

# REGULATORY RESPONSES TO GLOBAL CORPORATE SCANDALS

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## I. INTRODUCTION

The triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured. . .

—Hansmann and Kraakman (2001)<sup>1</sup>

Comparative corporate governance is at a fascinating juncture. For more than a decade, scholars have been interested in the structural differences and implications of a dispersed shareholding or “outsider” system of corporate governance, exemplified by the United States and United Kingdom, and “insider” systems with more concentrated ownership structures, traditionally found in continental Europe<sup>2</sup> and Asia.<sup>3</sup> Major international organizations have also engaged in the dissection and classification of comparative corporate governance laws.<sup>4</sup> Whereas outsider systems have typically been associated with a shareholder-centered paradigm of corporate governance, insider systems have been linked to a stakeholder model.

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<sup>1</sup> Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 468 (2001).

<sup>2</sup> See, e.g., Gustavo Visentini, *Compatibility and Competition Between European and American Corporate Governance: Which Model of Capitalism?*, 23 BROOK. J. INT'L L. 833, 836-37 (1998).

<sup>3</sup> Australia provides an interesting perspective on the comparative corporate governance debate. Although its system of corporate governance is traditionally treated as reflecting an “outsider” system of governance, in fact Australia constitutes a hybrid of the two systems, since its publicly listed corporate sector contains a high level of controlling blockholder ownership structures. See generally Asjeet S. Lamba & Geof Stapledon, *The Determinants of Corporate Ownership Structure: Australian Evidence* (Univ. of Melbourne Pub. Law Research Paper No. 20, 2002), available at <http://ssrn.com/abstract=279015>.

<sup>4</sup> See Amir N. Licht, *The Mother of All Path Dependencies Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147, 152 (2001).

Contemporary comparative corporate governance scholarship has postulated that “law matters” in the development and performance of financial markets.<sup>5</sup> And if law matters, then so, too, does law reform.<sup>6</sup> Two waves of international corporate law reform have occurred in recent years. Under the first wave, a number of countries with concentrated ownership structures<sup>7</sup> instituted reform programs to replicate aspects of the legal and structural patterns of countries with dispersed shareholding and deep liquid capital markets.

Yet, while some insider legal systems implemented first wave reforms, the corporate governance rules and norms in jurisdictions with outsider systems of corporate governance were themselves changing. In the wake of the corporate collapses, epitomized by Enron, countries such as the United States, United Kingdom, and Australia embarked upon reform programs designed to rectify perceived governance weaknesses in their legal systems.

These global corporate collapses represent a defining moment in the contemporary corporate governance debate. At the beginning of this decade, many commentators assumed that international corporate regulation was inexorably directed towards a single point of convergence, in the form of a standardized Anglo-U.S. shareholder-centered model of corporate governance.<sup>8</sup> The convergence assumption needs to be reassessed,<sup>9</sup> however, in

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<sup>5</sup> See, e.g., Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459 (2001); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 511-13 (1999).

<sup>6</sup> See generally Otto Kahn-Freund, *On Uses and Misuses of Comparative Law*, 37 MOD. L. REV. 1 (1974) (containing an early discussion of the extent to which comparativism may be useful as a “tool of law reform”).

<sup>7</sup> These include countries such as Italy, Germany and Japan. See Holly J. Gregory, *The Globalisation of Corporate Governance* (pt. 1), GLOBAL COUNS., Sept. 2000, at 52, 58-59 (2000), <http://crossborder.practicallaw.com/7-101-2701>.

<sup>8</sup> E.g., Hansmann & Kraakman, *supra* note 1, at 439. This is still a live issue. See, e.g., JEFFREY N. GORDON & MARK J. ROE, CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (2004) (asking whether the Anglo-American model of shareholder capitalism is destined to become standard or whether sharp differences will persist).

<sup>9</sup> See e.g., Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 BERKELEY J. INT'L L. 195, 196-200 (2004) (discussing the concept of “cultural compatibility” in legal transplantation); Gunther

the light of these collapses and the evolving international regulatory responses to them.

## II. A TALE OF TWO AUSTRALIAN CORPORATE COLLAPSES

All happy families resemble each other, but each unhappy family is unhappy in its own way.

—Tolstoy, *Anna Karenina* (1875-7)<sup>10</sup>

So intense was the brouhaha surrounding the collapses of Enron and WorldCom in the United States that it is easy to forget that these financial scandals mirrored a global phenomenon. The scandals and collapses,<sup>11</sup> for example, involving Independent Insurance and Marconi in the United Kingdom, Elan in Ireland, Kirch in Germany, Royal Ahold in the Netherlands, and HIH Insurance and One.Tel in Australia, posed analogous questions about the efficacy of corporate governance practices and financial regulation.<sup>12</sup>

The international scandals add an important dimension to the U.S. debate on what caused Enron. A number of theories were in circulation at the time of Enron's collapse. A prevalent assumption was that a major factor was the inadequacy of U.S. boards of directors,<sup>13</sup> however, Professor Coffee outlined at least

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Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, 61 MOD. L. REV. 11, 11-13 (1998).

<sup>10</sup> LEO TOLSTOY, *ANNA KARENINA* 1 (Alymer Maude trans., Oxford Univ. Press 1980) (1875-77).

<sup>11</sup> *E.g.*, Carol Matlack et al., *The Year of Nasty Surprises*, BUS. WK., March 10, 2003, at 48.

<sup>12</sup> *See, e.g.*, John Plender, *Missed Signals*, FIN. TIMES (London), June 20, 2001, at 18. Reactions varied considerably to the corporate scandals across different jurisdictions. They ranged, for example, from intense public backlash and law reform activity in Australia, to a more muted and sanguine approach in parts of Europe. *See generally* Luca Enriques, *Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms*, 38 WAKE FOREST L. REV. 911 (2003).

<sup>13</sup> *See Developments in the Law – Corporations and Society*, 117 HARV. L. REV. 2169, 2181-82 (2004); Jeffrey A. Sonnenfeld, *What Makes Great Boards Great*, HARV. BUS. REV., Sept. 2002, at 106.

three other possible explanations for the outbreak of U.S. financial scandals.<sup>14</sup> Different focal points in the international regulatory responses to the corporate collapses implicitly reflect different theories about their causes and about how to prevent their recurrence.

Two of the most notorious Australian corporate collapses, those of HIH Insurance (HIH) and One.Tel, form a factual backdrop to the discussion in this paper. HIH is the largest collapse in Australian corporate history, and was the subject of an A\$40 million Royal Commission (HIH Royal Commission), which reported its findings in April 2003.<sup>15</sup> One.Tel has spawned extensive, and continuing, proceedings in the Australian courts.

Superficially, at least, HIH and One.Tel appeared to be very different companies. When HIH was placed in provisional liquidation in 2001, it was Australia's second largest general insurer.<sup>16</sup> The chief executive officer (CEO) of HIH, Ray Williams, had founded its corporate predecessor more than thirty years earlier.<sup>17</sup> In contrast, One.Tel was a new player in the telecommunications market, with "extravagant aspirations" to become the foremost telecommunications provider in Australia and a major player in the European market.<sup>18</sup> Ultimately, One.Tel had a short shelf-life, surviving less than four years after it was floated on the Australian Stock Exchange (ASX) in late 1997.<sup>19</sup>

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<sup>14</sup> These possible explanations were: "the gatekeeper story," focusing on conflicts of interest in reputational intermediaries, such as auditors and analysts; "the misaligned incentives story," focusing on the role of executive pay; and "the herding story," focusing on the incentives of fund managers in relation to quarterly performance. See generally John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 308-09 (2004); see also Geoffrey P. Miller, *Catastrophic Financial Failures: Enron and More*, 89 CORNELL L. REV. 423 (2004) (examining commonalities of collapses).

<sup>15</sup> HIH ROYAL COMM'N, COMMONWEALTH OF AUSTRALIA, 1 THE FAILURE OF HIH INSURANCE xiii, 3 (2003), <http://www.hihroyalcom.gov.au/finalreport/index.htm> [hereinafter HIH REPORT]. The Royal Commission investigation lasted for 18 months. See generally Fiona Buffini et al., *Business Hits Back over HIH Reforms*, AUSTRALIAN FIN. REV., Apr. 22, 2003, at 1.

<sup>16</sup> Christopher Jay, *The Day of Reckoning*, in COLLAPSE INCORPORATED: TALES, SAFEGUARDS AND RESPONSIBILITIES OF CORPORATE AUSTRALIA 9, 10 (2001).

<sup>17</sup> *Id.* at 14.

<sup>18</sup> *Id.* at 29.

<sup>19</sup> *Id.* at 30.

In terms of corporate governance, however, the collapses of HIH and One.Tel displayed a number of similarities. Both companies had charismatic and dominating CEOs, and both engaged in high-risk practices in extremely competitive markets. In the case of HIH, these practices included failure to carry prudential insurance margins,<sup>20</sup> activities in the difficult London reinsurance market and the “murky” world of film finance,<sup>21</sup> and serious losses in the Californian workers’ compensation market.<sup>22</sup> HIH also undertook a takeover of another insurance company, FAI Insurance, which, according to the HIH Royal Commission, exhibited an unusual lack of due diligence checks, was “impetuous and based on completely inadequate information,”<sup>23</sup> and ultimately resulted in disastrous losses for HIH.<sup>24</sup>

Australia has had a system of continuous disclosure for publicly listed companies since 1994.<sup>25</sup> Nonetheless, in spite of the existence of a continuous disclosure rule at the time of the collapses of HIH and One.Tel, there seems little doubt that some investors and insiders benefited from more complete knowledge about the true financial positions of those companies than others were able to access.<sup>26</sup> Nor, it seems, did the directors of these companies have enough information as a result of the continuous disclosure regime. As in the cases of Enron and WorldCom,

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<sup>20</sup> According to the HIH Royal Commission Report, under-reserving was the major cause of HIH’s collapse. See HIH REPORT, *supra* note 15, at xxviii-xxx.

<sup>21</sup> Jay, *supra* note 16, at 13, 18; *Reinsurers Victorious on Film Claims*, INS. INSIDER, Mar. 1, 2001.

<sup>22</sup> HIH REPORT, *supra* note 15, at xxiii (describing HIH’s re-entry into the Californian workers’ compensation market as “a debacle” costing the group approximately A\$620 million).

<sup>23</sup> *Id.* at xxii.

<sup>24</sup> According to the Royal Commission Report, the FAI Insurance acquisition resulted in a loss to HIH of approximately A\$590 million. *Id.* at xxiv; see also *id.* at xxxi (describing “troublesome FAI contracts”).

<sup>25</sup> Australian Stock Exchange, Ltd., Listing Rule 3.1 (2004); Corporations Act, 2001, § 674 (Austl.).

<sup>26</sup> For example, it has been claimed that although the collapse of HIH came as no surprise to sophisticated investors, many of whom had exited from HIH prior to its collapse, it was wholly unexpected for many other groups, including employees and professional groups, such as the NSW Law Society, which had insurance with HIH. See Jay, *supra* note 16, at 13. In the case of One.Tel, see PAUL BARRY, RICH KIDS 292 (2002).

these collapses also involved aggressive and questionable accounting practices.<sup>27</sup>

In contrast to the characteristic dispersed shareholding associated with outsider systems of corporate governance, HIH and One.Tel both had substantial block shareholders. 50 percent of HIH was held by Winterthur Swiss Insurance Company, which had a strong international reputation and a high credit rating.<sup>28</sup> Winterthur Swiss was a passive investor in HIH, but was apparently so concerned about the company's performance that it ultimately sold its entire shareholding to the public in 1998.<sup>29</sup> The major shareholders in One.Tel were more high profile and more active in One.Tel's affairs than those of HIH. One of the reasons for Australia's great level of interest in One.Tel's collapse was that leading players in the saga were James Packer and Lachlan Murdoch, young heirs to large fortunes. Packer and Murdoch sat on the board of One.Tel as non-executive directors.<sup>30</sup> Their appointment followed a major investment by News Ltd. and PBL (the publicly listed companies controlled by, respectively, the Murdoch and Packer families) in exchange for a 40 percent stake in One.Tel.<sup>31</sup> Following the collapse of One.Tel, Lachlan Murdoch swore in an affidavit to the Australian Securities and Investments Commission (ASIC) that he had been "profoundly misled" about the state of One.Tel's financial position.<sup>32</sup>

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<sup>27</sup> In relation to HIH and FAI Insurance, for example, the HIH Royal Commission found that the companies entered into a number of transactions, which although described as reinsurance, did not genuinely shift risk, but were merely loans. The companies' classification of the transactions as reinsurance contracts substantially boosted profits. See HIH REPORT, *supra* note 15, at xxx-xxxii, xlii-xliii. In relation to One.Tel, see BARRY, *supra* note 26, at 361, which suggests that a change to One.Tel's accounting policy helped it to transform a \$25 million loss into an A\$ 9.8 million profit in its annual results in August 1999.

<sup>28</sup> HIH REPORT, *supra* note 15, at xxviii.

<sup>29</sup> See *id.* (sale by Winterthur was detrimental to HIH, since it eroded market confidence engendered by the presence of "a financially strong shareholder of global repute").

<sup>30</sup> BARRY, *supra* note 26, at 252-53.

<sup>31</sup> *Id.* at 359 (News Ltd. and Publishing and Broadcasting Ltd. agreed to invest A\$430 million immediately and invest a further A\$280 million in the future).

<sup>32</sup> See Christine Lacy & Annabel Hepworth, *One.Tel: ASIC Bombshell*, AUSTRALIAN FIN. REV., June 5, 2001, at 1 (quoting an affidavit lodged with the N.S.W.S. Ct. by Mr. Lachlan Murdoch).

With the benefit of hindsight, the collapses of HIH and One.Tel seem inevitable. Although the HIH Directors' Report for the year ending June 30, 2000 reported a consolidated profit of A\$18.4 million, a subsequent report by KPMG<sup>33</sup> advised that the company had been on the edge of insolvency for a number of years and should be placed in provisional liquidation.<sup>34</sup> A true picture of One.Tel's parlous financial state emerged only after an anonymous internal whistleblower,<sup>35</sup> sent an email to the chief finance adviser of One.Tel's major shareholder.<sup>36</sup>

Like Enron and WorldCom in the United States, HIH and One.Tel raised puzzling questions about what caused the collapses and how boards of directors and others within the corporate governance ecosystem, such as auditors, analysts, shareholders and regulators, could miss crucial warning signs of impending corporate disaster. This is a particularly intriguing question in relation to One.Tel's board, given the close involvement of sophisticated major shareholders in the business and their representation on the board.

The events at HIH and One.Tel prompted a series of significant corporate governance reforms in Australia that parallel post-Enron reforms in the United States and United Kingdom. The general regulatory responses in each of these jurisdictions have included, to date: (i) legislative reform;<sup>37</sup> (ii) governance

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<sup>33</sup> This report was commissioned by the new CEO of HIH, Randolph Wein, who replaced Ray Williams in December 2000. Jay, *supra* note 16, at 10.

<sup>34</sup> *Id.*; see also HIH REPORT, *supra* note 15, at xiii.

<sup>35</sup> The whistleblower was code-named "Ghostdogperil." BARRY, *supra* note 26, at 272-73.

<sup>36</sup> *Id.*

<sup>37</sup> These legislative reforms include the Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002); FINANCIAL REPORTING COUNCIL, THE COMBINED CODE ON CORPORATE GOVERNANCE (2003) (U.K.), <http://www.asb.org.uk/documents/pagemanager/frc/combinedcodefinal.pdf> [hereinafter U.K. COMBINED CODE]; Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act, 2004 (Austl.) [hereinafter CLERP 9 Act].

changes by self-regulatory organizations;<sup>38</sup> and (iii) judicial decision-making.<sup>39</sup>

The pivotal Australian legislative reform is the CLERP (Audit Reform and Corporate Disclosure) Act 2004 (the CLERP 9 Act 2004),<sup>40</sup> which, in contrast to the Sarbanes-Oxley Act of 2002 (SOX), had a long gestation period<sup>41</sup> and was the subject of extensive public debate and submissions prior to its ultimate commencement in July 2004. The CLERP 9 Act 2004 contains important regulatory reforms relating to the audit function,<sup>42</sup> disclosure,<sup>43</sup> shareholder participation in governance,<sup>44</sup> executive remuneration<sup>45</sup> and enforcement.<sup>46</sup> Just as SOX directly responded to specific issues relating to the collapse of Enron,<sup>47</sup> the CLERP 9 Act 2004 bears many hallmarks of the HIH collapse and subsequent Royal Commission.<sup>48</sup> The other key aspect of the Australian reforms was the introduction by the Australian Stock

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<sup>38</sup> See, e.g., NYSE, Inc., Listed Company Manual § 303A (2003) (corporate governance rules approved by the SEC on Nov. 4, 2003); ASX Corporate Governance Council, Principles of Good Corporate Governance and Best Practice Recommendations (2003) (Austl.) [hereinafter ASX Recommendations].

<sup>39</sup> See generally *infra* Part VI.

<sup>40</sup> CLERP 9 Act, *supra* note 37. This act was passed on June 25, 2004 and commenced operation on July 1, 2004.

<sup>41</sup> The CLERP 9 Bill, 2003, was based upon an earlier Government Issues Paper, Corporate Law Economic Reform Program, Issue Paper No. 9, COMMONWEALTH OF AUSTRALIA, CORPORATE DISCLOSURE: STRENGTHENING THE FINANCIAL REPORTING FRAMEWORK (2002), available at <http://www.treasury.gov.au/documents/403/PDF/Clerp9.pdf>. The final version of the CLERP 9 Bill was tabled in Parliament on December 4, 2003. Press Release, Treasurer of the Commonwealth of Australia, CLERP (Audit Reform and Corporate Disclosure) Bill Introduced (Dec. 4, 2003), <http://www.treasurer.gov.au/tsr/content/pressreleases/2003/103.asp>.

<sup>42</sup> CLERP 9 Act, *supra* note 37, sched. 1.

<sup>43</sup> *Id.* at scheds. 1, 6.

<sup>44</sup> *Id.* at sched. 8.

<sup>45</sup> *Id.* at sched. 5.

<sup>46</sup> *Id.* at sched. 4.

<sup>47</sup> See Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 4-18 (2003) (commenting on the close fit between the particular facts of Enron and the provisions of the Sarbanes-Oxley Act).

<sup>48</sup> See Press Release, The Commonwealth Treasurer, Government's Response to the Recommendations of the HIH Royal Commission (Sept. 12, 2003), <http://www.treasurer.gov.au> (follow "press release" hyperlink; then follow "2003" hyperlink; then follow "Government's Response to the Recommendations of the

Exchange of influential principles of good corporate governance.<sup>49</sup>

### III. THE BIG PICTURE: NORMS AND LAWS IN CORPORATE GOVERNANCE

I am becoming less and less comfortable with the phrase “corporate governance” – not because of its content but because it has been so widely used that it may become meaningless.

—The Hon. Justice Neville Owen,  
HIH Royal Commission Report (2003)<sup>50</sup>

Historically, corporate scandals have produced increased levels of regulation in the United States,<sup>51</sup> United Kingdom,<sup>52</sup> and Australia,<sup>53</sup> and the recent regulatory surge was therefore predictable. One of the key subjects on which reforms in these jurisdictions refocused attention was the board of directors, suggesting that board failure was a significant contributing factor to the corporate collapses.<sup>54</sup>

Since at least the 1970s, the board of directors has occupied a central role in monitoring and legitimizing managerial conduct

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HIH Royal Commission). Note, however, that the final version of the CLERP 9 Act contained amendments, which drew back from some of stricter recommendations in the HIH Report. See Jan Eakin, *Labor Says CLERP Will Fly in the Face of HIH*, SYDNEY MORNING HERALD, Dec. 5, 2003, at 21; Andrew Main, *Judge's Last Word: Audit Reform Risk*, AUSTL. FIN. REV., June 23, 2004, at 5.

<sup>49</sup> ASX Recommendations, *supra* note 38.

<sup>50</sup> HIH REPORT, *supra* note 15, at xxxiii.

<sup>51</sup> *E.g.*, Coffee, *supra* note 14, at 278 (comparing post-Enron environment with increased regulatory regime after late 1980s S&L crisis).

<sup>52</sup> See RICHARD SMERDON, A PRACTICAL GUIDE TO CORPORATE GOVERNANCE 1-3 (1998) (examining the interrelation between a series of U.K. corporate scandals in the late 1980s and early 1990s, such as Polly Peck, the Maxwell Group, Allied Lyons and Barings Bank, and the introduction of more stringent corporate governance principles).

<sup>53</sup> The introduction of the shareholder consent rules for related party rules under Australian corporate law, for example, was directly attributable to a spate of corporate scandals in the late 1980s, such as Bond Corp. and the Qintex Group. See generally Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 69 (2000).

<sup>54</sup> See Sonnenfeld, *supra* note 13, at 106.

within the corporation.<sup>55</sup> Of the panoply of modern governance techniques, the board of directors is viewed as the dominant accountability mechanism. This perception led to major changes in both the role and the structure of the board over recent decades. In the past, these changes have been driven, not by legislative intervention and direct regulation, but by the development of commercial practices and norms.<sup>56</sup>

Norms have become increasingly important in corporate governance. They have generally emanated from voluntary adoption of guidelines from a range of sources. A comparative study of corporate governance codes in Europe identified such sources as including governmental or quasi-governmental entities; committees organized by governments or by stock exchanges; business, industry and academic associations; directors' associations and investor-related groups.<sup>57</sup>

There is, nonetheless, a relationship between governmental regulation and voluntary corporate governance codes of this kind. The development of self-regulatory codes of conduct has tended to be either a response to the lack of specific governmental regulation in particular areas or, in some cases, a justification for the absence of such regulation.<sup>58</sup> A statement of best practices

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<sup>55</sup> For discussions about the evolving significance of the board during the 1970s see, for example, MELVIN ARON EISENBERG, *THE STRUCTURE OF THE CORPORATION* 149-185 (1976); see also Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1982); *In re Caremark Int'l Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996) (“[I]n recent years the Delaware Supreme Court has made it clear. . .the seriousness with which the corporation law views the role of the corporate board.”).

<sup>56</sup> See, e.g., John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151 (2001); see also Hansmann & Kraakman, *supra* note 1, at 455 (“We expect that the reform of corporate governance practices will generally precede the reform of corporate law, for the simple reason that governance practice is largely a matter of private ordering that does not require legislative action.”).

<sup>57</sup> Holly J. Gregory & Robert T. Simmelkjaer, II, Weil, Gotshal & Manges, LLP, *Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States* 16 (2002), [http://www.odce.ie/\\_fileupload/services/EU%20Comparison.pdf](http://www.odce.ie/_fileupload/services/EU%20Comparison.pdf) (on behalf of the European Commission, Internal Market Directorate General).

<sup>58</sup> This interrelation between government regulation and corporate governance was recognized in the early 1990s by Sir Adrian Cadbury, who argued that inadequate enforcement of good governance practices could lead to the renewal of onerous government regulation in the U.K. See John Holland, *Self Regulation and the Financial Aspects of Corporate Governance*, J. BUS. L. 127, 131 n.12 (1996).

concerning shareholder activism published by the U.K. body, the Institutional Shareholders' Committee (ISC),<sup>59</sup> arguably represents an example of the latter, preemptive role for some codes of conduct. The adoption of these principles by the ISC in 2002 was viewed as a direct attempt to forestall the introduction of stringent government legislation<sup>60</sup> imposing a statutory duty on institutional investors to intervene in corporate governance.

A global trend has emerged for stock exchanges to be more involved in corporate governance regulation. In Australia, the Australian Stock Exchange (ASX) has played a role in corporate governance since 1996, when it introduced a rule requiring listed companies to disclose certain corporate governance practices in their annual reports.<sup>61</sup> Institutional investors, however, criticized the rule as lacking regulatory teeth<sup>62</sup> since it avoided any prescriptive rules on content, merely requiring a company to disclose its main governance practices, if any. The Australian regulatory approach was, at that time, in clear contrast to the more stringent U.K. "comply or explain" approach. The now familiar "comply or explain" regulatory model was derived from the recommendations of leading U.K. corporate governance reports<sup>63</sup> and operated as a blueprint for Stock Exchange rules in many jurisdictions.

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<sup>59</sup> The ISC represents major U.K. institutional investors. In September 2005, the ISC published a revised version of its statement of investment principles for institutional investors. Press Release, NAPF Ltd., Institutional Shareholders' Committee Publishes Updated Statement of Investment Principles (Sept. 29, 2005), [http://www.napf.co.uk/news/PR2005/ISC\\_Statement\\_of\\_Principles.pdf](http://www.napf.co.uk/news/PR2005/ISC_Statement_of_Principles.pdf).

<sup>60</sup> Legislation had been canvassed following the influential Myners Report in 2001. See INSTITUTIONAL INVESTMENT IN THE UNITED KINGDOM: A REVIEW 2 (2001), <http://www.hm-treasury.gov.uk/media/2F9/02/31.pdf> (criticizing the reluctance of fund managers to take an activist stance).

<sup>61</sup> Australian Stock Exchange, Ltd., Listing Rule 4.10.3 (2004).

<sup>62</sup> The Investment and Financial Services Association (IFSA) was particularly critical of the structure and effectiveness of the rule adopted. See generally Joanna Bird & Jennifer Hill, *Regulatory Rooms in Australian Corporate Law*, 25 BROOK. J. INT'L L. 555, 598-600 (1999).

<sup>63</sup> COMM. ON CORPORATE GOVERNANCE, FINAL REPORT 57 (1998) (Hampel Committee); COMM. ON THE FIN. ASPECTS OF CORPORATE GOVERNANCE, REPORT 11 (1992) [hereinafter CADBURY REPORT]; STUDY GROUP ON DIRECTORS' REMUNERATION, DIRECTORS' REMUNERATION: REPORT (1995) (Greenbury Committee).

In the period prior to the HIH and One.Tel collapses, there was some backlash against Australian corporate governance practices.<sup>64</sup> Stan Wallis, the influential chair of the Wallis Committee on the Australian Financial System, publicly criticized “the formalised edicts” of Australian corporate governance norms, which he regarded as contributing to a compliance-based system, in comparison to the performance-based focus of U.S. corporate governance principles.<sup>65</sup>

Nonetheless, the collapses of HIH and One.Tel caused a hardening of norms in Australia. In response to these collapses, public pressure, and criticism about its credibility as a regulatory body, the ASX adopted a more stringent approach to corporate governance in 2003.<sup>66</sup> The ASX introduced a set of guidelines, the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* (the ASX corporate governance principles),<sup>67</sup> under which it adopts a U.K.-style “comply or explain” model.<sup>68</sup> One of the goals of the introduction of this enhanced disclosure regime clearly was to

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<sup>64</sup> There was parallel backlash in the U.K. See, e.g., Peter Burton, *Antecedents and Consequences of Corporate Governance Structures*, 8 CORP. GOVERNANCE 194 (2000).

<sup>65</sup> Wallis was particularly critical of the prevalence of a separation between CEO and chair in Australia, in contrast to the U.S., and argued that slavish adherence to corporate governance norms was stifling managerial risk-taking and performance in Australian companies, in comparison with their U.S. counterparts. Stan Wallis, Chairman of AMP, Coles Myer and Amcor, Corporate Governance – Conformance or Performance, 2000 Corporate Public Affairs Oration (June 29, 2000), in *J. BANKING & FIN. SERVICES*, Aug. 2000, at 14, 15-16.

<sup>66</sup> Criticism in this regard focused on the argument that, as a demutualized corporation in its own right, a conflict exists between the ASX’s twin goals of regulation and profit maximization. See, e.g., Editorial, *The Best Way to Restore Faith*, *AUSTL. FIN. REV.*, July 23, 2002, at 62.

<sup>67</sup> ASX Recommendations, *supra* note 38.

<sup>68</sup> The preferred terminology under the Australian model, however, appears to be an “if not, why not” model. See Richard Humphry, Managing Dir. and Chief Executive Officer, Australian Stock Exchange, Address at the AICD Forum, *If Not, Why Not?*, (Apr. 2, 2003), <http://www.asx.com.au/about/pdf/RGHA-ICD020403.pdf>; ASX Corporate Governance Council, Response to the Implementation Review Group Report 1 (2004), [http://www.asx.com.au/about/pdf/asx\\_cgc\\_response\\_to\\_irg\\_report\\_final.pdf](http://www.asx.com.au/about/pdf/asx_cgc_response_to_irg_report_final.pdf) [hereinafter ASX Council Response].

forestall stricter legislative regulation.<sup>69</sup> The majority of the ASX corporate governance principles deal directly with the board's role, structure and effectiveness.<sup>70</sup> Other principles deal explicitly with the integrity of financial reporting and disclosure of corporate information.<sup>71</sup> From 2004 onwards, Australian companies listed on the ASX should comply with, or explain their divergence from, these principles in their annual reports.<sup>72</sup>

It is unclear how significant these changes will be. Early criticism of the ASX corporate governance principles referred to the fact that some of Australia's most successful family-controlled corporations did not comply with the ASX principles and that the regime lacks sanctions for "non-compliance."<sup>73</sup> However, a report on the ASX corporate governance principles, delivered one year after their introduction by the Implementation

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<sup>69</sup> See Humphry, *supra* note 68, at 3 (stating that "[t]hrough a disclosure based approach, the ASX is keen to avoid a U.S. style *Sarbanes-Oxley* legislative solution. . . However, it has become clear that our federal politicians are prepared to legislate if business cannot get its house in order.").

<sup>70</sup> ASX Recommendations, *supra* note 38. This document is comprised of ten Principles, most relating directly to the board. Principle 1, *id.* at 15-17 (roles and responsibilities of board and management); Principle 2, *id.* at 19-24 (structure of board); Principle 3, *id.* at 25-28 (promoting ethical and responsible decision-making); Principle 4, *id.* at 29-33 (safeguarding integrity in financial reporting); Principle 7, *id.* at 43-45 (establishing a sound system of risk oversight); Principle 8, *id.* at 47-49 (encouraging enhanced board and management effectiveness); Principle 9, *id.* at 51-57 (determination of remuneration policies); Principle 10, *id.* at 59-61 (recognition of legitimate interests of stakeholders). Each Principle includes a number of specific recommendations designed to achieve the goals of the Principle, *id.*

<sup>71</sup> Principles 4, 5, 6 and 7, *id.*

<sup>72</sup> The ASX Listing Rules adopt a more prescriptive approach in relation to audit committees. Companies in the S&P/ASX All Ordinaries Index are required by ASX Listing Rule 12.7 to comply with the best practice recommendations in relation to audit committees. *Id.* at 31 (Recommendation 4.3, Principle 4).

<sup>73</sup> See, e.g., Alan Kohler, *Try Telling Frank, James or Rupert to Stand Down*, AUSTL. FIN. REV., Apr. 1, 2003, at 6; Elliot, *ASX Rules: Shut Up and You're Sweet*, THE AUSTRALIAN, Apr. 1, 2003, at 6. It appears that many companies are opting to follow the explanation, rather than substantive compliance, route. In the ASX's first review of compliance with the corporate governance guidelines, only 38% of annual reports reviewed adopted majority independent boards, with 48% disclosing alternative practices. See Fiona Buffini, *ASX Happy with Governance*, AUSTL. FIN. REV., May 17, 2005, at 9.

Review Group (IRG Report),<sup>74</sup> adopted a rather anodyne interpretation of the principles, highlighting their non-prescriptive and flexible nature. The IRG Report stressed that there is no necessity for compliance with the ASX corporate governance principles *per se*, rather, “the only *compliance* required is disclosure.”<sup>75</sup>

The HIH and One.Tel collapses have also generated skepticism about the gap between rhetoric and reality in corporate governance statements. The statements in HIH’s final annual report in 2000 presented the company as a paragon of corporate governance virtue in terms of board member experience,<sup>76</sup> committee structure,<sup>77</sup> attention to ethics and a code of conduct.<sup>78</sup> Nonetheless, legal proceedings relating to the collapse of HIH, which resulted in a deficit of approximately A\$5.3 billion, found that major breaches of directors’ duties occurred in the lead-up to the collapse.<sup>79</sup> Thus, in an early decision relating to the HIH collapse, *ASIC v. Adler*,<sup>80</sup> Justice Santow found that, in a series of related party transactions instigated by the non-executive director, Rodney Adler, and resulting in substantial loss to HIH, there

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<sup>74</sup> Implementation Review Group, Principles of Good Corporate Governance and Best Practice Recommendations: Report to the ASX Corporate Governance Council 31 March 2004 1 (2004), [http://www.asx.com.au/about/pdf/IRG\\_Report\\_to\\_ASX\\_CGC\\_final.pdf](http://www.asx.com.au/about/pdf/IRG_Report_to_ASX_CGC_final.pdf).

<sup>75</sup> *Id.* at 2. Reinforcing this approach, the IRG Report recommended the removal of the phrase “best practice” from the title of the ASX corporate governance principles, on the basis that “best practice” might impliedly suggest that all other practices were inferior. *Id.* at 1.

<sup>76</sup> “The Board remains comprised of directors with a wide range of experience necessary for the complex, international business HIH now represents. Drawing on a diverse range of professionals, HIH’s board of directors includes high-level experience in insurance, financial management, legal, accounting and investment areas.” HIH INSURANCE LTD., ANNUAL REPORT 1999/2000 18 (2000) [hereinafter HIH ANNUAL REPORT].

<sup>77</sup> The four main committees at HIH were the audit, human resources, reinsurance and investment committees. *Id.*

<sup>78</sup> See Pierpont, *Governance as a Form of Art*, AUSTL. FIN. REV., June 8, 2001, at 84. According to the HIH Royal Commission, the existence of a corporate governance model was negated by the failure of HIH’s board to assess periodically its practical effectiveness. HIH REPORT, *supra* note 15, at xxxiv.

<sup>79</sup> *E.g.*, Austl. Sec. & Invs. Comm’n v. Adler (2002) 41 A.C.S.R. 72; (2002) 20 A.C.L.C. 576.

<sup>80</sup> *Id.*

had been “a serious departure from HIH’s own investment safeguards . . . [t]hat may well have reflected a lax attitude prevailing in HIH’s affairs concerning its investment safeguards.”<sup>81</sup> The lesson here is the same as that of Enron<sup>82</sup> – the existence of corporate governance procedures like investment guidelines, an investment committee, and codes of conduct, are of little use when they are bypassed.<sup>83</sup>

There has also been a hardening of corporate governance norms in the United Kingdom as a result of the *Review of the Role and Effectiveness of Non-Executive Directors* (the Higgs Report), which was released in 2003.<sup>84</sup> The Higgs Report recommended strengthening requirements concerning composition of the board, independence of directors, and recruitment and appointment of directors and audit committees within the framework of the existing U.K. “comply or explain” regulatory model, rather than prescriptive government legislation.<sup>85</sup> The substance of the recommendations in the Higgs Report was adopted and incorporated into the U.K. Combined Code.<sup>86</sup>

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<sup>81</sup> *Id.* ¶ 266. For other examples of deviation from published guidelines at HIH, see HIH REPORT, *supra* note 15, at xxxiv.

<sup>82</sup> See WILLIAM C. POWERS, JR. ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. 1-28 (2002), available at <http://news.findlaw.com/hdocs/docs/enron/sicreport/sicreport020102.pdf>; Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309, 1312 (2002).

<sup>83</sup> See generally Note, *The Good, the Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes-Oxley, and the Problems with Legislating Good Behavior*, 116 HARV. L. REV. 2123, 2128-30 (2003) (discussing the “irrelevance” of Enron’s code of conduct in relation to the company’s downfall) [hereinafter *Corporate Codes of Ethics*].

<sup>84</sup> DEREK HIGGS, REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (2003), [http://www.dti.gov.uk/cld/non\\_exec\\_review/pdfs/higgsreport.pdf](http://www.dti.gov.uk/cld/non_exec_review/pdfs/higgsreport.pdf) [hereinafter HIGGS REPORT].

<sup>85</sup> According to Derek Higgs, the “brittleness and rigidity of legislation cannot dictate the behaviour, or foster the trust, I believe is fundamental to the effective unitary board and to superior corporate performance.” *Id.* at 3.

<sup>86</sup> U.K. COMBINED CODE, *supra* note 37; see also Press Release, Financial Reporting Council, FRC Issues Revised Combined Code (July 23, 2003), <http://www.frc.org.uk/press/pub0311.html>. Some specific recommendations of the Higgs Report (for example, that the chairman should not be allowed to chair the nomination committee) were wound back in the revised Combined Code amendments.

In the United States, the regulatory response to the collapse of Enron focused attention on governance by self-regulatory organizations and federal legislation and regulations.<sup>87</sup> These U.S. reforms (the 2002 reforms), under the revised New York Stock Exchange (NYSE) and NASDAQ listing requirements<sup>88</sup> as well as the demands of SOX, represent an interesting contrast to the Australian and U.K. regulatory responses in several respects. First, the 2002 reforms constitute a shift towards a legislative rules-based approach to corporate governance, with a higher level of mandatory governance standards. The final NYSE corporate governance rules,<sup>89</sup> for example, introduce a range of new mandatory requirements concerning board structure<sup>90</sup> to reflect generally accepted best practice in corporate governance. The

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<sup>87</sup> *E.g.*, Robert B. Thompson, *Corporate Governance After Enron*, 40 Hous. L. Rev. 99 (2003).

<sup>88</sup> For a useful comparative review of corporate governance reforms under the NYSE and NASDAQ requirements, see Weil, Gotshal and Manges LLP, Revised NYSE Corporate Governance Listing Standard Proposals (Apr. 15, 2003), [http://65.214.34.40/wgm/cwgmhomep.nsf/Files/RevisedNYSECorpGovListing/\\$file/RevisedNYSECorpGovListing.pdf](http://65.214.34.40/wgm/cwgmhomep.nsf/Files/RevisedNYSECorpGovListing/$file/RevisedNYSECorpGovListing.pdf).

<sup>89</sup> The NYSE corporate governance rules are codified in § 303A of the Stock Exchange's Listed Company Manual. NYSE, Inc., Listed Company Manual § 303A (2003). The background to the NYSE corporate governance rules is as follows. On February 13, 2002, the then-Chairman of the Securities and Exchange Commission, Harvey Pitt, requested that the NYSE review its corporate governance listing standards. The NYSE appointed a Corporate Accountability and Listing Standards Committee ("the Committee") to carry out this review. On June 6, 2002, the NYSE released the Committee's report. The NYSE Board of Directors approved the Committee's corporate governance rule proposals on August 1, 2002. The final NYSE corporate governance rules were approved by the SEC on November 4, 2003. See Press Release, U.S. Sec. and Exch. Comm'n, SEC Approves NYSE, NASDAQ Strengthening of Corporate Governance Standards for Listed Companies (Nov. 4, 2003), <http://www.sec.gov/news/press/2003-150.htm>; NYSE, Inc., Corporate Governance Rule Proposals Reflecting Recommendations from the NYSE Corporate Accountability and Listing Standards Committee As Approved by the NYSE Board of Directors August 1, 2002 (2002), [http://www.nyse.com/pdfs/corp\\_gov\\_pro\\_b.pdf](http://www.nyse.com/pdfs/corp_gov_pro_b.pdf).

<sup>90</sup> *Id.* For example, the NYSE corporate governance rules under § 303A provide, with some limited exceptions, that listed companies must have a majority of independent directors, *id.* § 303A.01; must have separate executive meetings of non-management directors, *id.* § 303A.03; must have a nominating/corporate governance and compensation committee composed entirely of independent directors, *id.* §§ 303A.04-05; must have an audit committee with a minimum of three members, all of whom must be independent, *id.* §§ 303A.06-07; must adopt corporate governance guidelines and a code of business conduct and ethics, *id.* §§ 303A.09-10; and that the CEO of a listed company must certify to the NYSE each year

reforms deviate from the traditional U.S. state-based model of corporate law as essentially “facilitative.”<sup>91</sup> While some provisions in SOX are framed as disclosure provisions only,<sup>92</sup> it has been argued that the likely impact of these provisions will be to mandate compliance.<sup>93</sup>

Second, the substance of many of the NYSE corporate governance rules is stricter than its counterparts in other jurisdictions, such as Australia.<sup>94</sup> Third, the reforms under SOX have a greater emphasis on criminal liability in corporate governance<sup>95</sup> than reforms in the United Kingdom and Australia. Finally, the reforms constitute an important reallocation of power in relation to the regulation of U.S. corporate law. Against the traditional backdrop of corporate governance regulation via state-based enabling legislation, SOX introduces prescriptive rules relating to corporate governance at a federal government level. It is this

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that he or she is not aware of any violation by the company of the NYSE corporate governance listing standards, *id.* § 303A.12.

<sup>91</sup> See, e.g., ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 85 (1993).

<sup>92</sup> See, e.g., Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002). The Act requires a company to disclose whether it has adopted a code of ethics for senior financial officers (and if not, why not). *Id.* § 406. It also requires an issuer to disclose whether at least one member of the audit committee is a financial expert (and if not, why not). *Id.* § 407.

<sup>93</sup> See Thompson, *supra* note 87, at 104.

<sup>94</sup> Compare NYSE, Inc., Listed Company Manual § 303A.02 (2003) with ASX Recommendations, *supra* note 38, at 20. The definition of “independence” is stricter under the NYSE corporate governance rules than under the ASX Corporate Governance Council’s Recommendations. For example, § 303A of the NYSE corporate governance rules refers to a number of relationships that will render a director ineligible from being considered independent. Also, while the NYSE corporate governance rules require that the audit committee, nominating committee, corporate governance committee and compensation committee should be composed entirely of independent directors, the Australian governance principles recommend only that such committees comprise a majority of independent directors.

<sup>95</sup> See, e.g., Sarbanes-Oxley Act, Pub. L. No. 107-204, tit. VIII, 116 Stat. 745, 800-04 (2002) (“Corporate and Criminal Fraud Accountability”); *id.* at 804-06 (Title IX, “White Collar Crime Penalty Enhancements”); *id.* at 807-10 (Title XI, “Corporate Fraud and Accountability”).

aspect of SOX that has been described as creating “shadow corporation law.”<sup>96</sup>

The 2002 reforms have been controversial from both international and U.S. perspectives. For example, Derek Higgs, the author of the U.K. Higgs Report, strongly criticized the shift from commercial norms to legislation under the U.S. reforms as creating an overly complex and prescriptive regime that would be difficult to enforce.<sup>97</sup> U.S. commentators were divided on the impact and wisdom of the 2002 reforms. Some viewed the reforms as a watershed in U.S. corporate law. Professor Bainbridge, for example, described them as “the most dramatic expansion of federal regulatory power over corporate governance since the New Deal,” arguing that the reforms were “deeply flawed” and would undermine traditional board autonomy.<sup>98</sup> Other commentators, however, viewed the reforms essentially as political window-dressing, containing extravagant rhetoric unmatched by the promise of significant deterrence or effective enforcement.<sup>99</sup>

Yet, the ultimate influence of the 2002 reforms could be more subtle than this. Whereas traditionally, corporate governance norms have preceded law, the post-Enron regulatory reforms suggest that the reverse may now be occurring in the U.S: law may be driving norms.

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<sup>96</sup> William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 973 (2003).

<sup>97</sup> See Andrew Parker & Tony Tassell, *US Corporate Reform Efforts Come Under Attack in Britain*, FIN. TIMES (London), Jan. 21, 2003, at 1. Continental Europe demonstrated ambivalence to the U.S. reforms. While there was considerable resistance to the rules-based regulatory approach of the U.S. reforms, countries such as France and Germany were nonetheless prepared to adopt reforms based on the Sarbanes-Oxley Act; see generally Enriques, *supra* note 12, at 918-22.

<sup>98</sup> Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REGULATION, Spring 2003, at 26, 29; see also Thompson, *supra* note 87, at 100 (arguing that the enduring legacy will be to make federal law an equal partner with state law in the area of corporate governance).

<sup>99</sup> See, e.g., Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915 (2003); Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN'S L. REV. 671 (2002); Ribstein, *supra* note 47 (expressing skepticism about the extent to which the 2002 reforms will effect significant changes to existing U.S. law).

Corporate governance changes implemented by General Electric Company (GE) following the 2002 reforms are indicative of such a trend in the direction of supermajority boards. The NYSE corporate governance rules now require listed companies to have a majority of independent directors.<sup>100</sup> However, GE announced that the company had adopted a new policy, whereby two-thirds of its board members were independent, and that pursuant to this policy, two directors (who did not satisfy the requirement of independence) would leave the board.<sup>101</sup>

International reaction to the stringency of the United States' post-Enron regulatory reforms has challenged a commonly held assumption that cross-listing of foreign firms on the NYSE, as a method of opting into a rigorous governance system, would contribute to convergence of corporate governance practices.<sup>102</sup> Some high profile Asian companies, such as Air China, have recently bypassed cross listing on the NYSE in favor of other international exchanges such as London and Hong Kong.<sup>103</sup> This suggests that stringent governance requirements in a particular jurisdiction may, in fact, discourage cross listing.<sup>104</sup>

#### IV. INTERNATIONAL REGULATORY DEVELOPMENTS AND THE BOARD OF DIRECTORS: THE "INDEPENDENCE" REQUIREMENT

'Cause you know sometimes words have two meanings.

—Stairway to Heaven by Led Zeppelin<sup>105</sup>

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<sup>100</sup> NYSE, Inc., Listed Company Manual § 303A.01 (2005).

<sup>101</sup> See *General Electric Appoints 2 Independent Directors*, N.Y. TIMES, Oct. 29, 2002, at C4; *GE Says It Is Dropping 2 Directors from Board*, N.Y. TIMES, Nov. 8, 2002, at C4.

<sup>102</sup> See Licht, *supra* note 9, at 197.

<sup>103</sup> E.g., Daniel Hilken, *New York Shy*, STANDARD (Hong Kong), Apr. 30-May 1, 2005, available at <http://www.thestandard.com.hk/stdn/std/Weekend/GD30Jp19.html>; *New Rules in the Global Fight for Listings*, FIN. TIMES (London), Mar. 11, 2005, at 15.

<sup>104</sup> Licht, *supra* note 9, at 197-98; see also Alison Maitland, *BT Chairman Criticises US Governance*, FIN. TIMES (London), Nov. 23, 2004, at 22.

<sup>105</sup> JIMMY PAGE & ROBERT PLANT, *Stairway to Heaven*, on LED ZEPPLIN, LED ZEPPLIN IV (Atlantic Records 1971).

The abiding lesson of the international corporate collapses is not new. It is about the need to control conflicts of interest. A major theme in the regulatory responses in the U.S., United Kingdom, and Australia was strengthening the role and structure of both external monitors, such as auditors,<sup>106</sup> and internal corporate monitors as a means of controlling managerial conflicts of interest and misconduct.

Reforms relating to board structure constitute an important intra-corporate regulatory response to the corporate collapses.<sup>107</sup> Superficially, there appears to be a high level of convergence among the U.S., U.K., and Australian corporate governance reforms in relation to independent directors. The idea of the independent director has become the new “Holy Grail” under the reforms, and will resonate through the entire board structure. For example, the United States’ 2002 reforms require listed company boards to have a majority of independent directors and to have compensation, nominating and audit committees composed entirely of independent directors.<sup>108</sup>

The attitude toward independent directors in jurisdictions with concentrated ownership structures is more tentative. An influential European report, the Winter Report, considered that non-executive or supervisory directors were also important in

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<sup>106</sup> The audit function, which is outside the scope of this paper, was a major theme in the international post-collapse regulatory reforms. For example, a significant proportion of both the Sarbanes-Oxley Act 2002 in the U.S. and the CLERP 9 Act of 2004 in Australia is devoted to issues involving auditor qualifications, independence and oversight. See Sarbanes-Oxley Act, Pub. L. No. 107-204, §§ 101-301, 116 Stat. 745, 750-77 (2002); CLERP 9 Act, *supra* note 37. This represents a widespread assumption that audit failure was a cause of the collapses. See generally John C. Coffee, Jr., *Understanding Enron: “It’s About the Gatekeepers, Stupid”*, 57 BUS. LAW. 1403 (2002); Melissa Fogarty & Alison Lansley, *Sleepers Awake! Future Directions for Auditing in Australia*, 25 U.N.S.W. L.J. 408, 421 (2002). This assumption was based on the view that commercial changes in the 1990s, particularly in the growth of cross-selling of non-audit services compromised auditor independence and provided incentives for acquiescent behavior by auditors. See John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 321 (2004); Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1237-40 (2002).

<sup>107</sup> See *Developments in the Law – Corporations and Society*, *supra* note 13, at 2181-82.

<sup>108</sup> See Sarbanes-Oxley Act, Pub. L. No. 107-204, § 301, 116 Stat. 745, 775-77 (2002); NYSE, Inc., Listed Company Manual §§ 303A.01, 04-06 (2003).

companies with a majority shareholder, as a means of ensuring independent monitoring on behalf of minority shareholders.<sup>109</sup> Nonetheless, there may be strong cultural resistance to independent directors in jurisdictions where concentrated ownership structures have traditionally prevailed. The Winter Committee, for example, explicitly rejected the U.S. paradigm of exclusively independent committees as inappropriate in the European context, where controlling shareholders and employee co-determination are common features of the corporate governance landscape.<sup>110</sup> It has also been suggested that, in parts of Asia, a “truly independent director may be considered an outsider rather than an outside director.”<sup>111</sup>

The concept of the independent director is a seductive one. It is one of at least three basic techniques used by corporate law to control conflicts of interest, particularly in areas such as executive remuneration.<sup>112</sup> International committees and standards of best practice on corporate governance<sup>113</sup> have long recommended there be a sufficient proportion of outside directors to exert a real level of influence on the board and therefore enhance accountability.

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<sup>109</sup> See HIGH LEVEL GROUP OF CO. LAW EXPERTS, REPORT OF THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS ON A MODERN REGULATORY FRAMEWORK FOR COMPANY LAW IN EUROPE 59-60 (2002), [http://europa.eu.int/comm/internal\\_market/en/company/company/modern/consult/report\\_en.pdf](http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf).

<sup>110</sup> *Id.* at 61.

<sup>111</sup> Licht, *supra* note 9, at 225.

<sup>112</sup> Other techniques are fiduciary duties (comprising self-constraint, with judicial enforcement), and alignment of managerial self-interest with the interests of shareholders. Jennifer Hill & Charles M. Yablon, *Corporate Governance and Executive Remuneration: Rediscovering Managerial Positional Conflict*, 25 U.N.S.W. L.J. 294, 301 (2002).

<sup>113</sup> In the U.K. see, for example, CADBURY REPORT, *supra* note 63, § 4.11. In Australia, see HENRY BOSCH, CORPORATE PRACTICES AND CONDUCT 14 (1991). In the U.S., see PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3A.01 (1994).

The rise of the independent director in the United States has been dramatic. One commentator has said that the “most noticeable aspect of American corporate governance is the law’s repeated resort to the independent director as a cleansing agent.”<sup>114</sup> For example, in the area of self-dealing transactions, the U.S. regulatory approach shifted from outright prohibition to use of independent directors as a filtering device.<sup>115</sup> This structural, legitimizing role for independent directors has been far less apparent in the United Kingdom and Australia, where traditionally there is no clear distinction between non-executive directors and the stricter concept of independent directors, and where shareholders perform a more important role in addressing conflicts of interest.<sup>116</sup>

Deeply embedded in corporate governance literature is the assumption that independent outside directors (as opposed to “affiliated” outside directors) make better monitors. While empirical studies have yet to prove a positive connection between independent boards and corporate performance,<sup>117</sup> this assumption lies at the heart of the current reforms in the United States, United Kingdom, and Australia.

The definition of “independent director” under the United States 2002 reforms has been described as “relatively pristine.”<sup>118</sup> One controversial element of the definition of “independence” is its ambivalent attitude toward directors who have a connection to major shareholders. Some would regard directors who represent major shareholders as possessing the ideal characteristics

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<sup>114</sup> James D. Cox, *Corporate Governance in the United States: The Evolving Role of the Independent Board*, in *CORPORATE GOVERNANCE: AN ASIA-PACIFIC CRITIQUE* 379, 388 (Low Chee Keong ed., 2002). See generally Laura Lin, *The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence*, 90 *Nw. U. L. REV.* 898, 904-12 (1996).

<sup>115</sup> See, e.g., Harold Marsh, Jr., *Are Directors Trustees? Conflicts of Interest and Corporate Morality*, 22 *BUS. LAW.* 35 (1966); Brudney, *supra* note 55, at 608-09.

<sup>116</sup> On contrasts between U.S. and U.K. law in this regard, see Deborah A. DeMott, *The Figure in the Landscape: A Comparative Sketch of Directors’ Self-Interested Transactions*, 62 *LAW & CONTEMP. PROBS.*, Summer 1999, at 243, 245-46. The U.K. Combined Code on Corporate Governance for example, still often focuses on “non-executive directors,” rather than “independent directors.” See U.K. COMBINED CODE, *supra* note 37, at 4.

<sup>117</sup> See Bainbridge, *supra* note 98, at 29.

<sup>118</sup> Chandler & Strine, *supra* note 96, at 987.

and incentives to serve as effective monitors. Nonetheless, such a concept is generally rejected in the post-Enron reforms, and it has been argued that the 2002 reforms implicitly adopt a view that ownership by a director, or affiliation with the owner, of a significant block of shares taints the director's independence.<sup>119</sup>

Although the commentary to the NYSE Corporate Governance Rules states that ownership, even of a significant amount, of stock would not be viewed "by itself" a bar to independence,<sup>120</sup> stock ownership may be a bar to independence for the purposes of membership of the audit committee under sec. 301 of SOX.<sup>121</sup> This latter approach to "independence" is replicated in the definition of "independence" in Australia under Principle 2 of the ASX corporate governance principles.<sup>122</sup> However, whereas 10 percent stock ownership will preclude independence under sec. 301 of SOX, a lower threshold of 5 percent shareholding applies for the purposes of the ASX corporate governance principles.<sup>123</sup>

The vision of independence under the 2002 reforms is interesting because it seems to encompass not only independence from management, but also independence from stakeholders, who may have strong incentives to monitor. From this perspective, it cuts across much accepted wisdom in contemporary corporate governance, concerning capacity and incentives of outside directors to function as effective monitors.<sup>124</sup> Particularly problematic is the danger that genuine independence may often be accompanied by ignorance and ineffectiveness.

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<sup>119</sup> *Id.* at 989-90.

<sup>120</sup> NYSE, Inc., Listed Company Manual § 303A.02 (2003).

<sup>121</sup> Under Sarbanes-Oxley § 301(3), for purposes of the audit committee, a director is deemed independent by Sarbanes-Oxley only if he or she is not an "affiliated person" of the company or one of its subsidiaries. For the implications of this provision on equity ownership by members of the audit committee, see generally Chandler & Strine, *supra* note 96, at 990-91; Deborah A. DeMott, *The Texture of Loyalty* 16-17 (Duke Law Sch. Legal Studies Research Paper Series, Research Paper No. 64, Mar. 2005), available at <http://ssrn.com/abstract=696881>.

<sup>122</sup> ASX Recommendations, *supra* note 38, at 20 ("An independent director is a non-executive director (i.e., is not a member of management) and: (1) is not a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company. . . .").

<sup>123</sup> *Id.* at 20 & n.6 (using "substantial holding" as defined in Corporations Act, 2001, § 9 (Austl.) as having 5 percent or more of the total number of votes attached to voting shares in the body or voting interests in the scheme).

<sup>124</sup> See generally Chandler & Strine, *supra* note 96, at 989-90.

There is an important exception to the independent director requirements under the NYSE corporate governance rules. “Controlled companies”—those which are more than 50 percent controlled by an individual, company or group<sup>125</sup>—are exempt from the independent director requirements. This exemption is proving significant for some foreign issuers listed on the NYSE. For example, PetroChina Co. Ltd. recently explained its deviation from the Exchange Rules relating to independent directors on the basis that the company fell within the “controlled company” exception, since China National Petroleum Corporation controls 90 percent of the company.<sup>126</sup>

The United States 2002 reforms, which require that the compensation, audit, and nominating and governance committees of listed companies must be composed entirely of independent directors,<sup>127</sup> are stricter, and go further, than parallel reforms in Australia and the United Kingdom. The ASX *Principles of Good Corporate Governance and Best Practice Recommendations*, for example, merely recommend that a majority of directors on these committees should be independent.<sup>128</sup> The recommendations under the U.K. Higgs report, subsequently enacted in the *Combined Code on Corporate Governance*, provide an interesting contrast to the 2002 reforms and contain a deceptively radical reform agenda. Like the NYSE corporate governance rules, the Higgs Report recommended that at least half the board should be independent non-executive directors<sup>129</sup> and included a high standard of independence. Indeed, the definition of independence in the Higgs Report is arguably more “pristine” than that of the NYSE corporate governance rules, since the Higgs Report required the board to determine that the director is independent,

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<sup>125</sup> NYSE, Inc., Listed Company Manual § 303A.00 (2005).

<sup>126</sup> PetroChina Co. Ltd. has 3 independent non-executive directors on its 13 member board. *PetroChina lists Differences in Corp Governance Practices Vis-a-Vis U.S. Issuers*, AFX-ASIA, Apr. 4, 2005, available at LEXIS.

<sup>127</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301(3)(a), 116 Stat. 745, 776; NYSE, Inc., Listed Company Manual §§ 303A.04-06 (2005).

<sup>128</sup> ASX Recommendations, *supra* note 38, at 22, 30, 54.

<sup>129</sup> HIGGS REPORT, *supra* note 84, at 35. Note, however, that this requirement was subsequently restricted under the revised Combined Code to companies falling within FTSE 350, on the basis that compliance would be difficult for smaller companies. U.K. COMBINED CODE, *supra* note 37, at 7 n.7.

not only in the sense of being free from material relationships with the corporation, but also “in character and judgment.”<sup>130</sup>

Although under the Higgs Report the fact that a director represents a particular “significant shareholder” constituted a relationship or circumstance which could undermine independence,<sup>131</sup> the report nonetheless strengthened the position of independent directors by envisaging a close relationship between major shareholders and directors after their appointment to the board. For example, the Higgs Report recommended the appointment of a senior independent director who should be available to resolve shareholder concerns “that have not been resolved “through the normal channels of chairman or chief executive,”<sup>132</sup> and advocated a range of techniques for establishing close contact and a relationship between non-executive directors and major shareholders.<sup>133</sup> These recommendations have translated into a key principle under the *Combined Code on Corporate Governance* 2003, that there should be “active dialogue” between the board and institutional investors.<sup>134</sup>

The U.K. Higgs Report also endorsed the ISC code of activism, which adopted a norm requiring institutional investors to intervene in the affairs of underperforming companies “when necessary.”<sup>135</sup> The relationship between non-executive board

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<sup>130</sup> HIGGS REPORT, *supra* note 84, at 81; *see also* U.K. COMBINED CODE, *supra* note 37, at 7.

<sup>131</sup> HIGGS REPORT, *supra* note 84, at 82; *see also* U.K. COMBINED CODE, *supra* note 37, at 7.

<sup>132</sup> HIGGS REPORT, *supra* note 84, at 31; *see also* U.K. COMBINED CODE, *supra* note 37, at 7, 18.

<sup>133</sup> HIGGS REPORT, *supra* note 84, at 69. Some of the recommendations of the Higgs Committee in this regard included proposals that the senior independent director should attend regular meetings with management and “a range of major shareholders” to develop an understanding of shareholder concerns, *id.*; that non-executive directors should be able to meet with major investors and should expect to do so if requested by the major investors, *id.*; that non-executive directors should meet with major investors as part of their induction into the company, *id.*; that a company should state what steps it has taken “to ensure that members of the board, and in particular the non-executive directors, develop a balanced understanding of the views of major investors.” *Id.*

<sup>134</sup> U.K. COMBINED CODE, *supra* note 37, at 18.

<sup>135</sup> INSTITUTIONAL SHAREHOLDERS’ COMMITTEE, THE RESPONSIBILITIES OF INSTITUTIONAL SHAREHOLDERS AND AGENTS - STATEMENT OF PRINCIPLES 3-4 (2002) (§ 4 “Intervening when necessary”).

members and major investors under the Higgs Report appears to be a variation of John Pound's political theory of the corporation, which envisaged a high level of interaction between management and major investors.<sup>136</sup>

In contrast to the Higgs Report, the concept of increased shareholder participation in corporate governance was muted in the United States 2002 reforms. At the time of the introduction of the reforms, two members of the Delaware judiciary asked whether a greater role for shareholders in the director election process might be the "forgotten element."<sup>137</sup> This possible lacuna recently gave rise<sup>138</sup> to a major controversy in the United States regarding participation by shareholders in the board nomination process.<sup>139</sup> Although the impetus for greater shareholder participation in the U.S. board nomination process appears to have abated, it is likely that the general issue of shareholder participation in corporate governance will continue to be contentious.<sup>140</sup>

To what extent will reliance on independent directors provide a panacea to the recent international corporate malaises? In relation to the Australian corporate collapses, there is no doubt that the boards of HIH and One.Tel both displayed deficiencies in the level of independence of board members. Nonetheless, it is doubtful whether differently structured boards would have altered the outcomes. At HIH, five of the seven directors were outside non-executive directors, but their independence was compromised by a number of factors. For example, three of the

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<sup>136</sup> See John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control*, 68 N.Y.U. L. REV. 1003 (1993). Cf. U.K. COMBINED CODE, *supra* note 37, at 18-19 (§ D.1 "Dialogue with Institutional Shareholders" and § E.1 "Dialogue with companies").

<sup>137</sup> Chandler & Strine, *supra* note 96, at 999.

<sup>138</sup> The issue arose from the SEC's recommendation in its 2003 Staff Report that there should be increased shareholder participation in the U.S. director nomination process, via use of the company's proxy statement to conduct a contested board election. See SEC. & EXCH. COMM'N, DIV. OF CORP. FIN., STAFF REPORT: REVIEW OF THE PROXY PROCESS REGARDING THE NOMINATION AND ELECTION OF DIRECTORS 30-31 (2003).

<sup>139</sup> See, e.g., Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 (2003); Martin Lipton & Steven A. Rosenblum, *Election Contests In the Company's Proxy: An Idea Whose Time Has Not Come*, (2003) 59 BUS. LAW. 67 (2003).

<sup>140</sup> See, e.g., Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

board members, including the chairman, were former partners of Arthur Andersen, HIH's auditor.<sup>141</sup> Two other clearly affiliated, non-executive directors were Rodney Adler, the former CEO of FAI Insurance, and HIH's legal adviser.<sup>142</sup> At One.Tel, the role of non-executive directors, James Packer and Lachlan Murdoch, is interesting.<sup>143</sup> Professor Langevoort has stated that good boards provide a crucial link with the outside world, enabling the corporation to claim and protect "its shares of external resources" by legitimizing the company in the eyes of key resource holders.<sup>144</sup> James Packer and Lachlan Murdoch, as representatives of One.Tel's major investors, arguably fulfilled this function, giving One.Tel credibility in the marketplace. Such a role, however, conflicts with the current definitions of independence.

However, it is by no means clear that lack of independence of directors at HIH and One.Tel actually contributed to the collapses. A key problem in the cases of both HIH and One.Tel was management's ability to block, filter or distort information reaching the board.<sup>145</sup> This problem is not necessarily solved by having a high proportion of independent directors.<sup>146</sup> Even prior to the 2002 reforms, there had been a strong increase in the United States in supermajority independent boards, with only one or two

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<sup>141</sup> The HIH chairman also continued to receive financial benefits from Andersen through a consultancy arrangement. HIH REPORT, *supra* note 15, at lvi.

<sup>142</sup> See HIH ANNUAL REPORT, *supra* note 76, at 13.

<sup>143</sup> It has, in the past, been less common for representatives of major shareholders to sit on boards in Australia than in other parts of the world. According to EGON ZEHNDER INTERNATIONAL, BOARD OF DIRECTORS GLOBAL STUDY 29 (2000), only 18% of Australian respondents reported that representatives of major shareholders sat on the board. This contrasted with 76% in Asia, 42% in Europe and 28% in North America. *Id.*

<sup>144</sup> Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 802 (2001).

<sup>145</sup> See HIH Report, *supra* note 15, at xxxix-xl, xliii.

<sup>146</sup> See Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 292-95 (2004) (outlining cognitive and other constraints, which may affect boards). Professor Langevoort stresses these cognitive constraints "rather than the over-simple politics of board capture." *Id.* at 289.

insiders on the board.<sup>147</sup> This is in contrast to the United Kingdom, where boards of public companies historically have had a higher percentage of executive directors.<sup>148</sup> Although the 2002 reforms mandate only a *majority* of independent directors on the boards of publicly listed U.S. companies, it is generally assumed that the rules will actually result in supermajority independent boards, due to the need to ensure that major board committees are wholly independent. This development may be demonstrated by the case of GE, discussed above. Alternatively, the 2002 reforms may prompt a shift back to larger boards, which recent principles of best practice in corporate governance have discouraged.

Insiders can, however, perform a valuable role, and the single-minded focus on the need for independent directors under the 2002 reforms may be misguided. Research shows, for example, that boards dominated by independent directors may be more effective in performing certain tasks, such as removal of CEOs for underperformance,<sup>149</sup> than in a general monitoring and advisory role. It seems that independent outside directors are also often reluctant to take an activist stance while publicly available performance criteria remain “respectable,”<sup>150</sup> yet one of the most potent messages of the international corporate collapses was the ability of management to use earnings management to create an illusion of respectability.<sup>151</sup> Similar reasoning also applies in relation to board committees, where inside directors may play a valuable role.<sup>152</sup>

In situations, such as at HIH and One.Tel, where there is distortion or withholding of information by management to the

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<sup>147</sup> See, e.g., Sanjai Bhagat & Bernard Black, *Board Composition and Firm Performance: The Uneasy Case for Majority-Independent Boards*, in CORPORATE GOVERNANCE INSTITUTE: BLUEPRINT FOR GOOD GOVERNANCE IN THE 1990s 95, 98 (1998).

<sup>148</sup> DeMott, *supra* note 116, at 248.

<sup>149</sup> See, e.g., Michael S. Weisbach, *Outside Directors and CEO Turnover*, 20 J. FIN. ECON. 431, 433-34 (1988).

<sup>150</sup> Bhagat & Black, *supra* note 147, at 101.

<sup>151</sup> See generally Gregory S. Rowland, *Earnings Management, the SEC, and Corporate Governance: Director Liability Arising from the Audit Committee Report*, 102 COLUM. L. REV. 168 (2002).

<sup>152</sup> See, e.g., April Klein, *Firm Performance and Board Committee Structure*, 41 J.L. & ECON. 275 (1998).

board, the presence of a supermajority of outside independent directors may only exacerbate the problem. The U.K. Higgs Committee clearly recognized this dilemma. While advocating a majority independent board, the Committee also recommended that there should be a strong executive presence on the board, to act as an informational check.<sup>153</sup>

Another problem with the touchstone of independence is that it is a slippery concept. Even when directors technically qualify as “independent,” there are a range of familiar psychological factors that can erode genuine independence, such as loyalty to an appointer on the board; “groupthink,” which can result in conformity of ideas and approach;<sup>154</sup> aversion of board members to adversarial roles; and similarity of executives’ and outside directors’ backgrounds and social circles.<sup>155</sup> The way in which “thick” social and institutional connections may affect a director’s independence was recently recognized by the Delaware Court of Chancery in *In re Oracle Corp Derivative Litigation*.<sup>156</sup> The One.Tel scenario also provides a good example of these more subtle factors that may impair independent judgment, yet will not necessarily fall foul of the relation-based tests for independence in, for example, the NYSE governance rules or the ASX corporate governance principles.<sup>157</sup>

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<sup>153</sup> HIGGS REPORT, *supra* note 84, at 33 (“There is a greater risk of distortion or withholding of information, or lack of balance in the management contribution to the boardroom debate, when there is only one or a very small number of executive directors on the board.”); *see also* U.K. COMBINED CODE, *supra* note 37, at 6 (recommending a balance between executive and non-executive directors “such that no individual or small group of individuals can dominate the board’s decision taking”).

<sup>154</sup> *See generally* Marleen A. O’Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003); Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 32 (2002).

<sup>155</sup> *See, e.g.*, James D. Cox & Henry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporal Cohesion*, 48 LAW & CONTEMP. PROBS. 83, 105-08 (1985).

<sup>156</sup> 824 A.2d 917 (Del. Ch. 2003); *Cf.* *Beam v. Stewart*, 845 A.2d 1040 (Del. 2004). *See generally* DeMott, *supra* note 121, at 26.

<sup>157</sup> The financial press made much of the fact that the CEO, Jodee Rich and two of the non-executive directors, James Packer and Rodney Adler, attended the same exclusive private Sydney boys’ school. *See, e.g.*, Patrice Gibbons, *Alumni of Upper Class Rooms*, BUS. REV. WKLY. (Melbourne), May 18, 2001, at 70.

In the cases of HIH and One.Tel, there is no doubt that effective checks and balances were both lacking and desirable. Ray Williams at HIH, and Jodee Rich at One.Tel, had notoriously dominating and charismatic personalities. Both had started the businesses from scratch and were regarded as visionaries.<sup>158</sup> Behavioral literature suggests that it is particularly important to have effective governance constraints for such business leaders,<sup>159</sup> who are often prone to the psychological trait of “overconfidence”<sup>160</sup> in their company.<sup>161</sup> A supermajority independent board will not necessarily be effective in this role.

One corporate governance device to deal with the problem of the charismatic CEO is the technique of separating the role of CEO and chair of the board. Most publicly listed companies in Australia and the United Kingdom adopt this practice, and it is expressly recommended under corporate governance principles in these jurisdictions.<sup>162</sup> Most listed U.S. corporations do not separate the roles, and this position was left unaltered by the 2002 reforms.<sup>163</sup> This, however, may be changing. Some commentators viewed the shareholder revolt at Disney in 2004, which resulted in CEO Michael Eisner losing his joint position as chairman of the board, as a sea change in the United States.<sup>164</sup>

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<sup>158</sup> E.g., Anne Davies, *Fluctuating Fortunes on Rich List*, SYDNEY MORNING HERALD, May 18, 2001, at 25.

<sup>159</sup> For an interesting analysis, see Michael Maccoby, *Narcissistic Leaders: The Incredible Pros, the Inevitable Cons*, HARV. BUS. REV., Jan.-Feb. 2000, at 69. According to Maccoby, narcissistic leaders thrive in chaotic times and have “compelling, even gripping, visions for companies, and they have an ability to attract followers.” *Id.* at 72.

<sup>160</sup> See Langevoort, *supra* note 146, at 299 (arguing that psychological traits such as overconfidence and optimism may be positively favoured within the world of corporate tournament theory).

<sup>161</sup> See Bainbridge, *supra* note 154, at 29-30 (“Although individuals may well be better at devising a brilliant plan [than groups], individuals often become wedded to their plans and fail to see flaws that others might identify . . . the board serves to constrain subordinates who have become wedded to their plans and ideas, rather than developing such plans in the first instance.”).

<sup>162</sup> See ASX Recommendations, *supra* note 38, at 21; HIGGS REPORT, *supra* note 84, at 23; U.K. COMBINED CODE, *supra* note 37, at 6.

<sup>163</sup> E.g., Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

<sup>164</sup> See Stephen Davis, *Culture Shift Shakes Corporate America*, FIN. TIMES (London), Mar. 15, 2004, at 7.

## V. AN EVOLVING ROLE FOR THE BOARD?

The recent worldwide corporate collapses resulted in a re-consideration of the appropriate role of the board and the nature of its interaction with management. A tension exists between the perception that boards require a sense of collegiality to perform well,<sup>165</sup> and the belief, expressed by Warren Buffett, that “dissent is needed in the boardroom.”<sup>166</sup> This tension was evident in a recent corporate governance mêlée at a major Australian bank, the National Australia Bank, where the tough stance taken by one independent director on the issue of a foreign trading scandal at the bank led remaining board members to convene a general meeting of shareholders to seek her removal from office.<sup>167</sup>

The corporate collapses also revived theoretical debate concerning the duties of directors and the nature of corporate governance generally. The collapses led to reconsideration of the implications of a shareholder-centered perception of corporate governance, in which the board’s sole goal is profit-maximization for the benefit of shareholders, and the part that such a model may have played in the collapses.<sup>168</sup>

Despite the dominance of a shareholder-centered paradigm in countries like the United States and Australia, it is only one of

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<sup>165</sup> See DeMott, *supra* note 121, at 10-11.

<sup>166</sup> *Dissent Is Needed in the Boardroom; Higgs’ Critics Have Failed to Grasp Why Change Is Needed*, FIN. TIMES (London), Mar. 10, 2003, at 20.

<sup>167</sup> Briefly, the background to this dispute was as follows. In January 2004, the then-CEO of the National Australia Bank (“NAB”), Frank Cicutto, announced that the bank was investigating currency option losses of approximately A\$180 million (the losses were subsequently assessed at A\$360 million). The CEO and Chairman of NAB resigned soon afterwards. NAB also announced that it had commissioned PricewaterhouseCoopers to conduct an investigation and prepare a report into the foreign exchange trading scandal. Catherine Walter, one of NAB’s non-executive independent directors, challenged the legitimacy of the report, claiming that PricewaterhouseCoopers had significant conflicts of interest. At a board meeting in March 2004, Catherine Walter was asked to resign as a director. When she refused to do so, the other directors announced that they intended to convene an extraordinary general meeting of shareholders to remove her from office. See *Timeline of NAB’s Recent Ups and Downs*, AAP NEWSFEED, May 11, 2005, available at LEXIS; Andrew Cornell & Stewart Oldfield, *Where NAB Went Wrong*, AUSTL. FIN. REVIEW, May 8, 2004, at 20; Pamela Williams, *The Heretic*, AUSTL. FIN. REVIEW, Aug. 27, 2004, at 74.

<sup>168</sup> See, e.g., William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002); Margaret M. Blair, *Directors’ Duties in a Post-Enron World: Why Language Matters*, 38 WAKE FOREST L. REV. 885 (2003).

a range of possible roles for the board. As Professor Brudney once noted, there are at least three possible roles for the board and independent directors – as monitors of integrity, efficiency or social responsibility.<sup>169</sup> The Cadbury Committee report in the United Kingdom stressed the integrity rationale and the importance of directors as a check on managerial misconduct, arising from lack of public confidence in the financial reporting system.<sup>170</sup> The subsequent Hampel Committee report, on the other hand, focused on an efficiency performance-based role for the board.<sup>171</sup> Many of the current corporate governance reforms in the United States, the United Kingdom, and Australia, dealing with, for example, internal corporate controls and the audit committee, represent at least a partial reversion to the image of the board as monitor of managerial and financial integrity.<sup>172</sup>

The corporate collapses also focused greater attention on the plight of stakeholders, such as employees, and on social responsibility issues.<sup>173</sup> In Australia, there has long been tension between the shareholder-centered nature of Australian corporate law and laws in other areas that effectively impose obligations on directors vis-à-vis a broader range of stakeholders. This tension is apparent in relation to Australia's corporate criminal regime, which introduces elements of a social responsibility monitoring role for directors. While under corporate law, the duty of directors to monitor diligently (or to implement compliance programs) has been relatively undemanding in both Australia and the United States,<sup>174</sup> Australian criminal law provides stronger incentives for directors to practice risk-management, and introduce codes of conduct and compliance programs. This is due to the

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<sup>169</sup> See, e.g., Brudney, *supra* note 55, at 658.

<sup>170</sup> CADBURY REPORT, *supra* note 63, § 4.5.

<sup>171</sup> See Alan Dignam, *A Principled Approach to Self-Regulation? The Report of the Hampel Committee on Corporate Governance*, 19 COMPANY LAWYER 140, 142-43 (1998).

<sup>172</sup> See, e.g., U.K. COMBINED CODE, *supra* note 37, at 16-17; DeMott, *supra* note 121, at 19.

<sup>173</sup> See Cynthia A. Williams & John M. Conley, *An Emerging Third Way?: The Erosion of the Anglo-American Shareholder Value Construct* (Univ. N.C. Legal Studies Research Paper No. 04-09, Dec. 9, 2004), available at <http://ssrn.com/abstract=632347>.

<sup>174</sup> In Australia, see, for example, *AWA v. Daniels* (1992) 7 A.C.S.R. 759; *Daniels v. Anderson* (1995) 16 A.C.S.R. 607. In the U.S., see, for example, *Graham v. Allis-*

fact that a corporation can be liable under the *Criminal Code*<sup>175</sup> if it had “a corporate culture” that encouraged or tolerated the commission of the crime.<sup>176</sup>

Several reforms, such as the provisions relating to adoption and disclosure of codes of ethics under the NYSE corporate governance rules<sup>177</sup> and SOX,<sup>178</sup> respond directly to the perception that such codes have been ineffective in preventing Enron-like collapses.<sup>179</sup> The provisions, which reflect a model of enforced self-regulation,<sup>180</sup> implicitly accept that directors and senior management play an important role in shaping the culture and setting the tone of an organization.<sup>181</sup> This is explicitly recognized in the U.K. *Combined Code on Corporate Governance*, which states that the board should set the “values and standards” of the company.<sup>182</sup> In Australia, the concept of “corporate culture” received

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Chalmers Mfg. Co., 188 A.2d 125 (Del. 1963); *In re Caremark Int'l Inc.*, 698 A.2d 959 (Del. Ch. 1996).

<sup>175</sup> The *Criminal Code* commenced general application to Commonwealth criminal offenses in December 2001. See Jennifer Hill, *Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?*, [2003] J. Bus. L. 1, 16 n.98.

<sup>176</sup> See generally *id.* at 16-20.

<sup>177</sup> See, e.g., NYSE, Inc., Listed Company Manual § 303A.10 (2003). Many of the post-Enron reforms also pay greater attention to risk management and stakeholder interests. See, e.g., ASX Recommendations, *supra* note 38. Principle 7, *id.* at 43-45 (recognizing and managing risk); Principle 3, *id.* at 25-28 (promoting ethical and responsible decision-making); Principle 10, *id.* at 59-61 (recognizing legitimate interests of stakeholders).

<sup>178</sup> Sarbanes-Oxley Act, Pub. L. No. 107-204, § 406, 116 Stat. 745, 789-90 (2002).

<sup>179</sup> See *Corporate Codes of Ethics*, *supra* note 83, at 2131, 2134 (2003) (describing the approach to corporate codes under Sec. 406 of the Sarbanes-Oxley Act as “aggressive”). Ultimately, however, the author considers that the new provision may create perverse incentives for corporate management to adopt narrow codes to restrict the circumstances in which a waiver to the code may be required, thereby undermining the policy goals of § 406. *Id.* at 2135-36.

<sup>180</sup> See generally Hill, *supra* note 53, at 56.

<sup>181</sup> See *Corporate Codes of Ethics*, *supra* note 83, at 2132; Deborah A. DeMott, *Organizational Incentives to Care About the Law*, 60 Law & Contemp. Probs. 39, 41 (1997).

<sup>182</sup> U.K. Combined Code, *supra* note 37, at 4.

prominence in a report on the National Australia Bank's unauthorized foreign exchange trading scandal in 2004, which was critical of the bank's culture.<sup>183</sup>

## VI. DIRECTOR AND OFFICER LIABILITY AS AN ACCOUNTABILITY MECHANISM

The fish rots from the head.

—Greek proverb<sup>184</sup>

One corporate governance mechanism that could improve accountability is greater judicial enforcement of director and officer liability. One of the most distinctive aspects of the international corporate scandals was the extent to which wrongdoing occurred in the upper echelons of corporate management.<sup>185</sup> Historically, the focus of corporate law in both the United States and Australia has been on liability of directors. Professors Thompson and Sale have argued, however, that this position is rapidly changing in the post-Enron U.S. context, where the expansion of federal law resulted in a new focus on the liability of corporate officers, as “the fulcrum of governance in today’s corporations.”<sup>186</sup> SOX<sup>187</sup> in the United States and the CLERP 9 Act<sup>188</sup> in Australia clearly reflect this trend by imposing an explicit obligation on chief executive officers and chief financial officers to certify their company’s financial reports. Similarly, sec. 406 of SOX focuses on senior financial officers, requiring that a public company disclose whether it has adopted a code of ethics for such officers.<sup>189</sup>

This transition in contemporary corporate law was recognized in the HIH Royal Commission Report. According to the

<sup>183</sup> See PricewaterhouseCoopers, Investigation Into Foreign Exchange Losses at the National Australia Bank 31-32 (2004), <http://www.nabgroup.national.com.au/vgnmedia/downld/pwcreport.pdf>; *NAB Head of Foreign Exchange Resigns*, FIN. STANDARD (Sydney), Mar. 18, 2004.

<sup>184</sup> See e.g., *Current Quotations*, Associated Press, August 1, 1988.

<sup>185</sup> See *Corporate Codes of Ethics*, *supra* note 83, at 2128.

<sup>186</sup> Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 861 (2003).

<sup>187</sup> Sarbanes-Oxley Act, Pub. L. No. 107-204, § 302, 116 Stat. 745, 777-78 (2002).

<sup>188</sup> Corporations Act, 2001, § 295A (Austl.).

<sup>189</sup> Sarbanes-Oxley Act, Pub. L. No. 107-204, §406, 116 Stat. 745, 789-90 (2002).

Hon. Justice Neville Owen, the traditional emphasis on the role and responsibilities of the board of directors may obscure the far more important role played by employees, such as executives and middle management, in the day-to-day business of companies.<sup>190</sup> Justice Owen stressed the need for legal liability and accountability to be coextensive with actual decision-making power within the corporation, which will often encompass employees.<sup>191</sup>

In Australia the events at HIH and One.Tel resulted in increased attention to executive officers' liability. Traditionally, the level of legal actions against directors and officers in Australia tended to be low. The standard of care and diligence imposed on directors was undemanding, although there has been an increase in the standard since the series of important insolvent trading cases in the 1990s.<sup>192</sup> Also, as in the United Kingdom, there existed substantial procedural barriers to minority shareholder actions against directors. While reforms in 2000 introduced a more liberal form of statutory derivative suit,<sup>193</sup> the absence of contingency fee litigation in Australia makes it unlikely that this form of litigation will be widely used. The 2000 reforms also introduced a statutory business judgment rule,<sup>194</sup> based on the U.S. model, for the benefit of directors.

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<sup>190</sup> HIH REPORT, *supra* note 15, at 104. Owen J. considered that "middle management" employees at HIH had engaged in undesirable practices and played a particularly significant role in the company's collapse. *Id.* at 121. He noted that in many larger companies, managerial decisions are made by management, without reference to the board. *Id.* at 122.

<sup>191</sup> *Id.* at lxv; see also COMMONWEALTH OF AUSTRALIA, CORPS. & MKTS. ADVISORY COMM., CORPORATE DUTIES BELOW BOARD LEVEL 1 (2005), [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/\\$file/Corporate\\_Duties\\_DP\\_May05.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/Corporate_Duties_DP_May05.pdf) (discussion paper responding to the HIH Royal Commission's calls for reform in this regard).

<sup>192</sup> See, e.g., *Commonwealth Bank of Australia v. Friedrich* (1991) 5 A.C.S.R. 115 (Austl.); *Statewide Tobacco Servs. Ltd. v. Morley* (1990) 2 A.C.S.R. 405 (Austl.) (aff'd by the Full Court of the Supreme Court of Victoria in *Morley v. Statewide Tobacco Servs. Ltd.* (1992) 8 A.C.S.R. 305 (Austl.)); see also *Comm'r of Taxation v. Clark*, (2003) 176 F.L.R. 235 (Austl.) (containing a useful discussion of the policy behind Australia's insolvent trading regime and its interaction with judicial decisions on directors' duties).

<sup>193</sup> Corporations Act, 2001, pt. 2F.1A (Austl.).

<sup>194</sup> *Id.* § 180(2).

Nonetheless, one development in Australia that has strengthened the enforcement of directors' duties is the increasingly strategic use by the Australian Securities and Investments Commission (ASIC) of the civil penalty regime as a regulatory mechanism. The civil penalty regime under the Corporations Act<sup>195</sup> was introduced in 1993; however, in its early years of operation, it was seldom used by the regulator,<sup>196</sup> and commentators pointed to its deficiencies and structural weaknesses.<sup>197</sup> More recently, though, ASIC has radically increased the number of actions brought under the civil penalty regime.<sup>198</sup> The scope of the civil penalty regime was extended under the Financial Services Reform Act 2001 (Cth) to cover market misconduct offenses, such as insider trading and continuous disclosure.<sup>199</sup> According to the Explanatory Memorandum, part of the reason for this expansion was the difficulty that ASIC had experienced in prosecuting such offenses.<sup>200</sup> The civil penalty regime offers the regulator the benefits of a lower standard of proof than criminal prosecution.<sup>201</sup> The CLERP 9 Act 2004 further strengthened ASIC's power in this regard. The Act granted the regulator the power to issue infringement notices and impose direct financial penalties<sup>202</sup> for contravention of the continuous disclosure regime.<sup>203</sup> Infringement notices and penalties may be issued not only against the disclosing entity itself, but also against any other

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<sup>195</sup> *Id.* pt. 9.4B.

<sup>196</sup> ASIC commenced only 14 civil penalty actions in the first 6 years of the operation of the civil penalty regime. George Gilligan et al., *Civil Penalties and the Enforcement of Directors' Duties*, 22 U.N.S.W. L.J. 417, 417 (1999).

<sup>197</sup> *See, e.g., id.*; Helen Bird, *The Problematic Nature of Civil Penalties in the Corporations Law*, 14 COMPANY AND SEC. L.J. 405 (1996).

<sup>198</sup> For a recent high profile example, see *Austl. Sec. & Invs. Comm'n v. Vizard* [2005] FCA 1037.

<sup>199</sup> Financial Services Reform Act, 2001 (Austl.).

<sup>200</sup> *See generally* Grant Moodie & Ian Ramsay, *The Expansion of Civil Penalties Under the Corporations Act*, 30 AUSTRAL. BUS. L. REV. 61, 62-63 (2002).

<sup>201</sup> *But see* *Briginshaw v. Briginshaw* (1938) 60 C.L.R. 336, 362-63 (suggesting that despite the clear difference between the standard of proof in civil and criminal actions, weight should sometimes be given in civil actions to certain aspects of criminal procedure, including matters such as the presumption of innocence).

<sup>202</sup> The ASIC infringement notice may specify a financial penalty of A\$33,000, \$66,000 or \$100,000 depending on a range of factors, including market capitalization. *See* Corporations Act, 2001, § 1317DAE (Austl.).

<sup>203</sup> *See generally id.*, pt. 9.4AA.

persons, including directors and officers, who are involved in a contravention.<sup>204</sup> The infringement notice regime constitutes a potent alternative regulatory mechanism to judicial proceedings, and was strongly condemned by the business community prior to its introduction.<sup>205</sup>

Although part of the rationale for the introduction of the civil penalty regime in Australia was to create a clearer line between criminal and non-criminal conduct, the boundaries between civil penalties and criminal liability have become increasingly blurred.<sup>206</sup> This blurring is apparent in the dramatic increase in the quantum of civil penalties against companies and officers.<sup>207</sup> In a recent High Court appeal relating to One.Tel, however, the blurring phenomenon worked in favor of corporate management. The Australian High Court denied an order sought by ASIC for discovery of documents in relation to civil proceedings against the former CEO of One.Tel, Jodee Rich, on the basis that the serious nature of the civil proceedings entitled Rich to claim the privilege against exposure to penalties.<sup>208</sup>

The litigation concerning related party transactions in HIH, *ASIC v. Adler*,<sup>209</sup> is a good example of the trend towards greater

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<sup>204</sup> See generally Greg Golding & Natalie Kalfus, *The Continuous Evolution of Australia's Continuous Disclosure Laws*, 22 COMPANY & SEC. L.J. 385, 403-07 (2004).

<sup>205</sup> See, e.g., Hugh Morgan, Op-Ed, *Beware the great corporate law divide*, AUSTL. FIN. REV., Dec. 2, 2003, at 63.

<sup>206</sup> This blurring was identified in a Victorian Supreme Court decision, *Austl. Sec. & Invs. Comm'n v. Plymin* (2002) 42 A.C.S.R. 670, 678 (Austl.).

<sup>207</sup> Although traditionally it was thought that criminal penalties should be stricter than civil penalties, many Australian courts appear to have adopted the reverse assumption in relation to civil penalties in the commercial realm. See, e.g., *Austl. Competition & Consumer Comm'n v. Roche Vitamins Austl. Pty Ltd.* (2001) A.T.P.R. 41-809 (Austl.) (court ordered civil penalties of A\$26 million against pharmaceutical companies for price-fixing); *Austl. Competition & Consumer Comm'n v. ABB Transmission & Distribution Ltd.* (2002) 190 A.L.R. 169, 171-72 (Austl.) (court ordered civil penalties for anti-competitive arrangements).

<sup>208</sup> See *Rich v. Austl. Sec. & Invs. Comm'n* (2004) 50 A.C.S.R. 242, 254 (Austl.) (McHugh, J. dissenting) (rejecting claim that civil penalty provisions, including disqualification provisions, are purely "protective" in nature); *infra* notes 221-223.

<sup>209</sup> (2002) 41 A.C.S.R. 72; (2002) 20 A.C.L.C. 576. An appeal to this decision was largely dismissed in *Adler v. Austl. Sec. & Invs. Comm'n* (2003) 46 A.C.S.R. 504; 21 A.C.L.C. 1810.

use of civil penalty proceedings brought by the regulator to enforce fiduciary duties in Australia. *ASIC v. Adler*<sup>210</sup> involved an action against three former directors of HIH: non-executive director, Rodney Adler; the CEO, Ray Williams; and the Chief Financial Officer, Dominic Fodera. ASIC alleged that the directors had breached their directors' duties, including the duty care under sec. 180 of the Corporations Act, in relation to a payment of A\$10 million by an HIH subsidiary to Pacific Eagle Equities Pty Ltd., of which Adler was a director, and certain subsequent transactions.<sup>211</sup> The transactions resulted in a loss to HIH of A\$6 million in less than six months.<sup>212</sup> The court held that breach of fiduciary duty had been established in relation to all three directors, yet found that Adler's contraventions were "the most serious of all,"<sup>213</sup> since, in bypassing proper corporate safeguards, such as vetting by the Investments Committee, Adler showed consciousness of impropriety.

*ASIC v. Adler* has a number of interesting features. First, while the duty of care and diligence had not previously been interpreted to impose a positive monitoring duty on directors to ensure that appropriate compliance systems are in place, the judgment suggested that such a duty exists under the Corporations Act, and may therefore point to a stricter approach in the future. Second, the penalties imposed were relatively stringent. Under the civil penalty provisions of the Corporations Act, it is possible for the court to impose disqualification orders,<sup>214</sup> compensation orders for loss,<sup>215</sup> and pecuniary penalties of up to

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<sup>210</sup> Austl. Sec. & Invs. Comm'n v. Adler (2002) 41 A.C.S.R. 72; (2002) 20 A.C.L.C. 576.

<sup>211</sup> *Id.* at 81-82.

<sup>212</sup> *Id.*

<sup>213</sup> *In re HIH Ins. Ltd.*: Austl. Sec. & Invs. Comm'n v. Adler (2002) 42 A.C.S.R. 80, 89. Mr. Adler's contraventions were also the most numerous. The court found that, whereas Mr. Williams and Mr. Fodera had contravened the Act seven and five times respectively, Mr. Adler had committed 101 contraventions. The court also found 84 contraventions by Adler Corporation.

<sup>214</sup> Corporations Act, 2001, §§ 206C, 206E (Austl.).

<sup>215</sup> *Id.* § 1317H.

A\$200,000 for individuals.<sup>216</sup> ASIC successfully sought each form of remedy.<sup>217</sup>

The court's power to impose disqualification orders under the civil penalty regime has become an important regulatory tool in Australia, and was further strengthened under the CLERP 9 Act 2004.<sup>218</sup> In *ASIC v. Adler*, for example, the court imposed a twenty-year disqualification against Adler.<sup>219</sup> The disqualification order applied to any involvement by him in the management of both public and private corporations.<sup>220</sup> The court stressed that the policy rationale for disqualification orders is not punitive in nature, but rather is based upon protection of the public.<sup>221</sup> This focus on protection of the public, and the need for public confidence in the market, is a common theme underlying many of the post-Enron regulatory developments. Nonetheless, in *Rich v. ASIC*,<sup>222</sup> the High Court considered any supposed distinction between "protective" and "punitive" proceedings in this area to be "elusive."<sup>223</sup>

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<sup>216</sup> *Id.* § 1317G.

<sup>217</sup> *E.g.*, *HIH Ins. Ltd.: Austl. Sec. & Invs. Comm'n v. Adler* (2002) 42 A.C.S.R. 80, 124-26.

<sup>218</sup> *See, e.g.*, Corporations Act, 2001, § 206BA (Austl.) (court, on the application of ASIC, can extend an automatic five-year disqualification period for an additional 15 years).

<sup>219</sup> (2002) 42 A.C.S.R. 80, 111. The court imposed a 10-year disqualification order against Mr. Williams. *Id.* at 121. The court held no disqualification order was justified against Mr. Fodera. *Id.* at 124.

<sup>220</sup> Santow J. stated, "It is simply nonsense to suppose that the private status of a company represents some kind of safety zone for members of the public in their dealings; that some kind of *cordon sanitaire* can be placed around private companies so members of the public never deal with them. . . One might moreover reasonably argue that the public need even greater protection dealing with private companies." *Id.* at 106.

<sup>221</sup> The protection of the public rationale trumped Mr. Adler's claim of personal hardship. *Id.* at 111.

<sup>222</sup> *Rich v. Austl. Sec. & Invs. Comm'n* (2004) 50 A.C.S.R. 242.

<sup>223</sup> *Id.* at 252 (Gleeson, C.J., Gummow, Hayne, Callinan & Heydon, J.J.). According to Justice McHugh, "[d]espite frequent statements by the judges who administer the legislation that the purpose of the disqualification provisions is protective, what the judges actually do in practice is little different from what judges do in determining what orders or penalties should be made for offences against the criminal law." *Id.* at 254.

The findings of the HIH Royal Commission in 2003<sup>224</sup> focused further attention on potential criminal liability of executive officers and directors. The Commission's Report identified fifty-six possible breaches of civil and criminal law by a number of HIH's directors and executive officers (including the CEO and CFO), which the Australian Government immediately referred to ASIC and the Director of Public Prosecutions.<sup>225</sup> In 2005, Ray Williams and Rodney Adler pleaded guilty to criminal charges brought against them. These included, in Williams' case, issuing a misleading prospectus and a false accounting statement, and in Adler's case, making misleading securities statements as well as intentional dishonesty in discharging his directors' duties.<sup>226</sup> Both men were sentenced to jail terms, with the judges in each case stressing deterrence as a relevant factor in sentencing and cautioning against leniency in white-collar crime.<sup>227</sup>

ASIC's A\$93 million civil penalty claim in relation to the One.Tel collapse has also proven interesting from the perspective of corporate governance. The focus of this litigation is on the executive officers, including Rich, since ASIC declined to commence proceedings against the outside directors of One.Tel, James Packer, Lachlan Murdoch and Rodney Adler. The decision in *ASIC v. Rich*<sup>228</sup> involved the status of former One.Tel chairman John Greaves for the purposes of the primary litigation. Greaves argued that he should not be held accountable to the same standards as the executive directors, such as Rich.<sup>229</sup> Rather, Greaves claimed that he should be viewed as analogous to One.Tel's non-executive directors and therefore excluded from the civil penalty proceedings. The court disagreed, holding that there was a reasonably arguable case that Greaves, who was

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<sup>224</sup> HIH REPORT, *supra* note 15.

<sup>225</sup> Press Release, The Hon. Peter Costello MP, Treasurer of the Commonwealth of Austl., *Report of the HIH Royal Comm.* (Apr. 16, 2003), <http://www.treasurer.gov.au/tsr/content/pressreleases/2003/020.asp>.

<sup>226</sup> *See generally* Regina v. Williams [2005] NSWSC 315; Regina v. Adler [2005] NSWSC 274.

<sup>227</sup> *See* Regina v. Williams [2005] NSWSC 315; Regina v. Adler [2005] NSWSC 274.

<sup>228</sup> [2003] NSWSC 85, ¶ 1.

<sup>229</sup> *See* Anne Lampe, *Chairman of the Board is Now Fair Game in Court*, SYDNEY MORNING HERALD, Feb. 25, 2003, at 5; Bill Pheasant, *Chairmen face greater legal burden, court rules*, AUSTL. FIN. REV., Feb. 25, 2003, at 1.

also chairman of the finance and audit committee, had special duties beyond those of the non-executive directors, leading to a higher standard of care and diligence, reflected in contemporary community expectations.<sup>230</sup>

The decision in *ASIC v. Rich*<sup>231</sup> explicitly reflected the approach of the Higgs Report in the United Kingdom, viewing the role of the chairman as “pivotal” in contemporary corporate governance.<sup>232</sup> The chairman, according to the Higgs Report, has “the responsibility of leading the board in setting the values and standards of the company.”<sup>233</sup>

## VII. EXECUTIVE REMUNERATION

If possible, honestly, if not, somehow, make money.

—Horace, *Epistles*<sup>234</sup>

Executive remuneration was a pervasive governance theme in many of the global corporate scandals,<sup>235</sup> and is considered one of a range of possible factors in the collapses.<sup>236</sup> Nonetheless, the post-Enron regulatory reforms accord varying degrees of attention to the theme of executive remuneration.

In the 1990s, strong convergence of corporate governance practices was evident in the area of executive remuneration.<sup>237</sup> Two techniques revolutionized the structure of executive remuneration in the United States during this period. The first was

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<sup>230</sup> See also *Austl. Sec. & Invs. Comm'n v. Vines* (2003) 48 A.C.S.R. 322; (2004) 22 A.C.L.C. 37 (relating to the position of chief financial officer).

<sup>231</sup> [2003] NSWSC 85.

<sup>232</sup> HIGGS REPORT, *supra* note 84, at 23.

<sup>233</sup> *Id.*

<sup>234</sup> THE SATIRES AND EPISTLES OF HORACE 168 (Smith Palmer Bovie trans., Univ. of Chicago Press 1959) (Epistles, book 1, epistle 1, lines 66-67).

<sup>235</sup> See Coffee, *supra* note 14, at 275-76; Miller, *supra* note 14, at 440; see also *The Role of the Board of Directors in Enron's Collapse: Hearing Before the Permanent Subcomm. of Investigations of the Comm. on Governmental Affairs*, 107th Cong. 53-54 (2002).

<sup>236</sup> Coffee, *supra* note 14, at 278.

<sup>237</sup> The levels of pay were, however, far higher in the U.S. than in other countries. See generally Marco Becht et al., *Corporate Governance and Control* 97 (European Corp. Governance Inst., Working Paper No. 02/2002), available at <http://ssrn.com/abstract=343461>.

the rise of performance-based pay.<sup>238</sup> This development promised to deliver appropriate incentives for superior performance and to reward executives according to their “just deserts.” The second technique was the phenomenon of option grants, which, although originating in the high-tech sector, became a dominant feature of executive compensation packages generally.<sup>239</sup> Use of option grants as a remuneration technique, widely emulated abroad in countries such as Australia and parts of Europe,<sup>240</sup> led to a massive escalation in executive remuneration for American CEOs during this period.<sup>241</sup> These developments were less pronounced in continental Europe, however, where stock options tended to be regarded with suspicion. It is interesting to note that one European company that used large stock options to reward its managers was the Dutch company, Royal Ahold NV, which collapsed in an accounting scandal around the same time as One.Tel, HIH, Enron and WorldCom.<sup>242</sup>

Important factors contributing to the rise of performance-based pay and option grants in the U.S. context included the existence of favorable tax treatment and the absence of any requirement to expense fixed price options against company earnings.<sup>243</sup> The emergence of this form of executive remuneration constituted a radical paradigm shift in corporate law, from a

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<sup>238</sup> See generally Ruth Bender, *Why Do Companies Use Performance-Related Pay for their Executive Directors?* 12 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 521 (2004).

<sup>239</sup> See Donald C. Langevoort, *Technological Evolution and the Devolution of Corporate Financial Reporting*, 46 WM. & MARY L. REV. 1, 5-6 (2004); Randall S. Thomas & Kenneth J. Martin, *The Determinants of Shareholder Voting on Stock Option Plans*, 35 WAKE FOREST L. REV. 31, 35 (2000). By 2002, stock options comprised a record 15.7% of U.S. companies' shares, and in some instances, exceeded 25% of equity. See *Fat Cats Feeding*, ECONOMIST, Oct. 11, 2003, at 64, 65.

<sup>240</sup> See David Cay Johnston, *American-Style Pay Moves Abroad: Importance of Stock Options Expands in a Global Economy*, N.Y. TIMES, Sept. 3, 1998, at C1, C4.

<sup>241</sup> See Randall S. Thomas, *Should Directors Reduce Executive Pay?*, 54 HASTINGS L.J. 437 (2003); Kevin J. Murphy, *Explaining Executive Compensation: Managerial Power versus the Perceived Cost of Stock Options*, 69 U. CHI. L. REV. 847 (2002).

<sup>242</sup> See Matlack et al., *supra* note 11, at 48.

<sup>243</sup> See Deborah A. DeMott, *Shareholder Challenges to Executive Remuneration*, 74 AUSTRAL. L.J. 576 (2000).

fiduciary model of executive remuneration to an alignment of interests model.<sup>244</sup> Previously, executive remuneration had been viewed as a classic corporate governance problem, necessitating a range of suggested regulatory techniques to reduce or eliminate managerial self-interest, such as fiduciary duty liability, use of independent directors, remuneration committees, or greater shareholder control.<sup>245</sup> Under the new paradigm, however, executive remuneration was seen not as a corporate governance problem, but as a solution—it was recast as a corporate governance technique in its own right.<sup>246</sup> Rather than seeking to control or eliminate managerial self-interest, the new paradigm sought to legitimize and harness managerial self-interest through alignment of the interests of management and shareholders.<sup>247</sup> It assumed that arm's length bargaining between the board and executives would result in efficient executive remuneration contracts.

The global corporate scandals refocused attention and public concern on the issue of executive remuneration. Many of the collapses raised serious questions about the alignment of managerial and shareholder interests in these companies. For instance, they raised questions about whether the relevant remuneration packages exacerbated, rather than solved, the principal/agent problem by creating perverse incentives for executives to pursue short-term strategies,<sup>248</sup> manage earnings, and manipulate share

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<sup>244</sup> See generally Michael C. Jensen & Kevin J. Murphy, *CEO Incentives – It's Not How Much You Pay, But How*, HARV. BUS. REV., May-June 1990, at 21-23, available at <http://ssrn.com/abstract=146148> (a pivotal article in this paradigm shift). See Charles M. Yablon, *Bonus Questions – Executive Compensation in the Era of Pay for Performance*, 75 NOTRE DAME L. REV. 271, 279-80 (1999).

<sup>245</sup> See Hill & Yablon, *supra* note 112, at 301.

<sup>246</sup> See Eric L. Johnson, *Waste Not, Want Not: An Analysis of Stock Option Plans, Executive Compensation, and the Proper Standard of Waste*, 26 J. CORP L. 145, 148 (2000); Robert Dean Ellis, *Equity Derivatives, Executive Compensation, and Agency Costs*, 35 HOUS. L. REV. 399, 402 (1998).

<sup>247</sup> See generally Hill & Yablon, *supra* note 112, at 301.

<sup>248</sup> See Patrick Bolton et al., *Executive Compensation and Short-termist Behavior in Speculative Markets* (Aug. 30, 2004), available at <http://ssrn.com/abstract=391881>; Janice Kay McClendon, *Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders' Interests and Promote Corporate Long-Term Productivity*, 39 WAKE FOREST L. REV. 971, 973-75 (2004).

price to enhance the value of options.<sup>249</sup> The Enron and One.Tel collapses epitomized these problems. In the aftermath of Enron, for example, it emerged that executives were paid large cash bonuses shortly before the company's collapse.<sup>250</sup> In the case of One.Tel, it was revealed in the company's annual report in September 2000 that the joint CEOs Rich and Keeling had received cash bonuses of A\$6.9 million.<sup>251</sup> The bonus payments, which were tied to the market capitalization of One.Tel, prompted public outrage in Australia and caused One.Tel's share price to plummet.<sup>252</sup>

The scandals of One.Tel and Enron highlighted the gap that can exist between the theory and practice of performance-based pay and demonstrated a range of general problems relating to executive compensation. The procedures for payment of the One.Tel bonuses raised concerns about conflict of interests and lack of arm's length dealing. It appears, for example, that the structure of the bonuses was suggested by the CEOs themselves, there was no discussion by the board about the reasonableness of the payments, and there was no advice from independent external compensation consultants.<sup>253</sup> Though the two board representatives of the major shareholders were aware of the bonus

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<sup>249</sup> See, e.g., Iman Anabtawi, *Secret Compensation*, 82 N.C. L. REV. 835, 852-56 (2004); Charles M. Yablon & Jennifer Hill, *Timing Corporate Disclosures to Maximize Performance-Based Remuneration: A Case of Misaligned Incentives?*, 35 WAKE FOREST L. REV. 83, 86-88 (2000).

<sup>250</sup> When the news of the Enron bonuses emerged, a former federal white-collar crime prosecutor was reported as saying, "[t]he levels of compensation that we are talking about here would certainly seem to be a powerful incentive for anyone to do anything." Kurt Eichenwald, *Enron Paid Huge Bonuses in '01; Experts See a Motive for Cheating*, N.Y. TIMES, Mar. 1, 2002, at A1. See generally Gordon, *supra* note 106, at 1234 (contrasting insiders with regular shareholders).

<sup>251</sup> See Sue Mitchell, *Lessons from the One.Tel Saga*, AUSTL. FIN. REV., Nov. 16, 2000, at 7.

<sup>252</sup> BARRY, *supra* note 26, at 210, 364. Nonetheless, the amounts received by the CEOs of One.Tel appear distinctly modest, when compared to the U.S. \$140 million, which was paid to Kenneth Lay for his work at Enron in 2000. See PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON GOV'TAL AFFAIRS, REPORT ON THE ROLE OF THE BOARD OF DIRECTORS IN ENRON'S COLLAPSE, S. REP. NO. 107-70, at 52 (2002).

<sup>253</sup> See Christine Lacy, *Board 'Didn't Approve' Bonuses*, AUSTL. FIN. REV., Apr. 23, 2002, at 3. The HIH Royal Commission found similar problems to exist at HIH, where the performance of the CEO was subject to "only the most perfunctory review" by the chairman, Cohen. See HIH REPORT, *supra* note 15, at xxxvi.

structure, most shareholders only learned of the existence of the bonuses after they had been paid.<sup>254</sup>

The One.Tel and Enron sagas demonstrated some of the ways in which the alignment of interest rhetoric in performance-based pay may fail to match reality. Enron, which prior to its downfall was regarded by many as a model of good corporate governance practice, made far greater use of incentive-based pay than comparable U.S. companies.<sup>255</sup> There was significant public condemnation of the reliance on One.Tel's market capitalization (which was ephemeral and unsustainable)<sup>256</sup> as the criterion for assessing performance of the joint CEOs. This has been a recurrent theme in academic literature. Commentators have criticized the structure of many performance-based pay packages on the basis that they use inappropriate criteria, are unduly favorable to management, provide little downside risk for executives, and create perverse incentives for short-term gain.<sup>257</sup>

Post-Enron principles of good governance stress the need for fine-tuning of performance-based pay packages to ensure that there is a "clear relationship between performance and remuneration."<sup>258</sup> Yet, one of the possible lessons of corporate collapses

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<sup>254</sup> It appears that the Board did not consider obtaining shareholder consent to the bonuses under Corporations Act, 2001, § 211, on the basis that the board regarded the bonuses as "reasonable" and therefore exempt from the shareholder consent requirement under Australia's related party transaction provisions. See Annabel Hepworth & Christine Lacy, 'Expert' Adler Defends Bonuses, AUSTL. FIN. REV., Mar. 20, 2002, at 1.

<sup>255</sup> For example, in 2000 Kenneth Lay received 69% of his pay in incentive-based compensation. See Stuart L. Gillan & John D. Martin, *Executive Compensation, Audit Fees and Board Oversight: Corporate Governance Beyond Enron* 18 (March 2004) (unpublished working paper), available at [http://jcooney.ba.ttu.edu/Finance\\_Department\\_Fall\\_2004\\_Seminar\\_Series\\_files/Enron%20Gov%20Comp%20Paper%20Oct%2026JM.doc](http://jcooney.ba.ttu.edu/Finance_Department_Fall_2004_Seminar_Series_files/Enron%20Gov%20Comp%20Paper%20Oct%2026JM.doc).

<sup>256</sup> See INT'L CORPORATE GOVERNANCE NETWORK SUBCOMM. ON EXECUTIVE REMUNERATION, EXECUTIVE REMUNERATION – THE CAUCUS RACE 27 (2002), <http://www.icgn.org/documents/ICGNExecRem.pdf> (noting that "[m]arket capitalisations may be, as we have seen, ephemeral.") [hereinafter EXECUTIVE REMUNERATION].

<sup>257</sup> See, e.g., GRAEF S. CRYSTAL, IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES 98-99 (1991). See generally Joshua A. Kreinberg, Note, *Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive*, 45 DUKE L.J. 138, 147-55 (1995).

<sup>258</sup> ASX Recommendations, *supra* note 38, at 51 (Principle 9, "Remunerate fairly and responsibly").

such as One.Tel and Enron is that, even in well-structured performance-based pay packages, the inherent powers and discretions of executive officers over disclosure and financial reporting may enable them to influence their own pay by manipulating and distorting the indicia of performance.<sup>259</sup> A controversial current issue in corporate law is whether the flaws in the operation of performance-based pay demonstrated in some of the corporate collapses were extreme and atypical, or whether they reflect systemic and continuing problems in executive remuneration.<sup>260</sup>

The issue of executive remuneration received different levels of attention in the post-Enron regulatory reforms. Interestingly, it received very little attention in the United States' 2002 reforms. One exception, however, is sec. 304 of SOX, which provides for the forfeiture of bonuses or incentive-based remuneration received by the CEO and CFO, if the corporation is required to restate its financial results due to misconduct and non-compliance with financial reporting requirements.<sup>261</sup> Remuneration was, however, a significant topic in the Australian<sup>262</sup> and

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<sup>259</sup> See generally Yablon & Hill, *supra* note 249, at 86; Lucien Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 754-55 (2002).

<sup>260</sup> See generally LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2004); John E. Core et al., *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142 (book review).

<sup>261</sup> Sarbanes-Oxley Act, Pub. L. No. 107-204, § 304, 116 Stat. 745, 778 (2002). It is also noteworthy that the SEC instigated new stock exchange listing standards in 2003 expanding the scope of the shareholder approval requirement for stock option plans. Order Approving NYSE and Nasdaq Proposed Rule Changes Relating to Equity Compensation Plans, 68 Fed. Reg. 39,995 (July 3, 2003). This reform was first suggested by Arthur Levitt in 1998, but had been put on hold until it received new impetus from the Enron collapse. Nonetheless, it has been argued that the new listing standards are structurally flawed in that shareholders vote only on the broad outline of a proposed plan, and not on individual executives' stock option packages. See *Developments in the Law - Corporations and Society*, *supra* note 13, at 2218-20.

<sup>262</sup> The HIH Royal Commission, for example, considered that there should, as a matter of priority, be an urgent review of legislative rules, accounting standards and ASX Listing Rules relating to directors' remuneration to ensure that together they achieve "clear and comprehensive disclosure of all remuneration or other benefits paid to directors in whatever form." HIH REPORT, *supra* note 15, at 116.

U.K.<sup>263</sup> regulatory responses to the corporate collapses. Although the issue of executive remuneration was largely absent from the original Australian reform proposals, it ultimately became an important theme in the CLERP 9 Act 2004<sup>264</sup> and appeared prominently in the ASX corporate governance principles.<sup>265</sup> Also, the enactment of a statute in 2003 permitting liquidators to reclaim unreasonable payments made to directors within four years of a company's liquidation<sup>266</sup> could be viewed as a direct response to the notorious bonus payments at One.Tel.

Under the CLERP 9 Act 2004 and the ASX corporate governance principles, the key regulatory responses to the problem of director and executive remuneration relate to enhanced disclosure and increased shareholder participation. The latter regulatory technique proved a particularly controversial aspect of the Australian remuneration reforms. The CLERP 9 Act 2004 included a provision<sup>267</sup> which requires shareholders to pass a non-binding advisory vote at a listed company's annual general meeting, signaling whether they adopt the remuneration report.<sup>268</sup> Unlike the United States, Australia has no tradition of non-binding or precatory shareholder resolutions, and such resolutions have traditionally been treated by the courts as beyond shareholder power.<sup>269</sup> While critics of the new provision have claimed

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<sup>263</sup> See *The Directors' Remuneration Report Regulations 2002*, 2002, S.I. 2002/1986 (U.K.); Paul Davies, Cassel Professor of Commercial Law, London Sch. of Econ. & Political Sci., Ross Parsons Address in Corporate Law, Sydney Law School: Disclosure, Audit and Executive Remuneration: A Eurocentric View 2 (Sept. 2, 2004), available at <http://www.law.usyd.edu.au/~parsons/AboutContent/ProfDaviesAddress.pdf> [hereinafter Davies Address].

<sup>264</sup> CLERP 9 Act, *supra* note 37, at sched. 5.

<sup>265</sup> See ASX Recommendations, *supra* note 38, at 51-57 (Principle 9 addresses best practices in director and executive remuneration); see generally David Ablen, *Remunerating 'Fairly and Responsibly' – The 'Principles of Good Corporate Governance and Best Practice Recommendations' of the ASX Corporate Governance Council*, 25 SYDNEY L. REV. 555 (2003).

<sup>266</sup> Corporations Amendment (Repayment of Directors' Bonuses) Act, 2003, sched. 1 (Austl.) (amending Corporations Act, 2001, §§ 588FDA, 588FE).

<sup>267</sup> CLERP 9 Act, *supra* note 37, sched. 5 (amending Corporations Act, 2001, § 250R(2)).

<sup>268</sup> See also *id.* (amending Corporations Act, 2001, § 250SA, such that the chair at a listed company's AGM must allow a reasonable opportunity for members as a whole to ask questions or make comments about the remuneration report).

<sup>269</sup> See *Nat'l Rd. & Motorists' Assoc. v. Parker* (1986) 6 N.S.W.L.R. 517, 522.

that the non-binding nature of the shareholder vote will render it ineffectual, it may represent a new example of regulation by “shaming” in corporate law.<sup>270</sup>

The new Australian provision is analogous to a reform that was introduced in the U.K. in 2002.<sup>271</sup> A high profile use of the U.K. provision was a vote by GlaxoSmithKline shareholders in 2003 against a large severance package for its CEO, which led a number of companies to meet with investors to modify proposed packages.<sup>272</sup> More recently, in response to adverse shareholder reaction, the board of the supermarket chain, Sainsbury, altered a remuneration package prior to the general meeting vote on the remuneration report.<sup>273</sup> Yet, to date, the power of shareholders to block or challenge executive remuneration plans has generally been weak.<sup>274</sup> The focus on greater fine-tuning of executive remuneration plans, following collapses like those at Enron and One.Tel, however, creates a tension in relation to increased shareholder participation. A danger of such fine-tuning is that executive remuneration packages are becoming increasingly complicated and abstruse, creating substantial barriers to effective disclosure<sup>275</sup> and use of shareholder approval as a governance technique in relation to executive pay.<sup>276</sup>

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<sup>270</sup> See generally David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811 (2001); see also Brian R. Cheffins & Randall S. Thomas, *Should Shareholders Have a Greater Say over Executive Pay?: Learning from the US Experience*, 1 J. CORP. L. STUD. 277, 310-11 (2001) (suggesting that the effectiveness of shareholder monitoring may be limited to situations where a corporation's remuneration practices deviate substantially from the norm).

<sup>271</sup> *The Directors' Remuneration Report Regulations 2002*, 2002, S.I. 2002/1986 (U.K.).

<sup>272</sup> See *Fat Cats Feeding*, *supra* note 239, at 65.

<sup>273</sup> See generally Davies Address, *supra* note 263, at 10.

<sup>274</sup> See generally Randall S. Thomas & Kenneth J. Martin, *Litigating Challenges to Executive Pay: An Exercise in Futility?*, 79 WASH. U. L.Q. 569 (2001).

<sup>275</sup> On the general problem of effective disclosure in relation to highly complex transactions see Schwarcz, *supra* note 82, at 1316-17.

<sup>276</sup> See EXECUTIVE REMUNERATION, *supra* note 256, ¶ 43.

### VIII. CONCLUSION

There is still no clear consensus on the underlying cause of the spate of global corporate collapses earlier this decade.<sup>277</sup> Indeed, an unresolved issue is whether the collapses occurred because of corporate governance failure or, more problematically, because reforms to corporate governance practices in the 1990s increased the pressure and incentives on management to engage in deceptive financial conduct.<sup>278</sup>

Nonetheless, the international scandals mark an important moment in comparative corporate governance. A range of jurisdictions, including the United States, United Kingdom, and Australia, introduced regulatory responses to perceived problems associated with the scandals. Although these regulatory responses have a number of common themes, they also have significant differences in focus and nuance. The contours of these regulatory responses are also often closely tied to home-grown scandals, such as Enron, in the case of the U.S. reforms, and HIH, in the case of the Australian reforms. Even when identical reforms are adopted across jurisdictions, the regulatory outcomes are unlikely to be the same, given underlying differences in corporate governance systems, legal cultures and enforcement mechanisms.<sup>279</sup>

Further reflection on the fundamental question of what caused the global corporate scandals will undoubtedly drive new species of reform. Commercial practice under the various reforms introduced in response to the corporate scandals may also lead to backlash and regulatory fine-tuning. Therefore, the current corporate governance environment is highly fluid and evolving. The convergence/divergence debate in comparative corporate governance needs to be reassessed in the light of the regulatory responses to the global corporate scandals. While globalization may have led to convergence of capital markets,

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<sup>277</sup> See generally Coffee, *supra* note 14; Langevoort, *supra* note 146.

<sup>278</sup> See Coffee, *supra* note 14, at 271.

<sup>279</sup> See generally Teubner, *supra* note 9, at 12-13; Licht, *supra* note 9.

predictions of regulatory convergence would appear to be premature.<sup>280</sup>

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<sup>280</sup> See, e.g., Robert Bruce, *Hope of Calmer Waters: After the Tumult and Shouting of Last Year, 2003 is Likely to be Less Dramatic – Though Many Challenging Issues Have to be Faced*, FIN. TIMES (London), Jan. 9, 2003, at 2.