

5 September 2002

SUBMISSION TO THE REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS

We refer to the request for comments on the review of the role and effectiveness of non-executive directors. The New South Wales Young Lawyers Business Law Committee, Australia wishes to make the following comments in relation to your consultation paper.

Introduction

There is no provision in the Corporations Act 2001 that gives any legal recognition or definition of the term “non-executive directors”. Having said that, it does not preclude the Courts to find non-executive directors liable for serious misconduct in the same way as an executive director would in carrying out his or her duties to the company.

In certain circumstances, an executive director is distinguishable to a non-executive director by the following (a non-exhaustive list):

- (1) Executive director
 - Participates in the day-to-day management of the company.
 - Hired on a full time basis.
 - The company expects the director to exercise a degree of care and skill.

- (2) Non-executive director
 - Participates on a more part-time basis and is normally hired for his or her expertise in the industry or to act as a counter balance to the executive directors.¹
 - The degree of care and skill is measured objectively.
 - Not bound to give continuous attention to the affairs of the company.²

Good Corporate Governance

The issue of non-executive directors taking a more active role in companies these days has become important to the requirement of good corporate governance. Good corporate governance is extremely important as it enhances the shareholders' confidence and also protects the interest of minority shareholders.

For example, a company may adopt policies that a certain number of board members should be non-executive independent directors and that the chairperson of audit and remuneration committees be a non executive director.³ This will create a well balanced board of members. We also note that as recommended the Bosch Committee chaired by Henry Bosch AO (“the Report”)⁴ independence of non-executive directors is more likely to be assured when the director:

- (1) is not a substantial shareholder of the company;

¹ Company Secretaries' Essentials, Chartered Secretaries Australia; Harris, J, Australia, 2002.

² *AWA Ltd v Daniels t/as Deloitte Haskins & Sells* (1992) 7 ACSR 759.

³ Fords, Australian Corporation Law - Principles and Practice, Butterworths, Australia.

⁴ The Bosch Committee's (Australia) Report is designed as a guide to directors, auditors and accountants, and to investors, as to accepted principles of good corporate practice.

- (2) has not been retained as a professional adviser by the company;
- (3) is not a significant supplier or customer of the company;
- (4) has not been employed in any executive capacity by the company within the last few years.

Standard of Care

Increasingly we have seen cases where the Courts are taking the view that the standard of care required of a non-executive director is not necessarily different from that required of an executive director.⁵ The standard of care in s180 of the Corporations Act 2001 requires an officer of a corporation to at all times exercise a reasonable degree of care and diligence in the exercise of his or her powers and the discharge of his or her duties. In *ASIC v Adler* (2002) 41 ACSR 72, The Court discussed the application of s180 and that an “officer” would cover officers in their capacities as non-executive directors.

Section 180 causes a problematic application in particular to non-executive directors where there is no express requirement of what degree of skill should be adopted, and if so, what degree of skill should apply. It would appear from case law that the degree of skill required by a non-executive director is measured objectively.

With the recent collapse of HIH Insurance Ltd, Australia’s second largest general insurance company in 2001, there is an increasing awareness to look upon directors and more importantly non-executive directors and their roles in such companies.

Questions

In relation to the questions posed in your consultation paper, we comment as follows:

Question A: What role should non-executive directors perform, and how does this compare to the present position?

In particular we refer to your question on the role of the Chairman and how does it relate to non-executive directors. We agree with the line of judgement in *AWA Ltd v Daniels t/as Deloitte Haskins & Sells* (1992) 7 ACSR 759 at 867 where:

“The Chairman is responsible to a greater extent than any other director for the performance of the board as a whole and each member of it. The chairman has the primary responsibility of selecting matters and documents to be brought to the board’s attention, for formulating policy of the board and promoting the position of the company. In discharging his or her responsibilities the chairman will cooperate with the managing director if the two positions are separate or otherwise with senior management.”

It would seem ideal that the two positions (ie. the chairman and the managing director) to be separate and independent of one another in order to promote efficiency in the board.

⁵ *Daniels v Anderson* (1995) 13 ACLC 614 at 661 – 665.

Question B: What knowledge, skills and attributes are needed, and what can be done to attract, recruit and appoint the best people to non-executive roles?

In particular we refer to your question on what key skills, knowledge and experience are needed by non-executive directors to perform the role effectively. We note that while it is not necessary for a non-executive director to have the same involvement in the company as an executive director, when it comes to responsibility, the same standards will be applied to both types of directors. As mentioned under the heading "Standard of Care" above.

In that case, for the next 10 years, a non-executive director will need to have the same skills, knowledge and experience of any company director. That is, being involved with the company financial matters, board decisions and so on.

Question C: Do existing structures and procedures facilitate effective performance by non-executive directors?

If it is prudent to adopt the recommendations put forward by the Bosch Committee, that a balance and a good mixture of members in the board is needed to promote efficiency, the current liabilities (though not the same responsibilities) adhered to non-executive directors would make it non-distinguishable from executive directors.

Non-executive directors would be discouraged to voice independent opinions and creative thinking in a particular industry if the current standard of care are of the same level expected of executive directors. One would expect non-executive directors would perhaps be less willing to accept such positions even if the main reason of such employment was solely for their expertise, knowledge and creative thinking.

This would defeat the purpose of employing such non-executive directors if the purpose of doing so is to extract certain expertise and knowledge where ordinary directors would not have.

Question D: Do existing relationships with shareholders or others need to be strengthened?

No comments.

Question E: How can non-executive directors be best supported to perform their role?

There is a need for reform in Australian legislation by providing additional defences provisions (to non-executive directors) which might otherwise make them personally liable for the company's breaches of laws. There is also a need to distinguish the different roles between executive and non-executive directors. This will encourage

“creative” non-executive directors who will not be “put off” accepting a position on the board.

Perhaps this is a long and tedious task to legislative. Instead an “officer” in s180 of the Corporations Act 2001 would cover all types of directors and that was the intention at that time when the legislation was drafted. However, given the rise of non-executive directors and their increasing involvement in companies, reform of the legislation in order to recognise and possibly defences will be need.

Question F: In what ways is the position different for smaller listed companies?

No comments.

Question G: What can we learn from international experience?

No comments.

ALEX WORNER
CHAIRMAN

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