication of the report, and this has guided and shaped changes in behaviours and market practices in a way that has been effective. It has engaged in well-promoted public education programs and, anecdotally, these appear to be accessible and helpful.

There is something to be said for recognising our regulator's strengths. While regulators must face candid scrutiny to build trust and confidence in our regulatory frameworks, it must also be balanced scrutiny. Regulators are required to make judgment calls and exercise discretions. They play a significant role in permitting flexibility that supports innovation and the reduction of red tape.

Regulators must also be conscious that they are funded by public money and that regulatory intervention imposes costs on companies that can impact, ultimately, those companies' shareholders. They have to choose their battles, try out some strategies, take some risks, and we should want them to do that. Sometimes those choices will not work out as they had hoped. Those actions all get judged with hindsight and regulators can fall victim to hindsight bias as much as anyone else.

In my view, it is important for trust and confidence in and effectiveness of our regulatory systems and our regulators that they both act fairly and are treated fairly.

Now, it is worth bearing in mind that the Royal Commission is an inquiry into misconduct and, as part of that, it is examining where there may have been failings in the regulatory systems or on the part of regulators that have contributed. It has not been tasked with providing
affirmation or support for the good work that companies or regulators do. We should not be expecting it to be a pyramid of support.

It has not been asked to examine the strategies that regulators employ that have, in fact, improved corporate conduct or improved the standard of communication to consumers and investors or increased public access to educative information. Its job is to highlight the failings. That does not mean that those engaging in the debate over "what next" should lose sight of the ultimate goal of improving outcomes.

We should not overemphasise regulatory strategies or regulatory structures that deter the regulated community from coming forward and seeking help and receiving education and support. We want boards to supervise actively and constructively. We want executives to escalate concerns as they identify them for the abundance of caution and not look for reasons why they do not have to. We want them to exercise judgment and to be recognised for identifying and dealing with problems well and to expect that they will be treated fairly when they do so.

There is no question that maximum Corporations Act penalties needed to be increased to be meaningful. However, there should not be a presumption that the maximum penalty should always be pursued, nor that complex cases that turn on technicalities are necessarily the right cases to pursue.

While the deterrence effect of the law suffers if enforcement of serious breaches is not seen to be pursued, there is also harm done if proceedings are pursued and penalties are imposed where the conduct is not perceived to be sufficiently culpable. If regulators take highly technical or pedantic interpretations of ambiguous laws, if they refuse to give guidance or if they engage in ambush litigation, there is as much risk that the law will be disregarded if it is seen to be unfair or impossible to comply with or if regulators take unreasonable positions as if it is not seen to be enforced in instances of serious breach.

None of this is to attempt to shift responsibility for the conduct highlighted to date in the Royal Commission or to suggest what the response should be. Far from it.
Rather, it is to acknowledge that regulatory discretion, engagement and judgment is important and that sanctions are not the only solution. Sometimes, the nudge may achieve more than the stick. Thank you.

THE HON JUSTICE F GLEESON: If I may say so, firstly, that was a very enlightening presentation and a rather sophisticated analysis of the escalating forms of sanction and enforcement action and contrasts strongly with a possibly simplistic mantra of "litigate first, negotiate later" which we, as litigators, are very comfortable with. We have a very short time for any questions.

DR AUSTIN: Thank you, chair. Shannon, you concentrate, understandably, on the position of ASIC and its potential changes in its enforcement approach. Do you think, in relation to APRA, there is a fundamental inconsistency between the prudential function and what the Interim Report is saying about enforcement?

MS FINCH: I may interpret the question slightly differently than you intended it, Bob, but I am troubled that if APRA were to also follow the kind of guide that has been given to ASIC in the Interim Report, that it would impair its prudential function. Part of the value in APRA's approach to date has been its willingness to engage and educate those entities that are prudentially regulated, and I think we have seen it be very effective over the years. It is potentially at odds with their traditional role that they become a regulator of conduct, but they might also say that in many ways they always have been, that conduct has always been relevant to stability and that they have engaged privately and quietly on conduct for some time.

Whether I like the idea that APRA is seen to seek penalties, to pursue litigation - I tend to think it will be counterproductive. But I also believe that they will exercise judgment as to the circumstances when it is appropriate for them to do so.

THE HON JUSTICE F GLEESON: Thank you. I think that concludes that session. Thank you very much, Shannon.

I will ask you to join me in thanking Shannon again. It was very informative.
DR AUSTIN: We now move straight on to the final presentation by Kevin McCann.

THE HON JUSTICE A BLACK: I am delighted to welcome the last speaker for the sessions today. He has an absolutely distinguished curriculum vitae, starting life in the role of a commercial partner at Allens Arthur Robinson as it then was, moving through to be the former chairman of several public companies and still holding a range of corporate and public roles. It is a pleasure to welcome Kevin McCann to speak today. He will be addressing matters that have already plain been touched in the course of this afternoon arising from the present Royal Commission, both in terms of the content of its inquiries and the wider lessons to be drawn from it and its implications for regulation of banking and other financial services.

MR McCANN: Thank you very much. Could I begin by thanking the Chief Justice for providing the facilities for this conference, which does cover important areas of corporate law, so thank you very much to the Chief Justice. Also to Justice Black, who over many years had an uncanny ability to advise me when to settle a case and when to litigate. Actually, his rate was 100 per cent. So thank you, judge. And, finally Bob Austin, who put all of this together and, as a result, I have had sleepless nights for the last month.

Let me begin by making some disclosures. In my CV I have disclosed that I am a former chairman of a bank, so I come with all of that baggage.

The second thing you will note is that the Interim Report is not an accessible document. It is 345 pages long and it has obviously been prepared under a time pressure, and so the result is that the conclusions of the Commissioner in parts are inconsistent, so it requires quite some concentration to figure out what he regards as the chief basis for misconduct.

I see, by the way, that Bob has given me 50 minutes - unlike the rest of the speakers, so thank you, Bob - which means I can go back to some background, because we were assuming a lot of understanding in the audience about a very complex field.

The first thing to note is that in my speech I will
look at the breakdown in culture and governance of the four
major banks - CBA, WBC, ANZ, NAB - and AMP, which led to
misconduct and the alleged illegal behaviour revealed in
the report.

As Shannon has mentioned, the APRA Prudential Inquiry
into the CBA is absolutely essential reading and it needs
to accompany any comments made on the inquiry.

I was also lucky to find some speech notes, which fell
off a truck, by Professor Graeme Samuel, who was a member
of the CBA panel. Graeme's comments are not as nuanced but
much more racy than those of Dr Laker.

Well, why have we got a royal commission? We have a
royal commission because of a number of issues which
occurred to Australia's largest company, namely, the CBA,
and that involved the following: mis-selling of
residential mortgages and margin loans in the Storm case,
2008; fees for no service in financial advice - that was
shared by all of the major banks and the AMP; an outdated
definition of "heart attack" sold by one of its
subsidiaries; anti-money laundering breaches, which
involved record fines; and the mis-selling of credit card
insurance. So there was a long litany of matters which led
to a lot of political pressure and media pressure and,
after resistance by Prime Minister Turnbull, he succumbed
and set up the Royal Commission.

Now, the terms of reference were touched on by
Shannon, but let me give you a bit more detail. The
inquiry was into misconduct, and "misconduct" was broadly
defined. It firstly included breaches of the law; it
included conduct which fell below community standards; it
dealt with conduct that involved breaches of trust or
unconscionable conduct; conduct that was misleading,
deceptive or both.

In having regard to changes in the law, the
Commissioner had to have regard to the economy generally
for access to and the cost for financial services for
consumers, for competition in the financial sector and for
financial system stability. So it was not just limited to
breaches of the law, as you see; quite a wide area.

His methodology has been to look at case studies, on
the basis that case studies that were indicative of general
trends of misconduct were the best way to proceed. Because of the fact that the AMP and the big four banks have paid hundreds of millions of dollars in remediation, frankly, it has become an inquiry into the big four banks and the AMP.

In terms of where the Commissioner focused his attention, in this paper I am going to look at financial advice and consumer lending. There was a whole lot of other areas, like indigenous lending, rural lending and small SMEs, but I won't be considering that today.

Okay, financial advice. We have the benefit, through the Royal Commission, of a paper by Professor Hanrahan on the framework for financial advice. That is 101 pages. She described the framework as a patchwork of legislation and the general law. And, by the way, the 101 pages only deal with financial advice, not with responsible lending.

The legislation is the Corporations Law, chapter 7; the Australian Securities and Investments Commission Act and the APRA legislation.

The focus of the Commission was on the provision of financial advice given to retail customers, and the law there requires services to be provided efficiently, honestly and fairly, and the FOFA - Future of Financial Advice - reforms were requiring some additional changes, that the providers of the advice had to act in the best interests of the client, and conflicted remuneration was banned. That was remuneration which you might expect could influence the recommendation of a financial product.

The core change, to act in the client's best interests, required a series of steps in order to qualify for that, and you also had record-keeping of the advice given by the adviser to the client.

Consumer lending was the other area where the Royal Commission directed its attention. The Royal Commission was interested in whether or not lenders had complied with the National Consumer Credit Protection Act. It is framed in a rather convoluted way, but, basically, to put it into a positive, the lender has to determine whether a contract is not unsuitable for the consumer, and that required making inquiries about the consumer's financial position.

Well, that is the background to the examination we
have had in the Royal Commission. Let me now go through some of the key findings of misconduct.

In the case of financial advice there were some really shocking revelations. The most egregious, I think, was the fee for no service. The fee for no service really arose because there were certain kinds of commissions which were prohibited, so the companies concerned came up with the idea that the people who lost the commission would now provide financial advice, but they did not actually have to provide any financial advice at all, and usually they did not. So what you got was a situation where people signed up for advice, they were debited in their accounts and were unaware they were being debited - if they had read their accounts they might have picked it up, but most of them did not - no advice was ever provided and the companies who licensed the advisers were well aware of that.

I recommend to you, if you want to study some really bad cases, the study on the AMP in volume 2 which reveals that senior executives of that company were aware that fees were being charged when no advice was going to be provided to clients.

Secondly, the case studies demonstrated that the licensees who licensed the advisers had no framework in place to ever determine whether or not the advice was being given. There was no monitoring, there was no checking, there was no data which they gathered to see what advice was being given.

Other misconduct was bad advice - that is, advice that was completely negligent and incompetent. There was improper conduct by advisers, which was dishonest and deceptive behaviour. Then there were inadequate systems to service clients. For instance, the AMP, when it became aware that someone was dead or was no longer giving advice, had no mechanism for turning off the deductions and there was no interest on the part of the executives of AMP in actually doing a manual workaround; they just continued to take the money without giving the advice, where the clients were not getting any advice.

In the case of the AMP, the Commissioner found that executives of the AMP knew of charging for no service but did not reveal that to ASIC and they also gave false and misleading information to ASIC about the misconduct of
which they were aware.

By the way, this is not in any way reflecting on the position of the independent opinion that was provided by a well-known law firm and where the allegation was made the chairman had played a role that was inappropriate. There is no finding against the chairman in the Interim Report, but we are talking about situations here where senior executives knew there had been breaches and, in the view of the Commission, lied to ASIC.

Now, in the case of home lending, there were a number of areas of misconduct which the Commission identified. Some 43 per cent of retail home loans come from mortgage brokers. I know from my own experience that mortgage brokers have provided a very positive role in some areas. They enabled disruptors to come in and compete against banks who had a branch system which the newly competing groups did not have. So 43 per cent of all mortgage loans with consumers are negotiated through intermediaries, mortgage brokers.

The Commission found that there was a confusion of roles and it was not clear who the mortgage broker represents: is he or she representing the interests of the borrower or the interests of the lender; what duties did the mortgage broker have to the borrower; the fact that there was no disclosure of commissions received and there was evidence that the brokers were persuading people to borrow more money than they needed; and also that the brokers' loans were more risky than other loans.

So the result was, he found, that the encouragement of the lenders was not to pursue the interests of the consumer; that compliance was relegate to a cost of doing business and profit trumped over the law.

I suppose the other rather extraordinary case of misconduct, which was mentioned yesterday by the managing director of the CBA, was credit card insurance. People were being signed up with the knowledge of the bank that they were ineligible for the insurance from day 1. In other words, there were people who were unemployed, and if you were unemployed you could not claim under the policy. Now, the amount of money was not large, it seems to have been between 10 and 15 million dollars, but that is an extraordinary thing to happen.
Well, the Commissioner had a very clear view in his executive summary as to why this misconduct occurred. He said:

[It is] greed - the pursuit of short-term profit at the expense of basic standards of honesty.

So let us now turn to what Bob set as my task today, and that is: what are the lessons learnt from the Royal Commission and, I would say, the APRA report. I have nine or ten, but probably those of you in the audience can find some more.

I mentioned that the Commissioner's rationale for misconduct fluctuates throughout the document: sometimes it is greed, sometimes it is remuneration, sometimes it is short-term profit. But at the end of his document he lists four reasons: conflict of interest and duty - and his concern there is staff and intermediaries who are pursuing profit and ignoring their responsibility under FOFA, the Corporations Law and the National Consumer Protection law; remuneration - this view that toxic remuneration leads to misconduct; culture and governance, which I will come back to; and regulatory response, which Shannon has referred to - his view is that the regulators were lax.

Now, interestingly enough, in the CBA report there is only passing reference to corporate governance. It is not dealt with. But it is interesting to see the progress of examination of the CBA CEO, and I think we are heading down to a commentary on corporate governance in the final report.

Although the Interim Report does not deal with corporate governance, I think it does invite us to consider whether there were reasons other than the reasons advanced by the Commissioner for the misconduct.

Okay. Lesson number 1. The misconduct which was identified is systematic and companies refused to acknowledge it. He is rightly critical of the financial institutions who invariably responded to misconduct by claiming they were the isolated actions of rogue staff or bad apples; it was never systemic, according to the chief executives.
One of the reasons of course that they didn't join the dots was that they didn't have the data, it appears, to even figure out how many instances of misconduct occurred. It does seem incredible in hindsight that an organisation like the CBA with a litany - every year they dropped another case of misconduct and yet, it was always due to some isolated and not interconnected event. Indeed, as late as May 2018 the Chairman of the AMP, at its AGM, addressed misconduct in the following terms:

A small number of individuals in our advice business made the decision not to follow policy, and inappropriately charged fees to customers when no service was provided.

The Commissioner's response is that rhetoric of this kind is common and responses of this kind are revelations of wrongdoing and are generally accompanied by apologies and an assurance that the public trust will be restored.

The CBA Report tells that public trust in the banks has been damaged by the misconduct issues that have been recorded. The Deloitte's Survey on trust released in October validates the comments in the CBA Report. It reveals that the people surveyed had a low opinion of the ethical behaviour of banks and their conduct towards customers.

I think the time has really come for the senior leadership of banks to acknowledge that the misconduct was systemic and not due to individual bad apples, and secondly, acknowledge that they failed to introduce the new cultural norms required to comply with legislation for regulating responsible lending and financial advice. They must now recognise that they should approach viewing their customers through the lens of commercial morality.

Third, they failed to prevent, protect and punish misconduct because they failed to identify the material conduct risks which they faced. Finally, they should acknowledge that they are committed to a comprehensive remediation of their corporate governance where it is required.

The CBA has no option because it has been forced to sign an EU with APRA and that takes up Shannon's point that
APRA can move and that is a much better way of dealing with what happened at the CBA than going to court. I would imagine that APRA, which has called for self-examination by major institutions, will be signing up the remaining three banks as they have all been found to have misconduct and I would have thought the AMP would also be in that category as well.

The next lesson is let's have a look at why was there such a massive misconduct by the four banks and if you think about it, they are four of the largest companies in Australia. The CBA is the largest listed company in Australia by 20 per cent. It is ahead of BHP by $20 billion. All the other four banks are in the top 10, as is Macquarie, so the banks are very important.

The CBA Report spells out very clearly the role of the board. The board is responsible for setting the risk appetite of the institution, they are responsible for setting the risk management framework, they delegate implementation of the risk management to the management and they have the job of over-sighting the management.

What happened at the CBA, according to the CBA Report, is they didn't get the information they needed from management to form a view about whether or not the risk management in that organisation was satisfactory. The reports were high level, they had a limited detailed profile of the organisation and very importantly, they failed to identify new and emerging risks.

I think one of the really interesting things for another day is the behavioural psychology around boards. If you are sitting in front of a CEO who has three law degrees, is a Rhodes Scholar, he excelled at Oxford, did another degree at NYU and then worked at McKinseys and his executive committee sitting around that table were absolutely outstanding people, he was voted CEO of the Year year after year, and it is the largest and most profitable company in Australia, it is a very brave director who challenges that individual and if you're a woman director, watch out, it's even tougher. That is something that someone needs to explore.

The result is there was no challenge to management. Management gave assurances that all was well. It seems to me reasonable to assume that CBA directors didn't know what
was coming down the track with FOFA and NCCP, and the policy behind the financial services legislation, which the Commissioner goes over again and again and again, is that the interests of customers should be favoured over that of the enterprise and the mindset of the provider should be, "Should we do this or should we not do this?"

When you think about the famous case involving Storm, that involved the mortgaging of pensioners' homes. The money was then given to a financier who then re-leveraged it through a margin loan. 10 years later I can't imagine anyone in this room would think that that is something that a financial institution should do and yet, 10 years ago no-one gave it a second thought. It was legal, "We'll do it."

My own experience - Macquarie has confessed that we had an enforceable undertaking and we were fortunate that we got an early one and we were not informed by management that FOFA would have such an impact on the culture of managing the business and in particular, we weren't told the policy behind the legislation requiring provision of advice in the best interests of the client. We didn't understand the changes in processes and documentation which were required. There was a reliance upon manuals and not actually explaining to people what was in the manuals.

I have set out in the paper a cultural roadmap and what the roadmap indicates is that strong leadership is needed. You need leaders who understand why the reform is occurring and are committed to drive change. They need to then identify to staff what changes are needed and how they are going to implement them. That means new behaviours and the success of the change program is when people understand the change that is needed, the policies behind them and why they are going to be implemented.

We realised at Macquarie that the risk committee wasn't good enough, so we set up a governance and compliance committee chaired by a very good lawyer and she reviewed issues, development of corporate governance and the corporate governance framework and particularly, new standards arising from legislative change. I believe that if that changed roadmap had been available to the boards of other banks, a lot of the grief that has been caused and identified would not have occurred.
Now, I should say my explanation is an explanation, I am not seeking to justify the fact we got it wrong, but you can understand why that occurred.

Let's turn to remuneration, lesson number 3. The Commissioner seems to regard remuneration by banks as the root of all evil. He makes the statement:

Every piece of conduct identified that has been contrary to law is a case where the existing Government structures and practices did not prevent the conduct occurring. The culture and conduct of the banks was driven by, and was reflected in their remuneration practices and policies.

Previous speakers have talked about this and I won't canvass what they have said, but I will point out that the CBA and Sedgwick reports proceed on the assumption that remuneration which has variable incentives in it can result in appropriate legislative outcomes, it doesn't always lead to misconduct, or won't lead to misconduct, and so does APRA where in fact they regulate variable remuneration.

It is an interesting read because the Commissioner seems to be trying to reform or change the way we remunerate in Australia, in that he thinks that perhaps the best way to go, including senior executives, is a flat salary and that he has got some support from the academic world that suggests that people don't want incentives. I have been a director for 40 years and the empirical evidence I get is to the contrary. People are motivated by incentives, and promotion, which has been suggested as the solution, I don't think will work.

Some of the proposals are quite interesting. He thinks that there should be no individual profit, entity profit should go into a pool and that everyone shares equally. Also, he doesn't like malus clauses because that would lead to concealment. Global bank regulators regard malus and clawback as essential tools of consequence management of misconduct. He also suggests that we need regulation banning certain kinds of remuneration and I suspect he has variable remuneration in his sights.

I think prescriptive legislation here is not the way to go. Boards have to be allowed to set remuneration. As
we heard earlier, there are different circumstances for companies and so you need flexibility and probably APRA is the best entity to do that, but I do have a concern that they don't have the resources to go right down through the corporation.

Lesson number 4, changes to the law. When you read Pamela Hanrahan's paper you realise how complex the law is and I agree completely with Commissioner Hayne that we need to simplify it so we don't lose sight of the principles that lie behind it. Amongst the panelists today there seemed to be an optimism that we should get law reform in this area. I am more pessimistic about the present situation in Canberra. I don't see that happening before the next election.

Lesson number 5, regulators. We have had a very good presentation on that but if I am on the board of a bank, this is what's coming. The new Deputy Chairman Daniel Crennan QC has foreshadowed a tougher line with banks. He said:

I am taking more matters to court and there will be less recourse to enforceable undertakings.

And:

They'll be lucky in future if they get an EU.

The disappointment for me here is dismissal of the merits of enforceable undertakings. In my experience they have been extremely effective in enabling a company to undertake a cultural change roadmap to embrace the principles of FOFA and get on promptly with remediation.

It is not correct to say that remuneration has been deliberately dragged out. Entities deal first with clients' complaints, next they review the files of advisers at risk and finally, they review files of other clients as required by ASIC. It is dealing with tens of thousands of files and that takes time.

Two other comments - Graeme Samuel, the former ACCC Chair, points out that court processes are important but that they suffer from random complexity in the legal
process and his challenge to the Chief Justice is as follows: he wants the Federal Court and the state courts to collaborate; he wants specialised groups of judges with expertise in the complexities of corporate securities and financial services law - and I know your court has that experience - and he also says that he likes enforceable undertakings.

I thought I would give you some light relief here and go back to "It was a bad week for ASIC in the courts" and the first thing I would like to read is a statement from Beach J who was required to hear a case involving Westpac which was in dispute with ASIC about the correct fine. ASIC was seeking a fine of $55 million and the bank said $3.3 million. In a delightful opinion - he was looking at penalty - and I thought this was wonderful, Beach J said:

First, my task does not involve the luxury of applying any asymmetric rectitudinous philosophy for the penalty phase, the task is to set a penalty appropriate to the facts so far. Second, the solution to this legal problem of identifying the maximum penalty applicable to Westpac's offending has not been assisted by ASIC's approach before me, which had all the irreconcilable atonality of a Schoenberg composition when compared with the cases pleaded and substantiated at trial.

As I say, not a good week. The other case involved Justice Gleeson's relative who came as an amicus curiae before Perram J and that was an agreed settlement between Westpac and ASIC, but the judge, not unreasonably, said he couldn't work out what the offence was, so he took counsel and counsel said perhaps there was no offence but if there was offence, it should be three times the number agreed. The result was that the judge said he would not make the orders. I suppose there are two learnings there for ASIC and also for Westpac. In future you've got to figure out what you've done wrong if you want a judge to endorse it.

Lesson 6 was litigation. If you engage in misconduct you will expect class actions. There are five against the AMP, one against CBA and one against another bank, so they're certainly going to happen if you are not careful.
The next is what are the implications for the non-financial sector and I think there was the following there. Both the report of the Commission and also the report from APRA - and James Shipton, Chairman of ASIC, has urged every listed company to read the report - show, firstly, the need for oversight of non-financial risk; be aware of material legislative change; be aware that ACCC and ASIC are coming after you; that when misconduct, actual or perceived, has occurred, stakeholders’ trust in companies evaporates, and I think companies that have mass consumer markets, like energy retailers and telecommunications, are at risk; and finally, cultural change needs to be driven internally by the board and management and not outsourced to consultants because that means that the employees see that management is serious.

Directors. I think I am sort of running out of time to get beyond some very high-level comments here. Jennifer Hill has given a really good address on the liability of directors, potentially, for failing to prevent misconduct and she argues that that may be actionable under section 180.

I know that there are some defences, such as reliance, but I would have thought that we are going to have a toughened-up regulator and if the Commissioner says "You must go to court", they might try that on, but I think the better regulator is probably APRA which has got really quite ample powers to deal with that.

Let me just wrap up by finishing on this point, the consequences of failure to provide governance and good risk management. In a sense, the first paper and the quote from Gower said it all, that once you alienate consumers, government, media, regulators, you've got trouble, and that is what has happened to the banks. We have wholesale criticism of their misconduct and we know that community trust has been badly eroded.

Secondly, the banks and the directors and shareholders and I suspect the community have paid an enormous price for the misconduct that has been revealed. In the case of the AMP the Chairman and the CEO went. In the case of the CBA the most admired CEO in the country went and a new chairman was appointed. In both cases you had an impression of a closed course: in other words, the directors went.
There are class actions in train. The cost of remediation to date is $4 billion and they are facing penalties now. APRA can impose $210 million maximum per offence and there is legislation in the house federally for another $210 million imposed by ASIC. Regulatory litigation by ASIC and APRA will distract board management. It is facing disruption in payment systems and it has strategic issues to address.

They have responded to their misconduct in their financial advisory business by selling out and in many cases the sales are going to be at a book loss. Finally, the CBA has an enforceable undertaking with APRA in relation to the CBA Report and I expect, as I say, all the other banks and the AMP will follow.

The conclusion, the lesson here, is that the banks' boards have no option, they have to get their act together, they have to engage in effective risk management, effective oversight of their management, and if I could quote from the APRA Report, "In the future the voice of the customer and risk must join in the anthem of financial success."

THE HON JUSTICE A BLACK: We have of course been very fortunate in Kevin McCann's paper. He has engaged in a very ambitious and I must say very successful exercise in answering the very hard task Professor Austin had set him of trying to identify lessons to be learned, indeed, in anticipation of the Commissioner having expressed a final view of the lessons to be learned. We do have some time now, we probably have about five or seven minutes for questions, I am sure there are many, so let me open the room to questions.

Yes, Professor Dimity Kingsford Smith.

PROFESSOR KINGSFORD SMITH: Yesterday, Mr Comyn was being asked a lot of questions at the Royal Commission about the root cause of the systemic non-compliance. One of the leading factors that he put his finger on was lack of capability and that capability seemed to be a capability in the legal and compliance team for the kinds of reasons we can imagine and have been enumerated.

I was interested that you raised, if I understood correctly, a similar kind of difficulty in your early enforceable undertaking at Macquarie. My question is
whether you think it was a technical incapability or
whether you thought it was, in a sense, an attitudinal
incapability of a narrative of profit in the institutions
that overcame the understanding that the ballpark had
changed with FOFA and other amendments, for example,
conflicted remuneration and so on, and that those things
just didn't add up to people operationalising what needed
to be done.

That is a very penetrating question, and I pondered
this for a while because I was a lawyer on the board at the
time, but this really was not my field. I spent most of my
life practising about 30 sections of the Corporations Law,
at the end of my career. At the beginning of my career
I did everything.

So the question is should I, being on the risk
committee, have inquired about FOFA and should I have done
my own work, or was I entitled to expect that the
management would come forward and explain this to me.

Now, when the report finally came in it became
apparent that, yes, people had not realised the impact it
was having, and the Commissioner talked about a nonchalance
about compliance. There is no question that we got,
I think, Deloittes or EY to write a manual and the
executives were given the manual. Well, that absolutely
missed the point of the change that was required from this
legislation.

I don't think I am answering your question, I am
sorry, Dimity.

So we decided the only way to fix this was to set up
a separate subcommittee under a former Mallesons partner
and she really got into it and we began to understand what
the legislation intended, and we were determined never to
be caught again if we got changes to legislation. So it
was the committee then, perhaps, providing proper oversight
because it was properly informed.

THE HON JUSTICE A BLACK: There is a question in the
second-back row.

MR EDWARDS: Thank you. Tim Edwards, I am a solicitor.
I am making some anecdotal observations and maybe asking
a question, I am not sure yet.
Could I come at it from being on the board of the
St James Ethics Centre for 20-odd years, which was set up
in 1989 at the conclusion of WA Inc, and so on, with the
aim to engage boards and senior managers into having
a discussion about ethical behaviour in the corporate
sector, and I am sure you are aware of all of that.

Over those years reviews were undertaken of public
companies, law firms and other entities, all with the idea
of looking at culture and behavioural change, and there was
inevitably some engagement, and a lot of engagement, by
those companies that used the services, but bit by bit the
behaviours slipped.

The behaviours that Shannon has talked about and which
you have alluded to, of the board accepting responsibility
for corporate behaviour and ethics and the like suffer from
the human condition: while they are under the pump,
everybody wants to behave and change cultures, and then, as
time goes on, that imperative lessens. I wonder if that is
going to be the case going forward now.

MR McCANN: No, I think we have come to a real watershed.
There is a very good decision by Beach J, I forget the name
of it now, where he talks about having to look at the FOFA
and the NCCP rules through the lens of corporate morality.

When I started off in the law we were black-letter:
if it was not prohibited, you could do it. Now, if you go
to Korea, we discovered at Macquarie, it is rather
different. The Americans assumed that if it was not
prohibited you could do it. But the Koreans said, "No, no,
no, maybe you can do it; maybe you cannot." But there was
this sense of morality: is it something we should do or is
it something we should not do, or is it something we ought
to do?

So I think in business now we are going to be having
to ask ourselves the question: "It may not be prohibited
by the law, but is it something we should do?" And
certainly in this new legislation where we have
relationships between business and consumers, more and more
the courts will be deciding whether we have behaved
appropriately or not, and probably there will be judge-made
law rather than these incredibly complicated prescriptive
rules where, as a result, as the Commissioner said, we have
all gone to the box-ticking exercise.

So, no, I think it is going to change. I know why it will change, because if you are facing penalties of $210 million, directors will not get away with situations much longer from shareholders where you are paying those sorts of penalties. If you think about it, the CBA paid a penalty of $700 million. Now, the consequences were dramatic: the CEO is gone and Catherine Livingstone has cleaned out the board. So there have been consequences. This is, again, the biggest company in Australia, one of the most profitable companies in Australia, and the CEO has gone and the board has gone.

THE HON JUSTICE A BLACK: I note the time. There may be time for one last question. I see Professor Austin agreeing, so one last question, if there are any questions remaining. In the second row there.

QUESTION FROM THE FLOOR: This might be very simplistic, but when are individuals going to be accountable? Whilst the company is paying a $210 million fine, are individuals ever going to be accountable? Do we not need to find the individuals and penalise them in a very real way to change the culture?

MR McCANN: Let me answer your question in two parts. There is no question that in the case of the competition law - I used to be on the board of a concrete company. Concrete companies made lots of profits because they colluded. The then Commissioner decided to sue not only the company but the chief executive, and that had a remarkable effect on outcomes.

At the moment, these breaches do not involve - well, I stand to be corrected, actually, by the experts in front of me as to whether there are criminal penalties for individuals in these cases or whether it is banning and things of that sort, but I think that probably the view is taken at the moment that if you have these huge penalties against companies, the boards and executives will do something about ensuring misconduct does not occur. You will prevent it, you will detect it and you will punish it.

THE HON JUSTICE A BLACK: Well, we should thank Kevin McCann for his paper.
DR AUSTIN: This is the last session, which is a discussion session. I think a substantial part of it ought to be to continue with the themes enunciated by Mr McCann, because they really bring into focus everything else that we have done, but we have a few agenda items to discuss and I am happy to say that the Chief Justice is going to join us upstairs and he might have one or two things to say.

I will start with Kevin McCann's paper. We have heard his prognostications of what will follow from at least what the Royal Commission has done so far and, looking into the future, what it may do. It seems to me that the overall conclusion is that the important thing from Mr McCann's point of view is that boards of directors should take the Royal Commission's findings very seriously and respond in a number of ways - respond in terms of making sure that they are properly informed about the law and making sure that remuneration structures are justifiable - and he has not recommended that there be a major legislative change in consequence upon everything that has happened.

I notice that Kevin is nodding and agreeing, but I wonder whether others might have comments to say about what can and ought to follow once the Royal Commission has made its final report. Would anyone like to kick off on that?

PROFESSOR KINGSFORD SMITH: Well, do you mean legal changes or structural changes to corporate governance?

DR AUSTIN: Everything.

PROFESSOR KINGSFORD SMITH: Everything? One of the things I think which could be done, which would require a legislative change, is that at the moment we have "twin peaks" regulators and they have overlapping remits. It may be helpful to revise their powers both to plug the gaps in the prudential side and in the conduct side - and I am sure that that will already be in train. What we heard yesterday morning all about the general themes of the responses to the interim report suggest there will be some of that coming along.

But it is, I think, important to better coordinate the prudential and conduct regulators, and one of the things which could be done is to give them both powers in
overlapping areas, where those overlaps are unavoidable, and to encourage them to coordinate in the exercise of those powers.

DR AUSTIN: Are you talking about APRA and ASIC?

PROFESSOR KINGSFORD SMITH: Yes.

DR AUSTIN: Are you including the ACCC?

PROFESSOR KINGSFORD SMITH: I have not, but I guess there is no reason why you might not.

In South Africa they have taken the "twin peaks" model on recently and it is kind of "Twin Peaks Mark II". They have gone ahead with something like this suggestion. I am sure we would look at what they have done and do it with "Twin Peaks Mark III", perhaps. But I think that is one thing that would require legislative change that could improve the overall projection of regulatory coverage.

DR AUSTIN: Would it be right to describe that as streamlining the interface between the regulators?

PROFESSOR KINGSFORD SMITH: Yes.

DR AUSTIN: And you say that should be a primary outcome?

PROFESSOR KINGSFORD SMITH: I think it would be a very helpful outcome.

Turning to the Commissioner's very interesting suggestions that you could have a number of principles which would hit the high notes of the purposes of financial services --

DR AUSTIN: Where would they be?

PROFESSOR KINGSFORD SMITH: Well, that is the question I was coming to. It is not easy to use principles-based regulation. There are a lot of paradoxes in it. It is not, however, impossible. Principles like that could be indicated as interpretive principles for the law you already have; they could be installed in the legislation as a principle referable to certain lower rules, lower-status rules of more particularity, and what we know about rule-making suggests that mixing principles with more
particularised rules works quite well.

The problem is, of course, between the scylla of uncertainty and the charybdis of particularity and complexity, and I know that the Law Council's submission and certainly the submission of the Centre for Law, Markets and Regulation has been that in relation to suggestions like this one, which are highly legal in their content, we need to have a few expert minds put to work to make sure that these recommendations or suggestions in principle, if they do become the Commissioner's recommendations, are operationalised and legislated for in a way that makes them legally work well. There is a bit too much of what some of us, when we talk about this, call "junk law" around; law that is proposed and seems to be something that everybody needs or even some of us want, but that does not work very well once it has got through the legislative sausage-making machine.

So having some expert legal firepower in putting into operation the Commissioner's recommendations I think would be really important.

I have one other suggestion about change, but I might leave it until later since I have used up a bit of time already.

DR AUSTIN: I might interject here, for the benefit of the audience, some information about the Law Council's submission on the Interim Report. They said that the law should be simplified with a key focus on the principles already embodied in the law such as acting honestly, efficiently and fairly and not misleading, and acting in the best interests of the customer. That, of course, invokes what the Interim Report said. They suggested that the radical simplification which changes compliance obligations should be avoided due to substantial cost which would be borne by businesses and ultimately consumers in adapting their compliance regimes. They cautioned against extending the best interests duty beyond the circumstances where the relationship with the intermediary is of a fiduciary character. Rather, they said, it should be made clear to consumers that they are not in an advisory relationship with their financial adviser, rather the opposite, they are being sold to by the intermediary. They recommended that the reforms should include simplifying information consumers receive from their financial adviser.
They noted that many of the issues raised in the Interim Report demand a careful and considered responsible reform at a fundamental policy level that capitalises on the experience since the introduction of the financial services and consumer credit regimes. In other words, it should be expert-inputted, I think. Accordingly, they recommend that the way to proceed in law reform is referral to the Australian Law Reform Commission.

Can I just add a personal view of my own. I think that there is a need to consider further law reform, particularly in the chapter 7 area, and I am surprised that Professor Kingsford Smith has said that the statement of principles in the legislation, supported by regulations, is successful. I would say not always, and I would say a good example of too much detail in the legislation, superimposed by a whole lot of regulations that you have to check up on whenever you want to give any advice, is not a successful way forward. You may not disagree with that, by the way.

The other thing that I have a concern about is that we have to make sure that the demand for law reform is not transformed into an excuse for what went wrong. We cannot blame the law for the misconduct that the Commission has uncovered. It has to be accepted that blame has to be attributed to those responsible for it.

Any comments?

PROFESSOR KINGSFORD SMITH: Could I just clarify, I did not necessarily mean that you impose principles on the rules in chapter 7 that we currently have, but if you are going to use principles of the sort that the Commissioner suggests, then I think that you are going to have to have some kind of level of particularity that goes with them in order to make the legislation workable and to meet the demand of the industry that they know what their obligations are.

DR AUSTIN: Does anyone else want to have some observations on the prospects of law reform as an outcome?

THE HON CHIEF JUSTICE TF BATHURST: It is obviously a potential outcome, indeed, law change I think is almost a near certain outcome and I use the word "change" deliberately, but speaking from almost an outsider's point of view, I would have thought the best approach would be to
consider the deficiencies that have emerged as a result of the Commission's report, the APRA Report, then work from there as to whether legislative reform, whether by way of principles based legislation or perhaps dealing with specific problems which came, should be implemented.

There are simple things like increasing penalties, that Kevin talked about, there may be an extension of criminal liability in respect of certain areas, but it is very difficult to talk about it in the abstract. One needs to have a long, cold look at it and see, if there are deficiencies in the law, the best way to remedy it. I do agree with you, just try and keep it simple because not only lawyers have to work with it, boards, risk management people and the like also have to work with it.

DR AUSTIN: Another powerful part of Kevin's paper and also Shannon's relates to the way in which we can learn a lot out of the CBA Report and the prospect that we may have future developments both contained in the final report of the Royal Commission and perhaps in other ways. I wonder whether the panel has a view on our prospects of getting another CBA Report, perhaps in a different context, or whether the circumstances that led to APRA generating that report were quite unique and not likely to be repeated. Do you want to comment on that, Kevin?

MR McCANN: Look, I think - how can I put it - the Royal Commission was necessary because even an insider like me didn't realise the extent of the misconduct that occurred and so if I didn't know the community was entitled to know what was happening, but I'm not sure that the Royal Commissioner - with the greatest of respect - is the best person to prescribe the remedies. He has some very unusual views on remuneration. Chief Justice, I would hate to see him in your Court of Criminal Appeal because your gaols would be full of bankers and ASIC managers, I think.

I think Dr Laker has come out with a very, very minimalist explanation of what went wrong and what should be done to remedy it. His comments on remuneration were comments in chapter, I forget which chapter it is but the one where he talks about how you remediate is really well written. My worry is you're going to get some conflicting views coming out of the Royal Commission. I think APRA has already done it in that space, so maybe the
Royal Commission could look at areas not covered by APRA.

DR AUSTIN: Where do you think APRA should be taken as a regulator? It now has the BEAR legislation to deal with. It's likely I guess that BEAR will be expanded in some ways and the question arises whether similar legislation should be extended to other parts of APRA's responsibility.

MR McCANN: It is interesting because when I began life on the Bank Board they were a very principled regulator. They didn't get into a lot of detail. By the time I left the board they were really into everything. Now they've got the BEAR legislation. They have been chastised by the Royal Commission so they will probably be signing up the other big three banks and the AMP to enforceable undertakings. They are a very small agency, they don't have a lot of resources and that's going to put quite a lot of stress on them if they have to regulate oversight that is used.

My point about remuneration is at the moment they're only limited to a handful of people. If they're having to go down into a bank that has 45,000 employees, even if they stop at 10,000 that's a huge task to audit whether or not that has been complied with; so the answer is I don't know.

The other thing I would say, Bob, is there is a turf war going on because ACCC has brought that case against underwriters and I'm not being rude, but I understand the question is whether or not a share is a good. When I taught personal property I thought it was a chose in action, but apparently the definition as such is capable of being interpreted as a good. So you've now got Mr Sims coming into the financial markets in a matter that's a conduct matter, not a competition matter.

DR AUSTIN: I don't want to get bogged down in the definition of goods and shares, but Shannon, would you like to add something to the observations about the ACCC? I know you're interested.

MS FINCH: Bob knows that I have some strong views on the subject. The cartel case that the ACCC is pursuing came as such a complete shock to the market.

DR AUSTIN: It produces a great overlap of regulatory involvements.
MS FINCH: It does, and I think it can be contrasted with the way that ASIC has engaged in trying to drive behaviour within the same community that is affected by the cartel case, where ASIC’s approach will be to review behaviour, identify it if they think that there are problems there, and once that has become known then proceed to enforce. The law is not supposed to take people by surprise.

DR AUSTIN: It sounds to me like a view is emerging on the panel that we desperately need a clear focus on regulatory cooperation. Would that be fair?

MS FINCH: I certainly think there’s nothing to be gained by regulators arm-wrestling over territory. That’s not in the interests of trust and confidence in our regulatory systems.

DR AUSTIN: I want to circle back to the first two papers, in conclusion, and refer again to Kevin’s reference to Professor Jennifer Hill who has cited ASIC v Adler and Santow J’s comments there to argue that directors can be made liable under the duty of care and diligence provisions for omissions if they don’t ensure that a company has appropriate compliance systems and acts in accordance with its authorised practices. She describes this as a responsibility of directors to ensure that companies are not engaging in organisational hypocrisy.

I think that could provide a foundation for expanding the scope of the statutory duty of care provision in section 180 to address some at least of the issues that are floating around concerning corporate culture, or the lack of it, which are currently being reinforced in other ways by the possibly fictional social licence to operate. We might find that there are duty of care cases that relate to the kinds of deficiencies in corporate culture that has been a concern in CBA reported by APRA and in other ways.

The question that is perhaps most interesting arising out of Professor Kingsford Smith’s paper is the extent to which her analysis about the public focus of section 180 might be extended to other statutory duties, including the best interest duty in section 181. It seems possible to argue that if you characterised those statutory provisions as part of the public law then the next question that will arise is the extent to which that characterisation affects...
the content of the duties and may take us to the conclusion, notwithstanding Professor Harris's paper and the debate that we had about that, that because the best interest duty is part of the public law, it is directed towards the interests of the community and the interests of the community must eventually be taken to trump the interests of shareholders. Would anyone like to comment about that?

PROFESSOR KINGSFORD SMITH: Going straight to the heart of your question, which is, I suspect, really asking me about 181 rather than 180, since that overlaps more with what Professor Harris had to say, 181 is a duty which is expressed as being open to the world in the same way that section 180 is, and although it is more directed in its language to the best interests of the company, it is a duty to act in the best interests of the company and to act honestly, but it does not expressly say that the duty is owed to the company. It is also the duty which has been most referred to in terms of interests which are not traditional interests that have been surveyed in the general law of companies. So, for example, it is the duty sometimes in which environmental interests are raised or interests of the community in some sort of more general way.

Somebody came to talk to me at the break about the fact that there were environmental law actions going on in the superannuation investment area which may go in this direction. Of course, they might also be covered by the section 180 duty of care.

So I think the kind of things that you are suggesting are certainly plausible. Where they will go is anyone's guess, I think.

DR AUSTIN: It seems like an increasingly open question. I think we should give the penultimate last word to this man, who might have something to say about the discussion we have just had, and then perhaps the Chief Justice might like to make some concluding remarks and close the conference.

ASSOCIATE PROFESSOR HARRIS: Thanks, Bob. Certainly Professor Kingsford Smith's analysis about the indicators of publicness of duties applies equally in section 181. We have the potential for criminal penalties, we have public
enforcement through a public regulator. But my comment to it would be why do we need to only focus on the first part of that section - that is, 181(1)(a)? What does it mean to say that directors have to act for a proper purpose? How do we frame those proper purposes, and could we reach a stage where ensuring that your company does its best to comply with the law is seen as being a proper purpose, and failing to ensure that your company complies with the law could be seen as acting for an improper purpose? These are some issues that have come up in US corporate law, particularly around the Caremark duty and duty of good faith, setting up compliance programs and monitoring those compliance programs. I do not think we have reached the stage in US law, nor in Australian law, where the failure to have a fully 100 per cent effective compliance program means that you have breached your duties. There might be a duty to ensure there is some compliance program and to monitor it, but we are not at the stage where you must ensure that no breaches occur.

THE HON CHIEF JUSTICE TF BATHURST: There are a lot of matters there on which I cannot comment except to say that no doubt these issues will be ventilated through the courts in the years to come.

What has been described as "stepping-stone liability" is very much a matter of controversy, and I think that is, when one is dealing with directors' duties, inevitably linked up to this private/public concept.

To go further, I can see the potential for litigation saying directors did not fulfil their duties of ensuring an adequate risk management system in circumstances where it could be shown that the lack of that risk management system was detrimental to the company. These are all matters that have been put into extreme focus, and Bob, with his usual ability, has forced the panel in the last few minutes to focus on them, and I am glad I generally kept quiet.

Can I simply say this: I think this conference has been fascinating. The issues are of considerable public importance, not only for lawyers but to the community generally and to the future health of our economy.

Can I thank the panellists for the enormous amount of work they put into their papers, the erudition with which they were delivered, and of course thank Bob for all the
work he did, and Barbara McDonald and the Ross Parsons Centre. I hope to see you all again here next year and I declare the conference closed.

AT 6PM THE CONFERENCE WAS ADJOURNED ACCORDINGLY
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blamed	[1]

blockroom	[1]

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