

The Emperor's New Clothes? (*)

- the case for aligning corporate constitutions with contemporary governance theory and practice including to mitigate the risk of inappropriate personal liability attaching to directors for lower level corporate managerial shortcomings –

Precis

1. Contemporary corporate governance theory and practice draws distinction between the role of the board in governing and directing, and the role of the CEO/management team in managing, the business and affairs of a corporation.
2. Yet both the Corporations Act and the typical provisions of the constitutions of Australian public companies do not draw this distinction. Each vest management responsibility for the business and affairs of the corporation specifically in the directors.
3. Should managerial shortcomings arise in the business and affairs of corporations and questions of responsibility and liability for such shortcomings arise, directors may not be able to rely on contemporary corporate governance theory and practice for relief therefrom and must defensively resort to reliance on exculpatory provisions of the Corporations Act such as:
 - S.180(2) (Business Judgement Rule)
 - S.189 (Reliance on information or advice provided by others);
 - S.190(2) (Responsibility for actions of delegate);
 - S.1318 (Discretionary Court relief where the director “ought fairly to be excused”).
4. Arguably there is opportunity for corporate constitutions to be amended to better align their provisions concerning responsibility for governing, directing and managing the company to better align with contemporary corporate governance theory and practice.
5. This paper reflects on prior academic writings on this issue and, without the need for legislative or regulatory reform, proposes alternate corporate constitutional provisions to better assure such alignment and, as a corollary, better protect directors from the risk of personal liability for lower level corporate managerial shortcomings.

- (*) “The Emperor’s New Clothes” is a short tale written by the celebrated Danish author Hans Christian Anderson, first published in 1837 as an instalment of Anderson’s “Fairy Tales Told for Children”. Idiomatically the tale and its title refers to something (e.g. a prevailing orthodoxy such as naïve reliance on the application of contemporary corporate governance theory and practice to absolve directors for responsibility for lower level corporate managerial shortcomings within a corporation) accepted as true or professed to be praiseworthy, due to reticence on the part of the relevant cohort to confront reality and be seen as going against the popular and convenient opinion of that cohort. In socio-psychological terms this malady is akin to the concept of “pluralistic ignorance”.

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1 Introduction

- (a) Corporations are virtual creations which, through legislation and regulation, are conferred a statutory licence to operate by society with general acceptance that the limited liability corporation has contributed significantly to mankind and its economic and social development.

“The limited liability corporation is the greatest single discovery of modern times ... even steam and electricity are far less important than the limited liability corporation.”

[Nicholas Murray Butler, President of Columbia University, 16 November 1911]

This acceptance has led to the corporate model becoming the de facto preferred standard for commercial (public and private) and not for profit/for purpose endeavour, as well as for public sector and statutory authorities.

“The law as to corporate personality and limited liability was created for the public interest to promote trade and responsible development of our nation”

[Young J. in *Ausbro Farex Pty Ltd v Mane* (1986) 4 NSWLR 419 at 424]

- (b) Typically the Australian corporate model evidences the following key features:
- a **corporation**, established under legislation, being legally recognised as a sui juris person with perpetual succession, able to own property, accept obligations and to sue and be sued in its own name;
 - power and control of the corporation being vested in a number of individuals (typically called “**directors**”) acting and making decisions together as a unitary group (typically called a “**board**”) with those directors being reposed with a number of statutory and general law “fiduciary” style responsibilities as well as other specific legislatively prescribed obligations;
 - the ultimate “**owners**” of the corporation (be they shareholders of commercial corporations, members of not for profit/for purpose organisations or, notionally, government ministers with ministerial portfolio responsibility for public sector statutory authorities) generally being absolved of liability for performance shortcomings of the corporation (“**corporate veil**”);
 - the directors as a board, **delegating** a raft of responsibilities relating to the day to day management, operations and affairs of the corporation to a chief executive officer or managing director, who in turn engages (in the name of the corporation) a team of executives, managers and employees, and sub-delegates authority (as appropriate) to them consistent with the intended responsibilities of their office and role in the corporation.
- (c) Corporations have become increasingly powerful and influential in our society, driven by resource efficiency principles of economies of scale and scope, to deliver greater productivity and performance outcomes. The size of many corporations, whether measured in terms of financial capitalisation, revenue base or workforce numbers, exceeds those of many sovereign nations. The span of control (geographical and functional) of many corporations is extensive both nationally and globally.
- Yet despite the size of the corporation or the extent of its span of control, ultimate responsibility remains vested in the directors of the corporation, meeting and making decisions as a board.
- (d) If and when corporate performance shortcomings arise, be they:
- financial insolvency;
 - environmental harm;
 - adverse occupational health and safety incidents;
 - fraudulent dealings by managerial personnel;
 - bribery and corruption incidents;

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- product safety concerns;
 - misleading and deceptive conduct;
 - anti-competition dealings;
 - racial or other minority vilification;
 - workplace/industrial relations and employment matters;
 - consumer protection breaches;
 - legislative compliance breaches generally;
 - corporate disclosure failures; or
 - otherwise,

typically the aggrieved party (whether an individual private citizen, a group or “class” of individual private citizens, a regulatory authority or compliance enforcement officers) will seek action to redress the corporate performance shortcoming. Such action may be civil or criminal by way of restorative compensation, retribution for wrongdoing and/or deterrence to reduce the risk of future corporate shortcomings by the alleged perpetrators and others generally.

- (e) Usually such action may be against the corporation and may also be against the directors (and sometimes other relevant officers) of the corporation depending on the nature of the corporate performance shortcoming and perceived responsibility for its cause.

In many civil cases where claim for responsibility is brought against corporate directors, it is the corporation which may ultimately accept financial liability for the claim by way of rights of indemnity held by the directors against the corporation (typically found in corporate constitutions and in collateral contractual arrangements commonly called “Deeds of Access and Indemnity”). Where the corporation may be financially compromised or otherwise legally proscribed from responding to a claim against it, whether that claim be directly by an aggrieved party or indirectly by way of indemnity claim by a director, then the relevant director may have to personally accept financial responsibility and liability for the claim. In the case of alleged criminality or personal egregious conduct by the director, which may include conduct, or lack of action, giving rise to an alleged compliance breach of legislation or regulation, then the director may have to accept personal responsibility and liability irrespective of the financial standing of the corporation without practical recourse to the corporation for indemnity protection.

2 Foundations for director liability claims

- (a) In 2012 AICD published a White Paper entitled “Mind the Expectation Gap”. The paper was authored by the same author as this paper. Despite the intervening 8 years, the issues and concerns raised in that White Paper apply equally today. The paper primarily addressed the differences in what the general public perceives to be, what the law prescribes to be, and what contemporary corporate governance theory and practice states to be, the proper role and responsibility of a director (with particular focus on non-executive directors). I commend to you the reading of that White Paper.

In 2020 AICD also published the findings of a research project commissioned by it concerning “Criminal and Civil Frameworks for Imposing Liability on Directors”. The research was undertaken by distinguished law firm Allens Linklaters. It provides an informative analysis of directorial liability frameworks and risks for directors of Australian companies relative to those in a number of comparator economically developed countries/jurisdictions i.e. Canada, Hong Kong, New Zealand, United Kingdom and USA (“**Comparator Jurisdictions**”). Of relevance, key high level findings of the research “...indicate that Australia’s director liability environment is unique ... and in many regards, uniquely burdensome ... as compared with the Comparator Jurisdictions”. I commend to you the reading of that publication.

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- (b) The foregoing mentioned 2 publications highlight the areas of prospective liability for directors in some detail. This paper will not duplicate that work. However the following can be surmised for directors of Australian corporations as to their primary sources of director liability:
- (i) As corporations are creations of legislation, in particular the Corporations Act 2001 (Cwlth) (“**Corporations Act**”) for most commercial and some not for profit/for purpose corporations, it is to the provisions of the legislation under which the corporation is constituted that reference primarily should be had as to the powers, responsibilities and duties of directors against which liability may accrue arising from corporate performance shortcomings.
 - (ii) There is an increasing raft of specific legislative or regulatory enactments whereby personal responsibility and liability is directly imposed upon directors arising from corporate outcome shortcomings. Paragraph 1(d) above touches upon a number of the issues addressed by such legislative or regulatory enactments. Typically direct liability is sometimes sought to be sheeted home to a director merely by virtue of the office held by the director and the responsibility, power or authority deemed (or assumed) to be conferred upon that office. This is done to encourage those in positions of responsibility in corporations to actively exercise their powers to ensure governance and management systems and processes are in place to assure legislative and regulatory compliance and the avoidance of the proscribed outcome or behaviour sought to be addressed by the legislation or regulation.
- (c) Having regard to the scale of the undertaking, due to the vast number of Federal and State legislative enactments otherwise involved (with some research studies estimating there to be around 700 such relevant legislative sources of liability for directors in Australia), this paper will confine the scope of its analysis and commentary to powers conferred upon directors of corporations constituted under the Corporations Act, and therefore duties and liabilities arising thereunder. However, subject to further consideration and analysis, it is perceived that the analysis and commentary in this paper also may have derivative relevance to liability risks for directors under those other legislative and regulatory enactments.

3 Powers of Directors

- (a) Powers of directors of corporations are found either in the Corporations Act and/or in the constitution of the corporation to which they are appointed.
- (b) Under the Corporations Act the default provision is found in S.198A (Powers of directors – replaceable rule):
 - “(1) *The business of a company is to be managed by or under the direction of the directors.*
 - (2) *The directors may exercise all the powers of the company, except any powers that this Act or the company’s constitution (if any) requires the company to exercise in general meeting.”*

[(*) underlining added]

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- (c) However being a “replaceable rule” it only applies if it has not been “displaced or modified by the company’s constitution” (refer S.135(2) of the Corporations Act).
- (d) Typically public companies in Australia specifically displace the “replaceable rules” of the Corporation Act and adopt specific constitutional provisions which address those matters that otherwise might be the subject of the “replaceable rules”. As evidence of this approach Schedule A to this paper contains an analysis of this phenomenon by reference to the powers conferred on, and responsibilities vested in, directors for the ASX 10 largest companies by market capitalisation. The constitutions for most of these ASX 10 companies appear to have been prepared by leading Australian law firms. Based on the author’s anecdotal experience of such matters, this approach is also typical of most other ASX listed public companies.
- (e) The addendum to Schedule A also contains sample provisions from the constitutions of those ASX 10 corporations concerning the appointment of a managing director (who then also usually acts as a chief executive officer) of the corporation and the delegation of authority from the board to the managing director.
- (f) From Schedule A the following common themes are evident as to the constitutional conferment of powers upon directors:
- (i) nature of powers conferred:
- “managing the business of the company”;
 - “managing and controlling the business and affairs of the company”; or
 - “business and affairs of the company to be managed by or under the direction of”
- (ii) to whom powers conferred(*)
- “the directors”; or
 - “the Board”.
- [(*) Although of academic interest, particularly as the Corporations Act includes scant reference to the term “the board”, as opposed to “the directors” (implicitly as a collective group) and “director” (individually) in the case of responsibilities, duties and liabilities arising from breaches thereof, it is perceived that no material practical consequence arises from this difference in terminology as used. Accordingly this paper will not further analyse or address this difference in terminology.]
- (g) Of note, although not all constitutions referenced in Schedule A use the same wording and terminology, each at least effectively includes reference to the directors or board (not anyone else) having the power to “manage (in some cases also “and control”) the business (in some cases also “and affairs”) of the corporation. In some cases the constitutional provision also picks up the further concept in replaceable rule S.198A as to the power being exercised “by or under the direction of the directors”.
- (h) Consistent with the key features of the corporate model (refer paragraph 1(b) above), as the power to “manage (and in some cases “and control”) is solely vested in the directors (or board), subject to certain referenced exclusions not of relevance to this current analysis, any delegation of such powers by the directors (or board) must also be empowered by either the Corporations Act or the provisions of the corporation’s constitution. Specific powers to delegate are generally found in the constitutions of the companies referred to in Schedule A and also S.198D of the Corporations Act:

“S.198D Delegation

- (1) *Unless the company’s constitution provides otherwise, the directors of a company may delegate any of their powers to:*
- (a) *a committee of directors;*
 - (b) *a director;*
 - (c) *an employee of the company; or*

(d) *any other person.*"

- (i) However a power to delegate is not a power to abrogate as is affirmed by S.190(1) of the Corporations Act and as is consistent with general law requirements.

"S.190 Responsibilities for actions of delegates

- (1) *If the directors delegate a power under Section 198D, a director is responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves."*

S.190(2) of the Corporations Act then goes on to excuse a director from responsibility for delegated powers in certain circumstances:

"(2) A director is not responsible under subsection (1) if:

- (a) *the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by this Act and the company's constitution (if any); and*
- (b) *the director believed:*
- (i) *on reasonable grounds; and*
 - (ii) *in good faith; and*
 - (iii) *after making proper enquiry if the circumstances indicated the need for inquiry;*
- that the delegate was reliable and competent in relation to the power delegated."*

- (j) S.189 of the Corporations Act (Reliance on information or advice provided by others) may also provide a degree of collateral protection to the director provided the conditions to the operation of that section can be established:

"S.189 (Reliance on information or advice provided by others)

If:

- (a) *a director relies on information, or professional or expert advice, given or prepared by:*
- (i) *an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or*
 - (ii) *a professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or*
 - (iii) *another director or officer in relation to matters within the director's or officer's authority; or*
 - (iv) *a committee of directors on which the director did not serve in relation to matters within the committee's authority; and*
- (b) *the reliance was made:*
- (i) *in good faith; and*
 - (ii) *after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation; and*
- (c) *the reasonableness of the director's reliance on the information or advice arises in proceedings brought to determine whether a director has performed a duty under this Part or an equivalent general law duty;*

the director's reliance on the information or advice is taken to be reasonable unless the contrary is proved."

4 Contemporary corporate governance theory and practice

- (a) A common mantra of contemporary corporate governance theory and practice is: "directors govern and direct and management manages the corporation"
- Where used in this paper, unless the context otherwise dictates, the term "management" refers to the general management team of the corporation lead by the CEO/Managing Director and "C-suite" executive team.
- (b) Without seeking to document a definitive treatise on such matters, contemporary Australian corporate governance reflects:
- (i) legislative and/or constitutional power to run a corporation being wholly vested in a unitary board of directors who in turn delegate responsibility for the day to day management, business, operations and affairs of the corporation, and implementation of the organisation's strategy, to the CEO and thereon by sub-delegation (as appropriate) to the broader management team;
 - (ii) the board of directors retaining certain powers to itself including by way of example (without seeking to provide a definitive list) powers to:
 - appoint and remove the CEO and set the CEO's remuneration;
 - approve the corporation's, purpose, values/desired culture, vision and strategy;
 - approve the corporation's annual budget;
 - set the corporation's appetite and tolerance for risk and oversee the corporation's risk management framework;
 - oversee management's performance in general against strategic, cultural and financial milestones set.
 - (iii) management being accountable to the directors for the performance of its responsibilities and functions and not exceeding the scope of its delegated authority;
 - (iv) the directors not unduly intruding or "meddling" in those responsibilities and functions which have been delegated to management, but reserving the right to actively engage in such matters, and give directions to management, if and as necessary as part of their oversight function, especially if material concerns arise as to management's performance of its responsibilities and functions;
 - (v) the board of directors also comprising within their ranks a number of non-executive directors to bring to bear a degree of independent objectivity, and special skills/diversity of perspective, where warranted, from that of the corporation's management team.
- (c) This segregation and allocation of roles and responsibilities between the directors and management is:
- (i) perceived to be desirable for the efficient and effective governance, control and management of the corporation especially where the corporation is large, perhaps with many employees and operational divisions across a wide geographic spread and functional business base;
 - (ii) readily reconcilable against the legislative and constitutional framework of the conferment and delegation of power mentioned in section 3 of this paper.
- (d) However, especially in the case of large corporations with many employees and operational divisions across a wide geographical spread and functional business base, the directors on the board (especially the non-executive directors) are likely to have

minimal direct control or “line of sight” oversight of many of the corporation’s business operations and its lower level management team, and in some cases minimal real knowledge of the detail of:

- (i) implementation of the corporation’s strategy at a lower managerial level;
 - (ii) the corporation’s affairs at an operational level;
 - (iii) many of the risks actually being assumed by management on behalf of the corporation in an operational environment;
 - (iv) the regulatory compliance requirements of the corporation’s various business unit endeavours; or
 - (v) the conduct and behaviours of line management personnel, especially those more remote from the corporation’s headquarters or main operating sites which might be more frequently attended by the directors.
- (e) Remembering that the exercise of all corporate powers, whether by statute or the corporation’s constitution, is initially conferred on the directors and then delegated to management, should a corporate performance shortcoming arise at lower management level over which a director reasonably has minimal direct control, line of sight or detailed real knowledge, then by virtue of S.190(1) of the Corporations Act the director remains “responsible” for the outcome with personal liability risk if the shortcoming might otherwise constitute a breach of duty, unless the director can avail him/herself of the exclusion of responsibility under S.190(2) of the Corporation Act (refer paragraph 3(i) above).
- (f) However to achieve this exclusion of responsibility:
- (i) All conditional elements to gain the exclusion must be established i.e.
 - the director believed on reasonable grounds at all times that the delegate would act in conformity with the duties imposed on directors; AND
 - the director believed:
 - on reasonable grounds; and
 - in good faith; and
 - after making proper inquiry if the circumstances indicated the need for inquiry;

that the delegate was reliable and competent in relation to the power delegated.
 - (ii) The onus of proof lies with the director seeking to rely upon the exclusion rather than the prosecutor or plaintiff having to disprove the elements which give rise to the exclusion of responsibility.

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- (g) These may present a considerable challenge for a director to satisfy, depending on the circumstances of each case. They only arise because responsibility for “managing the business (and affairs) of the company” primarily has been vested in the directors/board and then delegated to management.
 - (h) Other defences possibly may also be available to the director e.g. business judgement rule (S.180(2) of the Corporations Act - despite it being narrowly applied by the Courts), reliance on information or advice provided by others (S.189 of the Corporations Act – refer paragraph 3(j) above) and where the court determines at its discretion that the director “ought fairly to be excused” (S.1318 of the Corporations Act - despite this discretion being seldom exercised by the courts). However these are not directly relevant to the issue the subject of this paper.

5 Prior relevant complementary academic writings

- (a) The annals of jurisprudential writings on corporate governance and duties and liabilities of directors are voluminous. But one three-part set of writings on the subject matter of this paper is especially relevant. I refer to:
“The Roles and Duties of Australian Company Directors: a Restatement”
[R.P. Austin BA, LL.M (Syd) and D. Phil (Oxon) published in May 2010 as part of the Annual McPherson Lecture Series hosted by the TC Beirne School of Law at the University of Queensland].
- (b) Having reviewed and analysed the history of the development of the law on topic and the commercial history of the management and control of corporations, the authors opined that “the law reflects an unrealistic assessment of [a director’s] role, which [unrealistic assessment] is shared by public perception but is inconsistent with [directors’] own self-perception.” The authors also opined on the challenges to the likelihood of legislative reform to better align legal and public perception on topic with not only the self-perception of directors, but also with those responsible for contemporary corporate governance theory and best practice.
- (c) As a solution to this dilemma, the authors posited either:
 - (i) the legislated formality of a two-tiered board structure (akin to certain European corporate governance models) with a “supervisory” board (of non-executive directors) and a separate “management” board (of executive and management personnel); or
 - (ii) a “constitutional restatement” of roles and responsibilities between non-executive directors and executive directors “by removing the standard management article and substituting articles that would vest a supervisory role in the board of directors and a more focused management role in a sub-group of directors, namely those executive directors who occupy positions on the board.”

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- (d) The authors effectively dismissed the likelihood of application of the first approach, the formal two-tiered board structure, as it would necessitate material legislative and regulatory change in order to give effect to it with low likelihood of government and industry support for such an approach.
- (e) The second approach, of “constitutional restatement”, did gain some industry airing and feedback, including in commentary in the Company Director Journal of the Australian Institute of Company Directors (refer 2010 Vol 26 Issue 6 “Great Expectations” by-line John Colvin and 2010 Vol 26 Issue 7 “Double Trouble” by-line Domini Stuart). However, this second approach appears not to have found favour generally amongst the Australian corporate governance community over the following years perhaps largely due to:
- i) the strong acceptance in Australia of the unitary board approach, and therefore a resultant stigma against a two-tier board governance model (either formal or informal); and
 - ii) the authors not articulating or giving an example of the detail of the related constitutional and related corporate governance drafting for the “constitutional restatement” approach so as to give it full meaning and life.

6 An alternate unitary board approach

- (a) The analysis in section 4, especially paragraphs 4(e) – (g), provides a challenging outcome for directors, an outcome which might not be reasonable, measured, proportionate or tolerable in many circumstances. Given that the concepts suggested in section 5 involving a functional bifurcation of the board, either structurally (as per the European model) or notionally between non-executive and executive directors, has failed to find either legislative or popular favour or support, let us posit an alternate approach which draws upon those concepts but retains the current legislatively prescribed and popularly preferred unitary board model.
- (b) This alternate approach responds to the question:
- What if primary responsibility and power for managing the day to day business operations and affairs of the company was not primarily vested in the directors or board (refer replaceable rule S.198A of the Corporations Act and the analysis of typical constitutional provisions of leading Australian public companies in Schedule A), but rather:*
- *was vested directly with management, and with management being accountable to the directors or board for the exercise of that power; and*
 - *with power reserved to the directors or board to hold management to account for the exercise of that power, and to formally intervene in managing the business, operations and affairs of the company should the board be dissatisfied with management’s exercise of that power or should the board wish to prudentially limit the extent of that power?*

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- (c) Expressed in another more pejorative way:
- Why should not the constitutional provisions of corporations incorporated under the Corporations Act in displacing or modifying the replaceable rule provisions of S.198A (Powers of directors) articulate the powers conferred upon the directors/board and management in a manner that is consistent with contemporary corporate governance theory and practice, rather than in a cascading manner via a decreed omnipotent, and assumed omniscient, board of directors, which manner is perhaps more suited to a by-gone era and a governance regime that may be better suited to a small to medium sized enterprise (SME)?*
- (d) Schedule B to this paper proposes template or sample constitutional wording for such a revised approach, assuming that the replaceable rules contained in the Corporations Act (including S.198A – Powers of directors) have been displaced by another specific provision of the corporation’s constitution, as is currently typically the case.
- (e) The approach in Schedule B is reasonably self-explanatory in accordance with its terms and seeks to optimise flexibility, yet still vest in a unitary board of the corporation ultimate governance control over the corporation.
- (f) By the adoption of such an approach it is submitted:
- (i) this alternate approach retains the unitary board model and more accurately reflects the respective roles, responsibilities and powers of boards, CEOs and management teams in accordance with contemporary corporate governance theory and practice;
 - (ii) it will be the CEO, and not the directors and board, who is primarily responsible for the “management of the business, operations and affairs of the corporation”, at least until and to the extent to which such powers have not been displaced or restricted by the directors;
 - (iii) it is only in the absence of the appointment of a CEO, or if and to the extent of the displacement or restriction of CEO powers, that the directors will assume “management” responsibility for the corporation’s business, operations and affairs;
 - (iv) without the directors having primary responsibility and power for “managing” what essentially might be a relatively lower managerial level incidence of corporate activity (over which a director has minimal line of sight, real knowledge or control), it is difficult to envision how the occurrence of an adverse corporate outcome at that level should constitute a breach of duty by a director giving rise to personal liability and a claim against the director;
 - (v) having regard to (iv) above, there will not be the need for the director to have to establish an exclusion of liability defence under S.190(2) of the Corporations Act (refer paragraph 4(f) above).
- (g) This would not absolve a director from “turning a blind eye” to corporate performance shortcomings at a management or operational level. The directors would still be responsible for governing the corporation including holding management to account for the performance of its responsibilities. Accordingly neglectful and culpable failure to hold management to account, and to formally intervene if and as warranted, and responsibility for corporate managerial shortcomings to the extent to which the board has prudentially restricted management’s powers (refer section 7 following), may still give rise to a breach of duty by the director with associated personal liability arising.
- (h) Although Schedule B to this paper provides a template or sample constitutional wording to facilitate this approach, it is strongly recommended that corporations take their own legal professional advice concerning their own constitutions, circumstances and requirements, and not rely upon the general nature of the content of this paper.

7 Assuring Prudential Authority Restrictions upon Management's Primary Powers of Management

- (a) Without more, the alternate approach mentioned in section 6 could give the CEO relatively unlimited powers and authority with respect to “managing the business, operations and affairs of the Company” unless the directors (or board) intervened to either displace or restrict the CEO’s powers.
- (b) Contemporary corporate governance practice includes the delegation of the day to day management of the business, operations and affairs of the Company to the CEO, with controlled powers of sub-delegation to the management team, in accordance with a delegated authority matrix (“**DAM**”), or similar, that has been approved by the board. Typically a DAM will describe a functional aspect of the corporation’s business, operations and affairs, and will authorise a limit below which the CEO has authority to commit to on behalf of the corporation, and above which the approval of the directors or board is required.
- (c) To address the risk of the unintended consequences of empowering the CEO with unlimited authority in the management of the business, operations and affairs of the Company as mentioned in paragraph 7(a) above, it will be vital for the directors, as a board, to intervene and restrict the CEO’s powers and authority in an inverse (but comparable) manner as is commonly done with respect to a DAM but recognising:
 - (i) in contemporary corporate governance practice a DAM empowers a CEO with authority up to a limit;
 - (ii) with respect to the alternate approach in section 6 of this paper, the DAM (or its equivalent, perhaps a “RAM” or restricted authority matrix) would operate to restrict or disempower a CEO’s authority with respect to a designated function, or beyond a specified limit with respect to a designated function.
- (d) Schedule C to this paper proposes template or sample wording for such a RAM assuming that the constitutional wording set out in Schedule B has been adopted by the corporation.
- (e) However it will be important for any corporation adopting this approach to carefully craft the RAM to best relate to its needs having regard to the unique nature, size and spread (geographical and functional) of its business, operations and affairs. Accordingly Schedule C to this paper is merely as an indicative guide for consideration.

8 Conclusion

Contemporary corporate governance theory and practice draws distinction between the role of the board in governing and directing and the role of the CEO/management team in managing the business and affairs of a corporation.

Yet both the Corporations Act and the typical provisions of the constitutions of Australian public companies do not draw this distinction, vesting management responsibility for the business and affairs of the company specifically in the directors who might then delegate (but not abrogate) aspects of that responsibility to the CEO/management team.

Should lower level managerial shortcomings arise in the business and affairs of corporations and questions of responsibility and liability for such shortcomings arise, currently directors may not rely on contemporary corporate governance theory and practice to seek liability relief therefrom and must defensively resort to reliance on exculpatory provisions of the Corporations Act.

Arguably there is opportunity, without the need for any legislative change or intervention, for corporate constitutions to be amended to better align their provisions concerning responsibility for governing, directing and managing the company to better align with contemporary corporate governance theory and practice. Prior academic proposals to constitutionally achieve such an outcome have not found favour, probably largely on account to their sacrifice of the unitary board model of Australian corporate governance in order to achieve their objective.

This paper seeks to address this issue and propose an alternate approach, within a unitary board construct, to better assure such alignment and, as a corollary, better protect directors from the risk of personal liability under the Corporations Act and company constitutions for lower level corporate managerial shortcomings.

Although given the multiplicity of sources of directorial liability for corporate failures, be they legislative/regulatory (State or Federal) or at general law, the approach proposed by this paper might address but the “tip of the iceberg” of risk for directors, nevertheless as with all worthwhile journeys they start with a first step. At least the approach proposed by this paper is a step within the reasonable control of those adversely impacted by what has been described as the “expectation gap” for company directors.

Finally, and coming back to the title to this paper, one must assume that we do have a case of “The Emperor’s New Clothes” if corporate directors continue to profess the merits of contemporary corporate governance theory and practice, and thereby seek relief against liability for lower level corporate operational/management shortcomings over which they have minimal effective line of sight, real knowledge or control, yet continue to tolerate the express provisions of their companies’ constitutions which directly vest in those same directors primary responsibility and power for the management of the business and affairs of the corporation. Either corporate directors should act to seek to amend the constitutions of their corporations in line with the approach proposed by this paper, or they should recognise that any suggestion of relief of personal liability for lower level corporate operational/management shortcoming based on contemporary corporate governance and practice is as vacuous as “The Emperor’s New Clothes”.

Acknowledgement

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Schedule A

Matrix of relevant constitutional provisions of ASX 10 corporations(*) referable to the powers of directors [(*) as at 28 February 2020]

#	Name of ASX 10 Company	Relevant Constitutional provision #	Substantive text of the relevant provision
1.	CSL	73	The business of the Company is managed by the Board, who may exercise all powers of the Company that are not, by law or this Constitution, required to be exercised by the Company in general meeting.
2.	CBA	7.6	<p>The business and affairs of the company are to be managed by or under the direction of the Board, which (in addition to the powers and authorities conferred on it by this constitution) may exercise all powers and do all things that are:</p> <p>(1) within the power of the company; and</p> <p>(2) are not by this constitution or by law directed or required to be done by the company in general meeting</p>
3.	BHP Billiton	103	The management and control of the business and affairs of the Company are vested in the Board, which (in addition to the powers and authorities conferred on them by the Constitution) may exercise all powers of the Company except any powers which, by the Constitution or by law, are required to be exercised or done by the Company in general meeting.
4.	ANZ	5.1	<p>Except as otherwise required by the Corporations Act, any other applicable law, the Listing rules or this document, the Board:</p> <p>(a) has exclusive power to manage the business of the Company; and</p> <p>(b) subject to rule 5.3, [concerning sale of main undertaking] may exercise every right, power or capacity of the Company to the exclusion of the Company in general meeting and the members.</p>
5.	Westpac	10.1	The business of the Company is to be managed by the Directors, who may exercise all such powers of the Company as are not, by the Corporations Act or by this Constitution, required to be exercised by the Company in general meeting.
6.	NAB	11.1	The business of the Company is to be managed by the Directors, who may exercise all such powers of the Company that are not, by the Corporations Act or by this Constitution, required to be exercised by the Company in general meeting.

#	Name of ASX 10 Company	Relevant Constitutional provision #	Substantive text of the relevant provision
7.	Macquarie Group	10.1	The business of the Company is to be managed by the Voting Directors, who may exercise all such powers of the Company as are not, by the Corporations Act or by this Constitution, required to be exercised by the Company in general meeting.
8.	Wesfarmers	7.6(a)	The directors are responsible for managing the business of the company and may exercise all powers and do all things that are within the company's power and are not expressly required by the Act or this constitution to be exercised by the company in a general meeting.
9.	Woolworths Group	11.1	The business of the Company is to be managed by the Directors, who may exercise all such powers of the Company as are not, by the Corporations Act or by this Constitution, required to be exercised by the Company in general meeting.
10.	Telstra Corporation	26.1	The directors are responsible for managing the business of the company and may exercise all powers and do all things that are within the company's power and are not expressly required by the Act or this constitution to be exercised by the company in a general meeting.

**ADDENDUM TO SCHEDULE “A” – SAMPLE OF ASX 10 CORPORATION
PROVISIONS CONCERNING THE APPOINTMENT OF A MANAGING DIRECTOR
AND THE DELEGATION OF POWERS TO THAT MANAGING DIRECTOR**

1. Telstra Constitution

29.1 Managing directors and executive directors

- (a) *The directors may appoint one or more of the directors to the office of managing director or other executive director.*
- (b) *Unless the directors decide differently, a managing director’s or other executive director’s appointment as an employee:*
 - (1) *automatically terminates if the managing director or other executive director ceases to be a director; and*
 - (2) *subject to the provisions of any contract with the company (which may not limit the operation of rule 23.5), is subject to the same provisions as to resignation and removal as the other directors.*
- (c) *A managing director or other executive director may be referred to by any title the directors decide on.*

2. ANZ Constitution

7.1 Appointment and power of Managing Director

- (a) *The Board may appoint 1 or more Directors to be a Managing Director either for a specified term (but not for life) or without specifying a term.*
- (b) *The Board may delegate any of the powers of the Board to a Managing Director:*
 - (i) *on the terms and subject to any restrictions the Board decides; and*
 - (ii) *so as to be concurrent with, or to the exclusion of, the powers of the Board.*
- (c) *The Board may revoke the delegation at any time.*

7.2 Retirement and removal of Managing Director

Subject to rule 7.3, a Managing Director is not:

- (a) *subject to automatic retirement under rule 3.2; or*
- (b) *required to retire under rule 3.5,*

but (subject to any contract between the Company and that Managing Director) is otherwise subject to the same rules regarding resignation, removal and retirement from office as the other Directors.

3. NAB Constitution

11.8 Appointment of Managing and Executive Directors

The Directors may appoint an employee of the Company or one of its subsidiaries to the office of Managing Director and may appoint others to the office of Executive Director of the Company, to hold office as a Director for the period determined at the time of appointment (subject to any extension approved by the Directors), but not to exceed the term of employment of the employee.

The Directors may, subject to the terms of any employment contract between the relevant Director and the Company or subsidiary, at any time remove or dismiss any Managing Director or Executive Director from employment with that company.

11.12 Powers of Managing and Executive Directors

The Directors may:

- (a) *confer on a Managing Director or an Executive Director such of the powers exercisable by them, on such terms and conditions and with such restrictions, as they think fit; and*
- (b) *withdraw or vary any of the powers conferred on a Managing Director or an Executive Director.*

11.13 Delegation of Directors' powers

The Directors may delegate any of their powers to any persons they select for any period, to be exercised for any objects and purposes on any terms and subject to any conditions and restrictions as they think fit, and may revoke, withdraw, alter or vary the delegation of any of those powers.

The powers of delegation expressly or impliedly conferred by this Constitution on the Directors are conferred in substitution for, and to the exclusion of, the power conferred by section 198D of the Corporations Act.

Schedule B

Template or sample wording for a constitution concerning the conferment of corporate powers consistent with contemporary corporate governance theory and practice, assuming that the replaceable rules under the Corporations Act have been displaced by another provision in the constitution (which is typically the case in any event).

[00] Conferment and exercise of powers of the corporation

00.01 Directors' Powers

- (a) The directors, meeting and exercising authority as a board, are responsible and are empowered to:
 - (i) govern and direct the corporation;
 - (ii) oversee the exercise of the powers of the CEO, if appointed, under paragraph 00.02 of this constitution;
 - (iii) appoint, remove and remunerate, a chief executive officer or managing director (“**CEO**”) of the corporation in whom power to manage the business, operations and affairs of the corporation is vested in the terms of paragraph 00.02 of this constitution.
- (b) If the directors have not appointed a CEO under paragraph 00.01(a)(iii) of this constitution, then the directors, meeting and exercising authority as a board, are responsible and are empowered to manage the business, operations and affairs of the corporation.

00.02 CEO's Powers

If the directors, meeting and exercising authority as a board, have appointed a CEO under paragraph 00.01(c) of this constitution, then the CEO is:

- (a) responsible and is empowered to manage the business, operations and affairs of the corporation SUBJECT TO the provisions of paragraph 00.03 of this constitution;
- (b) accountable to the directors, meeting and exercising authority as a board, for the exercise and discharge of the responsibilities and powers conferred by this paragraph 00.02 of this constitution.

00.03 Directors' Reserved Powers

- (a) The directors, meeting and exercising authority as a board, are empowered by written notice to the CEO, to displace or restrict the responsibilities and powers of the CEO conferred by paragraph 00.02 of this constitution PROVIDED THAT any power properly and lawfully exercised by the CEO prior to such displacement or restriction remains valid and unaffected thereby.
- (b) The directors, meeting and exercising authority as a board, may by written notice to the CEO, countermand or vary any prior written notice to the CEO given under paragraph 00.03(a) of this constitution.
- (c) If and to the extent to which the responsibilities and powers of the CEO have been displaced or restricted by written notice duly given in the terms of this paragraph 00.03 of this constitution, then to the extent of such displacement or restriction, such responsibilities and powers immediately vest in the directors, meeting and exercising authority as a board.

(*) 00.04 Delegation of Powers

Any powers conferred by this section 00 of this constitution may be delegated, in accordance with the Corporations Act or other provisions of this constitution, by the person(s) in whom the power is conferred (“Delegator”) PROVIDED THAT:

-
- (a) The Delegator may impose terms, conditions and restrictions as the Delegator may determine on any such delegation and may at any time withdraw, suspend or vary any of those powers conferred on the delegate.
 - (b) The delegate must exercise the power delegated in accordance with any directions of the Delegator;
 - (c) Subject to paragraph (d) below, the delegation of a power does not relieve the Delegator from responsibility for the exercise of the power; and
 - (d) A Delegator is not responsible under paragraph (c) above if:
 - (i) the Delegator believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on the Delegator by the Corporations Act and this constitution (if any); and
 - (ii) the Delegator believed:
 - (A) on reasonable grounds; and
 - (B) in good faith; and
 - (C) after making proper inquiry if the circumstances indicated the need for inquiry;that the delegate was reliable and competent in relation to the power delegated.
- [(*) Note: this provision has been included as ss.198D and 190 of the Corporations Act refer only to delegations by “directors” and these proposed template/sample constitutional provisions also contemplates the prospect of a delegation of powers by a CEO who may not be a director of the corporation]

00.05 Limitation on Powers

No power purportedly conferred by this section 00 of this constitution confers any power which is:

- (a) beyond the power of the corporation; or
- (b) directed or required by this constitution or by law only to be done by the corporation in general meeting.

- (c) If the CEO delegates any power conferred by paragraph 00.02(a) of the Constitution, the CEO is responsible for the exercise of the power by the delegate(s) as if the power had been exercised by the CEO him/herself PROVIDED THAT the CEO is not responsible under this paragraph if:
- (i) the CEO believed on reasonable grounds at all times that the delegate(s) would exercise the power in conformity with the duties and responsibilities of the CEO; and
- (ii) the CEO believed:
- on reasonable grounds; and
 - in good faith; and
 - after making proper enquiry if the circumstances indicated the need for enquiry,
- that the delegate(s) was reliable and competent in relation to the power delegated.

3 Restricted Authority Matrix

#	Functional aspect of Company's business, operations and affairs	Restriction of CEO's power without Board approval
1.	<u>Audit</u> Appointment of external auditor and internal audit service providers.	No power
2.	<u>Corporate Structure</u> (a) Material changes to Company structure or structure of corporate group. (b) Appointment of directors to corporate group subsidiary companies.	No power No power
3.	<u>Debt/borrowings/mortgages/securities</u> (a) OPEX and/or CAPEX >10% beyond amounts in the annual approved budget. (b) Change of principal banker(s)/financier(s). (c) Material new or changed financial facilities >AUD\$[] (d) Mortgages and securities over Company or corporate group assets.	No power No power No power No power
4.	<u>Equity capital arrangements</u> (a) Equity issues and arrangements that may confer equity rights. (b) Dividend declarations, returns of capital and associated payments. (c) Equity buy-backs and redemptions. (d) Transactions analogous to foregoing.	No power No power No power No power
5.	<u>External/Investor Relations</u> (a) Release of half yearly and annual financial results and reports. (b) Calling of, and information provided to, shareholder meetings.	No power No power

#	Functional aspect of Company's business, operations and affairs	Restriction of CEO's power without Board approval
	(c) Release of price sensitive information including by ASX announcement other than in compliance with Company's Continuous Disclosure Policy.	No power
6.	<p><u>Loans/guarantees/financial benefits</u></p> <p>(a) Subject to (c) below, loans and debt deferrals >AUD\$[]</p> <p>(b) Guarantees of 3rd party debts/obligations (outside of corporate group).</p> <p>(c) Loans or financial benefits (outside of remuneration) to Company officers and/or related parties of Company officers.</p>	No power
7.	<p><u>Human Resources (excluding the CEO)</u></p> <p>(a) Appointment and dismissal of Company C-suite executives (including Company Secretary) without prior consultation and approval of Board.</p> <p>(b) Remuneration of Company C-suite executives (including Company Secretary) beyond scope of executive remuneration policy actually approved by Board, including with respect to STI's and LTI's.</p>	No power
8.	<p><u>Governance Generally</u></p> <p>Approval of Company:</p> <ul style="list-style-type: none"> • purpose • values • vision • strategy • risk management framework • risk appetite statement • risk tolerance statement • business plan(s) • annual budget(s) • annual insurance(s) • governance related policies • corporate policies and procedures resolved by Board as first needing to be approved by it 	No power
9.	<p><u>Contractual Commitments Generally</u></p> <p>(a) Where aggregate annual commitment under the contractual arrangement >AUD \$[]</p> <p>(b) Where the aggregate annual commitment under the contractual arrangement >AUD \$[] AND the contractual commitment is not able to be terminated by the Company within [] months without material penalty or cost</p>	No power

#	Functional aspect of Company's business, operations and affairs	Restriction of CEO's power without Board approval
10.	<p><u>Property/Asset dealings</u></p> <p>Any acquisition or disposal of property or assets (freehold, leasehold, real, personal or intangible) with balance sheet value >AUD \$[].</p>	No power
11.	<p><u>Legal Matters</u></p> <p>(a) Instigation or defence of material legal actions or proceedings involving the Company or any corporate group member or officer with prospective value >AUD \$[]</p> <p>(b) Material alleged legislative or regulatory compliance breach prosecution of Company or any corporate group member or officer with realistic prospective:</p> <p style="padding-left: 40px;">i) fine/compensation value >AUD \$[]</p> <p style="padding-left: 40px;">ii) custodial sentence >6 months</p> <p style="padding-left: 40px;">iii) loss of Company's or corporate group member's licence to operate</p>	No power
12.	<p><u>Generally</u></p> <p>Subject to the foregoing, matters materially beyond the ordinary management of the Company's day to day business, operations and affairs.</p>	No power

Signed for and on behalf of the Board by:

[Chair/authorised Director]