AUSTRALIAN ACCOUNTANTS, LAWYERS AND DIRECTORS CONFERENCE AT ASPEN, COLORADO, USA ON 9 JANUARY 2015[1]

COMPANY DIRECTORS: DECISIONS, DUTIES AND DILEMMAS

Introduction

In the time since I was required to propose a title for my paper to the organisers, I have also developed a sub-title for this paper: "What Gilbert & Sullivan can teach company directors today".

If any of the lawyers in the room who are taking notes wrote down Gilbert v Sullivan, there is no relevant case of that name of which I am aware. I am referring, of course, to W.S. Gilbert and A. Sullivan, some of whose satirical operettas lampooning the foibles of Victorian society remain popular today, at least with secondary schools and amateur musical societies.

I will deal with five topics:

(1) Separate legal personality or "familiarity breeds contempt";
(2) The business judgment rule;
(3) Duties to creditors;
(4) Class actions; and
(5) Six essentials for company directors.

"Familiarity breeds contempt"

Let us return to Gilbert & Sullivan. As many of you probably know, Sir Arthur Sullivan wrote the music and W.S. Gilbert wrote the lyrics.

[1] Justice Kunc gratefully acknowledges the assistance of Nita Rao BA, LLB (Hons) in the preparation of this paper. This text preserves the spoken delivery of the address.

Gilbert overcame a number of hurdles in life, of which I shall mention only two. The first was that his initial "S" stood for Schwenck. For a writer of lyrics, this was probably not the mellifluous middle name for which he might have wished. The second, and some of you may not think this was a misfortune, was that he had a brief and extremely unsuccessful career as a barrister. He recorded some aspects of his career in his short story "My Maiden Brief", which described his client's reaction at the denouement of his first court appearance:

> "No sooner had the learned judge pronounced this sentence than the poor soul stooped down, and taking off a heavy boot, flung it at my head, as a reward for my eloquence on her behalf; accompanying the assault with a torrent of invective against my abilities as a counsel, and my line of defence."[2]

Nevertheless, Gilbert's legal knowledge was very useful in his satires of Victorian society which, as readers of Charles Dickens will know, was fascinated with the law and lawyers. Gilbert's legal training was never more useful than when he and Sir Arthur Sullivan wrote their 1893 operetta, "Utopia Limited". Despite being a huge success at the time it is now hardly ever performed. Why that might be so is highly relevant to the first, and perhaps most important, point that I want to make in these remarks.

The story of Utopia Limited is reasonably straightforward. It is set on the beautiful South Pacific island of Utopia. Some wise men arrive on the island keen to promote what was said to be the advantages of modern English civilisation. One of those wise men was someone who we would today perhaps recognise as a venturer capitalist or hedge fund manager by the name of Mr Goldbury. In the operetta's key scene, Mr Goldbury tells the King that all of the county's problems will be solved if he were to incorporate the nation as Utopia Limited. This is what follows:

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[2] W S Gilbert, Foggerty's Fairy and Other Tales *(1890)*, 158-159

King: A Company Limited? What may that be? The term, I rather think, is new to me....

Mr. Goldbury (chorus part omitted):

Some seven men form an Association
(If possible, all Peers and Baronets),
They start off with a public declaration
To what extent they mean to pay their debts.
That's called their Capital; if they are wary
They will not quote it at a sum immense.
The figure's immaterial--it may vary
From eighteen million down to eighteenpence.
I should put it rather low;
The good sense of doing so
Will be evident at once to any debtor.
When it's left to you to say
What amount you mean to pay,
Why, the lower you can put it at, the better...

They then proceed to trade with all who'll trust 'em
Quite irrespective of their capital
(It's shady, but it's sanctified by custom);
Bank, Railway, Loan, or Panama Canal.
You can't embark on trading too tremendous--
It's strictly fair, and based on common sense--
If you succeed, your profits are stupendous--
And if you fail, pop goes your eighteenpence.

Make the money-spinner spin!
For you only stand to win,
And you'll never with dishonesty be twitted.
For nobody can know,
To a million or so,

To what extent your capital's committed!...

If you come to grief, and creditors are craving
(For nothing that is planned by mortal head
Is certain in this Vale of Sorrow--saving
That one's Liability is Limited),--
Do you suppose that signifies perdition?
If so, you're but a monetary dunce--
You merely file a Winding-Up Petition,
And start another Company at once!
Though a Rothschild you may be
In your own capacity,
As a Company you've come to utter sorrow--
But the Liquidators say,
"Never mind--you needn't pay,"
So you start another company to-morrow!

King: Well, at first sight it strikes us as dishonest,
But if it's good enough for virtuous England--
The first commercial country in the world--
It's good enough for us.

The King's reaction that it sounded a little dishonest was typical of the time (and may still be in some quarters). Gilbert & Sullivan were satirising Victorian England's obsession and fascination with the incorporated company. Law reform in the middle of the 19th Century meant that the capacity to incorporate a company (which previously had to be done by Royal Charter or an Act of Parliament for each company) was no longer limited to the very rich or the very aristocratic (to the extent to which there may have been a difference between the two). Everyone was marvelling at how incorporation meant that entrepreneurial activity could apparently be undertaken without personal financial risk.

The critical point is that, at the time, the creation of a completely artificial independent entity which had legal personality of its own, was revolutionary. It was so extraordinary that it was the stuff of popular comedy. But that is no longer the case.

The creation of the company as a vehicle for economic activity is the most successful legal fiction ever invented, so successful that it has become commonplace. But the commonplace is not the stuff of comedy. Hence, Utopia Limited would seem as unfunny to us today as a comedy about sliced bread. I suggest that Gilbert & Sullivan's operetta is now largely unknown precisely because what it lampoons has become so ordinary to us.

This brings me to my key point addressed, in particular, to those of you who are company directors. Today we have lost all sense of how extraordinary this idea of an artificial legal entity is. In my experience, setting aside deliberate criminality, most breaches of directors' duties are a result of a failure to understand and respect the consequences of this most fundamental point, namely that a company is a separate legal entity in respect of which directors owe duties. In other words, familiarity with the concept of separate legal personality has bred contempt.

While directors are not trustees in the strict legal sense, I respectfully suggest that modern day directors would do well to resurrect the 19th and early 20th century perception that directors, as controllers of their own and other peoples' money held in the legal fiction of the company, occupy a significant moral position of trust. The corollary is that the closer company directors come to a mindset that there is no relevant distinction between them and the company, the closer to certainty becomes the prospect that directors will breach the duties that they owe to their company and, as I shall develop, to others.

<u>Directors Duties in relation to Decision Making</u>

Directors are entrusted with the financial wellbeing of company and as such, the law places certain duties on them. The sources of these duties are under statute, specifically Chapter 2D of the Corporations Act 2001 (Cth), in common law and in equity. Broadly these duties dictate that directors in making decisions on behalf of the company must act in good faith, for a proper purpose, whilst maintaining their discretion, avoiding any personal and professional conflicts of interest and exercising care and diligence.

In examining the statute, section 180(1) of the Corporations Act imposes an obligation on directors and other officers to exercise care and diligence to the standard of a reasonable person, when making decisions on behalf of the company. Section 180(2) states that a director is taken to have met the requirements of s 180(1) and their equivalent duties at common law and in equity, if they; make that judgment in good faith, for a proper purpose, do not have a material interest, inform themselves about the subject matter of the judgment and rationally believe that the judgment is in the best interests of the corporation. This section, 180(2), is known as the business judgment rule and acts as a defence in some cases to allegations of non-compliance with s 180(1).

The value of the business judgment rule has been called into question by various practitioners, judges and academics. This is because one would assume that exercising care and diligence to the standard of a reasonable person would naturally require you to act in good faith, for proper purposes and without any conflicting interests. In ASIC v Rich [2009] NSWSC 1229 Austin J explained how difficult it would be to rely upon the defence under s 180(2). His Honour said at [7293]:

“The idea that the business judgment rule does not protect directors and officers from liability for inadequate performance is echoed by some commentary. Mr Neil Young QC has expressed the view that the business judgment rule arguably offers nothing but "window dressing", because as a defence to s 180(1) it propounds a standard no less stringent than that required by s 180(1) itself, so that it is difficult to conceive of a situation in

which a director makes a good faith, rational decision for a proper purpose and yet breaches s 180(1)".

Likewise, academics such as Professor Bob Baxt have questioned how the business judgment rule applies in practice.[3] For example, in ASIC v Healey (No 2) [2011] FCA 1003, Justice Middleton found that the directors had breached their duty of care and diligence under s 180(1) by not obtaining legal advice in analysing and reviewing the accounts of the company. Yet his Honour also viewed that these directors had taken all appropriate steps to seek advice and an explanation from accounting experts and that they had acted honestly and in good faith. His Honour found that failing to seek legal advice meant the directors could not rely upon the business judgment rule and were liable under the civil penalty provisions of the Act.

Whilst the value of the business judgment rule has been questioned, it does provide utility and acts as a defence in specific circumstances. These are helpfully outlined by Austin J in ASIC v Rich at [7294] and include where:

- the impugned conduct is a business judgment as defined;
- the directors or officers are acting in good faith, for proper purpose and without any material personal interest in the subject matter;
- they make their decision after informing themselves about the subject matter to the extent they believe to be appropriate having regard to practicalities;
- their belief about the appropriate extent of information gathering is reasonable in terms of the practicalities of the information gathering exercise (including such matters as the accessibility of information and the time available to collect it);
- they believe that their decision is in the best interests of the corporation; and
- their belief is rational in the sense that it is supported by an arguable chain of reasoning and is not a belief that no reasonable person in their position would hold.

[3] Robert Baxt, (2011) 7(6) *The Baxt Report* 1, 2.

In turning to the common law and equity, directors owe a variety of fiduciary and equitable duties. Fiduciaries, at their core, must not exercise an authority or power for the personal benefit or gain of the fiduciary or third party to whom a fiduciary duty is owed, without the beneficiary's consent.[4] This applies to situations where there is a real, sensible possibility of conflict.[5] However, importantly as Lord Millett explained in *Bristol & West Building Society v Matthew* [1998] Ch 1 at 16-17: (a) not every breach of duty by a fiduciary is a breach of fiduciary duty; (b) breaches of fiduciary duties are not where a director fails to use proper skill and care in the discharge of their duties; and (c) the fact that the source of this and other obligations of directors it to be found in equity rather than the common law does not make the obligation a fiduciary duty. Put simply, the powers exercised by directors are legal in character but equity dictates the manner in which those powers are exercised.[6]

So what do the cases about directors duties illustrate to us? Two major points, especially in relation to managing conflicts:

First, disclosure is the bare minimum. In situations where directors have conflicting duties owed due to multiple directorships or any personal interests, disclosure is necessary to avoid breaches of duty. In Darvall v North Sydney Brick & Title Co Ltd[7] a managing director absented himself from the discussion and voting on a certain business proposal in which he had a personal interest. The New South Wales Court of Appeal said that merely absenting himself was insufficient and that such absence needed to be accompanied by an explanation as to the nature and extent of his interests. Furthermore, as noted by Samuels JA in *Woolworths Ltd v Kelly*,[8] there is no precise formula that will determine the extent of detail required when a director declares his or her interest. It will turn on the facts of the case,

[4] *R v Byrnes* (1995) 183 CLR 501, 516-517.
[5] *Boardman v Phipps* [1966] 3 All ER 721, 756.
[6] William Gummow, 'The Equitable Duties of Company Directors' (2013) 87 *Australian Law Journal* 753, 755.
[7] (1989) 16 NSWLR 260.
[8] (1991) 22 NSWLR 189.

including the nature of the conflict, the financial position of the business and the powers and influences of the other directors. However, it will almost always be the case that fuller disclosure rather than less will be better.

That being said, company constitutions can weaken the application of the duty to avoid conflicts, requiring only that the director disclose the nature of the interest in order for them to fulfil his or her duty. Notably however, in *Groenveld Australia Pty Ltd & Ors v Nolten & Ors (No 3)*,[9] the company's articles of association allowed a director to vote on a proposal subject to the disclosure of his personal interests. He did so. The Court nonetheless found him to be in breach for failing to disclose certain wrong doings relevant to the vote.

Second, where the impugned transaction or proposal can lead to potential harm to the company, the director must ensure that the other directors appreciate the potential harm inherent in the transaction and point to steps that could be taken to reduce the possibility of harm.[10] Such action can include: advising shareholders who are voting to approve a transaction that the transaction is not in the best interests of the company,[11] using their power and influence with other directors to prevent the transaction going ahead[12] and suggesting ways that the other directors could reduce harm.[13] Simply resigning from a company is viewed as insufficient.[14] In sum, intervention is necessary.

Rosemary Langford and Ian Ramsay helpfully articulate various factors which the courts construe would, and should, give rise to requirements beyond the mere disclosure of conflicts.[15] They are:

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[9] [2010] VSC 533.
[10] *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 240-1.
[11] *Duke Group Limited (in liq) v Pilmer* (1999) 73 SASR 64.
[12] *Adler v ASIC* (2003) 179 FLR 1.
[13] *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 240-1.
[14] Reginald Barrett, 'Resolution of Directors' Conflicts' (1997) 71 *Australian Law Journal* 677, 679.
[15] Rosemary Teele Langford and Ian M Ramsay, 'Conflicted directors: What is required to avoid a breach of duty' (2014) 8 *Journal of Equity* 108, 124.

- when a company is engaging in new and unfamiliar business territory;
- when an entity with which the company is transacting is in financial difficulty;
- when a company suffers a significant financial loss;
- when there is one director who put the proposal to the board or who is driving the transaction;
- when one director has a higher degree of knowledge or experience;
- when one director has power or influence over the board;
- when one director is responsible for the everyday operations of the company;
- when a director is negligent as well as having a conflict;
- when a director will benefit personally; and
- when a director demonstrates reckless disregard or deliberate dishonesty.

Duties to Creditors

I will now turn to the relationship between directors and creditors. It goes without saying that creditors play a fundamental role in a company's functions. Despite this, the law does not impose duties on directors owing to creditors. In the landmark Australian company law decision of *Walker v Winborne*,[16] Mason J stated that the directors of an insolvent company in discharging their duty to the company, must take account of the interests of shareholders and creditors.[17] "Taking account" of the interests of creditors is not to be construed as treating such interests as paramount. Rather it requires being deferential to their interests in the appropriate circumstances.[18]

Fortunately, the insolvent trading provisions in the Corporations Act provide an appropriate vehicle for the protection and consideration of creditors' interests to directors' decision making powers. Whilst the High Court of Australia has stated that there is no direct recourse from creditors against

[16] (1976) 137 CLR 1.
[17] Ibid, 7.
[18] *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* 99 ACSR 1, 338.

company directors,[19] the Act imposes liabilities on directors who trade notwithstanding the insolvency of the company, and vulnerable position of the creditors.

Under section 588G of the Act, a director who fails to prevent a company from incurring debts where there are reasonable grounds for suspecting that it is insolvent is in breach of their duty as a director. Under this section, such director can attempt to rely upon the defences in s 588H, being that: there were reasonable grounds to expect the company was solvent, they were given competent information about solvency, the director did not take part in the management of the company because of an illness or some other reason and the director took all reasonable steps to prevent the company from incurring the debt. If they do not fall within any of the above categories, they are liable to account under s 588J, s 588K and s 588M and the civil penalty provisions under Part 9.4B of the Act. The circumstances in which a director may be liable under s 588G include: for reductions of capital involving repayments to shareholders, buy back of shares, redemptions of redeemable preference shares and the provision of financial assistance to a person acquiring a company's shares.[20]

The law may seem simple, however it is difficult to apply these provisions to the particular facts of a case given how difficult it is to determine the solvency of a company, especially in circumstances where companies move in and out of stages of insolvency.[21] However, the obligations are likely to arise when a company is on the verge of insolvency, where they are at risk of insolvency occurring or where they are in a dangerous financial position, parlous financial state or financially unstable.[22] The New South Wales Court of Appeal has espoused two principles with respect to where an "obligation" or due consideration must be given to creditors. First, whether directors should have paid regard to the interests of creditors can be difficult to decide, and depends

[19] *Spies v R* (2000) 201 CLR 603.
[20] Kevin Lindgren, *Business Law of Australia* (LexisNexis Butterworths Australia, 12th ed, 2011) 704.
[21] Andrew Keay, 'Directors' Duties and Creditors Interests' *Law Quarterly Review*, 443, 447.
[22] Ibid, 448.

on the facts of the case.[23] Second, wholly different considerations might come to the fore depending on the degree of a company's financial instability.[24]

So, what's a director to do when in the unenviable position of choosing between continuing to trade or ceasing to trade when the solvency of a company is unclear? Unfortunately there is no template in answering this question and the financial state of a company hinges on other considerations such as its business structure and the type of trade it engages in. This becomes more complicated when there is a need effectively to balance the interests of creditors with the interests of shareholders which is a balancing act implicitly endorsed in Australian case law.[25] As Street CJ noted, creditors are prospectively entitled, through the mechanism of liquidation to displace any power of shareholders and directors, to deal with a company's assets.[26] Whilst shareholders are crucial to the discussion of what is in the best interests of a company, creditors' interests' bear strong consideration in the context of what happens to the company upon liquidation or administration.

Despite these difficulties, academic Andrew Key has articulated several rules to guide a director's decision making process in circumstances where their actions will be scrutinised pursuant to the insolvent trading provisions of the Act.[27]

1) If a company is insolvent then the directors should cease trading. This is a hard, fast and uncontroversial rule.

2) If the financial state of a company is precarious, directors must not ignore such instability and inform themselves of the reasons for it.

3) Directors must not rely on the vicissitudes of the market to improve the solvency of the company or in the words of Romeo Montague; they will be

[23] *Linton v Telnet Pty Ltd* [1999] NSWCA 33 [26].
[24] *Kinsela and Anor v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722, 733.
[25] Keay, 'Directors' Duties and Creditors Interests' *Law Quarterly Review*, 443, 447.
[26] *Kinsela and Anor v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722, 730.
[27] Keay, 'Directors' Duties and Creditors Interests' Law Quarterly Review, 443, 472.

fortune's fool. Directors must take systemic actions to cut costs, restructure the business and minimise the debts owed.

4) Directors must seek professional financial advice and take such advice if shown to be strong and certain.

5) Directors should endeavour to treat creditors as a class. If payments are to be made to certain creditors this must be shown to be for the benefit of the class as a whole.

6) Where there are unsecured creditors, directors must determine whether a company has sufficient funds and assets to cover secured creditors and then take the company into administration or liquidation.

Class Actions

I will now turn to the issue of class actions. Many of you are familiar with the concept of class actions and the images it conjures up of lengthy, high profile and often costly litigation. In Australia, our most recent high profile class actions include those brought by the victims of the Black Saturday bushfires against insurers and the customers of ANZ against the bank over excessive bank fees. These cases, like all class actions, demonstrate the ability of people to seek redress through the courts for civil wrongs committed by corporations that are more powerful and well-resourced than any individual claimant.[28] Class actions aim and succeed in rebalancing a power imbalance by creating power in numbers that would be non-existent if claims were pursued individually.[29] For those of you less familiar with the structure and purpose of these claims, I will provide you with an outline.

In essence, class actions or "representative proceedings" as they are referred to under statute, occur when seven or more persons have claims against the

[28] Justice Bernard Murphy and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' 30 *Melbourne University Law Review* 400, 402.
[29] Ibid, 403.

same person, in respect of, or arising out of the same or similar or related circumstances which give rise to a substantial common question of law or fact.[30] They are to be contrasted with claimants pursuing litigation on an individual basis. The class action regime was first introduced in the Federal Court on 4 March 1992, in the Victorian Supreme Court since January 2000 and New South Wales in 2011. The provisions under these Acts mirror each other, although class actions are most commonly pursued in the Federal jurisdiction. For convenience I will only make reference to the Federal Court legislation.

Commonwealth and State legislation set out seven procedural requirements that are worth noting:

1. The proceedings may be brought regardless of the type of relief sought and whether the proceedings concern separate contracts, transactions entered into with the defendant or separate acts or omissions of the defendant.[31]

2. One plaintiff may be selected as the representative party or 'lead plaintiff' to effectively run the litigation on behalf of the rest of the group members. However, if this lead plaintiff is unable to adequately represent the interests of the group, the Court is able to substitute another group member to the coveted lead plaintiff role.[32]

3. The members of the group must be identified and the nature of the claims must be specified as well as the common issues of law or fact.[33]

4. Group members are able to opt out of the proceedings and must be given sufficient time in which to do so.[34]

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[30] See Part IVA of the *Federal Court of Australia Act 1976* (Cth); Part 4A of the *Supreme Court Act 1986* (Vic); Part 10 of the *Civil Procedure Act 1975* (NSW).
[31] Section 33C.
[32] Section 33D.
[33] Section 33H.
[34] Section 33J.

5. The court may order the discontinuance of proceedings where the costs of conducting a class action are likely to exceed the costs of each plaintiff bringing a separate proceeding, and it will be inefficient and ineffective means to deal with the claims of the group members.[35] The Court will also make such order where the lead plaintiff is unable to adequately represent the interests of the group members.[36]

6. One final point to note is that should a class action reach settlement and thus be discontinued, the Court is required to give approval and make orders with respect to the distribution of any money, including interest to be paid under a settlement or paid into the Court.[37]

7. The usual appeals processes remain.

Class Actions: In Practice

So what are the common grievances that galvanise groups and lead to the pursuit of class action litigation? There are many and they are varied. Historically class actions were commonly brought for product liability claims by consumers against manufacturers. These claims still enjoy a large part of the Court's attention with faulty knee and hip implants,[38] cartons of soy milk[39] and pharmaceutical drugs all being products the subject of litigation in Australia.[40] However, the emergence of litigation funders combined with the presence of sophisticated plaintiff law firms have led to a rise in shareholder and securities type class actions.[41] From the period of 2000 until 2009 shareholder actions were found to have increased to 18% of Federal Court class actions whereas

[35] Section 33N.
[36] Section 33T.
[37] Section 33V.
[38] King & Wood Mallesons, *Class Actions in Australia The Year in Review 2012* (2012) 12, King & Wood Mallesons, *The Review Class Actions in Australia 2013/2014* (2014) 32.
[39] King & Wood Mallesons, *Class Actions in Australia The Year in Review 2012* (2012) 26.
[40] King & Wood Mallesons, *Class Actions in Australia The Year in Review 2012* (2012) 15.
[41] King & Wood Mallesons, *The Review Class Actions in Australia 2013/2014* (2014) 13.

product liability class actions decreased to 6.8% of Federal Court class actions.[42]

There has also been much discussion of the role of litigation funders in class actions. Who are these litigation funders and why are they willing and in some cases almost desperate to fund class actions? Litigation funders are third parties who enter into agreements to finance large-scale litigation relating to issues such as corporate insolvencies, commercial and contractual disputes and securities and consumer protection claims. In return for funding, they get a "piece of the action" or portion of the settlement or judgment obtained, whilst exercising control over the prosecution of the litigation itself.[43] Their model is to shift the cost and risks of litigation from plaintiffs with personal interests, to institutions with commercial interests. These are institutional funders and can either be private companies such as LCM Litigation Fund and Claims Funding Australia or public companies such as Bentham IMF and Litigation Lending Services. However, with the exception of Bentham IMF they are never listed on the Australia Securities Exchange and rarely are their public accounts and financial information made available.

Despite their prevalence, litigation funders remain controversial as, to quote Chief Justice Bathurst, at first glance they stand at complete odds with the aims of ethical legal practice and exist solely to profit from the generation of litigation.[44] Indeed, historically they were considered illegal under the torts of maintenance and champerty under the common law.[45] Justice Keane in his speech "Access to Justice and Other Shibboleths" explains the reasons why this was so when his Honour said on page 2:

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[42] Ross McInnes and Alexandra Kennedy-Breit, 'Class Actions: Justice, Funding and the Next Game Changer' (2014) 10 *Law Society Journal* 82, 82.

[43] Justice Patrick Keane, 'Access to Justice and Other Shibboleths' (Speech delivered at the JCA Colloquium in Melbourne on Saturday, 10 October 2009) <http://jca.asn.au/wp-content/uploads/2013/11/2009AccesstoJustice.pdf>.

[44] Chief Justice Bathurst, 'Commercialisation of Legal Practice: Conflict ab initio; conflict de futuro' (Speech delivered at the Commonwealth Law Association Regional Conference in Sydney on Saturday, 21 April 2012) <http://www.austlii.edu.au/au/journals/NSWJSchol/2012/22.pdf>.

[45] *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* (2006) 229 CLR 386.

"In the traditional conception the courts are an arm of government charged with the quelling of controversies. In this paradigm, the courts, in exercising the judicial power of the state, are not "providing legal services". The parties to litigation are not acting as consumers of legal services: they are being governed —whether they like it or not. The torts of maintenance and champerty, whatever their historical origins, served the important purpose of protecting the administration of justice from having to deal with suits which would not be brought were it not for the funding provided by the intermeddler".

His Honour goes on to cite the joint dissenting judgment of Justices Callinan and Heydon in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*[46] where their Honours noted at 486 - 488 that "the purpose of court proceedings is not to provide a means for third parties to make money by creating, multiplying and stirring up disputes in which those third parties are not involved and which would not otherwise have flared into active controversy but for the efforts of the third parties, by instituting proceedings purportedly to resolve those disputes, by assuming near total control of their conduct and by manipulating the procedures and orders of the court with the motive, not of resolving the disputes justly but of making very large profits".

Justice Keane then goes on to note on page 2 that "it is unattractive that the exercise of judicial power should be viewed as a tradable commodity and that officers of the courts should act, or be thought to act, as factors for those engaged in the trade".

Justice Keane's comments can be contrasted with the approach taken by the Court of Appeal in Fostif, which reflected the view that was subsequently adopted by the majority in the High Court.

On appeal, President Mason said that the changes in attitude to litigation funders have been influenced by concerns about access to justice and the heightened awareness of the cost of litigation. His Honour noted that:

[46] (2006) 229 CLR 386.

"Governments have promoted the legislative changes in response to spiralling costs of legal aid. Courts have recognised these trends and the matters driving them.

'Ambulance chasing' still has negative connotations in many quarters, but it is now widely recognised that there are some types of claim that will simply never get off the ground unless traditional attitudes are modified. These include cases involving complex scientific and legal issues. [There is] social utility of funded proceedings, [because of] the financial risks assumed by funders.[47]

This liberal approach to litigation funding was reflected in the High Court's joint judgment of Gleeson CJ, Gummow, Hayne, Kirby and Crennan JJ where their Honours held that there was nothing about the litigation funding arrangement in that case that was either an abuse of process or contrary to public policy.[48]

Irrespective of the judicial position, litigation funding agreements are as ensconced in the practice of class actions these days as Kim Kardashian is in popular culture. They are here to stay. In light of that, focus and efforts have shifted from debating their merits to ensuring their regulation and accountability.

The present legislative framework has been criticised for being too plaintiff friendly. However, in Australia we have not seen a huge influx of speculative and frivolous claims. Indeed, a report produced this year by Vince Morabito of the Monash Business School revealed that while 19 federal class actions were filed from March 2013 until March 2014, this was well down from the

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[47] (2005) 63 NSWLR 203, 226.
[48] *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386, [88].

peak of 30 in 2003. The average number of claims in recent years is lower than it was a decade ago.[49]

Regardless of the numbers, greater attention is required to ensure that litigation funders do not exercise an excessive amount of control over litigation and remain accountable primarily to their clients instead of their shareholders. This does not exist at present because the current legislative framework governing class actions was developed when litigation funding was prohibited. Since 12 July 2013, the Corporations Regulations and ASIC's Regulatory Guide 248 have been used to dictate the behaviours of litigation funders in class actions. Notably, the Regulations require funders to have written procedures in relation to identifying, evaluating and disclosing conflicts of interests to members.

However, there are still calls for greater regulation and preventing what Attorney-General George Brandis has described as "wild cat" and "opportunistic" class actions.[50] The Productivity Commission has suggested establishing a licencing scheme for litigation funders under the Corporations Act whilst imposing ethical and professional standards and capital adequacy standards on them.[51] Further to this, Chief Justice Allsop recently suggested introducing a second Judge or Registrar to expedite the early stages of large class actions. This figure would identify the real value of the claims and whether the benefits to the interested parties would be commensurate to the costs that would be incurred in running the matter.[52] This must include a consideration of the amount of money the plaintiffs' themselves stand to

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[49] See discussion in Chris Merritt, 'Not enough class actions: Academic', *The Australian* (online), 14 November 2014 <http://www.theaustralian.com.au/business/legal-affairs/not-enough-class-actions-academic/story-e6frg97x-1227122272404>.

[50] Chris Merritt, 'Crackdown on Opportunistic class actions' *The Australian* (online), 23 May 2014 <http://www.theaustralian.com.au/business/legal-affairs/crackdown-on-opportunistic-class-actions/story-e6frg97x-1226927445137?nk=a46dd1ab2fe05123cc34e868efe42271>.

[51] Productivity Commission, *Access to Justice Arrangements*, Productivity Commission Inquiry Report No 2 (2014) 632.

[52] Hannah Low, 'Chief Justice James Allsop wants to end litigation warfare' *The Australian Financial Review* (online), 21 November 2014. <http://www.afr.com/p/national/legal_affairs/chief_justice_james_allsop_wants_xnKCunL6GREGQZNDHdbepK>.

receive after the litigation funders take their portion of the settlement or judgment.

In light of that, I want to mention two big class actions in Australia to give illustration to the operation of the class action regime. I will consider *Paciocco v Australia and New Zealand Banking Group* [2014] FCA 35 (otherwise known as the 'bank fees' class action) and *Matthews v SPI Electricity Pty Ltd; SPI Electricity Pty Ltd v Utility Services Corp Ltd*[53] (otherwise known as 'the Black Saturday Bushfire litigation').

In Paciocco, the issue for consideration by Justice Gordon was whether bank fees charged by ANZ including credit card late payment fees, honour fees, dishonour fees, non-payment fees and over limit fees were penalties. The applicants were Lucio Robert Paciocco and one of his companies Speedy Development Group Pty Ltd who brought the action on behalf of about 43,500 other customers due to the unlawful bank fees he argued he was paying. They were represented by well-known plaintiff solicitors, Maurice Blackburn lawyers and their action was funded by Bentham IMF Limited on a '*no win, no charge*' basis.

This litigation had a long running history beginning on 22 September 2010 when an initial class action was brought in the Federal Court. That case, Andrews v Australia and New Zealand Banking Group Ltd[54] travelled all the way to the High Court on the question of whether bank fees could be considered penalties irrespective of whether they were pursuant to a breach of contract. ANZ said that the fees needed to be in breach of a contract in order to be considered penalties. They had not breached any contracts ergo their fees were not penalties and enforceable. The High Court disagreed, saying that the issue does not turn on whether there is a breach of contract, but whether the purpose of the fee was to secure performance of a primary obligation by the party subject to the fee, or for further services or accommodation. Only in those circumstances and subject to the fee being a

[53] [2013] VSC 33.
[54] (2012) 247 CLR 205.

genuine pre-estimate of the damage that one party could suffer as a result of the other party's non-performance, was the penalty enforceable. Their Honours sent the matter back to Justice Gordon for Her Honour to determine what would be considered a penalty in light of the new criteria.

Ultimately, Justice Gordon decided that the late payment fees were penalties, whereas the honour fees, dishonour fees, non-payment fees and over-limit fees were not penalties and otherwise lawful. The outcome of this case is relatively neutral, with both sides enjoying some victory. The matter was heard on appeal in the Full Court of the Federal Court in November this year. I am sure the commercial world will await the result with much interest.

The second case I wish to canvas is the Black Saturday bushfire litigation. On 7 February 2009, Victoria was devastated by a series of bushfires which killed 173 people and destroyed 125,000 hectares of land and 1,000 homes in regional Victoria. A Bushfires Royal Commission inquiry found that one of the bushfires, the Kilmore East-Kinglake bushfire was caused by an old and arguably faulty SP AusNet power line. Ten thousand people joined in a class action against SP AusNet with Carol Matthews as lead plaintiff. The aptly named Justice Jack Forrest presided over a class action trial that lasted in excess of 200 days. On 15 July of this year, the matter settled with the plaintiffs receiving approximately $500 million, the biggest payout in Australian legal history.

The thoughts I would particularly like to leave with you about class actions in Australia are these. As the statistics demonstrate, and contrary to the impression that you may have formed from reading the business pages of our newspapers, Australia is not seeing a "flood" of class actions in the sense of the actual number of such cases that are commenced. Even fewer of those commenced actually go to trial. However, before they settle, and a fortiori in the case of those which do not, they often consume a great deal of a very valuable public resource, namely the time of the Court.

There is a serious discussion waiting to be had about the ultimate social and economic utility of pieces of litigation which can occupy a great deal of the Court's time, require a great deal of legal and other expertise but yield relatively small returns to individual litigants and, in some cases, very substantial returns to the lawyers involved. In making that observation I am not to be taken as suggesting that in any particular case those fees were not the legal equivalent of a fair day's pay for a fair day's work in cases of great complexity. Nevertheless, as debate continues about the degree to which class actions and those who fund them are to be regulated, I suggest that any discussion of those issues can only be useful if underlying assumptions about the social and economic utility of such actions are themselves first exposed to scrutiny and debate.

Conclusion – six essentials

I will conclude by addressing a question which some of you may be thinking about after listening to this necessarily general overview of the duties and responsibilities of directors and the risks, including of class actions in appropriate cases, that company directors might incur. That question is whether all of these duties can be observed, litigation avoided and a profit still be made? Self-evidently the answer to this question is "yes" because that is the experience of the overwhelming majority of company directors.

Nevertheless, I will conclude with six basic guidelines which I propose for the consideration of those of you who are company directors. They are distilled from practical reflection over many years as a legal adviser to companies and their directors, as a company director myself and, more recently, from the viewpoint of a judge. The six guidelines are:

1. Be honest.
2. Be diligent.
3. Undertake corporate activity on a reasoned basis. It is a very good discipline to record, either through a board paper or in the minutes of a board meeting, the reasons why a particular course of action which has

been resolved upon is considered by the directors (or at least a majority of them) to be in the best interests of the company and its shareholders.

4. Understand the fundamentals of how to read a profit and loss and balance sheet (or whatever this week's version of the accounting standards requires those documents to be called). While company directors do not have to be qualified accountants, they cannot do their job unless they have a basic degree of competence in understanding a company's accounts. I particularly emphasise that company directors should have a clear understanding of what their company's liabilities are and the correct classification of those liabilities as current, future and contingent.
5. Be completely unafraid to ask obvious or even apparently stupid questions and do not take for granted what management or advisers may be telling you. Make up your own mind on the proper assessment of the information presented to you once you are reasonably satisfied as the completeness and accuracy of that information, including making a judgment as to the competence of the person or organisation responsible for it.
6. Above all else, remember that it is the company's and not your personal interests that are to be served and that, in practical terms, as company directors you occupy significant positions of trust.

While these guidelines are necessarily general and specific problems will require specific advice, I am confident that company directors who act in accordance with guidelines such as these will remain within the law and their companies will continue to be the means by which good ideas, products and people generate economic well-being and social advancement.