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Corporate Governance

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Law and Practice

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Contents

Herbert Smith Freehills operates from 27 offices across Asia Pacific, EMEA and North America and is at the heart of the new global business landscape providing premium quality, full-service legal advice. The firm's Sydney and Melbourne-based head office advisory team (HOAT) is Australia's largest dedicated legal team specialising in corporate governance advice and was awarded 'Commercial Team of the Year' at the 2018 Australian Law Awards. As the 'go-to' governance adviser for market-leading listed companies in Australia, HOAT's permanent team of 17 qualified lawyers regularly advises major clients on sensitive and strategic matters relating to corporate culture and governance, executive remuneration, and shareholder engagement and activism.

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1. Introduction

1.1 Forms of Corporate/Business Organisations

Australian law provides for a number of forms of corporate/business organisation, including those listed below.

- *Individuals*: an individual may conduct business under their own name or, alternatively, they may register a business name with the Australian Securities and Investments Commission (ASIC) or applicable state or territory authority. Although administratively simple, the lack of a separate legal entity exposes the relevant individual to unlimited personal liability in relation to the business.
- *Partnerships*: a partnership is an arrangement, typically contractual, between two or more people or companies to carry on a business in common with a view to profit. Each partner is collectively and separately liable for the debts and obligations of the partnership. If one partner is required to pay the debt of the whole partnership, that partner can recover from the other partners their shares of the debt. In some states and territories, limited liability partnerships may be created (though they require one or more general partners with unlimited liability who are responsible for the management of the business).
- *Companies*: the most common structure for business ventures in Australia is a company. As a general principle, companies are separate legal entities under Australian law and distinct from the directors and management of the business venture. See below for an explanation of the classes of company permitted under Australian law.
- *Trust entities*: certain types of operating and trading trusts, 'stapled' structures and managed investment schemes are also permissible under Australian law. However, these are uncommon business structures outside of the financial services, infrastructure and real estate sectors.

Classes of Company

The registration, management and control of companies is governed by the Corporations Act 2001 (Cth) (Corporations Act), which is administered by ASIC.

The Corporations Act recognises that companies may be privately owned or publicly owned and provides for a number of sub-classes of company types within each of those categories.

Proprietary and public companies
Companies may be registered in Australia as either a proprietary (private) or a public company. A proprietary company is generally simpler and less expensive to administer than a public company because it is subject to fewer requirements under the Corporations Act. A proprietary company cannot have more than 50 non-employee shareholders and must have at least one member at all times. A proprietary company must not invite the public to subscribe for its shares or debentures, or to deposit money with the company. The only forms of proprietary companies are companies limited by shares or unlimited liability companies.

Proprietary companies can be further classified as 'small' or 'large' according to statutory thresholds for revenue, assets and employees. If a proprietary company is not classified as small, then it is a large proprietary company and subject to heightened administrative and reporting requirements under the Corporations Act.

A public company may raise funds from the public and be listed on the Australian Securities Exchange (ASX). A public company must also have an auditor and, if it has more than one member, must hold a general meeting of its members at least once each calendar year. The forms of public companies are companies limited by shares, companies limited by guarantee, unlimited companies and no liability companies.

Companies limited by shares – public or proprietary
The most common type of company, whether it is publicly or privately owned, is a company limited by share capital. With this structure, the personal liability of each shareholder is limited to the amount (if any) unpaid on the shares held by the shareholder. These companies are denoted by 'Limited' or 'Ltd' in their name if they are public companies and 'Pty Limited' or 'Pty Ltd' in their name if they are proprietary companies.

Other forms of company
The Corporations Act provides for several other forms of company, including companies limited by guarantee (common for charities), unlimited liability companies (common for professional associations) and no liability companies (only available in the mining sector). Each of these structures is subject to a different naming convention reflecting the differing levels of potential liability for members.

1.2 Sources of Corporate Governance Requirements

Australian corporate governance requirements are derived from common law, statute, exchange rules and market guidance. The principal sources of corporate governance requirements are as listed below.

Case Law
There are a number of corporate governance principles that are well established at common law and which have broad relevance for directors of Australian companies. Chief among these is a director's fiduciary relationship to the company and the duties that they owe to the company as a result of that relationship. At common law, company directors have fundamental duties including the duty of care and diligence and the duty to act in good faith in the best interests of the company and for a proper purpose. Company officers will also have a duty to the company under the principles of agency, requiring them to act within the scope of their authority.

Corporations Act
The Corporations Act is an Act of the Commonwealth of Australia and the primary law regulating the registration, control and management of companies. The Corporations Act applies varied obligations on companies, depending on the type of company (ie, small proprietary, large proprietary or public). Compliance with the Corporations Act is mandatory and a breach of the Act can attract both criminal and civil penalties. ASIC is responsible for the general administration and enforcement of the Corporations Act.

The Corporations Act includes a range of provisions which either directly or indirectly relate to corporate governance including:

- statutory directors' and officers' duties;
- rules pertaining to the appointment, rotation and removal of independent company auditors;
- financial and annual reporting requirements;
- director and senior executive remuneration reporting requirements, including the non-binding vote on the remuneration report and the 'two-strikes' rule (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**, below);
- continuous and specific periodic disclosure for certain entities to ensure that trading occurs on public markets that are 'fully informed' in relation to companies' affairs; and
- directors' and members' meeting procedures and rights.

The Corporations Act also contains certain replaceable rules and in some cases, companies may elect to have the replaceable rules apply to manage the company instead of a constitution.

1.3 Corporate Governance Requirements for Publicly Traded Companies

Companies with securities (eg, shares) publicly traded on the ASX are subject to additional requirements under the ASX's exchange rules and associated guidance on corporate governance.

ASX Listing Rules
Listed companies must agree to comply with the ASX Listing Rules and the operating and settlement rules of the exchange. The ASX Listing Rules set out, among other things, requirements for admission to list on the ASX and removal from the official list, continuous disclosure of information to the public, the rights that may be attached to the securities of a listed company, security holder approval for certain transactions and reorganisation of a company's capital.

The ASX Listing Rules also require listed companies to comply with specific corporate governance requirements for:

- disclosure of corporate governance practices;
- audit committee and remuneration committee composition (depending on index participation);
- adoption of a securities dealing policy for companies' directors and employees;
- continuous and periodic reporting; and
- notification of directors' interests.

ASX Corporate Governance Council's Principles and Recommendations (Fourth Edition)
Listed companies must prepare and publish a corporate governance statement which outlines their governance practices as compared to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (ASX Corporate Governance Principles).

The members of the ASX Corporate Governance Council (Council) represent a range of business, shareholder and industry groups with an interest in the orderly operation of the market and good governance of market participants. The Council published the fourth edition of its ASX Corporate Governance Principles in February 2019 which set out the Council's recommended corporate governance practices for entities listed on the ASX. The fourth edition takes effect for an entity's first full financial year commencing on or after 1 January 2020.

While compliance with the ASX Corporate Governance Principles is not mandatory, listed entities must report against them on an 'if not, why not' basis.

2. Corporate Governance Framework

2.1 Key Rules and Requirements

A number of additional corporate governance requirements are imposed under other pieces of Australian legislation, including those listed below.

Prudential Regulation for Banking, Insurance and Superannuation Entities
Specific prudential regulation applies to certain types of financial services businesses, including banking, insurance and superannuation entities. The Australian Prudential Regulation Authority (APRA) is an independent statutory authority that supervises regulated entities in relation to a range of matters including prudential conduct, capital adequacy, outsourcing and, increasingly, the governance practices of these entities.

Banking Executive Accountability Regime
The Banking Executive Accountability Regime (BEAR) is set out in Part IIAA of the Banking Act 1959 (Cth) and establishes accountability obligations for authorised deposit-taking institutions (eg, banks) and their senior executives and directors. The regime is administered by APRA and seeks to improve governance outcomes at authorised deposit-taking institutions by making managers accountable for the conduct of the staff in their areas of responsibility.

Resources and Reserves Reporting
Mining entities and oil and gas entities listed on ASX are required to meet with additional disclosure requirements in relation to their corporate reporting and to comply with industry codes which set minimum standards for public reporting of exploration results, resources and reserves.

Modern Slavery in Supply Chains
On 1 January 2019, new federal legislation commenced which requires certain organisations with consolidated revenue over AUD100 million to prepare annual modern slavery statements including, amongst other things, an explanation of areas of risk of potential modern slavery in relation to the organisation's supply chain, as well as an outline of the steps being taken to mitigate those risks and their effectiveness. The State of New South Wales has also passed similar legislation, applying to organisations with total revenue of AUD50 million or more, though those laws have not yet taken effect.

Other Regulatory Compliance Obligations
A number of other legislative requirements apply to Australian companies which may impact on the corporate governance or operation of those entities, or the duties or liability of their managers. Examples include financial services legislation, anti-money laundering and counter-terrorism legislation, taxation legislation, environmental legislation, workplace health and safety laws, and anti-trust and trade practices regulations.

2.2 Current Issues and Developments

There has been considerable debate in Australia over the past three years in relation to corporate governance, including strident public criticism of a number of large Australian companies in relation to perceived failings of corporate culture and conduct. This has also resulted in criticism of the effectiveness of the Australian regulators, including ASIC, which in turn, is driving an increasingly aggressive approach to regulatory enforcement within Australia.

Issues which have been at the heart of the debate include limitations of shareholder primacy (and discussion about the extent to which broader stakeholder interests should feature in corporate decision-making), the extent to which executives are held accountable for poor corporate conduct in the current system of corporate governance practised in Australia, and whether common Australian practices for remuneration incentives may encourage poor corporate conduct.

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
On 14 December 2017, the Government ordered an inquiry into the Australian financial services sector following widespread concern regarding reports of misconduct and poor corporate conduct in that sector. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, led by Justice Kenneth Hayne, was tasked with investigating key financial services institutions, making recommendations to the Government on law reform and referring potential breaches of law to relevant regulators.

The Final Report of the Royal Commission (Hayne Report) recognised the fundamental importance of effective leadership, good governance and appropriate culture within entities.

Key findings of the Hayne Report relating to governance were as follows:

- *cultural and governance self-assessments* – financial services entities were recommended to undertake a self-assessment of governance and culture examining the frameworks and practices for governance, culture and accountability within their corporate groups;
- *remuneration arrangements* – the Hayne Report advocated that remuneration should be used to reflect accountability, with incentives offered for good conduct and adjustments to be made when misconduct occurs; it also recommended increasing focus on the management of financial and non-financial risks within an organisation and the importance of linking risk management and remuneration outcomes;
- *expansion of the BEAR* – it was recommended that the existing BEAR be expanded to apply to other types of financial services entities, including APRA-regulated insurance and superannuation businesses; given the increasing focus on individual accountability at senior levels, there is speculation that the BEAR will be extended through legislative reform to other businesses and industries as well.

ASX Corporate Governance Principles
The fourth edition of the ASX Corporate Governance Principles was released shortly after the Hayne Report and further picked up on themes of corporate culture and 'tone from the top'. The key change reflected in the fourth edition is a shift towards recognising the importance of monitoring and taking responsibility for culture, conduct and behaviour within the corporate group. It also has an additional focus on the management of (and disclosure in relation to) non-financial risks, in contrast to the traditional emphasis placed on financial risks and performance of listed companies.

Institutional Investor and Proxy Adviser Voting Guidelines
Similar to other jurisdictions, large financial institutions and their proxy advisers are increasingly influential in relation to Australian corporate governance practices and, in relation to industry-based superannuation funds, increasingly activist in their approach to portfolio companies.

Australian listed companies commonly have regard to the corporate governance and voting guidelines published by large institutional investors (such as BlackRock and the Australian Council of Superannuation Investors (ACSI)) and proxy advisory bodies which advise or vote on behalf of large institutional investors (such as Institutional Shareholder Services (ISS), CGI Glass Lewis and Ownership Matters).

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

In Australia, shareholders of companies vest the board of directors with the power to manage the affairs of the company under the company's constitution. However, for significant public companies, the management and oversight of the company will usually be divided between the board (which may be comprised of a mix of executive and non-executive directors) and the management team (which are typically executives of the company). The size and composition of the board and specific responsibilities of management roles will depend on the type and size of the company.

Board
The board of directors is appointed by shareholders and oversees the management team and the governance of the company. The board is led by a chairperson, who is typically elected by the members of the board.

The board of a publicly listed company is usually comprised of a majority of non-executive directors (often, independent non-executive directors) and a small number of executive directors, for example the Chief Executive Officer (CEO). The ASX Corporate Governance Principles provide specific recommendations in relation to the composition and independence of listed company boards and board committees (see **4.3 Board Composition Requirements/Recommendations**, below).

The Corporations Act permits directors to delegate some of their powers to a committee of the board, another director, an employee of the company or any other person (unless the company's constitution provides otherwise). However, the board must retain ultimate oversight and decision-making power in respect of the matters so delegated and there are certain responsibilities that cannot be delegated by law (eg, approval of financial statements).

Board Committees
Common board committees, particularly for listed companies and other significant entities, include the following:

- remuneration committee;
- nominations committee;
- risk management committee; and
- audit committee.

These may be 'standalone' committees or combined. Other common focus areas for board committees are governance, people and human resources, corporate responsibility and sustainability and workplace, health and safety. Ad hoc committees of the board may also be established from time to time to focus on transactional projects or as a mechanism for managing potential conflicts of interest on the board.

Management
The management team are employees of the company and will typically be responsible for implementing an entity's strategic objectives, whilst operating within the values, codes of conduct, budget and risk appetite set by the board. The management team of a company will be led by the CEO who is often also a member of the board.

3.2 Types of Decisions Made by Governing Bodies
As noted above in **3.1 Bodies or Functions Involved in Governance and Management**, under company constitutions, the board will invariably be vested with responsibility for the management of the company and its affairs. The board then delegates the responsibility for the day-to-day management of the company to the management team through the board charter and its internal delegations framework and policies, subject to reserving certain matters for its own decision.

Responsibilities of a company that are almost universally reserved for the board include:

- approving the company's strategic direction;
- monitoring the company's performance;
- oversight of risk management;
- capital management decisions;
- approval of financial reports; and
- CEO succession.

Ordinarily, management will have authority for any matters or decisions not reserved by the board or required to be made by the directors under law. Most Australian companies will structure and organise their managerial decision-making through a delegations framework outlining the types of decisions likely to arise in the business and the limits of authority of key executives in making those decisions.

3.3 Decision-making Processes
Board and Board Committee Decision-Making
The company will have procedures for board and committee meetings contained in its constitutional documents and internal charters. At a board meeting, the directors will vote on decisions and the resolutions (ie, outcomes) will be recorded in the minutes of the meeting.

A high-level outline of the proceedings of board and committee meetings is also recorded in minute books maintained by the company for this purpose. Such records are commonly accepted by the Australian courts as evidence of the matters considered at the relevant meeting, particularly where they have been reviewed and approved by the board.

Management Decision-Making
The decision-making process of a management team will vary depending on the company. However, boards will usually adopt standing internal delegations of power to the CEO and management team to facilitate their day-to-day management of the company. Management will often have to engage with the board to seek approval of material decisions at board meetings.

4. Directors and Officers

4.1 Board Structure
The Corporations Act provides that a proprietary company must have at least one director, and at least one director ordinarily residing in Australia. Proprietary companies are not required to have a company secretary, although it is common practice within large corporate groups.

A public company (including those listed on ASX) must have at least three directors, two ordinarily residing in Australia. Public companies must have at least one Australian resident company secretary.

4.2 Roles of Board Members
The roles of the different members of boards of directors may include non-executive directors, executive directors, chairperson and managing director. Further detail on each of these members is set out below.

Directors Generally
Directors may be non-executive or executive directors.

Non-executive directors, including independent non-executive directors, are directors not employed by the company.

Non-executive directors provide objective oversight of the company's affairs and are not expected to be involved in the day-to-day management of the company.

Executive directors are directors who are also executives employed by the entity. Both non-executive and executive directors have the same baseline legal duties, responsibilities and potential liabilities. However, in practice, executive directors will often be held to a higher standard by virtue of their executive role. When determining whether a director has discharged their duties, Australian courts will apply an objective standard and consider the role of the relevant person and the expected expertise of persons occupying that role or office.

Chairperson
Significant companies in Australia typically have a director acting in the role of chairperson to lead the board and facilitate board and shareholder meetings. In some circumstances, the constitution may specify requirements or confer special powers on the chairperson, including whether they have a casting vote at board and shareholder meetings. The chairperson's role may be a standing appointment or may be for a specified meeting or time period.

Recommendation 2.5 of the ASX Corporate Governance Principles recommends that the chairperson of the board of a listed company be an independent director and that they should not be the same person as the CEO of the company.

Managing Director
It is very common in Australia for the CEO of an entity to be appointed to the board as an executive director. In such a case, that person is often given the title of managing director.

Typically, the managing director is responsible for the management of the company and its operations. This can include:

- developing, and implementing if approved, business plans, budgets and strategies for board consideration and approval;
- ensuring the board is informed of material business developments in relation to the company's operations and affairs;
- referring to the board proposed transactions, commitments or arrangements that exceed board set threshold parameters; and
- ensuring the company's financial reporting, control and monitoring mechanisms capture all relevant material information.

4.3 Board Composition Requirements/ Recommendations

Statutory Requirements
In Australia, the appointment of a director is governed by the Corporations Act. Only individuals, over the age of 18 years, are eligible to be appointed as a director. A person can be disqualified from managing corporations and, in that case, may only become directors with permission from ASIC or if court leave is granted.

Minimum and Maximum Number of Directors
Companies must meet the statutory minimum number of directors under the Corporations Act (see **4.1 Board Structure**, above). In addition, company constitutions may set out the minimum and maximum number of directors which a company must have.

Listed Companies
Under the ASX Corporate Governance Principles, all listed companies are subject to recommendations applicable to board and board committee composition (see **4.5 Rules/ Requirements Concerning Independence of Directors**, below). However, listed companies in the S&P/ASX300 Index are required by the Listing Rules to comply with certain of these recommendations.

In addition, recommendation 2.2 provides that listed companies should have and disclose a board skills matrix. The skills matrix should outline the mix of skills, knowledge, experience and capabilities that the board currently has or is looking to achieve in its membership. There is no prescribed format for a skills matrix and a board can decide which skills and competencies are most suitable.

The ASX Corporate Governance Principles also recommend that listed companies set measurable objectives for achieving gender diversity in the composition of their board, senior executives and workforce generally, and annually disclose their progress towards achieving those objectives. For listed companies that are included in the S&P/ASX 300 Index, the measurable objective for achieving board gender diversity is recommended to be that at least 30% of the company's directors be of each gender.

APRA-Regulated Entities
Boards of APRA-regulated entities are subject to heightened eligibility requirements under Prudential Standard CPS 520 which mandates that their directors be 'fit and proper' persons to ensure that the institution prudently manages risk related to its leadership.

4.4 Appointment and Removal of Directors/ Officers

In Australia, the Corporations Act, ASX Listing Rules and a company's constitution will govern how directors are appointed and removed.

Appointment and Re-Election
For both proprietary and public companies, pursuant to the Corporations Act, directors can be appointed by either

a shareholder resolution passed at a general meeting or a director resolution.

ASIC must be notified of director appointments within 28 days.

Additional requirements also apply to the appointment and re-election of directors under the ASX Listing Rules. Under ASX Listing Rule 14.4, a director appointed by the board of a listed entity (other than the managing director) only holds office until the next annual general meeting (AGM) of the company at which time they must seek election by shareholder resolution or retire.

ASX Listing Rules 14.4 and 14.5 also specify that for listed public companies: (i) a director, except the managing director, must stand for re-election at least every three years; and (ii) at least one director must stand for election, or re-election, at each AGM.

For listed public companies, ASX Listing Rule 3.16.1 prescribes that the ASX must immediately be notified of changes to the chairperson or directors.

Removal
A director of a proprietary company may be removed from office by shareholder resolution. Directors of public companies may also be removed by shareholder resolution, provided a specified process in the Corporations Act is followed.

The constitution of a proprietary company can provide for directors to be removed by board resolution. Directors of public companies cannot be removed by their peers and can only be removed by shareholder resolution.

Pursuant to standard company constitutions, the appointment of a managing director is usually terminated if that person ceases to be employed by the company.

Directors may also be removed if they are disqualified from managing corporations under Part 2D.6 of the Corporations Act or if they automatically vacate office in specified circumstances provided in the company's constitution (eg, becoming of unsound mind, being convicted of an indictable offence and, for APRA-regulated entities, ceasing to be a 'fit and proper' person under relevant prudential standards).

4.5 Independence of Directors and Conflicts of Interest

The rules and requirements in relation to potential conflicts of interest are set out in the Corporations Act and, for listed entities, the ASX Corporate Governance Principles provides additional considerations for director independence.

Conflicts of Interest
Under Section 181 of the Corporations Act, directors must act in good faith in the best interests of the company and for a proper purpose. This requirement reflects that decisions must be made in the interests of company with regard to shareholders as a whole, and not just individual shareholders or specific interest groups.

Section 191 of the Corporations Act outlines situations where a director must notify the other directors of a material personal interest in a matter that relates to the affairs of the company and, under Section 195, directors of public companies are not permitted to attend and vote at meetings considering matters in which they have a material personal interest (subject to some exceptions).

Director Independence
The ASX Corporate Governance Principles emphasise the importance of director independence as a means of providing objective oversight of listed companies, separate to management interests and other extraneous relationships. For this reason, the ASX Corporate Governance Principles recommend that listed companies have a chairperson who is independent and who is not the CEO. Box 2.3 of the ASX Corporate Governance Principles sets out instances of interests, positions and relationships that may raise issues for the independence of a director.

Composition recommendations under the ASX Corporate Governance Principles also emphasise that the majority of members of the board and board committees should be independent non-executive directors and have independent chairs. In the case of the audit committee, the Council also recommends that the chair not be the same person as the chairperson of the board.

For listed companies in the S&P/ASX300 Index, the ASX Listing Rules require that the Council's recommendations for audit committee member independence be complied with on a mandatory basis. S&P/ASX300-listed companies are also required to have a remuneration committee comprised solely of non-executive directors under the ASX Listing Rules.

4.6 Legal Duties of Directors/Officers

In Australia, high standards of business conduct are required of company directors and officers in the performance of their duties to the company. If a director or officer breaches their duties, they individually, as well as the company, could be subject to sanctions, including financial penalties and imprisonment. The range of duties directors and officers owe to the company under both statutory and common law are described below.

Common Law Duties
Under the common law, directors have duties to:

- act in good faith and exercise their discretion in what they consider to be the best interests of the company as a whole and not for a collateral purpose;
- not act for an improper purpose, that is, not exercise their powers to obtain some private advantage or for any purpose for which the power was not granted;
- maintain, as a board, any discretions they have and not limit themselves in the future from acting in the best interests of the company;
- avoid conflicts of interest, that is, not enter into engagements in which a director has a personal interest conflicting, or possibly conflicting, with the interests of the company; and
- act with care and diligence, meaning that directors actively apply their minds to considering the overall position of the company.

Statutory Law Duties
The statutory duties of directors and officers are contained in Part 2D.1 of the Corporations Act. Under the Corporations Act, directors and officers are required to:

- act with a degree of care and diligence which a reasonable person would exercise if he or she were a director or officer in the company's circumstances and had the same responsibilities of that director or officer;
- act in good faith in the best interests of the company and for a proper purpose;
- not improperly use information or their position to gain an advantage for themselves or someone else or to cause detriment to the company; and
- disclose to the other directors a material personal interest in a matter that relates to the affairs of the company (directors only).

For directors, these statutory duties apply in addition to the common law directors' duties set out above, although the two sets of duties are broadly consistent. The Corporations Act may impose other, more specific obligations, in the context of a particular sector (for example, the duty imposed on a holder of an Australian Financial Services Licence to have an appropriate conflicts management policy).

Business Judgment Rule
As set out above, one of the core duties of a director (or officer) is to exercise care and diligence in carrying out his or her duties. Directors and officers will meet the requirement to exercise due care and diligence both under the Corporations Act and the common law if, when making a 'business judgment' (ie, any decision to take or not take action in respect of matters relevant to the business operations of the company), certain conditions outlined in the Corporations Act were met when making that decision.

However, unlike other jurisdictions which have similar 'safe harbour' protections in their corporations laws, Australian courts have interpreted the scope of the business judgment rule narrowly and there have been relatively few examples of directors or officers successfully relying on the protection it (ostensibly) offers.

Other Duties – Prevent Insolvent Trading
Under the Corporations Act, there is a positive duty on directors to prevent the company from trading while insolvent. A director breaches this obligation if they fail to prevent the company from incurring a debt at a time when:

- the company is insolvent or becomes insolvent by incurring that debt (or by incurring debts including that debt);
- there are reasonable grounds for suspecting the company is (or would become) insolvent; and
- the director was subjectively aware of those grounds, or a reasonable person in a like position in a company in the company's circumstances would be so aware.

There are certain defences a director may rely on, including that the director believed on reasonable grounds that the company was solvent or took all reasonable steps to prevent the company from incurring the debt.

In 2017, the Corporations Act was amended to provide directors with a further defence to civil action for insolvent trading where the debt that the liquidator alleges had been incurred whilst the company was insolvent was incurred in connection with a course of action that is reasonably likely to provide a better outcome for the company than its immediate liquidation or administration.

4.7 Responsibility/Accountability of Directors
All directors have a duty to exercise their powers and discharge their duties in good faith and in the best interests of the company, which means that they must act in the best interests of shareholders as a general or collective body. In the event of actual or potential insolvency, the directors' duty to the company may extend to include consideration of creditor interests.

For directors of wholly owned subsidiaries, if the constitution expressly authorises those directors to act in the best interests of the holding company, Section 187 of the Corporations Act allows directors of wholly owned subsidiary companies to have regard to the best interests of the corporate parent in some circumstances.

4.8 Breach of Directors' Duties
A breach of duty by directors may result in proceedings being brought against them by:

- the company;
- shareholders, pursuant to statutory derivative action provisions in the Corporations Act which allow them to

institute proceedings in the company's name (provided the court in its discretion grants leave to the applicant);
- creditors, administrators and liquidators in the context of insolvent trading;
- third parties in the context of misleading and deceptive conduct or anti-competitive behaviour; and/or
- regulatory authorities such as ASIC and the Australian Competition and Consumer Commission (ACCC).

Breach of duty may involve civil or criminal penalties depending on the circumstances. In addition, any breach or alleged breach of directors' duties could have a significant impact on a director's personal reputation and the reputation of the company.

Both proprietary and public companies are prohibited under Part 2D.2 of the Corporations Act from exempting a director or officer from liability to the company. A company is also prohibited from indemnifying a director, or any other person, for liability against the following:

- liability owed to the company, or related body corporate;
- liability for certain types of pecuniary penalty orders and compensation orders;
- liability that is owed to a third party and did not arise out of good faith conduct; and
- legal costs, where the director is found guilty or liable in criminal proceedings or in proceedings brought by ASIC.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Directors also have duties which are found in other pieces of legislation and which may impose personal liability on directors for non-compliance. The primary areas where these duties arise can be found in financial services legislation, anti-money laundering and counter-terrorism legislation, taxation legislation, environmental legislation, workplace health and safety laws, and anti-trust and trade practices regulations. These and other statutory duties may be owed to the company's shareholders, its employees and relevant third parties.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

There are a number of approvals that are required in connection with the remuneration, fees or benefits payable to directors and officers.

For proprietary companies, the constitution may specify requirements in relation to approval of directors' remuneration.

For public companies, the constitution will generally require shareholders to approve the total aggregate amount of remuneration that can be paid to non-executive directors. Directors then have discretion as to how the amount is divided amongst themselves. The remuneration paid to executive directors is determined by the board, but it must be reasonable pursuant to Chapter 2E of the Corporations Act.

Listed companies are subject to a similar obligation under the ASX Listing Rules which requires directors' fees to be paid from within an aggregate fee pool approved by shareholders. Remuneration for executive directors is not subject to the same requirement. However, it cannot include amounts which are commissions on, or percentages of, the business' operating revenue.

Subject to the terms of a listed company's employee incentive scheme, ASX Listing Rule 10.14 also prohibits a director, or a related party, to acquire securities under an employee incentive scheme without shareholder approval (subject to certain exceptions). Termination payments to certain types of officers, including directors, are also limited under the ASX Listing Rules and Corporations Act.

Listed companies in Australia are not subject to binding shareholder votes in relation to their remuneration policies. However, listed companies are required to make detailed disclosure of their remuneration policies for (and payments made to) directors and key management personnel in their remuneration report. Those reports are subject to the following shareholder approval votes:

- an advisory vote by shareholders under Section 250R(2) of the Corporations Act; and
- a 'two-strikes rule' under sections 250U-250Y of the Corporations Act. Under that rule, if 25% of the votes cast at two consecutive AGMs oppose the adoption of the remuneration report, then a 'spill resolution' must be put to shareholders for re-election of the board. The requirement to stand for re-election does not apply to the managing director.

4.11 Disclosure of Payments to Directors/Officers

The disclosures that a company must make in relation to the remuneration, fees or benefits payable to directors and officers will depend on the type of company.

Most small proprietary companies are not required to prepare financial reports which means that there is limited disclosure in relation to remuneration payments.

For large proprietary companies and public companies, which are required to prepare financial reports, disclosure of remuneration paid to directors is typically required to be disclosed pursuant to Accounting Standard AASB 124 (Related Party Disclosures).

A listed company must make more detailed disclosure of their remuneration policies for directors and key management personnel in a specific remuneration report (Section

300A Corporations Act). Detailed disclosure requirements apply to the remuneration report pursuant to the Corporations Act, Corporations Regulations 2001 (Cth) and Australian Accounting Standards. The remuneration report must be presented to shareholders at the AGM for adoption by way of an advisory vote; for further detail see above, **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Directors of a company are accountable to its shareholders as the owners of that company. The rules and requirements that may govern the relationship between a company and its shareholders can be found in the Corporations Act and, for listed companies, the ASX Listing Rules.

The Corporations Act also prescribes that a company's constitution has the effect of a statutory contract between the company and each shareholder. The constitution typically contains provisions dealing with the powers of the company, issue and transfer of shares, members and directors' meetings, appointment and renewal of directors and dividend procedures. The company's constitution will usually be supplemented by board and board committee charters, corporate governance policies and other internal frameworks which further define the relationship between the company, the board, management and the company's shareholders.

5.2 Role of Shareholders in Company Management

In the absence of express constitutional provisions, shareholders are not able to direct the board in the exercise of its powers to manage the affairs of the company. As set out above in **3.1 Bodies or Functions Involved in Governance and Management**, company constitutions generally vest all powers of management in the board (and authorise the board to delegate those powers to management). Accordingly, the principal rights of shareholders to exert control over the company are to appoint or remove the directors or to amend the company's constitution.

A shareholder or shareholders holding more than 5% of the voting shares are able to requisition that a shareholders meeting be held or, at their own cost, can convene a shareholders meeting to consider any resolution validly within the power of shareholders. Either 100 shareholders together or any one or more shareholders holding more than 5% of the voting shares can also requisition that a resolution be put to the next general meeting convened by the board (provided it is at least two months after the requisition).

Shareholders have limited rights to demand access to information under the Corporations Act in the absence of a court order to inspect the books of the company. At common law, shareholders also have limited rights to inspect the books of a company, unless that inspection is necessary in relation to a specific dispute or question (and is only then granted to such extent as may be necessary for that purpose).

Major shareholders by virtue of the size of their shareholding are often able to engage further with management and the board and exercise a higher degree of control over how the company is managed. Major shareholders will often seek to appoint directors to the board of a company to effectively act as their spokespersons and to represent and protect their interests in the company.

5.3 Shareholder Meetings

Under the Corporations Act, public companies with more than one shareholder must hold an AGM at least once every calendar year within five months after the end of its financial year. Proprietary companies must hold such meetings if they are required by their constitution.

Meetings involving shareholders are subject to rules set out in the Corporations Act and companies' constitutions regarding the giving of notice and the time and place where the meeting can be held.

A shareholders' meeting may be called:

- at any director's own initiative; or
- at the request of shareholders holding at least 5% of the voting shares (see **5.2 Role of Shareholders in Company Management**, above).

The court may also call a meeting if it is impractical to call one in any other way.

5.4 Shareholder Claims

Shareholders can bring a claim and seek a remedy against the company or directors individually for the following bases of claim:

- *personal actions* – shareholders have a personal right to bring an action against the company or the individual directors where a cause of action has accrued to the member personally;
- *statutory derivative action* – the regime under Part 2F.1A of the Corporations Act allows shareholders to bring an action on behalf of the company where a cause of action has accrued to the company which the company is likely not to exercise;
- *statutory injunction* – shareholders can also seek a statutory injunction to prevent a contravention of the Corporations Act;
- *oppression* – shareholders under Part 2F.1 of the Corporations Act may bring a claim and complain they have been oppressed as a result of the conduct of a company's

affairs, an actual or proposed act or omission by or on behalf of the company, or a resolution or proposed resolution;
- *winding-up* – shareholders in limited circumstances may also apply to the court for an application to wind-up the company.

5.5 Disclosure by Shareholders in Publicly Traded Companies

There are a number of disclosure and other obligations on shareholders in public companies, including shareholder substantial notice and director notifiable interests as set out below.

Shareholder Substantial Notice

Shareholders are considered to have a substantial holding if they have relevant interests in voting shares or interests carrying 5% or more of total votes.

Pursuant to Section 671B of the Corporations Act, shareholders of public companies must provide a substantial holding notice if the shareholder:

- begins to have, or ceases to have, a substantial holding;
- has a substantial holding and there is a movement of at least 1% in their holding; or
- makes a takeover bid for securities of the public company.

Director Notifiable Interest

Subject to a company's constitution, directors can own shares in the company. Under the Corporations Act and ASX Listing Rule 3.19A, listed companies must notify the ASX of the notifiable interests of a director, which will then make that information publicly available.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

All large proprietary companies and public companies are required under the Corporations Act to prepare and lodge with ASIC a financial report, directors' report and auditors' report for each financial year (together forming an 'annual report'). In some circumstances, small proprietary companies may also have to prepare a financial report and directors' report (eg, where directed to do so by shareholders with at least 5% of the votes in the company or ASIC, or where the company is controlled by a foreign entity).

For companies that are listed, rather than lodging their annual report with ASIC, they may rely on class order relief and satisfy the lodgement obligation by releasing their annual report to ASX. All companies which are required to prepare an annual report must provide it to members within four months of the end of their financial year (or before 21 days before the company's AGM, if earlier).

Under the Corporations Act, directors are ultimately responsible for the veracity of financial statements. Directors have a duty to ensure that financial statements are compliant with accounting standards and present a true and fair view of the company.

Listed companies and other 'disclosing entities' are also required to prepare and lodge with ASIC a half-year financial report, directors' report and auditors' report. Listed companies also have supplementary periodic reporting requirements under the ASX Listing Rules, including lodging with ASX:

- a preliminary final report (Appendix 4E);
- a half-year report (Appendix 4D) (see also Section 320 Corporations Act);
- copies of annual reports and Appendix 4G corporate governance checklists; and
- for some ASX-listed companies – particularly companies with mining activities – quarterly reports (Appendix 4C).

6.2 Disclosure of Corporate Governance Arrangements

Proprietary companies and unlisted public companies have limited legal requirements in relation to disclosure regarding their corporate governance arrangements.

Under ASX Listing Rules 4.7 and 4.10.3, listed companies must prepare a corporate governance statement for inclusion in their annual report or to provide to ASX at the same time as their annual report. The corporate governance statement must disclose the extent to which the entity has followed the recommendations contained in the ASX Corporate Governance Principles during the financial year. If the entity has not followed a recommendation for any part of the reporting period, its corporate governance statement must separately identify that recommendation, the period it was not followed, the reasons for not following it, and any alternative practices adopted (if any). An appendix checklist is also required to be lodged with ASX showing compliance (or non-compliance) with each of the recommendations of the ASX Corporate Governance Principles at the same time the company's corporate governance statement is published.

6.3 Companies Registry Filings

A company's registry filing obligations will depend on its type, ownership and activities. Depending on these factors, its disclosure obligations may include some or all of the following:

- periodic financial reporting;
- officeholder notifications and changes to company information;

- continuous disclosure and other ASX announcements; and
- substantial shareholding notifications under the Corporations Act.

Filings Required Under the Corporations Act
Filing obligations under the Corporations Act include:

- reviewing the company's annual statement and lodging any amendments to ASIC within 28 days of the review date (as well as passing a solvency resolution, if required, and paying ASIC fees);
- notifying ASIC of any issue of shares or change to the company's share structure;
- notifying ASIC of a change to the company's principal place of business;
- notifying ASIC of a change to the company's member register (proprietary companies only);
- notifying ASIC of the names and residential addresses of directors and secretaries;
- responding to a return of particulars (which may be issued to a company if ASIC suspects or believes that particulars recorded in its register are incorrect, or if no documents have been lodged with ASIC for at least one year); and
- notifying ASIC of a change to the company's ultimate holding company (for proprietary companies only).

Continuous Disclosure Obligation and Other Filings Required Under the ASX Listing Rules
ASX listed companies are required to disclose a multitude of information to ASX for publication on its Market Announcements Platform, including certain information which is required to be disclosed to the market immediately in order to ensure that trading occurs on an informed basis.

The key disclosure obligation applicable to ASX listed companies under the ASX Listing Rules is the continuous disclosure obligation in ASX Listing Rule 3.1. This requires an ASX listed entity to immediately disclose to the ASX any information concerning it that a reasonable person would expect to have a material effect on the price or value of its securities as soon as it becomes aware of such information.

ASX Listing Rule 3 also sets out a number of other 'immediate' notification requirements applicable to ASX listed companies. These include, amongst other things, notifying ASX of:

- changes in address, telephone number, fax number or hours of registered office or principal administrative office;
- changes in details of where records and registers are kept;
- changes in director, CEO, chairperson, company secretary or auditor; and
- the material terms of any employment, service or consultancy agreement the company or one of its subsidiaries enters into with its CEO or directors (including their related parties), and any material variation to such an agreement.

The ASX Listing Rules provide other notification requirements in addition to the above, including in relation to members' meetings, share capital (ie, dividends, issues, reorganisations, buy-backs), options, takeovers, particular types of transactions, significant changes in the nature or scale of the company's activities, investor communications and other company-specific documents.

7. Audit, Risk and Internal Controls

7.1 External Auditors

Pursuant to Section 301(1) of the Corporations Act, large proprietary and public companies must appoint an external auditor in connection with its financial statements. Auditing and the appointment of auditors is strictly regulated by the Corporations Act. An auditor may be an individual registered auditor, a firm or a company authorised as an audit company.

Under Section 324DA of the Corporations Act, lead audit partners and other key persons involved in a listed company's audit must generally be rotated after five years. Auditors are also subject to significant duties of independence, diligence and skill. The accounting standard APES 110 Code of Ethics for Professional Accountants deals with independence requirements for auditors.

Non-Audit Services and Auditor Independence
Under Section 300(11B) of the Corporations Act, a company's directors' report must include:

- details of the amounts paid or payable for non-audit services;
- a statement whether the directors are satisfied that the provision of non-audit services during the year was compatible with the general standard of independence for auditors imposed by the Corporations Act;
- a statement of the directors' reasons for being satisfied that the provision of those non-audit services did not compromise the auditor independence requirements.

Requirement for Auditors to Attend Company General Meetings
Under Section 250RA of the Corporations Act, the auditor of a listed company is required to attend the AGM. At the AGM, shareholders have the opportunity to address oral questions to the auditor relevant to the specific matters at an AGM. There is also an opportunity for shareholders to ask the auditor written questions. If the auditor provides an

answer to a written question, the company must make the written answer available to shareholders as soon as practicable after the AGM.

7.2 Management Risk and Internal Controls

Under Section 180 of the Corporations Act, directors are required to exercise skill, care and diligence in the discharge of their duties as directors. This obligation requires directors to have regard to financial and non-financial risks and internal controls in overseeing the management of the company.

The ASX Corporate Governance Principles also outline that the board of a listed company is ultimately responsible for deciding the nature and extent of the risks to which a company is prepared to be exposed. The ASX Corporate Governance Principles recommend that a listed company should establish a sound risk management framework and periodically review the effectiveness of that framework.

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To enable the board to do this, the company must have an appropriate framework to identify and manage risks on an ongoing basis. It is the role of the board to set the risk appetite for the company, to oversee its risk management framework and to satisfy itself that the framework is sound. It is the role of management to design and implement that framework and to ensure that the company operates within the risk appetite set by the board.

Pursuant to recommendation 4.2 of the ASX Corporate Governance Principles, before the board of a listed company approves its financial statements for a full year or half-year period, the CEO and CFO are recommended to provide declarations to the board that, in their opinion, the financial records of the company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view, and also that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.