THE RISE OF INDEPENDENT DIRECTORS IN AUSTRALIA: ADOPTION, REFORM, AND UNCERTAINTY*

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* A version of this paper was originally presented presented at the conference on "Independent Directors in Asia," National University of Singapore, Feb. 26-27, 2015. An earlier version was presented at the conference on "Independent Directors in Japan and other Major Jurisdictions in Asia," Japanese German Center Berlin, July 17-19, 2014. We acknowledge helpful feedback from participants at both conferences, and valuable information or insights provided subsequently by Henry Bosch AO, Associate Professor Pamela Hanrahan and Tim Bednall, as well as earlier by Professors Frank Clarke, Graeme Dean, Ron Masulis and Ian Ramsay, George Gilligan, and Dr. Suzanne Le Mire. For research and editorial assistance, we also thank Michael Power, Ganesh Vaheisvaran, and Matthew Barry. We also acknowledge seed funding for research from Sydney Law School's Legal Support Scholarship Fund (2012-13), and feedback on some of these ideas presented at conferences on East Asian Law and Society (Yonsei Law School, Seoul, Sept. 30, 2011), "Business Law Reform in Asia" (Sydney Law School, Aug. 3, 2012) and "Developments in Corporate Governance: East Meets West" (Sydney Law School, Jun. 6, 2014) at Sydney Law School. A shorter version of this paper was prepared for Harald Baum, Souichirou Kozuka, Luke Nottage, and Dan Puchniak (eds.) Independent Directors in Asia (Cambridge University Press, forthcoming).

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> As the cigar smoke in the boardrooms clears, the comfortably reclining figures are instantly revealed as being of two types: the executive directors who run the business and take the rap, and the non-executive directors who, having read their papers carefully for the pre-lunch board meeting, asked their statutory question, and enjoyed a reasonable rib of beef, are ready to depart blamelessly to their bank,

> chambers, farm or villa for another two months.[1]
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> [The aim] is actually to draw attention [to] developing *it* as an independent decision maker.[2]

I. INTRODUCTION

Anglo-American corporate governance has long remained fixated on ensuring that the interests of dispersed shareholders in publicly listed corporations prevail over competing managerial interests.[3] The main solution offered here has been to conceptualize directors as the stockholders' agents for monitoring managers.[4] But the rise of large institutional stockholders in global markets, especially in the United States,[5] has cast doubt on this theory's empirical

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[1] *See* Philip L.R. Mitchell, *Non-Executive Directors*, 6 BUS. L. REV. 173, 173-174, (1985), cited in JEAN JACQUES DU PLESSIS ET. AL, PRINCIPLES OF CONTEMPORARY CORPORATE GOVERNANCE 101 (3d ed. 2014).

[2] Charles Groome of Hong Kong Venture capital fund, Deep Knowledge Venture, on the appointment of VITAL – an algorithm – to the firm's board of directors: Rob Wile, *A Venture Capital Firm Just Named an Algorithm to its Board of Directors: Here's What it Actually Does*, BUSINESS INSIDER (May 14, 2014), http://www.businessinsider.com.au/vital-named-to-board-2014-5 (emphasis added).

[3] *See, e.g.*, ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[4] *See generally* REINER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 35, 307-9 (2d ed. 2009).

[5] *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 875 (2013) (by 2009 the largest 1,000 U.S.

premise. Influential commentators now urge measures encouraging stockholders to take more active roles in corporate governance,[6] or press more broadly for enhancing their rights in light of expansive directorial discretion.[7]

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corporations had an average institutional holding of 73 percent); Ronald J. Gilson & Jeffrey N. Gordon, *Agency capitalism: further implications of equity intermediation,* RESEARCH HANDBOOK ON SHAREHOLDER POWER 32 (Jennifer G. Hill & Randall S. Thomas eds., 2015); Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation*, 239/2014 EUROPEAN CORPORATE GOVERNANCE INSTITUTE (ECGI) – LAW WORKING PAPER (2014); 456 STANFORD LAW AND ECONOMICS OLIN WORKING PAPER (2014); 461 COLUMBIA LAW AND ECONOMICS WORKING PAPER (2014). In this connection, activist funds serve as useful catalysts for corporate change. With over $120 billion under management, the consequences are meaningful, particularly in the United States where eighty per cent of activist interventions occur. *An Investor Calls*, THE ECONOMIST (Feb. 7, 2015), http://www.economist.com/news/briefing/21642175-sometimes-ill-mannered-speculative-and-wrong-activists-are-rampant-they-will-change-american. Elsewhere, *The Economist* reports that since 2009, fifty per cent of S & P 500 companies have had a "big activist fund" on their share register, with one in seven of these companies being subjected to an "activist attack." *Capitalism's Unlikely Heroes*, THE ECONOMIST (Feb. 7, 2015), http://www.economist.com/news/leaders/21642169-why-activist-investors-are-good-public-company-capitalisms-unlikely-heroes.

[6] *See* Paul Edelman, Randall Thomas, & Robert Thompson, *Shareholder Voting in the Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359 (2014); *cf.* Chief Justice Leo Strine, *Can We Do Better by Ordinary Investors? A Pragmatic Reaction, to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449 (2014) cited in Robert B. Thompson, *Whether Directors Must Maximize Shareholder Wealth-and the American Connection to the Increased Role of Activist Shareholders*, (paper presented at Supreme Court of New South Wales Annual Corporate Law Conference, Sydney, Australia, Sept. 8, 2015) (on file with the authors).

[7] *See generally* Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 18 HARV. L. REV. 833 (2005).

Others insist, albeit through the lens of stockholder wealth maximization and while allowing for significant differences among countries, that the board should retain significant decision-making powers.[8]

In this ongoing debate, the issue of board composition has largely escaped sustained academic attention.[9] The conventional wisdom advocates that the board should be predominantly non-executive and "independent," especially when exercising key functions where conflicts of interest may surface (such as conducting audits or nominations and approving remuneration). However, a closer comparative analysis of leading jurisdictions reveals that the meaning of independence remains far from settled.[10] For instance, the U.S. has gradually expanded independent director requirements, but retains a comparatively unusual definition of an "independent" director, by including within the definition a significant stockholder or its nominee.[11] By contrast, the Australian corporate governance framework

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[8] *See, e.g.*, Stephen M. Bainbridge, *Preserving Director Primacy by Managing Shareholder Interventions*, RESEARCH HANDBOOK ON SHAREHOLDER POWER 231 (Jennifer G. Hill & Randall S. Thomas ed. 2015); Stephen M. Bainbridge, *Director versus Shareholder Primacy in New Zealand Company Law as Compared to U.S.A. Corporate Law*, 14-05 UCLA L.-ECON. RES. PAPER (2014), http://ssrn.com/abstract=2416449.

[9] *Cf.* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. OF PA. L. REV. 1907 (2013); 13-19 U. PENN., INST. FOR L. & ECON. RES. PAPER 1922-23, http://ssrn.com/abstract=2279147 (arguing that the new landscape of institutional investors has resolved the problem of "captured directors").

[10] *See, e.g.*, Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73 (2007).

[11] *See, e.g.*, Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007).

has instead encouraged – and partly mandated – that boards include "independent" directors who are separated from significant stockholders. In this respect, as explained in this article, Australia has been a regulatory exporter: that is, the stricter conception of director independence has influenced other Asian-Pacific legal systems, especially those that share the English common law tradition, such as Hong Kong.[12]

The backdrop to the Australian approach is a "blockholder" tradition, involving family or other large companies.[13] While there is now a large and active market for stocks listed on the Australian Securities Exchange (ASX),[14] in the 1990s, stockholdings were significantly more concentrated and institutional investors less active than their U.S. and especially U.K. counterparts. In this environment,

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[12] *See Rules & Recommendations on the Number of Independent Directors in Asia*, ASIAN CORPORATE GOVERNANCE ASSOCIATION (July 2010).

[13] *See* Geof Stapledon, *Share Ownership and Corporate Control in Listed Australian Companies*, 2 CORP. GOVERNANCE: AN INT'L REV. 17 (1999); Asjeet Lamba & Geof Stapledon, *The Determination of Corporate Ownership Structure: Australian Evidence*, 20 U. OF MEL. PUBL. L. RES. PAPER (2001), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=279015; Richard Mitchell, Anthony O'Donnell, Ian Ramsay, & Michelle Welsh, *Shareholder Protection in Australia: Institutional Configurations and Regulatory Evolution*, 38 MELB. U. L. REV. 68 (2014), http://ssrn.com/abstract=2489807; Alan Dignam & Michael Galanis, *Australia Inside-Out: The Corporate Governance System of the Australian Listed Market*, 28 MELB. U. L. REV. 623 (2004).

[14] For statistics comparing other stock exchanges in the Asian region, *see* Luke Nottage, *Corporate Governance in Australia: The Evolving Blockholder Legacy*, 08/28 SYDNEY L. SCH. RES. PAPER (2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105639; *see also* Luke Nottage, *Corporate Governance and M&A in Australia: An Overview for Assessing Japan and the 'Americanisation' Thesis*, 08/28 SYDNEY L. SCH. RES. PAPER (2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105639.

another complicating corporate governance concern comes to the forefront: overbearing conduct by controlling shareholders vis-à-vis smaller shareholders.[15] Notwithstanding vocal criticisms discussed below, real concerns that a relaxation of the substantial shareholding criterion might disproportionately benefit large over smaller stockholders militated against its removal. In this connection, the Australian regulatory response, in part, has been to maintain a strict conception of independence.

There are many other factors in Australia's corporate governance framework that have arguably impacted the relevance of independent directors, and in particular, the perceived disciplinary function they perform. First, non-institutional blockholders have alternative means of monitoring risk and performance, such as by nominating and supporting executive directors. Second, hostile takeovers are still a prominent feature of Australia's corporate governance landscape and they enjoy quite high success rates thanks to the adoption of several substantive principles from the U.K., despite the latter's different underlying shareholding patterns. Third, the cumulative effect of bipartisan legislative amendments since the early 1990s – aimed primarily at empowering shareholders (especially vis-à-vis executives) and partly as a response to major corporate failures in the late 1980s and around 2001 – has further enhanced board accountability.[16] Fourth, the Australian Securities and Investment Commission's (ASIC)

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[15] *See, e.g.*, KRAAKMAN ET AL., *supra* note 5, at 35, 190-2, 195-6, 202-7, 256-65, 309-11.

[16] Helen L. Anderson, Michelle Welsh, Ian Ramsay, & Peter Gahan, *The Evolution of Shareholder and Creditor Protection in Australia: An International Comparison*, 61 INT'L & COMP. L. Q. 171 (2012).

more vigorous law enforcement strategy over the last decade, especially since the 2008 Global Financial Crisis (GFC), has also caused regulatory ripples in Australia's corporate governance framework.[17] (Of course, there have also been bombastic regulatory failures.)[18] In this fluid situation, blockholder influence over policy-makers or regulators may therefore be waning. Alternatively, blockholders may now view such changes as beneficial (or at the very least having little effect on large shareholders and dispersed shareholders), particularly as they relate to executive managers.

Part II of this Chapter explains the longstanding tension between those preferring a narrower view of directors' roles and duties (focused on corporate performance) and those advocating a broader view (with a greater emphasis on risk management, which may favor smaller shareholders with less information about their firm's activities). In so doing, it explores Australia's anomalous

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[17] Jennifer Hill, *Takeovers, Poison Pills and Protectionism in Comparative Corporate Governance*, *in* FESTSCHRIFT FUR KLAUS J. HOPT ZUM 70. GEBURTSTAG AM 24. AUGUST 2010 795-815 (S. Grundmann et al. eds., Walter de Gruyter 2014). The shift is generally consistent with a move from a "Coasian" (self-regulatory) model, via a "Public enabling" model, to a "Public enforcement" model. *See generally* A. Dignam, *Lamenting Reform? The Changing Nature of Common Law Corporate Governance Regulation*, 25 COMPANY & SEC. L. J. 283 (2007).

[18] *See, e.g.*, SENATE ECONOMICS REFERENCES COMMITTEE, PARLIAMENT OF AUSTRALIA, PERFORMANCE OF THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION: FINAL REPORT (2014) (highly critical of ASIC's ineffective regulation of financial planners); Adele Ferguson, Ben Butler, & Ruth Williams, *We Can Rebuild It: The Plan to Transform Toothless Tiger ASIC*, SYDNEY MORNING HERALD (June 28, 2014), www.smh.com.au/business/we-can-rebuild-it-the-plan-to-transform-toothless-tiger-asic-20140627-3az4m.html.

experience of large non-institutional blockholders in ASX-listed companies and suggests that this has had an impact on the roles and composition of boards. This analysis reveals that in the early 1990s, the narrower view appears to have won out. That is to say that there has been a shift away from executive boards towards "monitoring" boards,[19] with fewer members and more independent directors, who are expected to maintain minimum standards across a variety of roles.

Yet this transition has not been rapid or particularly smooth (Part III). Following the corporate excesses of the late 1980s, the Bosch Reports recommended more independent directors on boards, defined as excluding substantial shareholders. In 1992, the ASX suggested the introduction of mandatory requirements for independent directors. After strong resistance from the business community, it then proposed a U.K.-style "comply-or-explain" regime in 1994. The ASX eventually settled on an even weaker regime from 1996, requiring only disclosures for non-executive directors more broadly— without having to identify independent directors. Only after a wave of much more serious corporate failures at the turn of the twenty-first century – especially one harming very influential blockholders (One.Tel) – did the ASX implement (from 2004) a requirement for listed companies to adopt a majority of independent directors on an "if not, why not" basis. Minor revisions were made in 2007, but somewhat more stringent standards were then implemented in 2014. The most recent changes occurred in the shadow of some post-GFC legislative initiatives and case law that generally expanded the scope and content of duties

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[19] *See* Jennifer Hill, *Centro and the Monitoring Board – Legal Duties Versus Aspirational Ideals in Corporate Governance*, 35 U. N.S.W. L. J. 341 (2012).

owed by directors (including independent directors).[20] These changes were ushered in even though Australia did not suffer major bank failures or a recession.[21]

As explained in Part IV, the ASX's "Principles and Recommendations" remain the cornerstone of the Australian regulatory model, underpinned by Listing Rules (which have *mandated* an audit committee since 2004, and a remuneration committee since 2011, albeit only for the largest 300 companies, each requiring a majority of independent directors). There are comparatively and increasingly detailed criteria for assessing independence, such as whether the director has direct (or, since 2014, "family") links with a "substantial" (5%+) shareholder. This factor differs from the U.S. and appears to be derived from the U.K. model, but arguably is more theoretically defensible in Australia given its significant blockholder tradition.[22] Another interesting development is the compromise reached in the 2014 ASX Principles regarding directors' length of tenure, which was partly influenced by developments further afield such as those in Singapore and Hong Kong.

Despite these regulatory developments, there remains only weak Australian empirical evidence of positive effects of a majority-independent board on risk management and

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[20] *See* Jennifer Hill, *Evolving Directors' Duties in the Common Law World*, *in* RESEARCH HANDBOOK ON DIRECTORS' DUTIES 3-43 (Adolfo Paolini ed., Edward Elgar Publishing 2014).

[21] *See generally* Jennifer Hill, *Why Did Australia Fare So Well in the Global Financial Crisis?,* THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS (2012).

[22] Wolf-George Ringe, *Independent Directors: After the Crisis,* 72/2013 OXFORD LEGAL STUD. RES. PAPER (2013), http://ssrn.com/abstract=2293394.

overall corporate performance (Part V). In Australia, as well as other parts of the world, the received wisdom about independent directors has faced stronger critiques in the post Global Financial Crisis milieu.[23] Some commentators have criticized the general approach to defining director independence, which they claim myopically focuses on avoiding certain relationships, rather than promoting directors' positive attributes that might help minimize the impact of economy-wide conditions.[24] Others urge the adoption of a U.S.-style approach with respect to relationships with significant stockholders, arguing that Australian directors need more "skin in the game" in order to enhance corporate performance.[25] This point received support from former NSW Supreme Court Justice, Bob Austin. Writing in an editorial piece for Australia's leading financial newspaper, he argues that it is "time for us to revisit the definition of independence . . . to permit and encourage independent directors to have more skin in the

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[23] *See generally* Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855 (2014).

[24] *See* Suzanne Le Mire & George Gilligan, *Developing a More Complete Understanding of the Independence of Corporate Directors*, 2012-35 U. OF ADELAIDE L. RES. PAPER (2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2180671. *See also* Sally Wheeler, *Independent directors and corporate governance*, 27 AUSTL. J. CORP. L. 168 (2012); Neil Dunbar, *The Role and Value of Independent directors in modern Australian corporate governance*, 30 COMPANY & SEC. L. J. 312 (2012).

[25] *See* Marc-Oliver Fischer & Peter L. Swan, *Does Board Independence Improve Firm Performance? Outcome of a Quasi-Natural Experiment*, U. N.S.W., FIN. RES. NETWORK (2013), http://dx.doi.org/10.2139/ssrn.2312325; Pamela Hanrahan & Tim Bednall, *Independence of Directors Affiliated with Substantial Shareholders: Issues of Law and Corporate Governance*, 33 COMPANY & SEC. L. J. 239 (2015).

game."[26] Seemingly frustrated with the almost Frankenstein-like expansion of the ASX Corporate Governance's conception of independence, Dr. Austin reminds us that "investor independence is a different kind of independence and a different governance strategy, which has been bolted onto the management independence idea."[27]

Though speculative, a subconscious "status quo bias" may also be at work. This problem may be compounded by interest group politics. There is now a large (and well-networked) anointed group of incumbent independent directors, as well as various professional associations involved in "training" them. The resulting lack of public discussion is unfortunate. Many problems remain to be properly explored from theoretical, empirical, and comparative vantage points (Part VI). An analysis of historical and current developments in Australia regarding independent directors, then, the complex issues involved, and some possible ways forward for stock markets (including for the U.S.) where concentrated stockholdings have become a major contemporary concern.

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[26] Robert Austin, *Directors Should Have More Skin in the Game*, AUSTL. FIN. REV. (July 31, 2014), http://www.afr.com/opinion/our-writers/directors-should-have-more-skin-in-the-game-20140730-jk75h. Like Swan, Austin maintains that "investor independence is not necessary in order to achieve the board's independence from management," but appears to diverge from Swan's view regarding majority-led ID boards, declaring that the "majority of the board should be independent from management."

[27] *Id.*

II. BOARDS OF DIRECTORS IN AUSTRALIA'S LISTED COMPANIES

A. ROLES OF BOARDS

Scholarly debates on the supposed roles for directors on listed companies' boards have raged on since the early 1990s. A more expansive view (encompassing a broad range of responsibilities) was taken by a committee chaired by Henry Bosch, an eminent businessman who had led ASIC's predecessor from 1985 to 1990. This committee produced a report in May of 1991 for the Australian Institute of Company Directors (AICD: the Bosch Report),[28] updated in 1993 and 1995, with significant parallels to the Cadbury Report finalized in the U.K. in December of 1992.[29] By contrast, an influential judgment of the Supreme Court of New South Wales later suggested that contemporary boards would normally be expected only to set corporate objectives, appoint the CEO, and monitor progress.[30] An analysis by

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[28] *Corporate Practices and Conduct*, WORKING GROUP OF THE AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS ET AL. (1991) [hereinafter Bosch Report 1991].

[29] COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, REPORT (Dec. 1992) [hereinafter Cadbury Report], http://www.ecgi.org/codes/documents/cadbury.pdf.

[30] *AWA Ltd. v. Daniels* (1992) 7 ACSR 759 (Austl.). On appeal, instead of insisting on a clear demarcation between the roles of executive and non-executive directors, the majority of the NSW Court of Appeal, in *Daniels (formerly practising as Deloitte Haskins & Sells) v. Anderson* (1995) 37 NSWLR 438, 505 (Austl.), emphasized that a director's duty "will vary according to the size and business of the particular company and the experience or skills that the director held himself or herself out to have in support of appointment to the office" (per Clarke and Sheller JJA). This

Professor Fred Hilmer (the "Hilmer Report") also favored a narrower view.[31]

The broader approach has been favored since the establishment of the Australian Stock Exchange (ASX) Corporate Governance Council in 2002, comprising of business, shareholder, and industry groups. The Third Edition (2014) of the *ASX Corporate Governance Principles and Recommendations* (in effect from 2014) mirrors the First Edition (2003) and the Second (2007) by envisaging a broad range of responsibilities for boards of directors, albeit on an "if not, why not" basis. Pursuant to Principle 1 (to "lay solid foundations for management and oversight"), Recommendation 1.1 requires listed companies to disclose "(a) the respective roles and responsibilities of its board and management; and (b) those matters expressly reserved to the board and those delegated to management." The non-binding Commentary, which does not in itself trigger "if not, why not" disclosure obligations, states that:

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decision caused widespread consternation in the business community and led to a cacophony of calls for the clear differentiation between the duties and standard of "care and diligence" required from executive and non-executive directors, by way of legislative intervention. *See, e.g.*, CORPORATE LAW ECONOMIC REFORM PROGRAM, AUSTRALIAN GOVERNMENT, DIRECTORS' DUTIES AND CORPORATE GOVERNANCE: FACILITATING INNOVATION AND PROTECTING INVESTORS 43-45 (Australian Government Publishing Service 1997). For recent case law, arguably confirming a more expansive view of directors' duties, *see* Part III below.

[31] Helen Bird, *The Rise and Fall of the Independent Director*, 5 AUSTL. J. CORP. L. 235 (1995). *See generally* Dunbar, *supra* note 24. Hilmer was, at the time, the Director and Dean of the Australian Graduate School of Management; from June 2006, he became Vice-Chancellor at UNSW. Hilmer has also been a director of Westfield (a major property developer) from 2001 and CEO of Fairfax (a major newspaper group) from 1998 to 2005.

Usually the board of a listed entity will be responsible for:

- providing leadership and setting the strategic objectives of the entity;
- appointing the chair and, if the entity has one, the deputy chair and/or the "senior independent director";
- appointing, and when necessary replacing, the CEO;
- approving the appointment, and when necessary replacement, of other senior executives;
- overseeing management's implementation of the entity's strategic objectives and its performance generally;
- approving operating budgets and major capital expenditure;
- overseeing the integrity of the entity's accounting and corporate reporting systems, including the external audit;
- overseeing the entity's process for making timely and balanced disclosure of all material information concerning the entity that a reasonable person would expect to have a material effect on the price or value of the entity's securities;
- ensuring that the entity has in place an appropriate risk management framework and setting the risk appetite within which the board expects management to operate;
- approving the entity's remuneration framework; and

- monitoring the effectiveness of the entity's governance practices. [32]

Footnote 10 adds that "[s]ome of these matters may be delegated to a committee of the board, with the board retaining the ultimate oversight and decision-making power in respect of the matters so delegated."[33] In fact, as mentioned below (Part II.2), larger listed companies commonly have:

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[32] *See Corporate Governance Principles and Recommendations: Third Edition*, ASX CORPORATE GOVERNANCE COUNCIL 5-8 (Mar. 2014), www.asx.com.au/regulation/corporate-governance-council.htm [hereinafter ASX Third]; *cf.* Reegan Grayson-Morison & Ian Ramsey, *Responsibilities of the Board of Directors: A Research Note*, 32 COMPANY & SEC. L. J. 69, 77 (2014) (noting many similarities in Board charters disclosed by ASX Top 20 and 10 randomly selected small capitalization listed companies:

> These common responsibilities include responsibility for the strategic direction of the company, budget/financial approval/financial performance, appointment and performance of the CEO and senior management, risk management policy, reviewing/monitoring corporate governance policies and practices, and monitoring capital management, including approval of major capital expenditure. There are, however, some notable differences with regard to responsibilities such as monitoring the remuneration framework, overseeing succession planning, corporate social responsibility, and review of diversity initiatives and progress. Possible reasons for these differences were explored including the top 20 companies being under more pressure from large investors and others to demonstrate their commitment to these issues.).

[33] This is consistent with those provisions of the Corporations Act 2001 that concern delegation. *See Corporations Act 2001* (Cth) ss 198D, 190 (Austl.).

- audit committees: to monitor compliance (mandated from 2004 under ASX Listing Rules);
- remuneration committees: to advise on the pay packages of executives and directors (mandated since 2011 for ASX 300 companies); and
- nomination committees: to advise on appointing directors as well as the CEO (still less commonly found).

The Commentary to Recommendation 1.1 further explains that:

> Management will usually be responsible for implementing the strategic objectives and operating within the risk appetite set by the board and for all other aspects of the day-to-day running of the entity. It is also responsible for providing the board with accurate, timely and clear information to enable the board to perform its responsibilities.[34]

The role and responsibility of the board could be set out in a board charter, its annual report, or in some other document published on the entity's website. That document could usefully set out the role and responsibility of the chair and, if the listed entity has one, the role and responsibility of the deputy chair, and/or the "senior independent director." It could also contain the entity's policy on when and how directors may seek independent professional advice at the expense of the entity (which generally should be whenever

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[34] ASX Third, *supra* note 32, at 8.

directors, especially non-executive directors, judge such advice necessary for them to discharge their responsibilities as directors).

The concept of the "senior independent director," familiar in the U.K., but less so in Australia,[35] is later mentioned in the Commentary on Recommendation 2.5. This recommendation states, "the chair of the board of a listed entity should be an independent director and, in particular, *should not* be the same person as the CEO of the entity."[36]

B. BOARD SIZE AND COMPOSITION

A recent Credit Suisse study investigating the connection between board size and firm performance of companies drawn from leading ASX200 firms for the period 2008-2013 contends that for companies with a market capitalization of $5 billion, nine to eleven board members

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[35] *See generally* Alice Klettner, Thomas Clarke, & Michael Adams, *Corporate Governance Reform: An Empirical Study of the Changing Roles and Responsibilities of Australian Boards and Directors*, 24 AUSTL. J. OF CORP. L. 148 (2010).

[36] ASX Third, *supra* note 32, at 18 (emphasis added). The Commentary states that: "If the chair is not an independent director, a listed entity should consider the appointment of an independent director as the deputy chair or as the 'senior independent director', who can fulfil the role whenever the chair is conflicted. Even where the chair is an independent director, having a deputy chair or senior independent director can also assist the board in reviewing the performance of the chair and in providing a separate channel of communication for security holders (especially where those communications concern the chair)." *Id.*

produce the best shareholder returns.[37] For companies with a lower market capitalization, the optimal number of board members lies between six and eight.[38] Unfortunately, that study is completely silent on the breakdown of NEDs, IDs, or executive directors, so we must look elsewhere for a conception of board composition.

In September of 2013, the Australian Council of Superannuation Investors (ACSI) published its 12th Annual Research Report on "Board Composition and Non-Executive Director Pay in the Top 200 Companies: 2012," analyzing ninety-four of the largest qualifying companies in the Standard & Poors/ASX 200 Index as of June 30, 2012, (ASX 100) and eighty-six from the next 100 largest companies (ASX 101-200).[39] An executive recruitment firm, Korn Ferry, has also published its "2010 Board of Directors Study" based on a survey of Australia's 300 largest companies, by market capitalization as at June 30, 2010.[40] Some key results from these studies are summarized below in Table 1:

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37 CREDIT SUISSE, OPTIMAL BOARD MEMBER NUMBERS PRODUCE THE BEST SHAREHOLDER RETURNS (2014), https://doc.research-and-analytics.csfb.com/docView?language=ENG&format=PDF&source_id=csplusresearchcp&document_id=1045123501&serialid=VVLqr3kzN7u%2B6s1KERmJf9g6fAzZM6jWCpj7f0U0x%2BE%3D.

38 *Id*.

39 *Board Composition and Non-Executive Director Pay in Top 100 Companies: 2012*, AUSTRALIAN COUNCIL OF SUPERANNUATION INVESTORS (ACSI) RES. PAPER (Sept. 2013), http://www.acsi.org.au/board-comp-a-ned.html?layout=blog [hereinafter ACSI 2012] (with earlier reports dating back to 2002).

40 *2010 Board of Directors Study: Australia and New Zealand*, KORN FERRY INSTITUTE (Dec. 9, 2010), www.kornferryinstitute.com/reports-insights/2010-board-directors-study-australia-and-new-zealand.

Table 1: Snapshot of Australian Board Size and Composition

	Number of directors on boards	Proportion of NEDs & IDs	Committees	CEO separate from Chair	Average / Median Fees of Non-executive Directors (& Chairs)
ASX 100 (2012)	8.5 (average)	83% NEDs, of which 88% IDs (so **73% IDs**)	n/a	99% (93/94)	$218,434 / $203,250 (& $481,415 / $450,924)
ASX 101-200 (2012)	6.2	79%, of which 70% (so **56% IDs**)	n/a	87%(75/86)	$134,981 / $115,029 (& $225,534 / $193,230)
Top 300 (2010)	4–9 (89% of firms)	**77% NEDs** (82% for ASX 50)	Audit (97%), Remuneration (89%), Nomination (30%)	n/a	$124,985 / $102,500 (& $241,687/ $174,000)

Non-Executive Directors (NEDs) clearly form a large majority on boards, and most are also Independent Directors (IDs). This is especially true in Australia's biggest companies (the ASX 100, even compared to the ASX 101-200 companies).[41] A recent econometric study led by Professor Peter Swan (discussed further in Part V.2 below), which examines the performance of the largest 500 ASX listed companies between 2001-2011, also reported broadly consistent findings: 75% NEDs, with 32% IDs, and 39% "gray" (non-independent NED) directors, as well as an average (and median) board size of around six directors.[42]

The 2013 ACSI report suggests that the proportion of IDs in ASX 100 companies in 2012 (73%, or 585 out of 797 directorships) has grown considerably since 2004 (50%).[43] It notes though that the jump in 2005 (to 65%) arose because "ACSI [previously] classified all directors with more than nine years service on a board as affiliated [i.e. non-

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[41] Dane Etheridge, *Boards of a Feather Flock Together: Board Networks Among ASX Firms*, 2012 FINANCIAL MARKETS & CORPORATE GOVERNANCE CONFERENCE 10 (Nov. 4, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1972254 (noting that over 150 new listings were added from 2005-2006 alone, and that the number of ASC listed companies increased 46% from 2000-2007, while the number of directors only rose by 10%). Nonetheless, the largest 50 listed companies represent about 70% of total ASX market capitalization. *Id*. at 32.

[42] Fischer & Swan, *supra* note 25, at 2, 12-13, 49, Table 2; *cf.* Peter L. Swan & David Forsberg, *Does Board 'Independence' Destroy Corporate Value?*, 27TH AUSTRALASIAN FIN. & BANK. CONF. PAPER (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312325.

[43] This upward trend has continued, with the proportion of NEDs held by IDs rising slightly to 75.6% of all directorships in 2013. *Board Composition and Non-Executive Director Pay in Top 200 Companies: 2013*, THE 13TH ANNUAL ACSI STUDY INTO S&P/ASX 200 BOARDS 10 (Nov. 2014), www.acsi.org.au/images/stories/ACSIDocuments/generalresearchpublic/Board_Comp_and_Non-Exec_Director_Pay_in_Top_200_Companies_2013.Nov14.pdf [hereinafter ACSI 2013].

independent] and from 2005 only those directors who had spent more than twenty years on a board were considered affiliated."[44] When comparing 2012 with 2005, the growth in proportions of IDs was less dramatic, but still noteworthy – including in 2009 (where the proportion rose from 65.5% in 2008 to 69%).

Yet, as elaborated in Parts III and IV below, Professor Swan's study notes significant increases in large listed ASX companies adopting a majority of IDs since 2003 (when the *ASX Corporate Governance Principles* first required this, albeit on an "if not, why not" basis). Specifically, his study found that, in 2003, about 19% of firms had a majority of IDs (172 of 841 firms that year), rising to 57% by 2011 (551 of 969 firms), and then to 59% (including firms that had a majority of IDs before 2003).[45]

Even though the ASX only introduced a loose disclosure-based regime from 1996-2002, the largest Australian companies saw a significant increase in NED appointments and proportions on boards since 1992. This trend continued with a gradual expansion of IDs over the ensuing decade.[46] Yet, writing in 2002, Henry Bosch

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[44] *Id*. at 11 n.10: "[T]he change in definition was effective from the 2nd edition of the ACSI Guidelines, released in 2005."

[45] Fischer & Swan, *supra* note 25, at 9.

[46] By 1996, for 348 ASX 500 companies excluding banks and mining companies, Geoffrey Kiel and Gavin Nicholson reported an average board size of around 6 (compared to some estimates of 8.5 in the U.K. and around 12 in the U.S. around that time) and only about a quarter of firms (23%) where the CEO was also the Board chair (similar to the U.K., although 47% from 1990-1995, and much lower than the U.S., at 82% from 1981-1995). Geoffrey Kiel & Gavin Nicholson, *Board composition and corporate performance: How the Australian experience informs contrasting theories of corporate governance*, 11 CORP. GOVERNANCE: AN INT'L REV. 189,

suggested that: "Since [IDs] often owe their positions to the controlling shareholders it is not unknown for them to suppress any misgivings they may have about arguments which happen to work in favor of the individual interests of controllers."[47] Contemporaneous qualitative empirical research also documents serious problems faced by IDs in freely accessing the information necessary for the effective discharge of their duties.[48] In other words, the actual independence and impact of IDs on corporate governance seems to have been less than expected from the reported statistics.

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193 (2003). This was also true in 1995 for the largest 100 companies. *See* G. P. Stapledon & Jeffrey Lawrence, *Board Composition, Structure and Independence in Australia's Largest Listed Companies*, 21 MELB. U. L. REV. 150 (1997). A Korn Ferry survey of 200 companies in 1992 had noted an average board size of eight (ten for large companies), comprising 75% NEDs (jumping from around 50% over 1982-1992, with 60% appointing NEDs in 1992). Bird, *supra* note 34, at 253-54. Analyzing the largest 136 listed companies from 1994-2000 (excluding financial and utility companies), one study found an average board size of 7.8, comprising 54% IDs – albeit defined as not being "current or former employees, [having] business dealings with the firm, or [being] related (by family) to executive directors" Peter K. Pham, Jo-Ann Suchard, & Jason Zien, *Corporate Governance and the Cost of Capital: Evidence from Australian Companies*, 24 J. OF APPLIED CORP. FIN. 84, 86-87 (2012); *cf.* Part IV below; *see also* Reza Monem, *Determinants of board structure: Evidence from Australia*, 9 J. OF CONTEMP. ACCT. & ECON. 3 (2013) (analyzing small-, medium-, and large-sized ASX listed firms, finding for the large firms a median board size of 6.26 including 4.45 NEDs and with the top 20 shareholders having 67% average ownership).

[47] Henry Bosch, *The Changing Face of Corporate Governance*, 25 U. N.S.W. L. J. 270, 290 (2002).

[48] M. Nowak & M. McCabe, *Information Costs and the Role of the Independent Corporate Director*, 11 CORP. GOVERNANCE: AN INT'L REV. 300 (2003).

For ASX 100 companies, the 2014 ACSI Report finds a general plateauing in NED (and probably therefore now ID) board representation.[49] This result may well be due to the growth and consolidation of a cadre of "professional NEDs," defined as directors holding more than one board seat in the sample group(s). As Table 2 illustrates, this proportion of multiple directorships grew from 2001 (30.6%) to 2006 (45.1%), although it had fallen by 2012 (33.4%) and remained largely unchanged in 2013.[50]

Table 2: Snapshot of Multiple Directorships held by NEDs

Sample group	*Year*	*Number of NEDs*	*Proportion of NEDs held by professional NEDs*	*Held by:*
ASX 200	2012	1091	34%	170 persons
ASX 101-200	2012	426	8.4%	18
ASX 100	2012	665	33.4%	100
ASX 100	2006	626	45.1%	123
ASX 100	2001	536	30.6%	72

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[49] ACSI 2013, *supra* note 42, at 10-11.

[50] *Id.* at 16. However, the average tenure of NEDs in ASX 100 companies has not significantly increased in recent years, with the figure almost always hovering around 5.5-5.9 years. There was, for example, a marginal increase in average NED tenure from 5.8 years (2012) to 5.9 years (2013). *Id.* at 26. An anomalous year was 2007, with average NED tenure at 5.1 years. *See Board Composition and Non-Executive Director Pay in Top 100 Companies: 2008*, ACSI RES. PAPER 16 (Oct. 2009), http://www.acsi.org.au/images/stories/ACSIDocuments/detailed_research_papers/board_comp_and_non-exec_director_pay_in_top_100_companies_2008.oct_09.pdf [hereinafter ACSI 2008].

In 2012, 170 professional NEDs held 34% of the 1091 NED positions in the top 200 ASX companies (and 28.6% of all directorships). Similarly, in 2013, 163 professional NEDs held 33% of 1,123 NED positions in the top 200 ASX companies.[51] One professional NED, Peter Day, held five board seats in ASX 200 companies: four of those in ASX 100 companies.[52] An analysis of the top 200 ASX companies conducted in 2012 by a leading Australian newspaper further supports this penchant for multiple directorships. It found that of 1539 directors (both executives and NEDs), 205 held positions on multiple boards. Some of "the most interesting connections," the study revealed, "are at one or two degrees of separation from any particular company."[53]

The phenomenon of multiple directorships is not the exclusive domain of men. While women were generally under-represented among both NEDs and executive directors, the ASCI study found that women were more

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[51] ACSI 2013, *supra* note 42, at 16.
[52] *Id.*
[53] Marc Moncrieff, *Unravelling the Ties that Connect and Direct*, SYDNEY MORNING HERALD (Aug. 18, 2012), www.smh.com.au/business/unravelling-the-ties-that-connect-and-direct-20120817-24dxj.html (adding that "these are connections that would not be explicit from company disclosures unless a reader were to pursue a particular director's associations from company to company, as we have done. For example, BHP Billiton and Rio Tinto are the largest and second-largest companies listed on the ASX if measured by the total value of their shares. They are also, perhaps, the exchange's most prominent rivals. Yet, they are connected at a single degree of separation - Rio director Richard Goodmanson shares the Qantas board with John Schubert, a BHP director"). For similar observations on direct and indirect board interlocks as of 2007, especially among directors in the 50 largest ASX companies, see Etheridge, *supra* note 40, at 32-36.

likely to be professional NEDs.[54] (The 2013 ASCI Report reaffirms these findings.)[55] As of June 20, 2012, some notable female NEDs include: Catherine Livingstone AO (Non-Executive Chairman for Telstra Corporation and NED for Worley Parsons and Macquarie Group) and Carolyn Hewson AO (NED at BHP Billiton, Westpac Banking Corporation and Stockland).[56] Moreover, according to the 2014 ASCI Report, the average tenure for female NEDs has increased from 3.8 years (with a median of 2.1) in 2011 to 4.2 years (with a median of 2.8) in 2013.[57]

While these developments are to be lauded, there is real concern that the appointment of women to the boards of ASX-listed companies following the ASX's 2010 "if not, why

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[54] ACSI 2012, *supra* note 38, at 14-16 ("Of the 878 persons holding non-executive director roles at S&P/ASX 200 company boards in the 2012 sample:

- 707 held just one non-executive board seat at an ASX 200 company. This included 84 of the women in the sample (52% of all female directors) and 623 of the men (or 60% of all male directors in the sample).
- 137 held two board seats, including 33 women (21.3% of female non-executive directors) and 104 men (10.1% of all men).
- 27 held three board seats, including eight women (5.2% of women) and 19 men (2% of men).
- Six people held four board seats, two of which were men and four of which were women.
- One man, Garry Hounsell, held five board seats (four in the Top 100 and one in the ASX 101–200)." (citation omitted)).

[55] ACSI 2013, *supra* note 42, at 17.

[56] *Cultivating Greatness in the Boardroom*, KORN FERRY INSTITUTE 9, 11 (June 2012), http://www.kornferry.com/institute/458-cultivating-greatness-in-the-boardroom-what-makes-an-exceptional-non-executive-director-in-australasia.

[57] ACSI 2013, *supra* note 42, at 26.

not" disclosure rule regarding gender diversity is a mere box-ticking exercise. A recent Korn Ferry Australasia survey of fifty-seven female directors appointed to ASX 200 boards since the 2010 change remarked that while the majority of respondents reported improvements in board culture, 22% of respondents lamented the apparent fixation "on the idea that having one woman on the board ticks the box."[58] Those respondents therefore claim that boards have not made "any structural or philosophical changes to attract and appoint more women."[59] Other commentators have been more outspoken in their critique of board makeup, claiming that "possessors of just the right color, [caliber] and class of penis" are being elevated to these positions.[60] Nevertheless, by making available on its website various resources that listed companies may wish to consult with when seeking to implement such diversity recommendations,[61] as well as (once more) commissioning an independent analysis on their

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[58] *Beyond If Not, Why Not: The Pathway to Directorship for Women in Leadership*, KORN FERRY INSTITUTE 15 (May 2014), www.kornferryinstitute.com/reports-insights/beyond-if-not-why-not-pathway-directorship-women-leadership.

[59] *Id.* at 16, Figure 5; *see also* Alana Schetzer, *Women Stall on Reaching Australia's Highest Rungs*, SYDNEY MORNING HERALD (Nov. 1, 2014), www.smh.com.au/business/women-stall-on-reaching-corporate-australias-highest-rungs-20141031-11eulk.html.

[60] Jane Caro, *Get Real Ladies, Quotas on Boards Are For Losers. We want winners!*, THE GUARDIAN (Feb. 5, 2014), www.theguardian.com/commentisfree/2015/feb/05/get-real-ladies-quotas-on-boards-are-for-losers-we-want-winners.

[61] *See, e.g.*, *Diversity Resources*, ASX, http://www.asx.com.au/regulation/corporate-governance-council/diversity-resources.htm (last visited Sept. 18, 2015).

adoption since coming into effect,[62] the ASX evidently continues to treat its gender diversity initiative seriously.

Interestingly, the issue of diversity has taken on a wider import, with some commentators openly questioning the lack of cultural and ethnic diversity on Australian boards.[63] The 2010 amendments to the ASX Principles include Recommendation 3.2: the adoption of a "diversity policy" and its disclosure (or at least a summary) of that policy. The commentary defines diversity as including, but not limited to, "gender, age, ethnicity and cultural background."[64] Despite this inclusive definition – expanded

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[62] *See, e.g.*, *ASX Corporate Governance Principles and Recommendations on Diversity*, KPMG (2014), www.asx.com.au/documents/asx-compliance/kpmg-report-diversity-2014.pdf. For the second full year of reporting on diversity, the KPMG report notes that 98% of ASX 200 companies in 2013 had a diversity policy, an increase from 93% in 2013. *Id*. at 11.

[63] *See, e.g.*, Jean J. Du Plessis, Ingo Saenger, & Richard Foster, *Board Diversity or Gender Diversity? Perspectives from Europe, Australia and South Africa*, 17 DEAKIN L.R. 207 (2012); *Capitalising on Culture: A Study of the Cultural Origins of ASX 200 Business Leaders*, DIVERSITY COUNCIL AUSTRALIA (2013), http://www.dca.org.au/dca-research/capitalising-on-culture.html; L. McNamara, *Lack of Cultural Diversity a 'Risk'*, THE AUSTRALIAN (Jan. 3, 2013), www.theaustralian.com.au/business/lack-of-cultural-diversity-a-risk/story-e6frg8zx-1226546776157; Leo D'Angelo Fisher, *Know-how in the Asian century*, BRW (May 16, 2013), www.brw.com.au/p/leadership/know_how_in_the_asian_century_KnUSJGElduyjmNNyxjCVRP.

[64] *Corporate Governance Principles and Recommendations with 2010 Amendments: Second Edition*, ASX CORPORATE GOVERNANCE COUNCIL 24 (June 2010), http://www.asx.com.au/documents/asx-compliance/cg_principles_recommendations_with_2010_amendments.pdf [hereinafter ASX Second Amended].

in the Third Edition of the ASX Principles[65] – measurable objectives and metrics reporting relate *only* to gender diversity (ASX 2nd ed., Recommendation 3.3 and 3.4; ASX 3rd ed., Recommendation 1.5). As a result, there is little, if any, data collation of ethnic and cultural board diversity on ASX listed companies, and to our knowledge, nothing by way of Australian empirical studies exploring this burgeoning issue. Anecdotal evidence suggests, however, that the latest or emerging "big trend" is adding an Asian director to the board.[66] This is consistent with Australia's accelerating turn towards Asia in the twenty-first century, promoted by the Gillard Government in a White Paper released in 2012.[67]

Thus, a relatively small group of individuals is likely to continue to dominate directorships in larger Australian companies (especially NED and ID positions). This tendency may well intensify – somewhat ironically – as the ASX and

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[65] ASX Third, *supra* note 32, at Box 1.5 (stating that "diversity not only includes gender diversity but also includes matters of age, disability, ethnicity, marital or family status, religious or cultural background, sexual orientation and gender identity").

[66] Peter Durkin, *Meet the Directors From Hell*, THE AUSTL. FIN. REV. (June 21, 2012), http://www.afr.com/p/national/meet_the_directors_from_hell_X0het1wlEaJbuTHLWC4C8H.

[67] The (more center-right) Abbott Government, elected in 2013, however, has quietly removed it from official websites, except for an archive copy at http://trove.nla.gov.au/work/168973846?selectedversion=NBD49610931. For critiques of this shift, *see* Matt Wade, *What Happened to the Asian Century?*, SYDNEY MORNING HERALD (Oct. 1, 2014), www.smh.com.au/comment/what-happened-to-the-asian-century-20140930-10nxt9.html; *see also* Mark Beeson, *Is This the End of the 'Asian Century'?*, THE CONVERSATION (Oct. 29, 2013), http://theconversation.com/is-this-the-end-of-the-asian-century-19616.

corporate sector entrench gender diversity initiatives aimed at encouraging the appointment of women on boards (outlined next in Part III). Furthermore, limiting metrics reporting and the creation of measurable objectives to gender issues is unlikely to assist the promotion of more culturally diverse boards, notwithstanding the more expansive definition of diversity discussed above.

III. HISTORICAL MILESTONES

Scholarly debates on corporate governance and regulatory changes dating back to the early 1990s have underpinned the growth of IDs in Australia's listed companies, particularly the larger ones. This Part outlines major developments in the Australian corporate governance landscape concerning IDs.

A. THE BOSCH COMMITTEE REPORT AND THE ASX'S FIRST DISCLOSURE REGIME

Australia's stock market crash in 1987, coupled with corporate failures in the U.K. and the resultant Cadbury Committee Report (finalized and released in December of 1992)[68] strongly influenced the Bosch Committee Report (May of 1991, revised somewhat in 1993 and 1995). The Bosch Report recommended that Australian listed companies should have:

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[68] Bird, *supra* note 31, at 238-46.

- boards consisting of a majority of NEDs, of whom a majority should be IDs; and
- audit, remuneration, and nomination committees, each with a majority of IDs.

The Bosch Committee, which included representatives from the ASX, the Australian Institute of Company Directors (AICD), which was created from a merger in 1990, and the Law Council of Australia (the peak body for barristers and solicitors) envisaged independence as being freedom from both management and "any other external influence that might detract from their ability to act in the interest of the company as a whole."[69] Independence was presumptively satisfied if the ID was not:

- a substantial shareholder;
- employed by the company as an executive within the last few years;
- a professional adviser to the company;
- a significant customer or supplier; or
- in any significant contractual relationship with the company other than as a director.

This general definition and the Report's recommended board composition closely tracks the approach of the Cadbury Committee.[70] Intriguingly, in its

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[69] *Corporate Practices and Conduct*, WORKING GROUP OF THE AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS ET AL. 16 (1993) [hereinafter Bosch Report 1993].

[70] The Bosch Report recommended remuneration, nomination and audit committees, each with a majority of IDs, with sufficient IDs on the board

first edition published in 1991, the Bosch Report noted that while personal or professional associations with the company, its officers, or shareholders, should not preclude NEDs from serving as directors,

> it is [nevertheless] a useful safeguard to appoint to the Board at least two directors who have no [personal or professional] association with the company or its officers or *a particular shareholder*. The independence of a NED may be defined as not having:
>
> 1. A contractual relationship with the company other than the office of Director (and therefore not subject to the control or influence of any other director or group of directors).
> 2. Any relationship with the company which could affect the exercise of independent judgment.[71]

In its second edition in 1993, the Bosch Report added that independence is "more likely to be assured" when the director is not "a substantial shareholder" of the company.[72]

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overall so that their views could carry significant weight. While acknowledging that ID numbers would vary with board size, the Report mentioned that "it is unlikely that less than two will be able to exercise sufficient influence and it is desirable that at least one third of the Board should be genuinely independent." Bosch Report 1991, *supra* note 28, at 16-7. Similarly, the Cadbury Report recommended a remuneration committee, a nomination committee (with a majority of NEDs) and an audit committee (all NEDs, with a majority of IDs), thus a minimum of 3 NEDs including 2 IDs. Cadbury Report, *supra* note 29.

[71] Bosch Report 1991, *supra* note 28, at 6 (emphasis added).

[72] Bosch Report 1993, *supra* note 68, at 16.

The Cadbury Report, published in 1992, instead recommended that a majority of NEDs should be independent, meaning that "apart from their director' fees *and shareholdings*, they should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment."[73] This difference is all the more interesting, given that the Bosch Committee also had an eye on American developments that emphasized the importance of NEDs and IDs, such as the American Law Institute (ALI) *Principles of Corporate Governance* (released on March 31, 1992, but developed since 1978) and the New York Stock Exchange (NYSE) listing rules. Yet the U.S. continues to define independence to exclude being a substantial shareholder.[74] Apparently the Bosch Committee came up with this definition due to concerns that strong individuals, often with significant shareholdings, had abused their positions on Australian boards, resulting in major corporate collapses in the late 1980s and the response (led by the Business Council) to establish the Bosch Committee to restore public faith in listed companies.[75]

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[73] Cadbury Report, *supra* note 29, at para. 4.12 (emphasis added). However, the Cadbury Committee did "regard it as good practice for [NEDs] not to participate in share option schemes." *Id*. at para. 4.13.

[74] The NYSE had required since 1956 at least two "outside" directors (NEDs) on listed company boards, and since 1978 an audit committee comprising only IDs. The non-binding ALI Principles recommended a majority of directors free of any "significant relationship" with the company's senior executives (unless a majority of its shares were owned by a single person, a family group or a control group. in which case it should have at least three such IDs).

[75] Telephone interview with Henry Bosch AO, Former Chairman, National Companies and Securities Commission (Mar. 16, 2015). Another

In September of 1994, the ASX released a Discussion Paper that was heavily influenced by the Bosch Report, which the ASX noted had received a fairly poor response among listed companies. It proposed a new ASX Listing Rule requiring companies to include in their annual reports (from 1996) a statement as to whether they had followed its "Schedule of Corporate Governance Practices," and to explain why they had not followed specified practices. This proposal was similar to the Bosch Report's recommendation; this "comply or explain" approach was favored by the Cadbury Committee, and had been adopted in the U.K. since 1992. The ASX then invited public comment on the desirable

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response was the restriction on partial takeovers. Mr. Bosch also noted that the idea did not come from (then protean) institutional investor groups in Australia, as they did not have a formal organization at the time and were not on the original Committee. (Instead several large institutional investors responded favorably during the public consultation on the first draft Report, and released a public statement that companies that adopted the final Report recommendations would be looked on positively when making investment decisions.) The Bosch Committee was also aware that corporate governance was being examined in the U.K. in the wake of the Maxwell fiasco, but it had already had public consultations on its draft Report before the Cadbury Committee was established in May of 1991. It was only in 1995 that the Australian Investment Managers' Association (AIMA) published the first edition of what become know as its "Blue Book" guidelines for investment decisions, including recommendations on director independence defined largely in line with the Bosch Reports (including, importantly and even then somewhat controversially, independence from substantial shareholders). *See* Hanrahan & Bednall, *supra* note 25. *See generally* FRANK L. CLARKE ET AL., CORPORATE COLLAPSE: ACCOUNTING, REGULATORY, AND ETHICAL FAILURE (2003) (discussing Australia's corporate collapses in the 1980s, including in groups of companies where small shareholdings were leveraged into controlling interests).

schedule benchmarks for a minimum number of NEDs and (more tentatively) IDs, as well as for audit, remuneration, and nomination committees (including a majority of IDs). The caution with which the ASX proceeded here was apparently related to the negative responses to its 1992 Exposure Draft setting out a new listing rule mandating a minimum IDs requirement.[76]

Even this watered-down proposal proved controversial. It referred to the Hilmer Committee Report (entitled *Strictly Boardroom*, published in 1993), which was compiled by representatives from law schools, the ASX, investment advisers, merchant bankers, insurers, unions, and company directors, under the chairmanship of Professor Fred Hilmer. That report argued that the key functions of boards were to monitor and enhance corporate performance, but too much attention was being focused on the former. It recommended that guidelines on board make-up confused directors as to their responsibilities, whereas their interaction as a group is essential. The Hilmer Report did not seek to define the role of NEDs, instead urging them to prioritize performance responsibilities. It rejected requirements for IDs – except for the audit committee, where it recommended a majority of IDs that had no business relationship with the company that might impede independent judgment – because the role envisaged for IDs overall, as "quasi auditors" was perceived as unconstructive and unrealistic. One academic response to the 1994 ASX Discussion Paper similarly elaborated on various "environmental limitations" on IDs, like structural bias in (re)appointments, intimidation by management, a lack of cohesive power, questions as to

[76] Bird, *supra* note 31, at 237.

who would monitor such monitors, and a lack of adequate resources and experience.[77]

Following this strong resistance, the ASX backed off of introducing a U.K.-style comply-or-explain model. Instead, for the annual reporting periods ending on or after June 30, 1996, Listing Rule 4.10.3 required Australian companies merely to disclose their corporate governance practices.[78] The (then) Appendix 4A to this Listing Rule set out a non-exhaustive list of corporate governance matters that such companies could consider as part of their disclosure obligations.[79] But as commentators pointed out soon after the promulgation of this indicative list, it seemed to encourage ambivalent disclosure by failing to clearly distinguish between IDs and NEDs or between non-executive and independent chairs.[80] The direct impact of the

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[77] *Id.* at 246-53.

[78] "The rationale for the rule," according to Corporate Law Economic Reform Program Paper No. 3, "was that it would result in the release of more information of greater relevance to the market compared with a rule requiring specific corporate governance practices to be adopted by all listed companies." Commonwealth Treasury, *Directors' Duties and Corporate Governance*, 3 PROPOSALS FOR REFORM 1, 62 (1997).

[79] *See ASX Listing Rules, Guidance Note 9*, ASX (2014), http://www.asx.com.au/documents/rules/gn09_disclosure_corporate_governance_practices.pdf (under Disclosure of Corporate Governance Practices, previously Appendix 4A to the Listing Rules) [hereinafter Appendix 4A].

[80] Appendix 4A (entitled "List of corporate governance matters") referred expressly only to NEDs. Analyzing disclosures by a sample of 100 each of large-, medium-, and small-sized ASX companies, Ian Ramsey & Richard Hoad, *Disclosure of Corporate Governance Practices by Australian Listed Companies*, 15 COMPANY & SEC. L. J. 454, 460 (1997), noted that

> 60 per cent of the companies surveyed stated

new ASX disclosure appears to have been limited, although corporate governance practice by the early 1990s had witnessed an increase in NEDs, and by the late 1990s, larger listed companies were tending to appoint significantly more IDs as well as NEDs.[81]

> that their boards contain a majority of [NEDs]. A further 7 per cent state that their boards contain a majority of [IDs]; whilst 13 per cent state that their boards contain a majority of executive directors, and 6 per cent that there is an equal number of executive and [NEDs]. The figures for the different capitalization groupings indicate that larger companies are more likely to have a majority of NEDs, and smaller companies are more likely to have a majority of executive directors.
>
> A recent empirical study of the composition of the boards of directors of the largest Australian companies found that 40 per cent of the largest 100 companies have a majority of independent NEDs on their boards. Yet in the present study, only 16 per cent of the largest companies actually stated that this was the case in their corporate governance statements. This indicates that companies are not clearly addressing this issue in their corporate governance statements. In fact, the ASX indicative list of corporate governance matters in Appendix 4A refers only to [NEDs] and not [IDs].

(citation omitted). *See also* Stapledon & Lawrence, *supra* note 45.

This study also noted that 14% of surveyed companies (including 6% of large companies) did not discuss board composition in their corporate governance statements. Ramsey & Hoad, *supra* at 467 (Table A). The study concluded that there was "clearly substantial scope for improvement in disclosure of corporate governance practices" both generally and with respect to NEDs and IDs. *Id*. at 465.

[81] Bosch, *supra* note 46; *see also, e.g.,* Kiel & Nicholson, *supra* note 45; Helen Kang, Mandy Cheng, & Sidney J. Gray, *Corporate Governance and*

Australia was then hit by another wave of corporate collapses, in some ways worse than the corporate failures of the late 1980s. The corporate failures from 2001 were more obviously driven by poor corporate governance and inadequate regulation,[82] as opposed to general downturns in the share market and the economy.

One such dramatic failure involved One.Tel, a newer telecom company, which collapsed in May of 2001. News Limited and PBL were large blockholders, with Lachlan Murdoch and James Packer (respectively heirs to those large family-controlled companies) appointed NEDs of One.Tel.[83] Both Murdoch and Packer claimed they were "profoundly misled"[84] by executives regarding the company's true financial position, even though PBL and News Limited executives were regularly briefed on One.Tel[85] and Packer was substantially involved in its everyday business. Curiously, in evidence to the court, both Packer and

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Board Composition: Diversity and Independence of Australian Boards, 15 CORP. GOVERNANCE: AN INT'L REV. 194 (2007); Ingrid Bonn, Toru Yoshikawa, & Phillip H. Phan, *Effects of Board Structure on Firm Performance: A Comparison Between Japan and Australia*, 3 ASIAN BUS. & MGMT. 105, 117 (2004) (noting that for 104 largest manufacturing companies in 1998, average board size was 7.36, including 75% NEDs).

[82] *See generally* FRANK L. CLARKE ET AL., CORPORATE COLLAPSE: ACCOUNTING, REGULATORY, AND ETHICAL FAILURE (2d ed. 2007).

[83] *See generally* PAUL BARRY, RICH KIDS (2003).

[84] *See, e.g.*, Elizabeth Knight, *You've Come a Long Way Since the One.Tel Days, Packer*, SYDNEY MORNING HERALD (Apr. 15, 2014), http://www.smh.com.au/business/youve-come-a-long-way-since-the-onetel-days-packer-20140414-36nog.html.

[85] *See, e.g.*, A. Lampe, *One.Tel kept PBL Briefed, Court Told*, SYDNEY MORNING HERALD 25 (Oct. 5, 2005).

Murdoch suffered from serious memory lapses.[86] The corporate regulator (ASIC) did not bring proceedings against these NEDs, but only the non-executive chair and three other executive directors – two of whom accepted settlements. The NSW Supreme Court ultimately exonerated the other two directors.[87] Packer and Murdoch later settled their long-running disputes with One.Tel's creditors by paying them $40 million.[88]

Another spectacular collapse was HIH, then Australia's second largest insurer. It owed

> debts of about $5.3 billion, which Ray Williams and his cohorts achieved through gross mismanagement, largely charging too little for premiums and failing to put away enough to pay out claims. They concealed this by under-reserving (which boosts profits) and using "financial reinsurance" contracts to turn losses into gains. Williams, the chief executive, distracted the investment community with a string of takeovers, culminating in paying $300

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[86] *See* Vanda Carson, *Packer Man Blanks Out Pivotal 3 Weeks*, THE AUSTRALIAN 21 (Oct. 7, 2005) (noting that these dramatic memory losses extended to PBL's CFO, Geoff Kleeman, described as "PBL's eyes and ears" at One Tel).

[87] *Australian Securities and Investments Commission v. Rich* [2009] 75 ACSR 1 (Austl.); *see also* Hill, *supra* note 21, at 20-24.

[88] *Packer, Murdoch Stump Up $40m for One.Tel*, SYDNEY MORNING HERALD (Apr. 17, 2014), http://news.smh.com.au/breaking-news-business/packer-murdoch-stump-up-40m-for-onetel-20140417-36ulb.html.

> million for Rodney Adler's FAI Insurances in 1998.[89]

The biggest corporate failure in Australian history led to a Royal Commission, chaired by Justice Neville Owen, which cost $40 million and published its report in April of 2003 after an eighteen-month Inquiry. As well as highlighting HIH's corporate governance failures and recommending various improvements, the report led to ASIC bringing civil and criminal proceedings, which were largely successful against Williams and others.[90] Justice Owen nevertheless expressed reservations about IDs as a governance panacea:

> The weight of current opinion is that it is desirable to have a majority of independent directors on a public company board. The board of HIH had several 'independent' directors but this provided little protection against the folly of management. I am not convinced that a mandatory requirement for boards to have a majority of non-executive directors is either necessary or desirable. In most cases it will be desirable (assuming the

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[89] *See* Margot Saville, *HIH: The Inside Story of Australia's Biggest Corporate Collapse*, SYDNEY MORNING HERALD (Mar. 15, 2003), http://www.smh.com.au/articles/2003/03/14/1047583693489.html (reviewing M. WESTFIELD, HIH: THE INSIDE STORY OF AUSTRALIA'S BIGGEST CORPORATE COLLAPSE (2003)).

[90] *See* Hill, *supra* note 19; *see also* the case study summary by Aoun in the present paper's Appendix (also, unfootnoted, http://blogs.usyd.edu.au/japaneselaw/2015/02/guest_blog_hih.html).

> non-executive directors are truly independent) but flexibility ought to be maintained to enable corporations to be structured in a way that best suits their circumstances. Nonetheless, the trend in the prescription of codes of conduct seems to assume the premise. My recommendations have been developed accordingly.[91]

Justice Owen also doubted "why a substantial shareholding in the company should be regarded as compromising independence. Such a shareholding, [he maintained] may provide greater incentive to bring the interests of the company to bear."[92] One problem in the HIH debacle was that executives did not pass on sufficient information to the board. Another issue highlighted by the Owen Report was the lack of auditor independence (accounting firm, Andersen, had also provided other services to HIH), and insufficient independence on the company's audit committee set up to appoint them (including former Anderson partners). Legislation was later passed strengthening auditor independence, albeit not to the levels witnessed in the U.S. following the Enron debacle.[93]

A third and rather different corporate scandal also broke around the same time as HIH's collapse. James Hardie Industries Ltd. was the holding company for two subsidiaries that had manufactured and sold asbestos in Australia until 1987. In 2001, its board approved a proposal

[91] COMMONWEALTH OF AUSTRALIA, ROYAL COMMISSION OF INQUIRY INTO THE FAILURE OF HIH INSURANCE, FINAL REPORT 112, para. 6.2.6 (2003).
[92] *Id*.
[93] Nottage, *supra* note 14 (under "Disclosure," with further references).

to essentially move to the Netherlands, leaving behind the subsidiaries and establishing a foundation in Australia to manage growing asbestos claims. The board minutes also recorded that directors approved a draft announcement to the ASX (made the next day) that the foundation was "fully-funded" to meet future legitimate claims. By October of 2003, however, the foundation had to declare a huge funding shortfall. A public Inquiry chaired by David Jackson QC commenced in February and reported in September of 2004,[94] leading to the James Hardie group reaching a settlement with the NSW government in 2005. The regulator also sued James Hardie officers, the CEO/director, and NEDs for breach of the statutory duty of care, ending (albeit in 2012) with a significant victory in the High Court of Australia in *ASIC v. Hellicar*.[95]

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[94] NEW SOUTH WALES SPECIAL COMMISSION OF INQUIRY INTO THE MEDICAL RESEARCH AND COMPENSATION FOUNDATION, REPORT (Sept. 2004), http://www.dpc.nsw.gov.au/data/assets/pdf_file/0020/11387/01Part A.pdf.

[95] *Shafron v. Australian Securities and Investments Commission* [2012] 247 CLR 465 (Austl.); *see* Hill, *supra* note 21, at 11-20 (comparing Australian and Japanese government responses to asbestos issues); *see also* Joel Rheuben, *Government Liability for Regulatory Failure in the Fukushima Disaster: An Australian Comparison*, *in* ASIA-PACIFIC DISASTER MANAGEMENT: COMPARATIVE AND SOCIO-LEGAL PERSPECTIVES 101 (Simon Butt, et al. eds., 2014); *see also* Nottage, *supra* note 14 (discussing duties of care owed by directors and certain officers under the *Corporations Act* and general law).

B. THE ASX'S 'IF NOT, WHY NOT' DISCLOSURE REGIME SINCE 2003

In March of 2003, arguably to pre-empt more extensive legislative intervention, the ASX also unveiled the First Edition of its *Corporate Governance Principles* (in effect for its listed companies' first financial year after July 1, 2003). These principles generally adopted a U.K.-style "if not, why not" approach,[96] especially as it relates to the recommendation that the audit committee be comprised of all NEDs and a majority of IDs. However, for (larger) companies on the S&P/ASX All Ordinaries index, the ASX also adopted a new Listing Rule (presently Rule 12.7) mandating such an audit committee without exception.[97] Recommendation 2.1 of the ASX Principles also required all listed companies to have a majority of IDs on an "if not, why not" basis, and it largely adopted the criteria for independence first outlined in the Bosch Report.[98]

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[96] However, the Chair of the ASX Corporate Governance Council (since November 2011) suggested that the Australian "*if not*, why not" approach may be somewhat less directive than the U.K. "*comply* or explain" approach, which he saw as instead implicating a presumption that companies will comply with the recommendations. Alan Cameron, *How Do Directors Sleep at Night?*, *in* DIRECTORS IN TROUBLED TIMES 115, 118 (R. Austin & A. Bilski eds. 2009).

[97] *Principles of Good Corporate Governance and Best Practice Recommendations: First Edition*, ASX CORPORATE GOVERNANCE COUNCIL Recommendations 4.2 and 4.3 (Mar. 2003) [hereinafter ASX First]; *but cf. infra* Part VI (discussing the possibility anyway of "waivers" being given by the ASX).

[98] *Id*. Recommendation 2.2 added that the chair should be an ID, with Recommendation 2.3 splitting the roles of chair and CEO. PLESSIS et al., *supra* note 1. Part 4.4.2 also notes parallels between the Principles' criteria

The Principles included general comments somewhat reminiscent of statements in Justice Owen's Report and the Hilmer Report as to the need for boards to retain appropriate diversity:

> What constitutes good corporate governance will evolve with the changing circumstances of a company and must be tailored to meet those circumstances. Best practice must also evolve with developments both in Australia and overseas.
>
> There is no single model of good corporate governance. This document articulates 10 core principles that the ASX Corporate Governance Council [formed in 2012] believes underlie good corporate governance. Each principle is explained in detail, with implementation guidance in the form of best practice recommendations.
>
> Although the Council's recommendations are not mandatory and cannot, in themselves, prevent corporate failures or mistakes in corporate decision-making, they can provide a reference point for enhanced structures to minimize problems and optimize performance and accountability.[99]

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for IDs and those set out in the Investment and Financial Services Association (IFSA, now the Financial Services Council) "Blue Book" (*Guidance Note No 2:00: Corporate Governance: A Guide for Fund Managers and Corporations*, Dec. 2002); and that the U.K. Higgs Report (released in Jan. 2003) had for the first time defined IDs in great detail.

[99] ASX First, *supra* note 96, at 3 (emphasis added).

A similar approach was taken in the Second Edition of the ASX Principles adopted in August of 2007 (in effect from 2008).[100] As explained further in Part IV, the Second Edition made relatively minor changes overall and with respect to ID requirements.[101] These Principles reiterated that:

> The Recommendations are not prescriptions, they are guidelines, designed to produce an outcome that is effective and of high quality and integrity. This document does not require a "one size fits all" approach to corporate governance. Instead, it states suggestions for practices designed to optimise corporate performance and accountability in the interests of shareholders and the broader economy. If a

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[100] *Corporate Governance Principles and Recommendations: Second Edition*, ASX CORPORATE GOVERNANCE COUNCIL 4 (Aug. 2007) [hereinafter ASX Second] (largely repeating the paragraph above, although instead mentioning more succinctly that the recommendations are "a reference point for companies about their corporate governance structures and practices." They also repeat the view in the First Edition that "Corporate governance influences how the *objectives* of the company are set and achieved, how *risk* is monitored and assessed, and how *performance* is optimized. Effective corporate governance structures encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved."). However, the Second Edition, quoting from the HIH Report, elaborates the definition of "corporate governance" as being "'the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations.'" *Id*. at 3.

[101] *Id.* at Recommendations 2.1-2.3.

> company considers that a Recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it — a flexibility tempered by the requirement to explain why — the "if not, why not" approach.[102]

Analyses by the ASX from 2004-2007 found that just under half of the listed firms complied with Recommendation 2.1 (a majority of IDs on boards), although larger companies reported higher compliance.[103] Another ambiguous development for IDs in 2004 was the National Australia Bank's boardroom brawl that erupted following a foreign exchange trading scandal. One ID, Catherine Walter, challenged the board's decision to commission an investigative report by PwC, citing alleged conflicts of interest. Following the intervention of institutional investors, a compromise was reached: Walter and others involved in the dispute resigned.[104] This led to mixed reactions: some

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[102] *Id.* at 5. Largely repeating the First Edition, with footnote 2 noting, however, the mandatory audit committee requirement still for larger ASX companies. *Id.* at 5 n.2. The Third Edition tones down this message, although still mentioning that they constitute a disclosed-based regime that allows for flexibility. ASX Third, *supra* note 32, at 5.

[103] Anelgo Veljanovski, Albie Brooks, & Judy Oliver, *Independent Directors and Australia's Corporate Governance Model: A Survey of Independent Directors' Views*, 24 AUSTL. J. OF CORP. L. 33, 40 (2009) (curiously, the cited ASX Principles compliance reports no longer appear to be available online). For 2010, *see Analysis of Corporate Governance Disclosures in Annual Reports for year ended 30 June 2010*, ASX (2010), http://203.170.82.73/~firstgro/wordpress/wp-content/uploads/2011/07/corporate-governance-disclosures-in-FY10-annual-reports.pdf.

[104] Ultimately, the fallout from this scandal led to the resignation of six NEDs and the Chairman, Graeme Kraehe, as part of a "board renewal"

supported Walter's independent approach, whereas others warned of the risks of fragmenting boards. Some companies considered introducing "prenuptial agreements" for NEDs that would allow the board to review their "performance" every two years and remove them if their performance was deemed unsatisfactory. ASIC and some commentators declared that this would contravene the shareholders' non-derogable right to remove directors of public companies pursuant to Section 203E of the *Corporations Act 2001* (Cth), which then caused (some) companies to water down such agreements with directors.[105]

C. POST-GFC RE-REGULATION: BOARD DIVERSITY AND EXECUTIVE PAY

By mid-2008, the GFC had reached Australia's shores, but its impact was far less severe than most other major world economies.[106] Despite the collapses of smaller and mid-tier firms, as well as the near-collapse of Centro (a large

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process. *See* Peter Ryan, *Ex NAB Board Member Catherine Walter Speaks Out*, ABC AM (Sept. 1, 2004), www.abc.net.au/am/content/2004/s1189565.htm.

[105] Hill, *supra* note 21, at 30-38. However, the ASIC regularly issues reminders opposing this practice of director "pre-nuptial agreements," emphasizing that directors are ultimately accountable to shareholders. *See, e.g.*, *Media Release, 04-40 Removal of Directors of Public Companies*, AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION (Aug. 17, 2004). It may be that directors forced to resign do not kick up a fuss because they are keen to avoid reputational damage (as do directors caring about their reputations generally). *See especially* Ronald W. Masulis & Shawn Mobbs, *Independent Director Incentives: Where do Talented Directors Spend their Limited Time and Energy?*, 111 J. OF FIN. ECON. 406 (2014).

[106] Hill, *supra* note 21.

property developer) as early as December of 2007, major financial institutions did not implode.[107] Australia's relative success in weathering the GFC was largely due to a natural resources boom[108] as well as the economic resilience of China, which has been Australia's largest trading partner since 2007.[109] Other significant factors arguably include: differences in Australia's monetary and fiscal stimulus policy in response to the GFC; its "twin peaks" financial market regulation – centered on ASIC for business conduct regulation; the role played by Australian Prudential Regulation Authority (APRA) established in 1998 and significantly reformed following the 2003 HIH Royal Commission; Australia's unique banking history (including four very large and profitable banks that are not permitted to merge); and compulsory superannuation.[110] Interestingly, one of the reforms to APRA (agreed on in 2003) involved replacing its non-executive board with an executive group made up of a full-time CEO and 203 Commissioners.[111] With respect to banks and other regulated financial institutions, APRA essentially requires adherence to ASX criteria for

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107 Such as the "non-bank," Allco, which collapsed in 2008. *See* Paul Barry, *Coe. & Co.*, THE MONTHLY (May 2010), www.themonthly.com.au/issue/2010/april/1273118974/paul-barry/coe-co; on Centro, *see* Hill, *supra* note 20.
108 *See generally* ROSS GARNAUT, DOG DAYS: AUSTRALIA AFTER THE BOOM 7 (2013).
109 David Uren, *China Emerges as Our Biggest Trade Partner*, THE AUSTRALIAN (May 5, 2007), www.theaustralian.com.au/news/nation/china-emerges-as-our-biggest-trade-partner/story-e6frg6nf-1111113474544.
110 Hill, *supra* note 21.
111 *Id.* at 41.

director and committee independence, albeit without the leeway of an "if not, why not" approach.[112]

The major focus of post-GFC policy-makers in Australia has been executive pay. This is due to concerns over rising remuneration levels and the possibility of misaligned incentives that may encourage excessive managerial risk-taking. Since July of 2010, APRA has required a Capital Board Remuneration Committee with a majority of IDs, an ID chair, and a charter to set suitable remuneration policies for all Australian banks and insurance companies.[113] In March of 2009, the government commissioned a broader inquiry by the Productivity

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[112] Fischer & Swan, *supra* note 25, at 2 (citing Prudential Standard CPS510). This requirement has been in place since 2006 in Prudential Standard APS 510. *See, e.g.*, Ann-Marie Moodie, *Government Report Raises Dilemma Over Meaning of 'Independent'*, THE AUSTL. FIN. REV. (June 5, 2014) (discussing Commonwealth of Australia, *Better Regulation and Governance, Enhanced Transparency and Imposed Competition in Superannuation, Discussion Paper* (Nov. 28, 2013)).

[113] John H. Farrar, *The Global Financial Crisis and the Governance of Financial Institutions*, 24 AUSTL. J. CORP. L. 227, 239-40 (2010) (noting that these changes take as their starting point the Financial Stability Board's *Principles for Sound Compensation Practices* (Apr., 2009) adopted by the G20 leaders). *See also Discussion Paper: Remuneration – Proposed Extensions to Governance Requirements for APRA-regulated Institutions*, AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (May 2009), www.apra.gov.au/CrossIndustry/Consultations/Documents/AI_DP_PEGR_052009_ex_R.pdf; Shane Magee & Elizabeth Sheedy, *Governance of Financial Institutions: A Cross-Country Evaluation of National Codes Following Basel (2010)*, MACQUIRE UNIVERSITY (Nov. 5, 2013), http://www.mafc.mq.edu.au/linkservid/1540C6CD-BD86-F895-5B2ABD243C81C155/showMeta/0/ (finding that Australia ranks highly on implementing such board independence requirements under its banking regulation, but is only middling among eleven countries compared for consistency with Basel Committee recommendations).

Commission, which published a draft report in September and a final report in December of 2009.[114] Many of its recommendations focused on better disclosure of remuneration, but the most controversial was a "two strikes and re-election resolution" proposal. Under legislation introduced in December of 2010, which passed in June of 2011:

- if 25% or more shareholders voted at an AGM against the remuneration report (the "first strike"), the board would have to explain how their concerns were being addressed in the following year's report;
- if 25% or more voted against the remuneration report at the next AGM (the "second strike"), the shareholders would have to also vote to determine whether directors who had voted at the board in favor of the second report would need to stand for re-election (albeit with some exceptions);
- at the separate "spill meeting," to be held within 90 days, those directors would lose their positions if voted against by 50% or more of the shareholders.

Bodies such as the AICD and major law firms voiced concerns about the new legislative scheme, which went well beyond the purely advisory shareholder vote on remuneration enacted in 2004.[115] One study found that 104

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[114] *Executive Remuneration in Australia*, PRODUCTIVITY COMMISSION, PARLIAMENT OF AUSTRALIA (2009), www.pc.gov.au/projects/inquiry/executive-remuneration.

[115] Randall S. Thomas & Christoph Van der Elst, *Say on Pay Around the World*, 14-10 VAND. L. & ECON. RES. PAPER 20-21 (2014),

listed companies received a first strike in 2011, and 105 companies in 2012 (including twenty-two which received a second strike), but also noted some positive effect of the new rule on the executive pay-performance link (suggesting better incentive alignment).[116] Although key executives (or their closely related parties) whose remuneration may be disclosed in the remuneration report and who hold shares in the company may not vote on the remuneration and spill resolutions, it seems they may vote to reappoint the board. Thus, at Crown Limited's AGM in 2011:

> After shareholders voted against Crown's remuneration report, James Packer (Crown casino executive chairman and 46% shareholder) is reported to have told shareholders that in the event that shareholders vote against the remuneration report again in 2012, triggering the two-strikes rule and resulting in a board spill, he "will use [his] votes [as 46% shareholder] to ensure all directors are voted back in immediately."[117]

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http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2401761; Nottage, *supra* note 15.

116 Reeza Monem & Chew Ng, *Australia's 'Two-Strikes' Rule and the Pay-Performance Link: Are Shareholders Judicious?*, 9 J. OF CONTEMP. ACCT. & ECON. 237, 238 (2013).

117 Claire Macmillan, *Impact of regulatory reforms on executive remuneration in Australia – AGMs in 2011*, KEEPING GOOD COMPANIES 100, 102 (Mar. 2012) (adding that "it appears that the 'no' vote was born of shareholder concerns about Crown's disclosure standards for remuneration, rather than the amount or manner in which executives were to be paid. For example, a representative of Perpetual (who did not vote against the report on the basis that Mr Packer does not take a salary), reportedly

The government also asked CAMAC to investigate executive remuneration reporting and arrangements, but it reported only in April of 2011.[118] Neither governmental report considered the possible implications of Australia retaining a comparatively strong blockholder tradition in listed companies, or whether IDs were better equipped to control remuneration arrangements.

In April of 2010, the ASX responded to growing concerns about executive pay by releasing an exposure draft of further proposed amendments to its *Corporate Governance Principles*, including those relating to remuneration and board diversity; it also revised its Listing Rules. Amendments to the Principles in 2010 (in effect from the 2011 financial year) clarified the roles of the remuneration committee but reaffirmed its long-held recommendation (since the 2003 Principles) that an ID should chair the remuneration committee, which should have a majority of IDs, and at least three directors. A new Listing Rule (12.8, in effect from 2012) further mandated that an entity listed in the S&P/ASX 300 Index at the beginning of its financial year

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Crown's largest shareholder after Mr Packer, commented that 'this is an issue of disclosure ... the vote should result in the company increasing its disclosure around these issues.' The Australian Shareholders' Association reportedly considered that Crown's executive remuneration was not excessive. Rather, its concerns went to the lack of transparency in Crown's incentive plan because specific performance hurdles, their weightings and executives' performance were not disclosed." (citations omitted)).

[118] *Executive Remuneration*, CORPORATION AND MARKETS ADVISORY COMMITTEE, AUSTRALIAN PARLIAMENT (Apr. 2011), http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2011/$file/executive_remuneration_report_april11.pdf.

should have a remuneration committee comprised solely of NEDs (like the audit committee) for the entire duration of that financial year.[119]

In addition, the 2010 amendments to the ASX Principles introduced new disclosure requirements concerning board diversity, prompted particularly by concerns over a persistent lack of women directors in listed companies.[120] In September of 2008, the newly elected Rudd Government requested that CAMAC inquire into board diversity. Its Report in March of 2009 included (more limited) recommendations for the ASX Principles. The CAMAC Report noted that the proportion of women directors in the ASX 200 companies had remained around 8% since 2002, with those in executive management around 11-12% from 2004-2008 (and only half in line management, which is considered a valuable precursor to board appointments).[121]

Interestingly, this Report, as well as the original terms of reference from the Government and especially the amended ASX Principles,[122] suggest a possible positive link

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119 Macmillan, *supra* note 116, at 100-101 (also suggesting amendments along these lines).

120 Etheridge, *supra* note 40, at 35-36 (finding that diversity had diminished somewhat over 2004-2007).

121 *Diversity on Boards of Directors*, CORPORATION AND MARKETS ADVISORY COMMITTEE, AUSTRALIAN PARLIAMENT 26-28 (Mar. 2009), www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2009/$file/board_diversity_b5.pdf. In Australia's largest 100 companies in 1995, women held 3.6% of 889 board seats, with most (29 out of 32 seats) held by women in non-executive positions. Stapledon & Lawrence, *supra* note 45, at 186.

122 ASX Third, *supra* note 32, at 11 (asserting, "Research has shown that increased gender diversity on boards is associated with better financial

between enhanced board diversity and corporate performance. However, researchers such as Douglas Branson have pointed out that most studies have found no or even some negative effect on overall corporate performance. Instead, he summarizes the more commonly advanced arguments in favor of appointing women on boards as follows: helping to avoid "groupthink" and corporate collapses, providing a positive role model for women employees, positive signaling for consumers, better functionality in an increasingly diverse world, and alignment with developments in international and domestic anti-discrimination law.[123] Reduced emphasis on the groupthink-focused argument[124] may be related to Australia escaping the GFC with comparatively few corporate collapses. Less understandable though is the lack of linkage in the recent discourse between this broader topic of board

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performance.") Footnote 17 cites two studies showing this from 2011. *Id*. at 11 n.17. ASX Third also adds that "promotion of gender diversity can broaden the pool for recruitment of high quality employees, enhance employee retention, foster a closer connection with and better understanding of customers, and improve corporate image and reputation." *Id*. at 11.

[123] Douglas Branson, *An Australian Perspective on a Global Phenomenon: Initiatives to Place Women on Corporate Boards of Directors*, 27 AUSTL. J. OF CORP. L. 2, 4-5 (2012).

[124] *But see* Vijaya Nagarajan, *Regulating for Women on Corporate Boards: Polycentric Governance in Australia*, 39 FED. L. REV. 255, 257-62 (2011), carefully assessing, in a leading Australian law journal, four main reasons for having more women on boards: improved decision-making (and avoiding groupthink), better profitability, a more democratic representation of social diversity, and enhanced corporate image for employees, consumers and shareholders. *See also* Wheeler, *supra* note 24 (noting recent theoretical and empirical literature questioning aspects of the original "groupthink" problem).

diversity and the arguably related question of IDs, including longstanding debates even in Australia about whether IDs truly help to prevent corporate failures or to enhance business performance (as mentioned in Parts II and V).[125]

Further discussion about IDs (and NEDs more generally) surfaces sporadically throughout a third significant report emerging soon after the GFC in CAMAC: *Guidance for Directors* (April of 2010). In August of 2009, the Government sought CAMAC's views on whether and how Australia might benefit from more guidance to both executive directors and NEDs in light of guidance or codes of conduct available to directors abroad, such as the U.K.'s Higgs Report (2003) and revised Corporate Governance Code. After detailing various official and non-official sources of guidance available in Australia, the U.K., North America, and internationally (especially the OECD and Basel Committee on Banking Supervision), the CAMAC Advisory Committee concluded that it did "not see a need for the development of a new code of conduct or best practice guidance by a regulator," but that (*inter alia*) it would be "timely for the ASX Corporate Governance Council to review its principles and recommendations in light of international developments."[126] CAMAC also noted that: "The overriding responsibility of directors is to act in the best interests of the company. This can be a difficult and demanding task. It includes, but goes beyond, an

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[125] Exceptionally, but briefly, see Le Mire & Gilligan, *supra* note 24, at 463-64.

[126] *Guidance for Directors*, CORPORATIONS AND MARKETS ADVISORY COMMITTEE, AUSTRALIAN PARLIAMENT 73 (Apr., 2010), www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2010/$file/guidance_for_directors_report_april2010.pdf.

understanding of compliance and other legal issues. First and foremost, it requires directors to focus on the business of the company and direct it towards success."[127] It then argued that directors should not become "subject to licensing or other requirements that could be employed to administer or enforce a mandatory code or best practice principles,"[128] (although APRA did enforce these criteria for its regulated financial institutions). CAMAC further argued that, in general:

> There are dangers too in moving to a more prescriptive approach that attempts to codify the large volume of existing regulation. It could result in inflexibility or complexity or a focus on formal compliance rather than in helping to bring about substantive improvements in governance practices and behaviour. It could also have the effect of imposing new or enhancing obligatory standards on directors in complying with their current statutory and common law duties and responsibilities. Furthermore, it may give the misleading impression that particular matters are more settled, or less open to further development, than may in fact be the case.[129]

From 2012-2013, the ASX Council duly reviewed its Principles and commenced a public consultation on a Third

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[127] *Id*.
[128] *Id*. at 79.
[129] *Id.* at 80.

Edition, which was finalized in March of 2014.[130] This new edition added recommendations to establish a risk committee (either standalone or as part of an audit committee, also needing a majority of IDs) or otherwise to disclose the company's risk management practices, and to disclose whether and how it regards economic, environmental, and social sustainability risks. It slightly amended the diversity-related recommendations (such as for those with disabilities) and elevated some practices or disclosures hitherto mentioned in the Commentary on the Principles into actual Recommendations (triggering the "if not, why not" disclosure obligations), while allowing several more flexible alternatives for smaller listed companies. The Third Edition also made minor amendments to the provisions on IDs, as explained next in Part IV. For example, the Commentary on "close family ties" as indicia of a lack of independence was elevated into "the Box." Throughout the Council's consultation paper, references were made and comparisons were drawn:

> to the corporate governance codes operating elsewhere, including those in the UK, Singapore, Hong Kong, South Africa, Canada, NYSE's Corporate Governance Rules, and the International Corporate Governance Network's Global Corporate Governance Guidelines (Revised 2009). These codes were chosen on the basis that they apply to major

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[130] *See* ASX Third, *supra* note 32 (consultation documents and public submissions can be found at: www.asx.com.au/regulation/corporate-governance-council/review-and-submissions.htm).

> and comparable markets to the Australian market and are written in English.[131]

Other differences from the earlier editions include: bringing the (somewhat confusing) reporting recommendations into the substantive recommendations themselves; rewriting some of the general commentary to give it more of a "directive" tone; and the significant expansion in footnote references.

D. Developing Case Law on Directors' Duties

The recent changes at the ASX have occurred against the backdrop of various government reviews and some legislative enactments, as well as some significant developments in Australian case law. On the one hand, the Jackson Inquiry Report (2004) agreed with James Hardie that due to principles of limited liability and separate legal personality, it was not required to contribute to the foundation's funding shortfall for asbestos claims. But the Jackson Inquiry Report identified such principles as needing review in light of contemporary community expectations. That Inquiry also prompted two governmental reports that considered whether the existing law required directors and officers to only protect the interests of shareholders (i.e. not other stakeholders). Reports from CAMAC[132] and a

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[131] *Id.* (citations omitted).

[132] Available at http://www.camac.gov.au/camac/camac.nsf/byHeadline/ReportsFinal+Reports+Home?openDocument (Corporations and Markets Advisory Committee).

Parliamentary Joint Committee[133] found that Australian corporate law permits a broader stakeholder perspective, notwithstanding the scant case law (especially as a corporation approaches or becomes insolvent). As a result, they did not recommend legislative reform along the lines of Section 176 of the U.K. *Companies Act 2006*.[134]

On the other hand, case law regarding duties of care and diligence owed by directors has grown significantly since 1993, with ASIC enjoying a high success rate in its enforcement proceedings.[135] Admittedly, in *ASIC v. Rich* (decided on November 18, 2009),[136] the (executive) directors of One.Tel were protected by the statutory business judgment rule – although, unlike in the U.S., the defendants had the burden of proving that its preconditions were satisfied – in relation to managerial conduct such as business planning and budgeting. Notwithstanding ASIC's defeat here, Austin J. agreed with the regulator's argument that the definition in Section 180(3) would not protect directors violating their duties to monitor or oversee management.

In *ASIC v. Macdonald (No. 11)* (decided on April 23, 2009), the business judgment rule was not pleaded because James Hardie's directors and officers denied affirmatively approving the draft announcement on funding asbestos claims, which was made the following day to the ASX. Gzell

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[133] Availableat http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services (Parliamentary Joint Committee on Corporations and Financial Services).

[134] Hill, *supra* note 21, at 33-42.

[135] Greg Golding, *Tightening the Screws on Directors: Care, Delegation, and Reliance,* 35 U. N.S.W. L. J. 266 (2012).

[136] *ASIC v. Rich* (2009) 236 FLR 1 (Austl.).

J. considered but then rejected a delegation defense, holding that: "Management having brought the matter to the board, none of them was entitled to abdicate responsibility by delegating his or her duty to a fellow director."[137] His Honor concluded that the NEDs as well as the executives had breached the statutory duty of care because they knew or should have known that such unequivocal public statements could result in legal liability, harm to the company's reputation, and market backlash. This judgment was later reversed by the NSW Court of Appeal, but primarily based on a different view of the facts before the trial judge (as to whether the board had in fact seen and approved the draft announcement). In the subsequent appeal to the High Court of Australia, *ASIC v. Hellicar*,[138] the High Court reversed the Court of Appeal decision, ultimately affirming the primary judge's findings. This case, writes Hill, represents:

> a major victory for ASIC and other government regulators, as well as a cautionary tale for directors. The *James Hardie* litigation as a whole represents a watershed in Australian corporate law. Previously, Australian corporate law, like its US counterpart, tended to maintain a clear divide between conduct and decision rules, particularly in relation to non-executive directors. Although the leading decision on directors' duty of care and

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[137] *ASIC v. Macdonald* (2009) (No. 11) 256 ALR 199, 260 (Austl.).

[138] *ASIC v. Hellicar* (2012) 247 CLR 345 (Austl.) (reversing *Morely v. ASIC* (2010) 247 ALR 205 (Austl.)). For a deeper critique, however, see Harry Glasbeek, *The James Hardie directors: A case of missing directors and misdirection's by law*, 28 AUSTL. J. OF CORP. L. 107 (2013).

> diligence, the mid-1990s case of *Daniels v Anderson* contained strong dicta about the responsibilities of all directors, ultimately these aspirational statements were not matched by liability for non-executive directors.[139]

In the Federal Court of Australia's decision in *ASIC v. Healey* (decided on June 27, 2011), both executives and NEDs of Centro were found to have breached their statutory duty of care and diligence by, for example, approving Centro's financial statements that erroneously classified $2 billion of current liabilities as non-current.[140] This breach was found even though (a) Middleton J. found the directors "intelligent, experienced and contentious people,"[141] (b) an audit committee existed (with IDs), and (c) there had been auditing reports from a major accounting firm.

The Commentary on Recommendation 2.6 (on induction for new directors and professional development opportunities) for the Third Edition of the ASX Principles (2014) cites *ASIC v. Healey* to urge companies to provide the necessary resources for directors to develop a sufficient understanding of accounting matters in order to properly discharge their minimum duties regarding its financial statement literacy.

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[139] Hill, *supra* note 21, at 19 (citing Brian Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385 (2006) (on U.S. law) and *Daniels v. Anderson* (1995) 37 NSWLR 438 (Austl.)).
[140] *ASIC v. Healey & Ors (No. 2)* (2011) 196 FCR 430 (Austl.).
[141] *Id.* at para. 8.

> In *ASIC v Healey* . . . the Federal Court held that it is the duty of every director of an entity subject to section 344 of the Corporations Act . . . to read the financial statements of the entity carefully and to consider whether what they disclose is consistent with the director's own knowledge of the entity's affairs. It is important that a listed entity's board have a diverse range of skills and experience and this necessarily means that not all directors will have the same level of accounting skills and experience. Nevertheless, it is in the interests of a listed entity and its security holders (and also in the personal interests of the director concerned) that each director of the entity has an appropriate base level of understanding of accounting matters.[142]

ASIC v. Healey is the only judgment cited in these Principles, although the current edition adds several footnote references to statutory provisions and ASX Listing Rules (and even some other material) compared to the two earlier editions.

IV. DEFINING INDEPENDENT DIRECTORS

Unlike in the United States (*e.g. Sarbanes Oxley Act 2002*), there are no legislative prescriptions concerning board composition and definition of independence in Australia. Instead, soft law instruments such as the ASX CGP prop up

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[142] ASX Third, *supra* note 32, at 26 n.22.

the Australian regulatory framework. As mentioned above in Part III, the emergence of IDs as a centerpiece of Australian corporate governance practices traces its roots to these ASX initiatives, especially around 2003, when it first introduced Principles and Recommendations on an "if not, why not" basis. The First and Second Editions (2007) are very similar, but the Third Edition (2014) contains significant modifications.

Recommendation 2.1 in the First and Second Editions requires a majority of the board to be IDs. The Commentary views IDs as separate from management and any business or other relationship that could "materially interfere with – or could reasonably be perceived to materially interfere with" – the exercise of their independent judgment.[143] Because the Commentary (especially in the Second Edition) also highlights that all directors should bring an independent judgment to bear on board decisions, and because separation from management is a characteristic shared by all NEDs, the distinguishing feature of IDs logically must be matters that (actually or reasonably) "materially interfere" with their exercise of independent judgment.[144]

Importantly, the Commentary lists in Box 2.1 various relationships that "define" a lack of independence (according to the First Edition) or that "may affect independent status" (according to the Second Edition).[145] All

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[143] The First Edition of the Principles adds a reference to "unfettered and independent judgment." ASX First, *supra* note 96, at 19.

[144] In many ways, this is consistent with the Bosch Committee's views introduced above in Part III.1.

[145] ASX Second, *supra* note 99, at 16. This also differs slightly from the First Edition by adding to the Commentary on Principle 2 that, generally ("structure the board to add value"), the board should be structured so

NEDs should provide any information relevant to their independence, with the board then identifying in the annual report's corporate governance statement those directors it considers to be IDs. If the board considers those directors "independent" notwithstanding the existence of relationships listed in Box 2.1, it should provide reasons in support of this conclusion. The Second and Third Editions state that such relationships should then be disclosed in the annual report. Despite the board's ultimate discretion to declare those directors affected by the Box 2.1 relationship factors as "independent," these relationships have had a significant impact on corporate practice. In making such assessments, the Commentary to both the First and Second Editions emphasize the importance of boards evaluating "materiality thresholds from the perspective of both the company and its directors, and to disclose these." A footnote to that text provides one example.[146]

The Third Edition omits this specific example of a materiality threshold, reordering and rephrasing the Recommendations and Commentary, but essentially retains the same approach as the earlier editions. Recommendation 2.3 calls for the company to identify those directors adjudged as IDs, and to disclose if and why that assessment

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that it "encourages enhanced performance of the company," as well as exercising independent judgment, reviewing and challenging management, and properly understanding and dealing with current and emerging business issues.

[146] *Id.* at 16 n.11 ("For example, a board may decide that affiliation with a business which accounts for, say, less than X% of the company's revenue is, as a category, immaterial for the purpose of determining independence. If the company discloses the standard it follows and makes a general statement that the relevant director meets that standard, investors are better informed about the board's reasoning.").

has been made notwithstanding the existence of a Box 2.3 factor. It also requires disclosure of "the length of service of each director."[147] The "materiality" of the relationship is still mentioned, but in the Box itself (detailing the list of interests of relationships that "might cause doubts" about a director's independence), rather than in the Commentary itself. The assessment depends on the extent of interference with the director's capacity for exercising independent judgment "and to act in the best interests of the entity and its security holders generally."[148] The Commentary also talks about IDs not being "allied with the interests management, a substantial security holder or other relevant stakeholder," and cautions how this "appellation . . . gives great comfort to security holders and [is] not one that should be applied lightly."[149] Table 3 summarizes the relevant considerations that may compromise a director's independence, thus calling for board assessment.

Table 3: Changes in ASX Principles and Recommendations Regarding IDs

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[147] ASX Third, *supra* note 32, at 16; ACSI 2013, *supra* note 42 (finding that the average (and median) tenure of NEDs, which is significantly higher for men than women, increased for ASX 100 companies from 5.6 in 2011 to 5.8 years in 2012 (median 4.7), as well as for ASX 101-200 companies).
[148] *Id.* at 16 (Box 2.3).
[149] *Id.* at 16. The Commentary adds a duty on candidates for directorships – seemingly not just for NED positions – to "disclose to the company all relationships or interests that may bear on independence," which in turn should be disclosed to shareholders in materials for board elections. *Id.* at 17.

First Edition (2003) Box 2.1[150]	**Second Edition (2007) Box 2.1**	**Third Edition (2014) Box 2.3**
1. substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company	1. [same as the first edition]	1. [similar to the 2nd edition, but omits being '*directly*' associated with 'security holder', rather than 'shareholder']
2. within the last three years has been employed in an executive capacity by the company or another group member, *or been a director after ceasing to hold such employment*	2. [essentially the same: 'is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the	2. [very similar, but refers to the company's 'child entities' rather than a 'group member']

[150] Only the First Edition lists these relationships in the negative, defining an ID to be an NED ("not a member of management"), which is not a substantial shareholder, an employee, etc. ASX First, *supra* note 96, at 20.

	board']	
3. has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided	3. [same]	3. [similar, but refers to "partner, director *or senior employee* of a provider of material professional services to the entity or any of its child entities"].
4. is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer	4. [same]	4. [quite similar, but adds having "been *within the last three years*" in a "material business relationship (e.g. as a supplier or customer"]
5. has a material contractual relationship with	5. [same]	5. [very similar, but refers to the company's "child

the company or another group member other than as a director of the company		entities" rather than a "group member"]
6. *has served on the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company*		6. *has been a director of the entity for such a period that his or her independence may have been compromised*
7. *is free of any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company*		
		7. has close family ties with any person who falls within any of the

		categories described above

This comparative analysis (with different editions' provisions italicized for emphasis) demonstrates strong similarities over time, but the Third Edition reflects tightened criteria.[151] That is particularly evident with respect to associations with professional services providers and business partners of the company. The Third Edition also incorporates "close family ties" into the Box. This is yet another example of a relationship that "might cause doubts" about the director's independence, thus triggering the disclosure and reporting obligations discussed above. The earlier editions merely set out Commentary that: "Family ties and cross-directorships may be relevant in considering interests and relationships which affect independence, and should be disclosed by directors to the board."[152] The elevation of "family ties" in the Third Edition into the Box, however, appears qualified. A careful reading reveals that the Third Edition only refers to "close" family ties. More curiously it is silent on any reference to potential problems with cross-directorships.[153] Arguably, such relationships may be captured by the catch-all definition in the

151 For a broader comparison of changes in the Corporate Governances Council's Recommendations from the Second Edition to the Third Edition, see *Translation Table Corporate Governance Council Recommendations (New to Old)*, ASX CORPORATE GOVERNANCE COUNCIL, http://www.asx.com.au/documents/asx-compliance/translation-table-2014-cgc-recommendations.pdf.

152 Restated in ASX Second, *supra* note 99, at 17.

153 *Cf., e.g.,* Moncrieff, *supra* note 52, *and* Part VII *infra*, including Kiel & Nicholson, *supra* note 45, and Etheridge, *supra* note 40, on interlocks.

Commentary (although the Box itself has not included such a catch-all since the First Edition(see item 7 in Table 3 above).

A broad reference to directors' tenure, conspicuously absent from the Second Edition, resurfaces in the Third Edition. In contradistinction to the First Edition, it is reworded to focus on its possible detrimental impact on independence. The Commentary to the First Edition mentions that: "The UK Higgs Report nominates 10 years in relation to director tenure considerations, but [this] has not yet been adopted in the UK. The Council will continue to monitor developments in other jurisdictions in this area."[154] The 2013 ASX Corporate Governance Council's public Consultation Paper for the Third Edition noted, "Tenure was subsequently dropped from Box 2.1 in the 2nd edition"[155] (without elaboration), but that subsequently, "the UK, Singapore, South Africa and Hong Kong codes have all been amended to recommend that there should be a rigorous review of the independence of those directors who have served more than 9 years."[156]

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[154] ASX Second, *supra* note 99, at 21.

[155] ASX CORPORATE GOVERNANCE COUNCIL, REVIEW OF THE CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS: CONSULTATION PAPER 11 (Aug. 16, 2013), www.asx.com.au/documents/asx-compliance/cgc-3rd-edition-consultation-paper.pdf.

[156] *Id.* at 11-12 (citations omitted) (*e.g.,* to the Singapore Code Guideline 2.4 [maximum of 9 years] and Hong Kong Code Provision A.4.3 [9 years]); Thomas Ritchie, *Independent directors: Magic Bullet or Band-Aid?*, BOND U. CORP. GOV. E JOURNAL 6 (2007), http://epublications.bond.edu.au/cgi/viewcontent.cgi?article=1004&context=cgej (remarking that the ASX's Consultation Paper in 2006 had suggested that length of service should be viewed as an issue relating to succession, not independence of the board. Ritchie also notes that U.S.

This controversial "9-year" tenure was featured in an early draft of the Third Edition, but the ASX Corporate Governance Council did not adopt this proposal. The Council was evidently aware of the controversy this was likely to engender as the accompanying review tentatively suggested the 9-year service period as a possible "indicator,"[157] militating against independence. The Third Edition now refers to a director serving "for such a period that his or her independence may be compromised,"[158] with the Commentary explaining that:

> the Council recognises that the interests of a listed entity and its security holders are likely to be well served by having a mix of directors, some with a longer tenure with a deep understanding of the entity and its business and some with a shorter tenure with fresh ideas and perspective. It also recognises that the chair of the board will frequently fall into the former category rather than the latter.
>
> The mere fact that a director has served on a board for a substantial period does not mean that he or she has become too close to management to be considered independent. However, the board should regularly assess

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and European models around that time, the first edition of the ASX Principles were also distinctive in having a catch-all provision and stricter criteria regarding employment with a company consultant, but looser criteria regarding being an employee in that only those working "in an executive capacity" may lack independence.).

[157] ASX Third, *supra* note 32, at 2 [9].

[158] *Id*. at 16, Box 2.3.

> whether that might be the case for any director who has served in that in that position for more than 10 years.[159]

This compromise may well be in response to the stiff opposition from directorial lobbies and other interest groups. For instance, the AICD, which has long opposed the ASX's indicative list of factors informing the question of directorial independence, is particularly critical of the re-emergence of tenure as a factor that might inform the question of directorial independence. In its submission to the ASX Corporate Governance Council, the AICD rejected this move and was scathing of any references to "arbitrary time limits." The submission also warned that the ASX's approach here "fails to acknowledge the benefits" of long-serving directors, such as: continuity of organization-specific knowledge (of greater importance in complex industries), greater board stability, and improved board dynamics and collegiality.[160]

Although it is tempting (and too convenient) to characterize this concession as a panicky capitulation to the strong resistance by director lobbies and other vested interests, there may be more at stake here. In fact, the status quo may reflect efforts to accommodate the significant

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[159] *Id.* at 17.

[160] *Submission on Revised Corporate Governance Principles and Recommendations*, AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS 6-7 (Nov. 14, 2013), http://www.companydirectors.com.au/~/media/Resources/Director%20Resource%20Centre/Policy%20on%20director%20issues/2013/AICD%20%20submission%20on%20revised%20Corporate%20Governance%20Principles%20and%20Recommendations.ashx.

increase in ID numbers brought about by the ASX corporate governance initiatives since 2003. Put another way, the ASX's backing down may also be tacit acknowledgment of the lack of supply of appropriately qualified directors. Of course, these reforms, and the stark reality of a (supposedly) thin director labor supply market, combine to generate a large group of incumbents – a group that includes a significant cohort of "professional IDs" – who may not wish for their independence to be so rigorously assessed with respect to length of tenure (see Part II above).

Interestingly, in the subsequent main AGM season in 2014, major proxy voting advisory firms continued to highlight the problems associated with lengthy ID tenure. For example, ISS recommended that after twelve or more years, a director could be classed as no longer independent. Together with CGI Glass Lewis, it also opposed the re-election of Rowena Danziger to the Crown Resorts board, arguing she was a "non-independent director on a board that is non-majority independent," because she was a seventeen-year veteran of Packer family-dominated company boards and a family friend. Concerns also went beyond major family-dominated companies (such as Ramsay Health Care and Harvey Norman). Both proxy advisory firms also recommended against re-electing Peter Warne to the board of ASX, which he had sat on along with its merged entity, Sydney Futures Exchange, for twenty-four years.[161]

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[161] Georgia Wilkins, *It's AGM Season and Directors are in the Cross-Hairs as Shareholders Chase Answers*, SYDNEY MORNING HERALD 8 (Sept. 27, 2014). Ulysses Chioatta, governance expert and former head of ISS, maintains that directors with a "no" vote "over 10% is a vote of no confidence" and it's a "huge reputation blow. Most directors always get re-elected with 95% plus."

They were concerned also about "overboarding" (holding too many directorships) both generally and in this particular case. Warne sat on the boards of two other major listed companies, and chaired boards in two more – with each chairmanship considered by CGI as equivalent to two regular board memberships. According to CGI, holding more than five directorships is undesirable "overboarding," and this becomes particularly troublesome during sudden increases in corporate activity (e.g. a takeover attempt).[162]

Next we discuss how the "substantial shareholder" relationship can potentially compromise independence. While this is mentioned in all three editions of the ASX Principles (as in the original Bosch Report of 1991), the Third Edition no longer includes a footnote cross-reference to the definition in the *Corporations Act 2001* (Cth) (5%).[163] It also adds the following new Commentary:

> In relation to the fourth example in Box 2.3 (being or being an associate of a substantial security holder), the holding of securities in the entity may help to align the interests of a director with those of other security holders, and such holdings are therefore not discouraged. The example simply reflects that

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[162] Stephen Letts, *Shareholder Activists Target Long-serving and Over-committed Directors*, ABC NEWS (Oct. 19, 2014), www.abc.net.au/news/2014-10-17/shareholder-activists-target-long-serving-directors/5821122.

[163] *Cf. e.g.*, ASX Second, *supra* note 99, at 13 n.13, referring to section 9 of the *Corporations Act* (still otherwise applicable and defining "substantial holding" as 5% or more of the total number of votes attached to voting shares).

> a director holding or representing a substantial stake in the entity is likely to be seen as having a different interest to security holders with smaller stakes.[164]

The Council here appears mindful of critiques from financial economists, such as Professor Peter Swan, who argue that the "if not, why not" approach of the ASX Principles towards requiring a majority of IDs has caused a decline in corporate performance.[165] Swan, a long-time trenchant critic of the ASX Corporate Governances Principles on ID "requirements," is especially critical of the 5% "substantial shareholder" (or their associates) "rule" (discussed further in Part V). These criticisms, it seems, have served as a catalyst for ACSI's first collation of director shareholdings in ASX-listed companies. That study reports that 11.5% of NEDs of ASX 100 companies had "no skin in the game" (no shares in the companies they govern), which is described as a "concerning statistic."[166]

A final subtle difference in the Third Edition is that it no longer footnotes the fact that its Box factors have been "adapted" from the definition given in guidance for fund managers (and others) from their peak body in Australia, the so-called "Blue Book" developed by the Investment and Financial Services Association (IFSA).[167] IFSA is now called the Financial Services Council, and still promotes a Blue Book. Its definition for IDs bears close parallels to the

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[164] ASX Third, *supra* note 32, at 17.
[165] Fischer & Swan, *supra* note 25.
[166] ACSI 2012, *supra* note 38, at 3 (33-5. 21% of ASX 101-200 NEDs had no shares).
[167] *See, e.g.*, ASX Second, *supra* note 99, at 17 n.12.

current ASX Principles.[168] Investors may also wish to consider the guidance offered by another major peak association, ACSI, which has recently outlined indicia (reproduced in Table 4) for assessing independence (albeit on a "case-by-case basis").

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[168] *Cf. Corporate Governance: A Guide for Fund Managers and Corporations*, INV. & FIN. SERVS. ASSOC. 18 (2009), http://www.fsc.org.au/downloads/file/IFSAGuidanceNotes/2GN_2_ Corporate_Governance_2009.pdf (referring to being associated "directly or indirectly" with a substantial shareholder, or having been an "employee," not even a "senior employee," of a material professional adviser or consultant to the company). This Blue Book also highlights potential issues in holding multiple directorships, although not focused solely on IDs and without recommending a precise maximum number. Commentary on Recommendation 2.1 of the Third Edition ASX Principles requiring a remuneration committee requires it to review time required from NEDs, who must make disclosures before accepting other directorships requiring significant time commitments. ASX Third, *supra* note 32, at 15.

Table 4: ASCI's Criteria for Determining Independence [169]

A non-executive director should be independent…	Factors that may compromise independence
… of executives and advisers	Employment in the past 3 years
	Senior employment by a significant professional adviser in the past 3 years
… of substantial shareholders	Ownership of over 5% of the voting rights in the company's shares
	An officer, director, representative or employee of such a shareholder
… of the company's investments	A director or employee of another company in which the main company has invested more than 5% of the share capital
… of customers, suppliers and other service providers	A major supplier or customer to the company (or their representative or executive)
	A material contractual relationship with the company
	Receiving fees for services to the company at a level indicative of either significant involvement in a company's affairs, or are significant in relation to the salaries received by directors
… of relationships which may impact decision-making	Relationships (including other directorships) that could be (or be perceived to be) capable of materially interfering with acting in the company's best interests.
	Benefiting from a related party transaction
… of incentive pay	Participation in performance incentive schemes, including options that are also granted to executives.
… from a relationship with a related-party	Spouses, de facto spouses, parents, children of affiliated directors, executive directors, senior executives and advisers
… in a takeover bid	Participating in the bid for the counterparty (either as buyer or seller).
… due to an appropriate length of board tenure	There is no firm threshold for when the length of a directorship affects independence. It is assessed on a case-by-case basis.

169 *ACSI Governance Guidelines: A Guide for Superannuation Funds to Monitor Listed Australian Companies*, ACSI 15 (July 19, 2013), http://acsi.org.au/images/stories/ACSIDocuments/2013%20ACSI%20 Guidelines.pdf.

On their face, the ACSI criteria are more detailed and stringent than the ASX factors. Length of tenure, however, is not specified. Nevertheless, in ACSI's 2013 board composition survey, 20+ years seems to be used as one threshold for determining whether directors are "affiliated," as opposed to being independent.[170] That study went on to explain that this was:

> based on the classification by ACSI of directors, which can differ from that of the company. For example, Woodside in its 2012 annual report classifies as independent former Shell executive Christopher Haynes, who retired in 2011, despite Shell owning 23% of the company's shares and having nominated Haynes to the board. ACSI classified Haynes as affiliated. These cases illustrate that the ASX Council's guidelines on assessing director independence, unlike the rules of foreign stock exchanges such as the NYSE, allow for considerable exercise of judgement by company boards when assessing director independence.[171]

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[170] ACSI 2013, *supra* note 42, at 9-12 ("Prior to 2005, ACSI classified all directors with more than nine years' service on a board as affiliated and from 2005 only those directors who had spent more than 20 years on a board were considered affiliated (the change in definition was effective from the second edition of the ACSI Guidelines, released in 2005).").
[171] *Id.* at 11 (citation omitted).

V. ASSESSING THE IMPACT AND ROLES OF IDS IN AUSTRALIA

How effective has the gradual increase in IDs on listed company boards in Australia (especially in larger companies post-2003) been? When the ASX initially proposed a mandatory requirement (in 1992), and then a U.K.-style comply-or-explain regime (in 1994), many commentators queried whether IDs would make much difference in practice. The ambiguous U.S. empirical evidence concerning the impact of IDs on overall corporate performance was also highlighted.[172] The ASX later compromised by introducing a more relaxed disclosure regime in 1996, as outlined in Part III above. Naturally, it took several years for Australia-specific empirical research on IDs to emerge.

A. ECONOMETRIC STUDIES OF NED OR ID IMPACT ON CORPORATE PERFORMANCE IN AUSTRALIA

Quantitative studies investigating the (in)efficacy of IDs have produced ambivalent results. Table 5 below sets out a selective assortment of econometric studies investigating the impact of IDs on corporate performance in Australia.

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[172] Bird, *supra* note 31, at 255-8.

Table 5: ID Impact on Corporate Performance

Study	*Sample size (and year)*	*Definition of directors*	*Firm Performance*	*Impact*
Muth & Donaldson (1998)	largest 145 from 550 sampled from 1173 listed ASX companies (1992)	Composite "board independence"[173]	1993-4	**negative** for composite shareholder wealth (ROA and ROE) and sales growth
Lawrence & Stapledon (1999)	ASX 100 (1995)	IDs (as per AIMA / IFSA in 1997)	1985-1995	**nil**
Cotter et al. (2003)	ASX 200 (1997)	IDs (as per AIMA)	1997	**nil**
Kiel & Nicholson (2003)	348 from ASX 500 (1996, excluding banks and mining firms)	NEDs	1996-98 (averages)	**positive** for Tobin's Q but **negative** for ROA
Hutchison (2002)	229 from ASX 500 (1998)	NEDs		**negative**[174]

[173] Proportion of NEDs; interest alignment (relationships with executives, suppliers etc., significant shareholders, family members & founders); CEO duality; board size; average age.

[174] Marion Hutchinson, *An Analysis of the Association Between Firms' Investment Opportunities, Board Composition and Firm Performance*, 9 ASIA-PACIFIC J. OF ACCT. & ECON. 17 (2002) (analyzing 229 ASX 500 firms in 1998). Hutchinson also found that growth firms tend to have executive boards but that those firms performed better with more NEDs.

Matolcsy et al. (2004)	306 from sample of largest 507 companies (2001)	Outside NEDs (including "gray directors" with "potential links to the managers … such as bankers or lawyers")	1999-2001	**positive** for composite Market Value but only for firms with above-average "growth options" (market to book value)
Bonn et al. (2004)	104 manufacturing firms from the top 500 companies (1998)	NEDs	1999	**positive** only for ROA (contrasting Japan: nil for Market to Book value)
Setja-Atmaja (2009)	316 from ASX (1998, excluding banks)	IDs (but not as per ASX Principles 2003)	2000-05	**positive** for closely-held firms, and overall (with greater impact for closely-held firms or those paying low dividends)[175]
Pham et	136 largest	NEDs (not	1994-2003	**positive** for

[175] Closely-held companies were defined as those with a shareholder with more than 20% ownership. They preferred fewer IDs and underperformed widely-held companies, suggesting "rent extraction" from the larger shareholder(s). *See also* Kang et al., *supra* note 83, and Pham et al., *supra* note 48, at 90.

al. (2012)	ASX (excluding financial and utility companies)	current or former employees, or related by family to executive directors or with business dealings)		cost of capital
Fischer & Swan (2013)	ASX 500 (2001-11, so 969 distinct firms)		2001-11	**negative** (and other effects summarized below)
Swan & Forsberg (2014)	ASX 200 (2002-12), so 430 distinct firms		2002-12	**negative** (and other effects summarized below)

Generally speaking, the evidence supporting the proposition that IDs are responsible for improvements in overall corporate performance or value is not strong. However, there are various methodological difficulties with these studies, including:

- Some studies only focus on NEDs, while others distinguish between IDs and NEDs, albeit with varying definitions;
- The time periods and sample sizes for firms are generally limited, thus impacting on robustness of the results;
- Studies often do not refer to earlier research, perhaps because they were published too close together or simply overlooked, often resulting in different control variables exacerbating difficulties in comparing studies;

- All such econometric studies also have serious limitations regarding measurement of key variables (including measures of corporate performance, such as Return on Assets or ROA, as the dependent variable),[176] and especially endogeneity between the independent and dependent variables (including the extent of IDs).

Such endogeneity is particularly troublesome because companies that do poorly tend to appoint more IDs (and vice versa). To test for causation under such circumstances, ideally we need a mandatory rule change that forces all companies (good and bad performers) to adopt IDs. The ASX Principles and Listing Rules, as outlined above (Part II), instead leave scope for board and company discretion (at least regarding the "majority of IDs" requirement). Even though Listing Rules have for some time mandated IDs for audit committees (since 2004) and remuneration committees (since 2011) for certain listed companies, designing a convincing econometric study that assesses board independence here is proving particularly difficult. Consequently, none have been published in Australia.[177]

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[176] Tobin Q, for example, is a theoretical concept that needs to be approximated. It assumes that current market prices are an effective measure of corporate value – a proposition that became much more contestable after the GFC, although the allure of the associated "efficient markets hypothesis" remains remarkably strong. *Cf.* JOHN QUIGGIN, ZOMBIE ECONOMICS: HOW DEAD IDEAS STILL WALK AMONG US (2010) (critiquing the idea).

[177] We thank Professor Ron Masulis (Professor Swan's colleague at UNSW) for the helpful discussion (June 6, 2014) regarding these methodological issues.

This endogeneity problem remains serious for the large-scale econometric study of ASX listed company performance publicized in 2013 under the leadership of Professor Peter Swan.[178] The fact that the introduction of the 2003 ASX Principles constituted only a "quasi-natural experiment" lessens without completely destroying the impact of his controversial key conclusions:

> majority board independence reduces firm performance regardless of whether the criterion is shareholder value in terms of the Tobin's *Q* or Market-to-Book ratios, or accounting performance as measured by the industry-adjusted ROA. We also find that boards once they become dominated by independent directors are far poorer at replacing a relatively under-performing CEO, pay poorly performing CEOs significantly more, and take home significantly higher director fees . . . We estimate the dollar cost of these treatment effects over the period 2003-2011 conservatively at AUS $69 billion, making it one of the most costly and disastrous

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[178] Gavin Smith, Peter L. Swan, & David R. Gallagher, *Institutional Investor Monitoring and the Structure of Corporate Boards*, (Oct. 2, 2007) (unpublished paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=939441 (curiously noting that institutional influence was negatively related to board size and positively related to board independence, with institutions working to remove inside directors (thus increasing the proportion of NEDs and IDs) if firms performed badly).

> regulatory changes ever implemented in Australia by a private regulator.[179]

The study by Swan, which was particularly critical of the ASX Principles' view that independence could be compromised by associations with a major shareholder, has attracted largely unfavorable responses.[180] Initially, on August 28, 2013, the politically conservative, Murdoch family-owned newspaper, *The Australian*, reported that:

> Simon Marais, chief investment officer at fund manager Allan Gray, was unsurprised by the findings and considered the existing rule "ridiculous". He said: "The best director is someone who has as much money at stake as possible in the company."
>
> "What is important," Professor Swan added, "is independence from management, not from the owners." Over the nine-year period, total chief executive pay roughly doubled to $2.2 million at the companies that enacted more "independent" boards, and non-executive director fees were almost $45,000 a year higher.
>
> "If you owe your position to the CEO would you be hard on him?" Mr. Marais said.
>
> Professor Swan blamed the "ludicrous" rule for contributing to a "catalogue of

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179 Fischer & Swan, *supra* note 25, at 9. This estimated "cost" however, should be contextualized in light of the ASX's current market capitalization of around $1.5 trillion.

180 *Cf.* Austin, *supra* note 26.

corporate disasters", citing Fairfax, Qantas and Rio Tinto in particular. "Rio has 14-odd directors sitting in London all divorced from the reality of the Australian business," he said.

"When the stock price plummets due to poor monitoring, a director with negligible shareholding feels less pain than does a substantial shareholder." Mr. Marais decried the inertia and lack of investor discipline applied to local boards. "It's often like the old Soviet elections when investors have a choice of six candidates for six positions," he said.

The share of independent directors at top 200 companies has jumped from less than 10 per cent in 2002 to about 60 per cent today. "They solved the 'principle agent problem' by destroying the principle," Professor Swan quipped, alluding to the theory that explains why managers (the agent) of a firm are able to profit at the expense of the owners (the principle).

Ian Ramsay, professor of corporate governance at Melbourne University, said skills, expertise and experience were more relevant criteria than "independence" per se.

But he said there was "no simple answer", suggesting the existing rules were in any case guidelines and did not need to be changed: "The quality of decisions of directors with substantial wealth tied up in the company may also not be in a company's best interests." Under the auspices of improving corporate governance, stock exchanges in the US and Europe began in the early 2000s

> insisting that listed firms had boards with a majority of independent directors, following the high-profile collapses of US giants Enron and WorldCom.
>
> "It's amazing regulators cite these examples as justification for independent directors when those companies in fact had majority independent directors," said Professor Swan, who said the ASX deserved credit for making the independent director rule optional.
>
> An ASX spokeswoman said it continually reviewed its rules and was open to improvements.[181]

The next day, however, the same reporter presented more negative reactions to Swan's study:

> The Australian Institute of Company Directors and the ASX said yesterday "compositional factors" made it very difficult to reach UNSW finance professor Peter Swan's conclusion that ASX-listed companies that had boards with a

[181] Adam Creighton, *Shareholders Suffer as Independent Directors Pay Fat Cats*, THE AUSTRALIAN 19 (Aug. 28, 2013), www.theaustralian.com.au/business/companies/shareholders-suffer-as-independent-directors-pay-fat-cats/story-fn91v9q3-1226705307903#; *see also*, Serkan Honeine & Peter L. Swan, *Is Company Performance Dependent on Outside Director 'Skin in the Game'?*, (2010) (unpublished paper) (finding a significant positive relationship between NED ownership and firm performance, especially during the GFC where endogeneity effects might arguably be less).

majority of independent directors had destroyed $70 billion in shareholder value and overseen a doubling of chief executive pay.

Kevin Lewis, the head of compliance at the ASX, said the number of successful small mining firms in the past decade, which were typically too small to have independent directors, would probably distort any such study.

"And the big four banks didn't do well during the period of the GFC, and they had boards with a majority of independent directors," he said.

"Peter Swan's view of corporate governance appears to be a long way away from global best practice," he added, citing rules mandating "independent" boards in US and European jurisdictions and pointing out that the ASX Corporate Governance Council, which includes shareholder groups, recommended the 2003 guidance which led to more boards with independent directors.

Steven Burrell, a spokesman for the [Australian Institute of Company Directors], said bigger companies were more likely to have independent boards and bigger firms inevitably paid their directors and management more.

"Obviously independence is not the be-all and end-all of corporate governance; directors with skin in the game are clearly desirable, but we support the status quo," he said.

"*Directors with a large shareholding in a*

> *company can compromise the interests of small shareholders*," he said, pouring cold water on the argument that more directorial "skin in the game" promotes better decisions.
>
> Andrew Jackson, head of research at Vinva fund management, said: "The current level of ownership by independent directors in Australia is very low. For instance, directors own less than 0.10 per cent of the company for the majority of ASX300 stocks -- which is a bit disappointing.
>
> "All else equal, we would prefer that independent directors have skin in the game via a material direct holding in the company they direct."[182]

The italicized comments by Burrell above are apposite in light of Australia's "blockholder" legacy.[183] An early and small-scale econometric study by Setja-Atmaja found a

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[182] Adam Creighton, *ASX, Directors Dispute Claims Execs to Blame*, THE AUSTRALIAN 27 (Aug. 29, 2013) (emphasis added). However, the following week Creighton returned to a familiar tune, that is, decrying the growth of independent directors on Australian boards and advocating, much like Professor Swan, for a "costless change in regulation" by removing the requirement that IDs remain unconnected through the 5%+ shareholding criterion. In so doing, he described Professor Swan as "[o]ne of the few Australian economics professors of international standing" and his study as "one of the more remarkable academic studies in Australia." *See* Adam Creighton, *Independent Directors a Bad Idea*, THE AUSTRALIAN 32 (Sept. 6, 2013).

[183] Robert Baxt et al., *Corporate Governance in Australia: The Evolving Legal Framework and Empirical Evidence*, *in* CORPORATE GOVERNANCE: AN ASIAN-PACIFIC CRITIQUE (Low Chee Keong ed., 2002).

positive impact from IDs on closely-held companies or those paying low dividends (a policy that may favor blockholders, because they can extract value in other ways).[184]

Putting aside the question of how IDs might help mitigate agency costs between large and dispersed shareholders, recent studies have investigated the supposed wealth destruction caused by majority independent boards in Australia. In contrast to the results found by Swan, earlier Australian studies – despite their limitations – indicate neutral or even some positive effects associated with the growth of IDs (see Table 5 above). A recent study by Swan's colleague at the UNSW School of Business, Professor Ron Masulis, also found a significant positive impact of monitoring of CEOs (turnover), after the 2002 SOX legislation in the U.S. mandated all IDs for audit committees.[185] In addition, recent meta-studies from around the globe tend to find no significant effects from IDs on overall corporate performance,[186] in contradistinction to the overwhelming negative effects found for Australia by

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[184] Lukas Y. Setia-Atmaja, *Governance Mechanisms and Firm Value: The Impact of Ownership Concentration and Dividends*, 17 CORP. GOVERNANCE: AN INT'L REV. 694 (2009). *See generally* Nottage, *supra* note 14 (discussing blockholder, as well as the Crown example regarding executive remuneration referenced above in Part III).

[185] Lixiong Guo & Ronald Masulis, *Board Structure and Monitoring: New Evidence from CEO Turnovers*, 28 REV. FIN. STUD. 2770 (2015), http://rfs.oxfordjournals.org/content/28/10/2770.full.pdf+html.

[186] *See* Margret Blair, *Making The Hard Call: The Unheralded Role of Corporate Boards of Directors*, YOUTUBE (Jan. 30, 2014), www.youtube.com/watch?v=VgwThLU8478 (providing further references and arguing that the lack of statistical correlation instead supports her "team production theory" of corporate governance).

Swan.[187] Moreover, earlier work by Swan had acknowledged studies showing that IDs at least "have been shown to

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[187] Interestingly, Professor Swan, a staunch advocate of free market principles and a long-time skeptic of mandatory corporate governance compliance regimes, has also written in support of "super-voting shares" first touted by Rupert Murdoch's Newscorp. *See, e.g.*, Peter L. Swan & G. Garvey, *Response to the Australian Stock Exchange's Discussion Paper on Appropriate Voting Rights for Equity Securities*, 9 COMPANY & SEC. L. J. 158 (1991) (expressly acknowledging that the underlying study was commissioned by News Corporation) and Peter L. Swan, *"Why Super Shares Can Be Vital Tools in the Creation of Wealth"*, AUSTL. FIN. REV. (May 19, 1994). Though a critic of what he has described as "largely uninformed and unmotivated independent directors . . . responsible for [$70 billion in] value destruction," he has offered some qualified support for the ASX's "if not, why not" regulations, if only because the ASX does not require "complete compliance." *See* Peter L. Swan, *Boards Must Change*, THE AUSTRALIAN 23 (Sept. 5, 2013). Professor Swan went as far as characterizing the ASX's definition of IDs as a "communistic desire to lock out significant shareholders" from participation in corporate management. Elsewhere, Swan again argues this disconnect between ownership and control created by ASX ID rules "is the most ludicrous rule since capitalism was invented. It's pure Soviet Union-ism, command and control." *See* Peter L. Swan, *Skin in the Game: Is Board Independence Destroying Firm Value?*, U. N.S.W., BUS. SCH. (Oct. 13, 2013), https://www.businessthink.unsw.edu.au/Pages/Skin-in-the-Game-Is-Board-Independence-Destroying-Firm-Value.aspx. *See also* Peter L. Swan, *The ASX Governance Council and "Independent" Boards*, 8 L. & FIN. MKT. REV. 196 (2014). Swan's views appear to be deeply held, and have predictably found a sympathetic ear in the newspaper owned by Newscorp. *See, e.g.*, Peter L. Swan, *Independent Directors Don't Help Investor Cause*, THE AUSTRALIAN 28 (Apr. 19, 2011). In that opinion piece, Professor Swan launched his crusade against the so-called 5% rule:

An independent director is one who is not a substantial shareholder owning 5% or more, has not been employed in an executive capacity within the last three years, and has not been a principal of a material professional adviser or a material consultant to the company within the last three years. These characteristics collectively help to provide an episodic monitoring function, by benefiting shareholders in extraordinary or crisis situations."[188]

Nonetheless, Swan (curiously with a new co-author) updated this econometric study with a new data set in late 2014. Once more, the findings lambast ID "performance" in Australian listed companies. He contends that ASX 200 companies with majority ID-led boards have "destroyed between $30.7 billion and $51.6 billion of shareholder value over the period 2002-2012."[189]

Perhaps due to the strong vested interest now among incumbent IDs (anecdotally referred to as the "chosen ones"),[190] as well as peak bodies like the AICD that became

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define ignorance of company affairs and lack of motivation – negligible "skin in the game." Swan went on to mention Lachlan Murdoch and how the latter's then 9% holding in Network 10 disqualified him from being an ID.

188 Smith, *supra* note 174, at 7.

189 Swan & Forsberg, *supra* note 41, at 30. In this latest study, Swan has yet again revised downwards the supposed destruction of "shareholder value" attributable to majority ID-led board. *Cf.* Peter L. Swan, *Submission to Financial System Inquiry*, FIN. SYS. INQUIRY (Mar. 31, 2014), http://fsi.gov.au/files/2014/04/Swan_Peter.pdf (estimating $85 billion over the period 2002–2012).

190 *Cf.* PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES, BETTER SHAREHOLDERS – BETTER COMPANY SHAREHOLDER ENGAGEMENT AND PARTICIPATION IN AUSTRALIA, § 4.76 at 59 (2008), www.aph.gov.au/binaries/senate/committee/corporations_ctte/shareh old/report/report.pdf (arguing more generally that "board patronage and dominance by an entrenched few is unhealthy for good corporate governance" and urging that processes for electing directors in Australia could be "substantially improved"). The former Chief Justice of NSW publically suggested that institutional investors should promote a list of potential professional IDs, picking up a proposal from Professors Gilson and Kraakman in the U.S. (originally in 1991, revived in 2009 with

increasingly involved in training them and promoting their interests over the 1990s,[191] the ASX Council decided against relaxing ID disclosure requirements in its Third Edition Principles (Part V). If anything, the requirements were slightly tightened. However, Commentary was added about the possibility of shareholder links with directors instead creating some positive benefits, along with some more flexible disclosure provisions, especially for smaller listed companies (e.g. regarding audit committees).

B. OTHER EMPIRICAL RESEARCH INTO IDS IN AUSTRALIA

What about other possible effects from IDs, such as reducing the likelihood of corporate collapses? Unfortunately, it is difficult to prove such counterfactuals. Case study research can be illuminating, but little work has been done in Australia. In fact, some prominent corporate failures instead undermine this argument. As mentioned above (Part III), the failed HIH group was notionally an "early adopter" and appeared to have a majority of IDs even before the 2003 ASX Principles were introduced; as did the Centro group, which almost failed in 2007.[192]

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respect to "the directors' guild"), however, this idea has not found traction in Australia. *See* James Spigelman, *Institutional Shareholders and Corporate Governance*, 28 COMPANY & SEC. L. J. 235, 241 (2010).

[191] *See* Bosch Report 1991, *supra* note 28, at 281-82 (also noting the emergence of a significant board consulting industry).

[192] *See generally* D.F. JACKSON Q.C., REPORT OF THE SPECIAL COMMISSION OF INQUIRY INTO THE MEDICAL RESEARCH AND COMPENSATION FOUNDATION (2d ed. 2004) (the HIH board had 13 directors of whom five were executive and eight were NEDs, but some of those were arguably not IDs).

Broader *qualitative* research in Australia has also been limited. One study, published in 2008, based on interviews of thirty directors (with multiple appointments, including twenty-four only with NED positions and five with NED and executive director positions), as well as sixteen Australian fund manager executives in Australia, reported that IDs should have the following qualities:

- demonstrate independence of mind, information, relationships with the company, and income;
- be responsible to shareholders; and
- be available, allocating sufficient time for board duties, and appointed for a limited time.[193]

Another survey identified 684 IDs from the top 200 ASX listed companies in 2006 (an average of 3.4 directors per company), but merely secured 143 responses (22.5% response rate). Most respondents (85%) had more than five years' experience as an ID and 41% had served on boards for over ten years, with 66% also having served on more than 5 boards over these periods.[194] Most (81%) had executive experience in one or more companies, and many (61%) viewed themselves as "professional directors."[195]

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[193] One respondent remarked that IDs "should not remain on the board of a particular company for too long . . . we have said ten years is ample." *See* Margaret McCabe & Margaret Nowak, *The Independent Director on the Board of Company Directors*, 23 MANAGERIAL AUDITING J. 545, 558 (2008).

[194] Veljanowski et al., *supra* note 102, at 44. Regrettably, the authors do not mention the average tenure of those directors sitting on the same board.

[195] *Id.* at 44-45.

Unfortunately, such "sample bias" somewhat undermines the respondents' views on the appropriate roles and features for IDs, and corporate governance generally in Australia. It is unsurprising, therefore, that 95% thought that IDs strengthen corporate governance. More interestingly, questionnaire responses were evenly split on whether having IDs would lead to conservative decision-making. 30% thought there was need for a U.K.-style "senior ID" and only 26% thought that international business experience was needed to be an effective ID.[196] Most (90%) preferred the "self-regulatory" approach of the ASX Principles to mandatory requirements, especially in light of diverse needs of companies, the flexibility of guidelines, and, crucially, because independence was dependent on the character or state of mind and is something that could be legislated.[197] The respondents generally favored the ASX Principles' indicia of (non-) independence, including not being a significant customer or supplier to the company, a professional advisor, recent executive, appointment due to a personal relationship, or representing a major shareholder.[198]

The authors add that:

> The only issue upon which the respondents differed was whether an effective

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[196] *Id.* at 47-49. *Cf.* Janice How et al., *Internationalisation and Corporate Governance: Australian Evidence,* 6 ASIA PACIFIC J. OF ECON. AND BUS. 42, 42 (2002) (showing that the degree of a firm's internationalization in Australia had a significant impact on the proportion of IDs with international experience).

[197] Veljanowski et al. *supra* note 102, at 45-51.

[198] *Id.* at 50 (especially Table 6 titled "Qualitative Data on ASX Corporate Governance Principles ID Criteria").

[ID] should not have directorships in common with other directors. Only 10.7% agreed with the proposition while 42.6% of respondents disagreed and 46.7% were undecided. However, this finding is consistent with respondents' views on other matters. The majority of respondents (65.3%) consider that there is a shortage of good people to take on the role of an [ID] and 100% of respondents agree that [IDs] should not be limited to one board. Given these findings whereby multi-directorships are going to be the norm, then common directorships would be expected and difficult to avoid.

Respondents were asked their opinion as to the appropriate tenure period for an [ID]. The majority of respondents (69.3%) did not agree that board tenure should be limited by a prescribed maximum term. In addition, the number of boards that an [ID] could sit on at any one time also received strong responses. All respondents (100%) considered that an [ID] should not be limited to only one board and only 16% of respondents considered that a full-time executive should be limited to only one board. As to the number of boards that an [ID] should be limited to was not as clear cut in the responses. Only 28% of respondents considered limits should be put in place, but when asked if the limit should be no more than five boards respondents' were split with only 45.9% in agreement.[199]

Given such results, it is unsurprising that the Third Edition of the ASX Principles make relatively few changes regarding IDs (as explained in Part IV). But much more research, qualitative and quantitative, could have been and should be done in Australia.

VI. WHERE TO NEXT?

As discussed in Part II.2 above, IDs are now a very prominent and entrenched part of the Australian corporate landscape. Yet, as outlined in Part V, there remains a surprisingly limited empirical foundation behind measures that encouraged IDs in Australian listed companies loosely from 1996 and more extensively (on an "if not, why not" basis) from 2004, as well as mandating IDs on the audit committee and now the remuneration committee. There remains underlying uncertainty as to the primary roles that they (and directors more generally) are expected to play, such as corporate value creation versus risk management (Parts II.1 and III). Some institutional investor analysts in Australia are also privately critical about IDs, suggesting that their "mates" often appoint them and that the significant financial incentives drawn from multiple board appointments lead them "not to rock the boat" (unless a capsize is imminent, resulting in serious and obvious corporate failure, with the attendant reputational damage).

[199] *Id.* at 50.

Such critics consider "industry experience" as being much more important for corporate boards overall (*cf.* Part V.2 above).[200]

Apart from Peter Swan's controversial work claiming wholesale wealth destruction caused by IDs (Part V.1), few other academic studies have seriously questioned the received wisdom about IDs. However, doubts were raised in passing in 1997 and 2003 (as mentioned in Part I above), and more sustained critiques are now emerging in Australia. Even before the GFC, in 2007, two professors of accounting (Clarke and Dean) strongly criticized the independence "dogma":

> Independence continues to be cited as an essential objective of reforms relating to auditors and directors, when it could equally be argued that the expert knowledge required in an ever more complex corporate world is more likely to be characteristic of those immersed in, dependent for their welfare

[200] Personal communication from an experienced investment fund analyst to Nottage on June 29, 2014, adding that a lawyer or accountant ID might still be useful especially for risk management provided the other directors had very strong industry experience. On IDs not "rocking the boat," *cf.* Kathy Fogel et al., *Powerful Independent Directors*, EUR. CORP. GOVERNANCE INST., FINANCE WORKING PAPER NO. 404/2014 (Sept. 2015), and the NAB boardroom brawl and its aftermath in 2004 referenced above in part III. On problems of holding individual directors to account for their decision-making, see PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES, *supra* note 186, §4.73 at 59 (quoting a proxy advisor: "From the outside, it is a very hard thing for an institutional shareholder to work out [whether] 'Is this individual director a great guy [sic] on a board that is a dud?'").

> upon, the affairs of their corporation. Rigging board structures, as some have suggested, to comprise half NEDs continues to be a sought after ideal, though how part-time directors can and will monitor executives' work effectively is yet to be demonstrated. Virtues attributed to having audit committees comprising only NEDs continue to be promoted, notwithstanding the fact that audit committees have been in existence for over sixty years, and have been features of companies involved in spectacular collapses at, for example, Enron, HIH and One.Tel.[201]

These authors also objected to independence being "more often described as the outcome of particular circumstances than it is explained."[202] They argued that a more productive focus would be on honesty, even though this can only be fully determined after the event, whereas back-up criteria of (lack of) independence can seemingly be monitored *ex ante*: "A heavy hand has been used to achieve appearance, when arguably, with effective enforcement, a simple prescription that directors and auditors 'act honestly' would suffice."[203]

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[201] CLARKE ET AL., *supra* note 81, at 44. *See also* FRANK L. CLARKE ET AL., THE UNACCOUNTABLE AND UNGOVERNABLE CORPORATION: COMPANIES' USE-BY-DATE CLOSES IN 65 (2014).

[202] CLARKE ET AL., *supra* note 81, at 48-9.

[203] *Id.* at 50, 60-63. However, this prescription is not as simple as it first appears, *see, e.g.,* Julian Blanchard, *Honesty in Corporations*, 14 COMPANY & SEC. L. J. (1996). Australian corporate law experimented with this formulation in the *Corporations Act 2001* (Cth) SS 232 (Austl.) but has

Such calls to roll back or at least revisit rules promoting directorial independence – hardly "heavy handed" in Australia anyway – were not widespread and soon ran up against renewed concerns about corporate ethics and practices in the wake of the GFC. Australia emerged relatively unscathed from that crisis, but it still had quite a patchy record in enforcing – even through ASIC – directors' duties. The main regulatory response has instead been to require more independence and disclosures associated with remuneration committees (from 2011, especially for ASX 300 companies) and in general for listed companies (under the 2014 ASX Principles, albeit still on an "if not, why not" basis). This is unlikely to surprise Clarke and Dean, who cynically suggested that: "Revamping and rebadging existing arrangements is a common political ploy by professional bodies, governments and their agencies when in crisis. It gives the appearance of there being a positive response to the public discomfort."[204]

More recently, two legal academics based in Australia have also questioned the concept and practicalities of director independence, drawing instead on ethics, philosophy, political science, and psychology to urge a broader or "thicker" version of independence. Le Mire and Gilligan begin by linking this to the philosophical concept of autonomy, and more specifically to "freedom from external influence" and especially "capacity for self-rule" (involving both competence and rational decision-making), with independence being "both an aspect of character and . . .

since reverted to the "good faith" requirement, *Corporations Act 2001* (Cth) ss 181 (Austl.), https://www.comlaw.gov.au/Series/C2004A00818.

[204] CLARKE ET AL., *supra* note 81, at 62.

outward-regarding in that it shapes the way an individual relates to the wider community."[205] Echoing Clarke and Dean, they go on to criticize the "thin" version of director independence evident in the ASX Principles, focused on "structural barriers" to block various relationships that might *negative* independence, but by emphasizing various psychological influences that anyway tend to erode independence (such as "group think" and socialization). Le Mire and Gilligan advocate elaborating and enhancing *positive* features of independence as well, such as:

- 'capacity' (e.g. training, expertise, and continuing professional development);
- 'status' (e.g. identification internally and externally as independent); and
- 'power' (e.g. comprising a majority, meeting separately from other directors, and setting the agenda).[206]

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[205] Le Mire & Gilligan, *supra* note 24, at 450.

[206] *Id.* at 459 (Figure 1). *See also* Wheeler, *supra* note 24, at 182-86 (focusing more closely on psychological research into decision-making, noting that avoiding "group think" is not so straightforward). To illustrate, a recent modification of that theory is that "an essential element is not group cohesion but perceived collective efficiency based on the group's prior success. Translated into the language of boards this looks like an argument for liming the length of service of [NEDs] . . . rather than an argument for using independent to cut through social ties." *Id.* at 185. Wheeler also points out that it is instead in socially cohesive groups, "exactly the sort of boardroom appointments that independence plus is considered to prevent, are more likely to see individuals voice dissent and the group then deal with that." *Id.* at 184.

From this perspective, they favor the more holistic U.K. Corporate Governance Code (as revised in 2010, after the 2009 Walker Review) over the (then, Second Edition) ASX Principles, since the former arguably mandates board satisfaction regarding the capacity and expertise of directorial independence.[207]

The explicit inclusion of "close family ties" and length of tenure (albeit unspecified) as factors potentially compromising independence in the Third Edition ASX Principles (2014) arguably moves in the direction of the U.K. Code (see Part IV above). Despite some rewording, especially in the Commentary, the Principles retain a comparatively "thin" or structural vision of independence.

More recently, Hanrahan and Bednall have picked up such critiques, as well as the particular objection from Swan about possibly undermining "skin in the game," and therefore overall corporate performance. They argue that the independence requirement should be relaxed – but not completely abandoned – with respect to certain shareholdings. They find that about a quarter of ASX 200 firms have a total of 112 directors who are, or are affiliated with, substantial (5+%) shareholders (of whom 109 are declared to non-independent, following the ASX Principles approach), but that 72 (70 declared non-independent) are not associated with what they term "controlling" shareholders. They suggest that the latter cohort should no longer be

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[207] Le Mire and Gilligan then analyze how various soft-law instruments (ASX Principles, U.K. Corporate Governance Code) and regulatory requirements (*Sarbanes-Oxley Act 2002*, NYSE Listed Company Manual) promoting independence deal with a cascading series of relations that can compromise independence. Le Mire & Gilligan, *supra* note 24, at 458-74 (especially Table 1 and 2).

defined as (prima facie) lacking independence, because those directors are already sufficiently constrained with respect to possible conflicts of interest by various other corporate law rules. Furthermore, Hanrahan and Bednall state that the present approach "has a chilling effect on the participation at board level of individuals who have a powerful incentive to act as an effective counterbalance to both management and, where relevant, controlling shareholders."[208] However, it remains to be seen if and when their proposal may be picked up by the ASX Corporate Governance Council, which has only just released a new edition of its Principles, or perhaps by adventurous, individually listed companies who may seek to redefine some directors (affiliated) with smaller shareholdings as nonetheless independent.

A more holistic conception of director independence may gradually emerge as a by-product of the ASX's recently introduced "diversity disclosure" policies. But, as discussed in Part III above, those changes, and the associated highly politicized debates, make surprisingly few direct references to the question of directors' independence. This disjuncture may be because policy makers may now see Australia's IDs framework as self-evidently useful – "mission accomplished" – despite occasional academic critiques, such

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[208] Hanrahan & Bednall, *supra* note 25, at 5. As constraints on partisan (in)action by directors, they include rules on director appointment and dismissal; limits on them participating in certain board discussions and decisions; constraints on directors' conduct; and Australian courts' broad powers to intervene for oppression. For earlier but very general justifications of independent directors in order to regulate serious conflicts of interest, rather than necessarily to improve overall corporate performance, see also Bosch, *supra* note 74; Stapledon & Lawrence, *supra* note 45.

as those mentioned above, and also because it is now underpinned by a sizable cohort of well-connected "professional directors" (Part II). More cynically, switching the reform focus to board "diversity" (though, in effect, currently limited to gender diversity) creates the façade of remedying inadequate corporate governance practices, but without addressing the much more politically difficult questions, such as whether existing corporate accounting standards and practices need a radical overhaul.[209]

This is unfortunate because the IDs question itself is far from settled. Conceptually, it is related to the tension as to whether IDs – and indeed the board as a whole – should focus more narrowly on corporate performance or instead on broader matters such as risk management.[210] The tension was first highlighted in the early 1990s in Australia (Part II above), but it is also relevant to the diversity question. Moreover, Wheeler, writing on initiatives enhancing boardroom diversity in Australia and the U.K., and board independence ("independence plus"), suggests that a "structural solution has been applied to a perceived behavioral problem."[211]

Secondly and more concretely, increasing women representation on boards may well have unexpected effects due to the high preponderance of IDs already in Australia. For example, women currently in full-time middle or senior management, who are already under-represented, may be lured to (part-time, but lucrative) multiple ID appointments. While that might enhance corporate performance (or at least

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[209] *Cf. generally* CLARKE ET AL., *supra* note 84; CLARKE ET AL., *supra* note 74.
[210] *See generally* Dunbar, *supra* note 24.
[211] Wheeler, *supra* note 24, at 182.

have other benefits for the other firm(s)) there may be more far-reaching negative effects for the original firm. More worryingly, Australia may (at least in the short term) end up with more "trophy women" on boards, as in the U.S.[212] Such trends might exacerbate broader potential problems for board independence, such as an unnatural amplification of the "professional directors" phenomenon, increased board interlocks, and IDs' board tenure.[213]

Thirdly, broader empirical, theoretical, and comparative research into issues such as multiple and interlocking directorships in Australia is needed.[214] Direct interlocks may be less frequent than in the past, but cross-directorships no longer draw specific treatment in the 2014 ASX Principles. Interlocks were still significant in the mid-1990s,[215] as well as from 2000-2007.[216] Further, there is also a real possibility of, say, director X serving on board of company A, director Y serving on company B, with both X and Y also serving on the board of company C. Although

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212 Branson, *supra* note 122, at 8-9 (as noted, especially in the U.S.).

213 For large firms in 2001, for example, one researcher found that firm valuation in high-growth firms was significantly negative for IDs with tenure of more than one year, and for IDs with at most two other board positions. Zoltan Matolcsy, Donald Stokes, & Anna Wright, *Do Independent Directors Add Value?*, 14 AUSTL. ACCT. REV. 33, 37-38 (2004)

214 For similar appeals in the United States, *see, e.g.*, Michal Barzuza & Quinn Curtis, *Board Interlocks and Corporate Governance*, 39 DEL. J. CORP. L. 669 (2014).

215 Kiel & Nicholson, *supra* note 45, at 192 (finding an average of around six interlocks per firm in 1996, compared to earlier studies finding around four in 1991 and six in 1986 and the late 1970s).

216 *See also* Etheridge, *supra* note 40 (finding that board sizes and (differently specified) interlocks spiked around 2003, with board networks becoming less connected in recent years).

each of X and Y may well qualify as independent under the ASX Principles, if they get to know each well at company C, this scenario raises corporate governance implications.[217] Also, even if X and Y do not serve together in other companies like C, what if they have or develop close personal or social connections, even via or supplemented by membership of AICD or other bodies that (somewhat ironically) now provide training for IDs? Put briefly, directors may satisfy a company's independence requirements, but through social connections, they may not be independent of each other. As observed by the late Dr. Simon Marais (of the investment firm, Allan Gray), directors are "often friends, they may have worked together before and they're very often known to the CEO before they join the board. All of this is wrong."[218] Such social connections are known to be particularly pervasive in smaller (population) economies,[219] as well as some Asian economies,[220] and therefore may further undermine any

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[217] *Cf.* Moncrieff, *supra* note 52 (focusing more on the potential negative impact on product market competition (*e.g.*, where companies A and B are oligopolistic "rivals")).

[218] Domini Stuart, *The Importance of Independence*, COMPANY DIRECTOR MAGAZINE (Mar. 1, 2014), www.companydirectors.com.au/Director-Resource-Centre/Publications/Company-Director-magazine/2014-back-editions/March/Feature-The-importance-of-independence.

[219] Again, we thank Professor Ron Masulis for this general observation.

[220] For example, in India, 67% of all listed companies with a market capitalization above $50 million USD are family businesses. *See* CREDIT SUISSE, ASIAN FAMILY BUSINESS REPORT 2011 10 (2011), https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=88E4D28A-83E8-EB92-9D56EA529104BFC2.

beneficial effects from having nominally independent directors.

Indeed, some early econometric research in Australia found *worse* corporate performance from *greater* board independence (on a composite measure), but predominantly where those boards *also* exhibited high levels of "network connections." The latter (composite) measure included both *internal connections* (the number of links each director had with other directors on the board, and the highest number of links held by an individual director) and *external connections* (the director's numbers of links with external organizations, and the number of directors from other organizations linked with each member of the focal company's board).[221] An explanation for the observed result may be that directors with high levels of independence from management *and* many connections with other directors and/or outsiders are either too "busy" to concentrate on monitoring and corporate performance,[222] or deliberately make more poor choices to benefit blockholders, non-shareholder stakeholders, or other outsiders.

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[221] Melinda M. Muth & Lex Donaldson, *Stewardship Theory and Board Structure: A Contingency Approach*, 6 CORP. GOVERNANCE: AN INT'L REV. 5, 13, 19, 25 (1998).

[222] *Cf.* Ronald Masulis & Shawn Mobbs, *What Can We Learn from Independent Directors with Multiple Board Seats about Board Monitoring and Corporate Actions?*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE, WORKING PAPER NO. 353 (2013) (finding that even "busy" directors need not be associated with poor oversight and firm outcomes; the latter are instead characteristic of the subset who view the firm as relatively less important for their reputation). *See generally* Adrian C. H. Lei & Jie Deng, *Do Multiple Directorships Increase Firm Value? Evidence from Independent Directors in Hong Kong*, 25 J. INT'L. FIN. MGMT. & ACCT. 121 (2014) (for a look at the subject in Hong Kong).

Still, this represents only one empirical study. A recent analysis of all U.S. directors instead finds that higher firm valuations are associated with "powerful" IDs, defined in terms of their broader "social power" or network connections.[223] An intriguing question is whether such a result is peculiar to countries with more dispersed shareholdings and/or activist institutional investors (as in the U.S.), as opposed to those with more non-institutional blockholders (as is still probably the case in Australia).[224]

Another Pandora's box in Australia is the extent to which listed companies (even the ASX 300) are routinely exempted from minimum requirements for IDs (on audit and now remuneration committees). In other words, the frequency of, and the reasons for, the ASX's "waivers" to its own Listing Rules remain unclear. One commentator contends that such waivers are rather pervasive,[225] but this question also deserves closer empirical treatment.

In conclusion, the foregoing analysis demonstrates that the real aims and achievements of Australian ID

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[223] Fogel et al., *supra* note 195. Other insights from social psychology also suggest how social cohesion can generally *improve* decision-making in group situations. *See* Wheeler, *supra* note 24, at 182-84.

[224] *See* Satheesh Kumar T. Narayanan, *Is the Institution of Independent Directors Irrelevant?: A Critical Inquiry into Why the Institution Has Failed to Lead to Better Corporate Governance*, (Dec. 10, 2012) (unpublished paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2190351 (arguing from an Indian perspective, where shareholdings also tend to be more concentrated, that directors should only be able to have very few ID positions).

[225] Elisabeth Sexton, *ASX Merger Plan Raises Questions of Governance*, THE AGE (Oct. 29, 2010), www.theage.com.au/business/asx-merger-plan-raises-questions-of-governance-20101028-175s7.html (quoting Professor Jennifer Hill).

requirements remain surprisingly under-explored. A closer analysis is warranted not just because this corporate governance issue is of continuing significance for one of the Asia-Pacific region's most active stock markets – whether in terms of minimizing future large-scale corporate failures or more controversially enhancing corporate profitability. A closer analysis is also further warranted, as pursued in this article, because more sustained attention is required to challenge the perceived wisdom concerning IDs due to the important implications for various Asian-Pacific economies that have been strengthening minimum ID requirements. Australia's experience is particularly interesting for those countries experiencing a shift towards more concentrated stockholdings (like the U.S.) because it problematizes whether and how to mandate or encourage directorial independence from substantial stockholders.

APPENDIX: THE CAUTIONARY TALE OF HIH - 'INDEPENDENT' DIRECTORS AS LEMONS

Much has been said[226] and much ink has been spilled[227] over the failure of HIH Insurance Ltd. ('HIH') in

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226 *See, e.g.,* David Knott, Chairman of the Australian Securities and Investments Commission, Address to the Australian Institute of Company Directors, Adelaide (May 23, 2001).

227 *See, e.g.,* Roman Tomasic, *Corporate Collapse, Crime and Governance*, 14 AUSTL. J. OF CORP. L. 183 (2002); Michael De Martinis, *Do Directors, Regulators, and Auditors Speak, Hear, and See No Evil? Evidence from the Enron, HIH, and One.Tel Collapses*, 15 AUSTL. J. OF CORP. L. 1 (2002); Farid Varess, *The Buck Will Stop at the Board? An Examination of Directors' (and Other) Duties in Light of the HIH collapse*, 16 C.L.Q. 12 (2002);

2001, arguably Australia's worst corporate collapse.[228] Billions of dollars of wealth were destroyed, some of HIH's directors and senior management team were thrown into jail,[229] and there were enormous social and economic impacts on various stakeholders (especially employees) and HIH insurance policy holders. Justice Neville Owen's three-volume Royal Commission Report catalogued a cascade of disastrous operational decisions, fraught business expansion, chronic under-provisioning, ineffective auditing,

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COMMONWEALTH OF AUSTRALIA, ROYAL COMMISSION OF INQUIRY INTO THE FAILURE OF HIH INSURANCE, FINAL REPORT, vol. 1-3 (Apr. 18, 2003) [hereinafter HIH Royal Commission], http://pandora.nla.gov.au/pan/23212/20030418-0000/www.hihroyalcom.gov.au/finalreport/index.htm; Jean du Plessis, *Reverberations After the HIH and Other Recent Corporate Collapses: The Role of ASIC*, 15 AUSTL. J. OF CORP. L. 225 (2003); MARK WESTFIELD, HIH: THE INSIDE STORY OF AUSTRALIA'S BIGGEST CORPORATE COLLAPSE (2003); JOHN DOUGLAS MALTAS, THE DEMISE OF HIH: WHAT PART DID FAILED CORPORATE GOVERNANCE POLICIES PLAY? (2005); Gregor Allan, *The HIH Collapse: A Costly Catalyst for Reform*, 11 DEAKIN L. REV. 137 (2006); Roman Tomasic, *The Challenge of Corporate Law Enforcement: Future Directions for Corporations Law in Australia*, 10 U. W. SYDNEY L. REV. 1 (2006).

228 There are various measures by which to determine the magnitude of the collapse, *see, e.g.,* du Plessis, *supra* note 2; *cf.* Paul von Nessen, *Corporate Governance in Australia: Converging with International Developments*, 15 AUSTL. J. OF CORP. L. 1, 9 (2003). On any reckoning, the collapse was huge.

229 Two directors, Rodney Adler and Ray Williams, each received maximum custodial sentences of four and a half years. Of the nine prosecutions ASIC pursued, eight resulted in custodial sentences. *See Media Release, Former HIH Chief Financial Officer Sentenced on ASIC Charges*, ASX (Nov. 6, 2007), http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2007-releases/07-289-former-hih-chief-financial-officer-sentenced-on-asic-charges/.

and limp regulatory oversight. These problems were all caused, and compounded by, poor corporate governance structures.[230] In this connection, the "shambling journey towards oblivion," wrote Justice Owen, had deep roots.[231]

Many used HIH's demise as a clarion call to improve auditor independence, extend corporate liability to senior managers, and, of course, improve corporate governance. However, this brief case study merely draws attention to the endemic dysfunctionality of HIH's board and, in particular, the inefficacy of its pusillanimous non-executive directors. Put bluntly, when viewed through the lens of effective corporate governance, the (notionally) majority "independent" board of then Australia's second largest insurer (but leading general insurance company) showed itself to be a "lemon."

Yet it is illusory to say that the majority of the board was independent (in the sense used in this article). Closer examination exposes the truth. A snapshot of HIH's board at June 30, 1999, reveals a board of thirteen directors, five of whom were executive directors.[232] Of the eight non-executive directors,[233] the bulk were compromised: four inside directors (Charles Abbott,[234] Rodney Adler,[235]

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[230] For a useful synopsis, see HIH Royal Commission, *supra* note 2, at vol. 1, xvi-xx.

[231] *Id.* at vol. 1, xiii.

[232] Raymond Williams, Dominic Fodera, Terence Cassidy, George Sturesteps, and Randolph Wein. *See* HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262, para. 23.2.2.

[233] Geoffrey Cohen, Charles Abbott, Rodney Adler, Justin Gardener, Alexander Gorrie, Neville Head, Michael Payne, and Robert Stitt; HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262, para. 23.2.2.

[234] Charles Abbott served as a legal consultant to HIH and the law firm Blake Dawson Waldron (BDW) where he was formerly a partner. In

Geoffrey Cohen[236] and Robert Stitt[237]) and two could be charitably characterized as outside directors (Justin Gardener[238] and Michael Payne).[239] Thus, there were only

1996, after learning that BDW was not on HIH's legal panel, he lobbied for this to change. Abbott's consultancy agreement with BDW involved payment of a $25,000 annual fee (indexed) and 10% of fees rendered by BDW on work he introduced. Abbott was also associated with HIH's major shareholder between 1995 and 1998; *see* HIH Royal Commission, *supra* note 2, at vol. 1, pg. 114-15, para. 6.2.7; vol. 3, pg. 262, para. 23.2.2; pg. 298-300, para. 23.6.3.

235 Following HIH's acquisition of FAI Insurance, Rodney Adler (FAI's then CEO and major shareholder) joined HIH's board in April 1999, where he remained until its collapse. At that time, he was also engaged as a consultant by HIH. The consultancy agreement (the terms of which were never documented) was lucrative. Adler secured a payment of $40,000 per month for his services, which Justice Owen described as being no more than Adler ought to have done as a non-executive director. *See* HIH Royal Commission, *supra* note 2, at vol. 1, para. 3.3; vol. 3, para. 23.6.2.

236 Geoffrey Cohen, chairman of HIH (and its predecessor, CE Health since January 1992) was a former partner of Arthur Anderson (CE Health's, and then HIH's auditor since 1973). While serving as HIH's chairman and non-executive director for over ten years, Cohen enjoyed an (undisclosed) lucrative consultancy agreement and retirement benefits from Anderson; *see* HIH Royal Commission, *supra* note 2, at vol. 1, pg. 51-54, para. 3.1-3.2.2; vol. 3, pg. 86-87, para. 21.4.3 (detailing these and other benefits from Anderson); pg. 262, para. 23.2.2.

237 Robert Stitt QC was appointed as a non-executive director to CE Health in January, 1992, and sat on the board for about ten years. Prior to his appointment to the board, he had provided legal advice to the [HIH] group over a "lengthy period"; HIH Royal Commission, *supra* note 2, at vol. 1, pg. 51, para. 3.1; vol. 3, pg. 262, para. 23.2.2. From 1998 to 2001, Stitt was also a director of HIHC, a wholly-owned subsidiary of HIH, but never attended any directors meeting because he most probably "forgot" he was on its board. *Id*. at vol. 3, pg. 324-25, para. 23.9.5.

238 From December 2, 1998, Justin Gardener became the third former Anderson partner to join HIH's board. He was a member, and later chair

two independent non-executive directors: Alexander Gorrie[240] and Neville Head.[241] Justice Owen thought that these directors had met Derek Higgs' criteria of "independence,"[242] before noting that they had both resigned by the end of 1999.[243]

Although HIH was then without independent directors until its collapse in 2001, Gorrie and Head's efforts to improve corporate governance structures proved to be in vain. As we will see, that HIH's corporate culture "was

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of the HIH's audit committee. Prior to "immediately" joining HIH after leaving Anderson, Gardener was HIH's audit partner from 1973 to 1989, whereby cultivated a business relationship with Ray Williams, whom considered Gardener a "true business advisor." *See* HIH Royal Commission, *supra* note 2, at vol. 3, pg. 86-88, para. 21.4.3; pg. 262, para. 23.2.2.

239 Michael Payne had a long association with HIH. In fact, he was co-founder of HIH's predecessor in 1968. Although he was non-executive director by June 1999, he had previously sat on the HIH's board as an executive director, and was CEO of HIH (U.K.). S*ee* HIH Royal Commission, *supra* note 2, at vol. 1, pg. 51-58, para. 3.1-3.4.2; vol. 3, pg. 262, para. 23.2.2.

240 But Alexander Gorrie was previously a director of CIC Insurance, which HIH's predecessor, CE Heath, acquired in June 1995. He was appointed as an alternate director to HIH in August 1995, and then as a non-executive director in 1997; *see* HIH Royal Commission, *supra* note 2, at vol. 1, pg. 54, para. 3.2.2.

241 Neville Head was appointed to the board of HIH's predecessor, CE Heath, as a non-executive director in January 1992. He resigned in August 1999. HIH Royal Commission, *supra* note 2, at, vol. 1, xxxvii; pg. 51, at para. 3.1.

242 *See* Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (Jan. 2003), at 37.

243 *See* HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262, para. 23.2.2.

inimical to sound management practices" is undeniable. As the Royal Commission's Report further explained:

> The problematic aspects of the corporate culture of HIH – which led directly to the poor decision-making – can be summarised succinctly. There was blind faith in a leadership that was ill-equipped for the task. There was insufficient ability and independence of mind in and associated with the organisation to see what had to be done and what had to be stopped or avoided. Risks were not properly identified and managed. Unpleasant information was hidden, filtered or sanitised. And there was a lack of sceptical questioning and analysis when and where it mattered.[244]

This short quote not only encapsulates the serious flaws in management practices, but also highlights the anemic contribution by the non-executive directors to HIH's governance. These interconnected problems deserve further unpacking, for they reveal three major lessons that may be drawn from HIH's failure.

Firstly, the dangers of a dictatorial CEO, coupled with a weak board, are apparent here. Ray Williams, described as a "dominant personality" and unrivalled in terms of "authority and influence,"[245] treated the company he co-

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[244] HIH Royal Commission, *supra* note 2, at pg. 216, vol. 1, xvii. For a useful synopsis of corporate governance failures here, see *id.* at xxxiii-xliii.

[245] HIH Royal Commission, *supra* note 2, at vol. 1, xxvii.

founded as his personal fiefdom.[246] He did not tolerate dissent. Moreover, even though Williams spearheaded a series of disastrous business decisions, some of which even lacked fundamental due diligence, he remained "unchallenged."[247]

A second and related problem was the ineffective monitoring by the board. Executive directors and senior management were not kept in check. To the contrary, the board appeared captured by senior management. The evidence strongly suggested that there was *never* an instance where the board "rejected or materially changed" management proposals.[248] This was no doubt due to the board's reluctance to oppose such proposals, given that Williams sponsored them all.[249] With the benefit of hindsight, Gorrie conceded that managerial pressure over board deliberations compromised its independence.[250]

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[246] For instance, there was no nomination committee, and all candidate's chosen by Williams were ratified. *See* HIH Royal Commission, *supra* note 2, at vol. 3, pg. 264, para. 23.2.4.

[247] HIH Royal Commission, *supra* note 2, at vol. 1. For example, in relation to Williams' proposal to launch a takeover of FAI at 75c per share, there was "no discussion about the price" and "none of the other directors dared question him." Westfield, *supra* note 2, at 110. Justice Owen identifies the FAI acquisition as "yet another example of management pursuing an objective without regard to the role of the board." HIH Royal Commission, *supra* note 2, vol. 3, pg. 274-76, para. 23.3.3.

[248] HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262, para. 23.2.2.

[249] HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262-63, para. 23.2.2.

[250] *But cf.* HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262-63, para. 23.2.2 (noting the evidence given by the other independent director, Head, whom despite overwhelming evidence to the contrary, denied that board independence was compromised by managerial influence).

It is true there were instances where non-executive directors raised governance concerns.[251] But those efforts were too little, too late. In two separate letters in May of 1999, Gardener (to Williams) and Head (to Cohen) aired concerns about managerial control over board agenda and HIH's corporate governance procedures (especially the adequacy of discussion over "critical issues" and the quality of board papers) respectively.[252] Neither Gardener's nor Head's concerns, or suggested improvements, were taken seriously. They were not circulated at a formal board meeting, but rather were briefly canvassed at a specially convened meeting of non-executive directors called by Williams. The other non-executive directors (Head was abroad) predictably fell into line.[253] Much responsibility for these corporate governance failures was sheeted home to Geoffrey Cohen, said to be an "ineffective chairman."[254] In particular, Justice Owen found that Cohen's responsibility here was to ensure the board properly considered Gardener's memo,[255] as well as to act on Head's "astute and well-reasoned"[256] concerns.

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[251] *See generally* HIH Royal Commission, *supra* note 2, at vol. 1, xxxvii; vol. 3, pg. 267-71, para. 23.2.6.
[252] HIH Royal Commission, *supra* note 2, at vol. 3, pg. 267-8, para. 23.2.6.
[253] HIH Royal Commission, *supra* note 2, at vol. 1, xxxvii; vol. 3, pg. 268, para. 23.2.6.
[254] HIH Royal Commission, *supra* note 2, at vol. 1, xxxvii. Cohen failed to hold the CEO Williams to account and he inexcusably relinquished control of the board agenda to management: xxxvii-xxxix.
[255] See HIH Royal Commission, *supra* note 2, at vol. 1, xxxviii; vol. 3, pg. 269, para. 23.2.6.
[256] HIH Royal Commission, *supra* note 2, at, vol. 1, xxxviii.

The third lesson to be drawn from HIH's failure relates to its poor business ethics[257] and its conflicts of interest management system. In short, there was no such system. Once more, the unfortunate star here is the chairman. (Cohen appears to have adopted a cavalier attitude to conflict of interest management. For instance, somewhat inexplicably, he denied a conflict of interest arose via his position as chairman of HIH audit committee and his personal consultancy agreement with Andersen.)[258] Cohen was also singled out as having a special responsibility to ensure the identification, consideration, and resolution of possible conflicts of interest.[259] Justice Owen found that Cohen's "abdication" of responsibility in this respect proved to be a "grave impediment to the proper functioning of the board."[260] However, the Royal Commission was also careful to point out that the chairman was not solely to blame: "the board should have also ensured that proper procedures were in place."[261] The independent directors, in particular, shirked their responsibilities here.

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[257] *See supra* notes 10-15. Justice Owen suggested that some board members may have "grasped the theory" of conflict of interest, but the practical applications, suggested otherwise: HIH Royal Commission, *supra* note 2, at vol. 1, xxxvi.
[258] HIH Royal Commission, *supra* note 2, at vol. 3, pg. 262, para. 23.2.2.
[259] HIH Royal Commission, *supra* note 2, at vol. 1, pg. 114, para. 6.2.7; vol. 3, pg. 271–272, para. 23.2.6.
[260] HIH Royal Commission, *supra* note 2, at vol. 3, pg. 272, para. 23.2.6.
[261] HIH Royal Commission, *supra* note 2, at vol. 3, pg. 271, para. 23.2.6; vol. 1, pg. 114–115, para 6.27. *See also id*. at vol. 1, (stating that xxxvii: "The board should have recognised [this] as a problem an moved on its own initiative to install a proper system").

While there was a "semblance of standard corporate governance mechanisms at work,"[262] HIH's failure is a stark reminder of the likely outcome that the coupling of poor corporate governance structures with disastrous (mis)management can have. Even though HIH was fundamentally flawed on so many levels, the independent directors still ought to have done more.

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[262] HIH Royal Commission, *supra* note 2, at vol. 1, pg. 101.