Evolving Regulation of Corporate Governance and the Implications for D&O Liability: The United States and Australia

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I. INTRODUCTION

In the wake of corporate scandal, regulators worldwide responded with new mandates and reforms in an effort to reinstate trust and certainty in the marketplace. Those reforms are now challenged by the current credit crisis. This article compares the modern corporate regulatory environments in the United States and Australia, including an analysis of the climate for Directors & Officers (D & O) liability coverage. Comparing these regulations across two large markets with similar historical bases for assessing director and officer liability allows us to explore which reforms may be more effective as new scandals emerge.

In the United States, corporate governance laws have evolved gradually since the 1950s,[1] but 2002 brought the most dramatic change with the

1. *See* ABA Committee on Corporate Compliance, *Corporate Compliance Survey*, 60 BUS. LAW. 1759, 1760 (2005); Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1578 (1990); John D. Copeland, *The Tyson Story: Building an Effective Ethics and Compliance Program*, 5 DRAKE J. AGRIC. L. 305, 311 (2000); Charles J. Walsh & Alisa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save its Soul*, 47 RUTGERS L. REV. 605, 650 (1995).

Sarbanes-Oxley Act.[2] Similarly, in Australia, corporate law has evolved gradually over the last several decades with recent updates in response to managerial wrongdoing.[3] Now, the global economic downturn has brought new scandal to both markets. Given that both governments drafted their regulatory reforms in the context of multiple scandals that demolished investor confidence, a comparison between the two systems' corporate governance programs[4] should inform future outcomes and help determine which system better accomplishes its desired goals.

We begin in Section II by describing the corporate scandals that spawned new legislation in order to illustrate the context in which each government drafted their respective reforms. In Section III, we evaluate these reforms for similarities and differences. In Section IV we analyze how each country's regulatory schemes may impact D & O liability. Finally, we conclude by exploring what the future may hold for American and Australian corporate governance in light of the current credit crisis and beyond.

II. MODERN CORPORATE SCANDALS IN THE UNITED STATES AND AUSTRALIA

A. Current Credit Crisis

1. The United States

While many of the scandals at the end of the 1990s involved accounting improprieties, the current crisis stems from distortions in the real estate market. After the bursting of the technology bubble, a new bubble developed in residential real estate in the United States.[5] The explosion in home prices was partly driven by the securitization of home

2. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 & 29 U.S.C.) [hereinafter SOX].

3. *See* Roman Tomasic, *The Modernisation of Corporations Law: Corporate Law Reform in Australia and Beyond*, 19 AUSTL. J. CORP. L. 2, 60 (2006).

4. *See* HarrisBeach.com, *The Sarbanes-Oxley Act of 2002—Legal Alert*, Aug. 2002, http://www.harrisbeach.com/news/articleviewer.cfm?aid=175; Larelle Chapple & Boyce Koh, *Regulatory Responses to Auditor Independence Dilemmas—Who takes the Stronger Line*, 21 AUSTL. J. CORP. L. 6 (2007).

5. Nelson D. Schwartz & Vikas Bajaj, *Credit Time Bomb Ticked, but Few Heard*, N.Y. TIMES, Aug. 19, 2007, at A1.

mortgages.[6] Securitization is a process which involves pooling income streams or receivables, such as payments on a mortgage, and selling securities backed by those payments.[7] In a typical transaction, the lender, commonly referred to as an originator in securitization parlance, assigns a loan to a subsidiary of an investment bank.[8] In exchange for the receivable, the originator receives a lump sum payment.[9] The subsidiary, in turn, combines that loan with hundreds of other loans in a special purpose vehicle (SPV).[10] The SPV then sells securities backed by payments on the underlying mortgages.[11] These securities resemble other debt instruments and are typically traded among large, institutional investors.[12]

Although the process existed for some time, the securitization of mortgages gained new prominence as investment banks reaped huge profits by packaging home mortgages into securities and selling them to investors with a seemingly endless appetite.[13] Banks sold these securities to all parts of the financial system, including insurance companies, hedge funds, and other foreign investors.[14] Additionally, many American investment banks that manufactured these securities held these assets on their books.[15]

While a full recounting of the ensuing crisis is beyond the scope of this article, the market for mortgage-backed securities simply suffered a systemic failure. Beginning in 2007, the national housing market experienced dramatic turmoil.[16] At the center of the storm were subprime mortgages—loans made to individuals with poor credit or little credit history.[17] Rising defaults from subprime borrowers and questions about the ability of other borrowers to repay their loans raised questions about the value

6. Ben Steverman & David Bogoslaw, *The Financial Crisis Blame Game*, BUSINESSWEEK, Oct. 10, 2008, *available at* http://www.businessweek.com/investor/content/oct2008/pi20081017_950382.htm.

7. *See* Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2186–87 (2007); Lois R. Lupica, *Asset Securitization: The Unsecured Creditor's Perspective*, 76 TEX. L. REV. 595, 599–600 (1998).

8. Peterson, *supra* note 7, at 2209; Lupica, *supra* note 7, at 600.

9. Lupica, *supra* note 7, at 600.

10. Peterson, *supra* note 7, at 2209.

11. *Id*.

12. Aaron Unterman, *Exporting Risk: Global Implications of the Securitization of U.S. Housing Debt*, 4 HASTINGS BUS. L.J. 77, 80 (2008).

13. *Id.*

14. Peterson, *supra* note 7, at 2188.

15. Edmund L. Andrews, *Troubled Assets Still on Books Could Pose Risk, Panel Says*, N.Y. TIMES, Aug. 11, 2009, at B2.

16. Nelson D. Schwartz & Vikas Bajaj, *supra* note 5.

17. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1261 (2002).

of the securities held throughout Wall Street. Furthermore, fraudulent practices by some in the mortgage industry meant that some borrowers took on mortgages that they had no ability to repay.[18] Together, these factors lead to a steep decline in the value of these mortgage-backed securities.[19] Because investment banks used the mortgage-backed securities as collateral for loans to take on additional risk, many suffered a classic "run on the bank" from their creditors and trading partners.[20]

2. Australia

Although the mortgage-backed securities crisis originated on Wall Street, the effects of the crisis have spread throughout the global financial system. Financial institutions of all shapes and sizes, including those in Australia, purchased these securities of diminishing value.[21] In addition, the machinery of securitization around the world ground to a halt, preventing companies from raising new funds or rolling over existing debt.[22] Australian financial institutions, like their American counterparts, were unable to use securitization to make new home loans.[23]

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18. *See generally* Lois R. Lupica, *The Consumer Debt Crisis and the Reinforcement of Class Position*, 40 LOY. U. CHI. L.J. 557 (2009) (examining the causes of the credit crisis and focusing on the overextension of consumer credit in the residential real estate market).

19. *See The Economic Outlook: Testimony Before the J. Econ. Comm.*, 110th Cong. (2008) (testimony of Federal Reserve Chairman Ben Bernanke), *available at* http://www.federalreserve.gov/newsevents/testimony/bernanke20080402a.htm (noting that "large financial institutions . . . have reported substantial losses and writedowns" of mortgage-backed securities).

20. *See, e.g.*, Landon Thomas Jr., *Run on Big Wall Street Bank Spurs Rescue Backed by U.S.*, N.Y. TIMES, Mar. 15, 2008, *available at* http://www.nytimes.com/2008/03/15/business/15bear.html (describing the run on Bear Stearns); *see also* SEC OFFICE OF THE CHIEF ACCOUNTANT DIVISION OF CORPORATE FINANCE, REPORT AND RECOMMENDATIONS PURSUANT TO SECTION 133 OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008: STUDY ON MARK-TO-MARKET ACCOUNTING *in* Lizabeth Ann R. Eisen, *Securities Offerings 2009: What Counsel Need to Know to Get Deals Done in Challenging Markets*, 1734 PLI/CORP 283, 297 (Apr. 23–24, 2009) (claiming that the credit crisis was triggered by "a 'run on the bank' at certain institutions").

21. *See generally* Berkely Cox & Jeremy Green, *Securitisation in Australia in* GLOBAL SECURITISATION AND STRUCTURED FINANCE 2008, *available at* http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_091_098_Australia.pdf.

22. RESTORING CONFIDENCE IN SECURITIZATION MARKETS, SEC. INDUSTRY FIN. MARKET ASS'N, Dec. 3, 2008, at 6, *available at*http://www.sifma.org/capital_markets/docs/Survey- Restoring-confidence-securitization-markets.pdf.

23. Wietske Blees, *Grinding to a Halt*, RISK MAG., Sept. 1, 2008, *available at* http://www.risk.net/public/showPage.html?page=814352.

B. *Accounting Scandal & Sarbanes-Oxley*

1. The United States

Before the current credit crisis however, the U.S. had a series of striking scandals so impactful that they lead to the overhaul in corporate governance regulation that we now know as Sarbanes-Oxley, commonly referred to as SOX. Sarbanes Oxley was a major piece of legislation passed in 2002 and named for sponsors Senator Paul Sarbanes and Representative Michael Oxley. Although a full review of Sarbanes Oxley is beyond the scope of this article, it made significant changes to the accounting practices of public companies. Among other matters, SOX impacts the relationship between auditors and public companies,[24] and corporate governance practices that touch on financial reports and internal controls.[25] SOX also establishes stiff penalties for violations of its provisions.[26]

The "line leader" in the accounting scandals that produced SOX was Enron, formerly one of the largest international traders of electricity and natural gas.[27] The Enron scandal emerged from a deadly combination of unsuccessful partnerships that produced excessive debt, which, in turn, led to misleading financial reporting.[28] As the company fell apart, stock prices plummeted, creating a downward spiral.[29] Eventually, Enron filed for Chapter 11 bankruptcy. The misleading statements and fraudulent acts did not stop at Enron's boardroom, but encompassed their accounting firms as well. Arthur Andersen, one of the biggest accounting firms, was to ensure that investors could rely on Enron's financial statements.[30] On June 15, 2002, however, the government convicted Arthur Andersen of obstruction of justice for its involvement with Enron, including the shredding of pertinent documents. Arthur

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24. SOX, *supra* note 2, § 203.
25. SOX, *supra* note 2, § 301.
26. SOX, *supra* note 2, § 802.
27. *Timeline of Enron's Collapse*, WASH. POST, Feb. 25, 2002, http://www.washingtonpost.com/ac2/wp-dyn?pagename=article&node=&contentId=A25624-2002Jan10&notFound=true. Enron evidenced its undiscriminating approach to canvassing politics by hiring Linda Robertson, formerly with the Clinton administration, to head its Washington office as Vice President for Federal Government affairs exactly one month following Lay's personal contribution to Bush's campaign. *See also* Robert O'Harrow, Jr. & Lucy Shackelford, *Understanding Enron*, WASH. POST, http://www.washingtonpost.com/wp-srv/business/enron/front.html.
28. Robert O'Harrow, Jr. & Lucy Shackelford *supra* note 27.
29. *See* Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309, 1310 (2002).
30. *See* O'Harrow & Shackelford, *supra* note 27.

Andersen was the first accounting firm ever to be convicted of a felony.[31]

As fraud and corruption involving Enron and its accounting firm surfaced, on July 21, 2002, WorldCom, a leading international communications network, took Enron's title as the largest Chapter 11 bankruptcy filing in history.[32] Enron and WorldCom had in common an unfortunate effort by officers to conceal and misstate financial information to make profits appear larger. Enron executives accomplished this fraud by utilizing off-balance sheet transactions to shift debt off of the books through various fraudulent partnerships and then shredding incriminating documents with the assistance of Arthur Andersen.[33] The methodology utilized by WorldCom was far more basic, but no less fraudulent. Worldcom's executives—Bernard Ebbers, Scott Sullivan, and others—inflated earnings in two ways. First, by capitalizing expenditures on the balance sheet that should have been recorded as expenses on the income statement, they deferred expenses and inflated net income.[34] Second, typically after the end of each quarter and just before their audit or review, they booked large entries to record revenue that had never been earned.[35] The executives frequently reassured the public that the company's impressive growth rate was sustainable, but, as it turns out, those growth rates were sustained only by increasingly overinflated revenue.[36]

Before the public could recover from the news of these frauds, Tyco, a maker of equipment for various industries (including electrical, fire and security, healthcare, and telecommunications), became embroiled in a similar scandal involving financial misstatements and a blatant misuse of corporate funds. On September 12, 2002, the government indicted

31. N. Craig Smith & Michelle Quirk, *From Grace to Disgrace: the Rise & Fall of Arthur Anderson*, 1 J. BUS. ETHICS EDUC. 91, 91 (2004). However, the conviction of Arthur Anderson was later overturned due to a finding of error in the jury instructions. Bill Mears, *Arthur Andersen Conviction Overturned*, CNN, May 31, 2005, http://www.cnn.com/2005/LAW/05/31/scotus.arthur.andersen/.

32. *WorldCom Company Timeline*, WASH. POST, Mar. 15, 2005, http://www.washingtonpost.com/wp-dyn/articles/A49156-2002Jun26_3.html.

33. O'Harrow & Shackelford, *supra* note 27.

34. Dennis R. Beresford, Nicholas deB. Katzenbach, & C.B. Rogers, Jr., *Report of Investigation*, SPECIAL INVESTIGATIVE COMM. OF THE BOARD OF DIRECTORS OF WORLDCOM, INC. at 11, Mar. 31, 2003, *available at* http://www.sec.gov/Archives/edgar/data/723527/000093176303001862/dex991.htm#ex991902_2.

35. *Id.* at 13–15.

36. *Id.* at 13.

former Tyco CEO, Dennis Kozlowski, and CFO, Mark Swartz, for selling stock at artificially inflated prices, as well as taking $170 million for personal use through improper bonuses and forgiven company loans.[37]

Similarly, executives from Adelphia Communications Corp., a cable TV operator, and ImClone, the maker of a cancer drug, both suffered the same fate. Adelphia's founder, John Rigas, and his family spent over $1 billion for personal expenses.[38] ImClone Chairman, Sam Waksal, and his family and friends sold millions of dollars of stock immediately before the FDA announced it would not approve the company's cancer drug.[39] Eventually, the ImClone scandal ensnared Martha Stewart, who sold 3,000 shares of ImClone stock immediately prior to the FDA disclosure.[40]

In addition to financial malfeasance at some of America's largest companies, many major investment banking firms put their own profits ahead of their clients' interests.[41] For example, several investment banks issued positive research reports on companies to win investment banking business while privately telling favored clients that the companies were not on solid footing. Because of these practices, on May 21, 2002, the New York Attorney General, in association with the Securities Exchange Commission (SEC), forced Merrill Lynch to agree to a series of penalties for misleading investors.[42] These penalties included structural reform, production of a statement of contrition, and payment of a $100 million fine.[43] Salomon Smith Barney, like Merrill Lynch, has also misled its clients and the larger investing public.[44] The National Association of Securities Dealers (NASD) found that Salomon Smith Barney issued misleading

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37. Andrew Ross Sorkin, *2 Top Tyco Executives Charged With $600 Million Fraud Scheme*, N.Y. TIMES, Sept. 13, 2002, at A1, *available at* http://query.nytimes.com/gst/fullpage.html?res=9B00E0DF1131F930A2575AC0A9649C8B63. Tyco, as a corporation, was not charged because the wrongdoing was limited to specific officers within Tyco. *Id.*

38. *Ex-ImClone Boss Charged with Fraud*, BBC NEWS, June 12, 2002, http://news.bbc.co.uk/1/hi/business/2041385.stm [hereinafter *Imclone Fraud*]; *Jurors Begin Deliberations in Adelphia Fraud Trial*, N.Y. TIMES, June 29, 2004, at C2, *available at* http://query.nytimes.com/gst/fullpage.html?res=9C06E1DF1538F93AA15755C0A9629C8B63.

39. *See Imclone Fraud*, *supra* note 38.

40. *Id.*

41. William H. Donaldson, Chairman, U.S. Sec. & Exch. Comm'n, *Testimony Concerning Global Research Analyst Settlement Before the Senate Committee on Banking, Housing and Urban Affairs* (May 7, 2003) (transcript available at http://www.sec.gov/news/testimony/ts050703whd.htm).

42. *Id.*

43. *Id.*

44. *Salomon Pays the NASD Piper*, FORBES.COM, Sept. 23, 2002, http://www.forbes.com/2002/09/23/0923grubman.html.

research reports on Winstar Communications and levied a $5 million fine.[45] Ultimately, ten Wall Street firms, including some of the most venerable names in American finance, agreed to $875 million in disgorgement and civil penalties.[46]

2. Australia

The United States was not alone in its corporate failures. In the first half of 2001, Australia saw HIH Insurance, One.Tel, and Harris-Scarfe fall.[47] Like their American counterparts, these scandals involved inadequate disclosures and accounting problems.[48]

HIH Insurance was founded in 1968 and went public in 1992.[49] HIH comprised several separate government–licensed insurance companies, including HIH Casualty and General Insurance Limited, FAI General Insurance Company Limited (FAI), CIC Insurance Limited (CIC), and World Marine and General Insurances Limited (WMG).[50] HIH wrote many types of insurance policies in Australia, the USA, and the UK. In Australia, HIH's practice included compulsory insurance (such as workers' compensation and compulsory third party motor vehicle insurance) and non–compulsory insurance (such as home contents and travel insurance).[51]

As early as 1992, HIH's accounting practices drew questionable attention. On June 4, 1992, British insurance broker CE Heath wrote off 45% of its under–performing subsidiary—CE Heath International

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45. *Id.*
46. SEC Fact Sheet on Global Analyst Research Settlements, http://www.sec.gov/news/speech/factsheet.htm (last visited May 5, 2009).
47. Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WIS. INT'L L.J. 367 (2005); Paul von Nessen, *Corporate Governance in Australia: Converging with International Developments*, 15 AUSTL. J. CORP. L. 1 (2003); Bonnie Buchanan, *Australian Corporate Casualties*, *in* CORPORATE GOVERNANCE: ADVANCES IN FINANCIAL ECONOMICS 55, 55 (2004).
48. *See* Buchanan, *supra* note 47.
49. The full corporate history of HIH can be found in HIH Royal Commission. Neville Owen, REPORT OF THE HIH ROYAL COMMISSION, Commonwealth of Australia, pt. 2, ch. 3 (2003), *available at* http://hihroyalcom.gov.au/ (HIH Royal Commission).
50. David Kehl, *HIH Insurance Group Collapses*, Nov. 29, 2001, http://www.aph.gov.au/library/intguide/econ/hih_insurance.htm. *See also* Gregor Allan, *The Collapse: A Costly Catalyst for Reform*, 11 DEAKIN L. REV. 137 (2006) and Jean du Plessis, *Reverberations After the HIH and Other Recent Australian Corporate Collapses: The Role of ASIC*, 15 AUSTL. J. CORP. L. 225 (2003).
51. Kehl, *supra* note 50.

Holdings Ltd.—a precursor to HIH, on the stock exchange.[52] A due diligence report prepared by Ernst and Young regarding the merger found there was not a "prudential margin," but the merger proceeded nonetheless.[53] Insurers frequently incorporate a "prudential margin" when calculating a provision for outstanding claims so that the provisions exceed the central estimate of such claims, or the mean of the distribution of possible outcomes based on historical claims. Such a cautious approach was not followed by HIH, resulting in harsh criticism by the Royal Commission.[54]

The ultimate nail in the coffin for HIH, however, came in 1998 when HIH began a formal takeover of FAI Insurance Ltd.[55] HIH completed the takeover in January 1999.[56] However, early 1999 marked records for natural disasters, declining premiums, and low interest rates, resulting in a profit decline for HIH of 39%.[57] Losses mounted and share prices dropped. In 2000, the news worsened as questions of failure to disclose information to shareholders arose.[58] By September of 2000, regulators suspended trading of HIH shares. Trading was suspended again in February 2001 as Standard and Poors dropped HIH's credit rating and losses continued to skyrocket.[59] By March 2001, HIH was in liquidation and an investigation was launched by May 2001.[60]

At almost the same time, in April of 2001, Harris-Scarfe, Australia's third largest retail group, collapsed.[61] At the time of its liquidation, it had been in operation for 150 years.[62] The story sounds remarkably familiar, with allegations of overstated profits and false financial statements.[63] Harris-Scarfe's losses set records, including a debt of $65 million (Australian) to ANZ bank.[64]

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52. *Id.*
53. *See* Buchanan, *supra* note 47.
54. Deborah DeMott, *Inside the Corporate Veil: The Character and Consequences of Executives' Duties*, NELLCO Legal Scholarship Repository, at 14, *available at* http://lsr.nellco.org/cgi/viewcontent.cgi?article=1046&context=duke_fs (last visited Mar. 30, 2010).
55. *See id.*
56. Kehl, *supra* note 50.
57. Buchanan, *supra* note 47.
58. *Id.*
59. *Id.*
60. Kehl, *supra* note 50.
61. Buchanan, *supra* note 47, at 61.
62. Philomena Leung & Barry J. Cooper, *The Mad Hatter's Corporate Tea Party*, 18 MANAGERIAL AUDITING J. 505 (2003).
63. *Id.*
64. Buchanan, *supra* note 47. For a recent discussion of the effect of this failure and claims made against the D & O insurance of directors, see Debra Lane, *Court Appoints Liquidators to Enable Claims Under D & O Policy*, 22 AUSTL. INS. L. BULL. 126 (2007).

Last but not least, One.Tel, an Australian telecommunications company, went into liquidation in May 2001.[65] One.Tel apparently suffered similar industry problems as seen during the same period in the U.S. and Europe.[66] As industry pressures created cash problems, One.Tel engaged in insolvent trading, insider trading, and market disclosure failures.[67] In addition, at a time when One.Tel experienced A$290 million in losses, its executives received bonuses of A$7 million.[68] At the time of its collapse, One.Tel had approximately A$600 million in liabilities.[69]

These scandals were remarkable on many levels, including their simultaneous occurrence, how they manifested worldwide, the extent of their fraud, and how they reflect an apparent lack of concern for governance. Unfortunately, these scandals also shared a common outcome—severe damage to investor confidence.[70]

III. COMPARATIVE REGULATION

A. The United States

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002,[71] declaring, "[n]o more easy money for corporate criminals; just hard time."[72] The bill raced through Congress. Sarbanes-Oxley criminalized certain behaviors that had not previously been criminal and

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65. *See* Brian R. Cheffins & Bernard S. Black, *Outside Director Liability across Countries*, 84 TEX. L. REV. 1385, 1440 (2006) (discussing the prosecutions which arose from this collapse). *See also* Michael De Martinis, *Do Directors, Regulators, and Auditors Speak, Hear, and See No Evil? Evidence from the Enron, HIH, and Collapses*, 15 AUSTL. J. CORP. L. 66 (2002).

66. Buchanan, *supra* note 47.

67. Leung & Cooper, *supra* note 62.

68. *Id.*

69. Buchanan, *supra* note 47. *See also* ASIC v. Rich (2003) 174 F.L.R. 128; Tanya Josev, *Tailoring Directors' Duties to 'Contemporary Community Expectations': New Directions for the Courts Post-ASIC v Rich*, 22 CORP. & SEC. L.J. 553 (2004).

70. Jerry Knight, *No Market Rebound Until Companies Come Clean*, WASH. POST, June 17, 2002, at E1, *available at* http://www.washingtonpost.com/ac2/wpdyn?pagename=article&node=&contentId=A61568-2002Jun16&notFound=true (stating the damage is demonstrated by the fact that "the economy has grown less than 3 percent in the past year, its most anemic expansion in four decades").

71. SOX, *supra* note 2.

72. President Bush Signs Corporate Corruption Bill**,** 2 PUB. PAPERS 1319–22 (July 30, 2002).

significantly increased the penalties for existing crimes.[73] The statute imposes additional requirements that were intended to increase corporate compliance with legal and ethical standards.[74] It also requires issuers of securities to disclose in periodic reports whether they have adopted a code of ethics for senior financial officers, and if not, to explain why.[75] According to the Act, any amendments and waivers to the company's code of ethics must be immediately disclosed in a public filing.[76]

In addition, the Act directs national securities exchanges to prohibit the listing of company securities where the audit committee has not established procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters.[77] In adopting the regulations, the SEC made clear that it was not mandating specific requirements for reporting procedures, but companies were instead being provided with the flexibility to develop procedures appropriate to their circumstances.[78]

The statute responds directly to the multitude of scandals by including provisions to criminalize specific wrongdoings, as well as vastly increasing penalties to deter future corporate misconduct. It creates personal accountability for the corporations' directors and officers with almost no forgiveness for failures to be accurate and transparent. Overall, the Act's provisions, in concert with mandates to regulators, strive to restore the integrity of the marketplace.

B. Australia

The reform of Australian corporation law has been a work in progress over the last two decades.[79] However, major corporate collapses in Australia of HIH, Harris-Scarfe, and One.Tel resulted in legislative proposals for corporate governance standards.[80] In Australia, Sarbanes-Oxley has, to a degree, also served as a model for change.[81]

73. Paul Fiorelli, *Will U.S. Sentencing Commission Amendments Encourage a New Ethical Culture Within Organizations?*, 39 WAKE FOREST L. REV. 565, 572–73 (2004).

74. *See* Rebecca Walker, *The Evolution of the Law of Corporate Compliance in the United States: A Brief Overview*, *in* ADVANCED CORPORATE COMPLIANCE WORKSHOP 2007 ch. 1, 43–44 (2007).

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. Tomasic, *supra* note 3.

80. von Nessen, *supra* note 47.

81. *Id.*

After the quick passage of SOX, the Chairman of the Australian Securities and Investments Commission (ASIC) proposed that the Australian Stock Exchange (ASX) impose more rigorous corporate governance standards.[82] In response, the ASX introduced a set of guidelines, the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations.[83] The ASX Principles provide a comprehensive guide to best corporate governance practice, including several initiatives similar in substance to those introduced by SOX.[84]

Further, a lack of audit independence and inaccurate reporting contributed to the financial collapses in Australia.[85] Much like the United States, Australia responded by passing reforms entitled, "Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (CLERP 9)."[86] CLERP 9 aims to rebuild the integrity of the audit system by emphasizing and assuring auditor independence.[87]

C. Comparisons Between Australian and American Corporate Governance Reform

Despite some notable differences between the United States and Australian reforms, they are substantially similar regarding both the underlying motivations for enactment and the goals that the regulations are intended to meet.

While the overall goals of transparency, accountability and accuracy are the same, the implementation is somewhat different. The United States has channeled all of its reforms into Sarbanes-Oxley. There is no

82. *Id.*

83. ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (2d ed.), Aug. 2007, http://asx.ice4.interactiveinvestor.com.au/ASX0701/Corporate%20Governance%20Principles/EN/body.aspx?z=1&p=-1&v=1&uid= [hereinafter ASX Recommendations]; *see also* Hill, *supra* note 47, at 378.

84. von Nessen, *supra* note 47.

85. *Id.*

86. Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004, No. 103 (2004), *available at* http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/0/66B0C93ECDA86C21CA256F720011722E?OpenDocument [hereinafter CLERP 9].

87. *Id.*; *see also* Chapple & Koh, *supra* note 4, at 6 (2007). The Australian proposals, like those in the United States, identify risks to independence caused by an audit firm's performance of non-audit functions and by the hiring by the firm of former auditors. As in the United States, mechanisms to safeguard auditor independence include an independent audit committee and rotation of audit staff.

single statute like SOX that regulates corporate governance issues in Australia. Instead, Australia retained a disclosure model with some legislative requirements found in CLERP 9,[88] supplemented by exchange listing rules[89] that implement corporate governance principles.[90] The ASX Principles adopt a "comply or explain" model, whereby companies listed on the ASX must comply with, or explain their divergence from, these principles in their annual report.[91] If the ASX is not satisfied with an explanation, or believes a flagrant breach occurred, they will refer the matter to the ASIC.[92] Thus, the U.S. has put most of its corporate reform eggs in one legislative basket with some assistance from regulatory and exchange listing standards. Australia, on the other hand, has some eggs in the legislative basket, but placed many more in the baskets of regulators and exchanges.

Implementation aside, the substance of the regulations bears substantial similarities. Both countries' new corporate governance regimes contain reforms relating to director independence, board committees, executive compensation, internal controls and ethics, disclosure, related party transactions, enforcement, and auditor independence, though the intricacies of those reforms are not always congruous.[93] Just as SOX directly responded to specific issues relating to the collapse of Enron and other companies, CLERP 9 bears many hallmarks of the HIH collapse and other scandals.[94]

1. Boards, Committees, and Directors

Given the Board of Director's role as the body that ultimately oversees the company, several of the reforms in Australia and the United States have focused on how the board functions. Specifically, the reforms have addressed the makeup of the entire board, the audit committee, and the compensation committee. In the United States, the listing requirements of the major stock exchanges, NYSE and NASDAQ, require that a majority of the board be made up of independent directors.[95] The listing

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88. CLERP 9, *supra* note 86.

89. ASX, *Listing Rules*, http://www.asx.com.au/supervision/rules_guidance/listing_rules1.htm (last visited Mar. 30, 2010).

90. ASX Recommendations, *supra* note 83.

91. *See* Hill *supra* note 47, at 378.

92. *Id.*; *see also* Corporations Act, 2001, § 777 (Austl.).

93. *See infra* pt. II.C.(i)–(vii).

94. Hill, *supra* note 47, at 373 (2005).

95. NYSE, Inc., Listed Company Manual § 303A.01 (2009), *available at* http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1182508124422.html&displayPage=/lcm/lcm_section.html [hereinafter NYSE Manual];

requirements also define independence with great detail.[96] At a minimum, a director is not independent if she is, or, within the last three years, has been, an executive officer or employee of the company. Additionally, the individuals may not have any material relationship with the corporation. This includes both commercial and professional relationships. A director is not independent if an immediate family member falls into any of the described circumstances. The listing rules also contain detailed requirements relating to interlocking board memberships.

Similarly, the Australian Securities Exchange *recommends* that a majority of the board be made up of independent directors.[97] As explained above, Australia, like the UK, has adopted the lighter touch regulatory model ("comply or explain") rather than the direct legislative requirement model adopted by SOX. This might in part be due to the smaller pool of qualified accountants and experienced directors in a country of only 20 million (acknowledging the difficulties with complying with a totally inflexible requirement), but may also be due to Australia's historic willingness to look to the UK for guidance in law reform. According to the ASX Principles, a board must identify directors it considers independent. The board should also provide the reasons it considers the individual independent "notwithstanding the existence of relationships listed in Box 2.1." These circumstances, which define "independence" for the purposes of the ASX Principles, are substantially similar to the approach taken by the NASDAQ and NYSE. Like the NYSE and NASDAQ requirements, the ASX Principles note that family ties and interlocking board memberships may impact independence and should be disclosed.

Because many of the scandals that produced Sarbanes-Oxley involved accounting malfeasance, audit committees were prime candidates for reform. One of the primary reforms to affect the operation of boards of directors is Rule 10a-3, promulgated by the SEC under the Securities and Exchange Act of 1934. Rule 10a-3 mandates each national securities exchange to implement initial and continuing listing requirements that contain the provisions of the rule. Primarily, Rule 10a-3 provides that the audit committee be made up of at least three members and that all

NASDAQ, Inc., Listing Rules, § 5605(b) (1), *available at* http://nasdaq.cchwallstreet.com/NASDAQ/Main/ [hereinafter NASDAQ Rules].

96. NYSE Manual, *supra* note 95, § 303A.02; NASDAQ Rules, *supra* note 95, § 5605(a) (2).

97. ASX Recommendations, *supra* note 83, at recommendation 2.1.

members of the committee be independent directors. The rule also requires audit committees to be responsible for supervising the work of the registered public accounting firm and to establish a procedure for complaints relating to accounting or auditing matters. Finally, audit committees must have authority to engage independent counsel, advisers, and funding to carry out its duties. An additional requirement is SOX § 407, which requires at least one person to be a financial expert.

The ASX Principles recommend that a board establish an audit committee.[98] Unlike the approach taken in the United States, the Principles only recommend that the audit committee consist of a *majority* of independent directors, rather than entirely of independent directors. However, the Principles do note that the trend is for the audit committee to consist only of independent directors. Under the ASX Principles, the scope of the audit committee's responsibilities is similar to the framework established by Sarbanes-Oxley Rule 10a-3. The audit committee must "review the integrity of the company's financial reporting and oversee the independence of the external auditors"[99] and be "given the necessary power and resources to meet its charter."[100] Like § 407 of Sarbanes-Oxley, the ASX Principles also recommend that the audit committee include members who are "financially literate"[101] and that at least one member have "relevant qualifications and experience."[102] Furthermore, the ASX Principles recommend the company disclose the names and qualifications of members of the audit committee. Although the ASX Principles merely offer recommendations about the makeup of an audit committee, ASX Listing Rules specifically require the top 300 companies in the S&P All Ordinaries Index[103] to have audit committees.[104]

The roles of Chief Executive Officer and Chairman of the Board have also received a great deal of attention. Many commentators have suggested these positions be split between two individuals.[105] There is no law or listing requirement in the United States that requires the Chairman of the Board to be separate from the CEO. However, some firms have identified

98. *Id.* at Recommendation 4.1.

99. ASX Recommendations, *supra* note 83, at Recommendation 4.3, Official Commentary.

100. *Id.*

101. *Id.* at Recommendation 4.2, Official Commentary.

102. *Id.*

103. The S&P All Ordinaries Index represents the 500 largest companies in the Australian equities market and is published by Standard and Poor's, a financial market information firm.

104. ASX Recommendation, *supra* note 83, at Recommendation 4.1.

105. Joann S. Lublin, *Splitting Posts of Chairman, CEO Catches On*, WALL ST. J., Nov. 11, 2002, at B1.

a "lead independent director" in an effort to demonstrate strong corporate governance.[106] In contrast, ASX Principles suggest that the Chair should be an independent director.[107]

2. Executive Compensation

Given the enormous rise in compensation for senior executives in recent years, executive pay has received special scrutiny. In particular, complex compensation packages based on stock option awards have caught the eye of regulators. Much of the scrutiny focused on executives who were especially cozy with their boards on matters of compensation. As a result, both the NYSE and the NASDAQ established listing requirements that require companies to have a compensation committee composed entirely of independent directors.[108] Similarly, ASX Principles recommend a board establish a Remuneration Committee that consists of a majority of independent directors and is chaired by an independent director. In addition to the requirements for independence, companies in both the United States and Australia must disclose certain information regarding the compensation of senior executives. In the United States, the SEC has promulgated rules that require companies to disclose significant information about executive pay through a Compensation Discussion and Analysis item in their annual report.[109] In addition to basic information about the amount of compensation, this item also requires companies to include a narrative, in "plain English," that explains the compensation package and examines the factors that underlie each compensation decision. Similarly, the Australian Corporations Act requires substantial disclosure in a remuneration report about the compensation for a company's senior executives,[110] which also must be open for discussion by members at the annual general meeting.[111] and put to a non-binding vote of shareholders.[112] Like the SEC approach, the

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106. *See, e.g.*, Washington Mutual, Inc., Proxy Statement (Schedule 14A) (Apr. 4, 2008), *available at* http://www.sec.gov/Archives/edgar/data/933136/000127727708000173/april42008.htm.

107. ASX Recommendations, *supra* note 83, at Recommendation 2.2.

108. NYSE Manual, *supra* note 95, § 303A.

109. Securities & Exchange Act of 1934, 17 C.F.R. § 229.402 (2009) [hereinafter SEC Act].

110. Corporations Act, 2001, § 300A (Austl.).

111. *Id.* § 250SA.

112. *Id.* § 250R.

Australian approach requires companies to disclose the policy for determining compensation and the relationship between such policy and the company's performance.[113]

In addition to shareholder consideration of the remuneration report, Australian shareholders are also required to approve termination or retirement payments for directors and managers.[114] Approval, however, is not required where the payments are within permissible limits based upon a statutory formula that factors in the annual remuneration and length of service of the director or manager.[115] As a result of a number of high profile departure packages paid subsequent to the global financial crisis,[116] the Australian government has recently proposed that the statutory formula be tightened significantly. The proposal would require shareholder approval where the departure payments exceed one year's annual salary (previously a long-serving manager or director could receive up to seven years annual salary without approval), and approval would be required to be given at a general meeting only after the manager/director had departed.[117]

3. *Internal Control and Ethics*

One common thread among the string of corporate scandals is the lack of ethical principles pertaining to internal governance, particularly with regard to accounting. In response, reform has focused on preventative mechanisms to ensure that proper internal controls are in place.

Most significantly, in the United States, management must annually file a report assessing the reliability of the company's internal financial controls, and independent auditors must attest to that report.[118] The substantial costs of complying with this provision immediately triggered heated debate and widespread criticism.[119] Perhaps for that reason,

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113. *Id.* § 300A (1).

114. *Id.* §§ 200A, 200B.

115. *Id.* § 200F.

116. *See, e.g.*, Gerard McManus, *Sol Trujillo leaves Telstra with a cool $20m*, HERALD SUN, Feb. 27, 2009, http://www.news.com.au/heraldsun/story/0,21985,25113002-664,00.html.

117. *See* Exposure Draft of the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, http://www.treasury.gov.au/documents/1531/PDF/Termination_Bill_Exposure_Draft.pdf.

118. SOX, *supra* note 2, § 404.

119. *Compare* Robert Prentice, *Sarbanes-Oxley: The Evidence Regarding the Impact of SOX 404*, 29 CARDOZO L. REV. 703 (2007) (arguing that the costs of compliance with SOX 404 are overstated and outweighed by the increased accuracy in financial reporting that has resulted), *with* Joseph A. Grundfest & Steven E. Bochner, *Fixing 404*, 105 MICH. L. REV. 1643, 1673 (2007) (arguing that the "marginal costs of

Australia refrained from instituting such a demanding requirement. The ASX Principles simply require that companies establish a sound system of risk oversight, management, and internal control, or disclose their reason for declining to do so.[120] At the time SOX was enacted, the amount of compliance costs was only speculative. But now, several years later, and with the benefit of hindsight, the cost-benefit analysis may be empirically tested. Perhaps surprisingly, commentators are increasingly opining that the costs of § 404 compliance are outweighed by the benefits; that is, the initial criticism of § 404 may have been overstated.[121] Thus, Australia may have declined to require audits of internal controls because of a knee-jerk reaction to a reform that has ultimately proved to be worthwhile.

In a far less controversial measure, both the United States and Australia have encouraged the creation and implementation of internal ethics codes. In a deviation from the norm, the United States incorporated the Australian disclosure-based approach and requires that public companies disclose whether or not they have adopted a code of ethics for senior financial officers, including the controller.[122] While the ASX requires the Code itself, SOX does not compel action by a public company in this instance. The ASX does. Similarly, under the ASX Principles, Australian boards should institute a code of conduct to guide the directors, key executives, and employees as to the "practices necessary to maintain confidence in the company's integrity."[123] In addition, the ethics code should address the "responsibility and accountability of

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compliance far exceed the marginal benefits, causing the waste of billions of dollars on inefficient implementation of Section 404 controls").

120. ASX Recommendations, *supra* note 83, at Recommendation 7.1.

121. *See*, *e.g.*, Prentice, *supra* note 119, at 726–32 (arguing that compliance costs are overstated). Much of the remaining criticism revolves around the disproportionately high compliance costs for small businesses and whether those businesses should be exempt from § 404. *See*, *e.g.*, Robert P. Bartlett III, Symposium, *Going Private but Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms' Going-Private Decisions*, 76 U. CHI. L. REV. 7 (2009) (arguing that smaller businesses are more likely to fund their going private transactions with financing that does not trigger § 404 compliance); Ehud Kamar, et al., *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*, 25 J.L. ECON. & ORG. 107, 129–30 (2009) (concluding based on an empirical analysis that § 404 "disproportionately burdens small firms").

122. SOX, *supra* note 2, § 406; NYSE Manual, *supra* note 95, § 303A.10.

123. ASX Recommendations, *supra* note 83, at Recommendation 3.1.

individuals for reporting and investigating reports and unethical practices."[124]

4. Disclosure: Accounting, Continuous Disclosure, and Officers' Certificates

Issuers, both Australian and American, have long been required to periodically prepare and file financial statements (quarterly in the United States and semi-annually in Australia).[125] Recent developments, however, have significantly affected the required contents of those financial statements. Differences have emerged regarding accounting rules governing certain situations: an officer's responsibility for the contents of the financial statements, and the responsibility to continuously disclose certain developments.

First, Australia and the United States have adopted different sets of accounting standards, which have responded differently to the accounting scandals. Currently, companies registered with the SEC must comply with Generally Accepted Accounting Principles (U.S. GAAP), promulgated by the Financial Accounting Standards Board (FASB).[126] In 2003, Australia joined a growing number of countries that subscribe to the International Financial Reporting Standards (IFRS), promulgated by the International Accounting Standards Board (IASB).[127] Compared to U.S. GAAP, IFRS is relatively young and, perhaps consequently, represents a more principles-based approach with fewer specific rules addressing narrower issues.[128]

There are several differences between U.S. GAAP and IFRS, including, for instance, the treatment of off-balance sheet transactions—the primary

124. *Id.*

125. *See* ASX Listing Rules, *supra* note 89, §§ 4.1–4.2C (semi-annually).

126. *See* Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards, Accounting Series Release No. 150 (Dec. 20, 1973) (SEC concluding private sector would most effectively set accounting standards); Commission Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Securities Act Release No. 33-8221, 80 SEC Docket 175, (May 27, 2003) (reaffirming FASB as delegate in light of Sarbanes-Oxley).

127. *See* IASB and the IASC Foundation, *Who We Are and What We Do*, http://www.iasb.org/Use+around+the+world/Use+around+the+world.htm (listing when all its members, including Australia, adopted IFRS).

128. The IASB was preceded by the International Accounting Standards Commission (IASC), which was founded in 1973. Stephen A. Zeff, *U.S. GAAP Confronts the IASB: Roles of the SEC and the European Commission*, N.C. J. INT'L L. & COM. REG. 879, 879 (2003). But, until 2001, its founding countries, including the United States, continued to support their own standard-setting bodies, largely ignoring the IASC. *Id.* at 880. In 2001, the IASB, which was adequately funded and comprised of independent experts, issued its first widely-accepted standard. *Id.* at 885.

mechanism through which Enron perpetuated its fraud.[129] IFRS, with a broad brush, effectively prohibits all off-balance sheet transactions, but U.S. GAAP permits off-balance sheet transactions if certain specific rules are satisfied.[130] In this area, U.S. GAAP allows for aggressive issuers, such as Enron, to structure transactions so that off-balance sheet treatment is appropriate (formalistically), even thought off-balance sheet treatment may be substantively inappropriate.[131] SOX now requires disclosure of all off-balance sheet transactions, but they are still not prohibited.[132]

At the request of the SEC, since 1988, the FASB and the IASB have been implementing a "best efforts" approach to convergence on a topic-by-topic basis.[133] The process has gained momentum, following the SEC's announcement in March 2008 that foreign private issuers in the United States could comply with IFRS without reconciling to U.S. GAAP.[134] At least regarding off-balance sheet transactions, the Enron scandal is likely to affect the convergence of FASB and IASB standards.[135]

Dissatisfied with executives' attempts to disclaim knowledge of the inner-workings of their financial statements, both countries now require

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129. *See* Kurt Eichenwald & Michael Brick, *Deals that Helped Doom Enron Began to Form in the Early 90's*, N.Y. TIMES, Jan. 18, 2002, at A1.

130. *See* John M. Holcomb, *Corporate Governance: Sarbanes-Oxley Act, Related Legal Issues, and Global Comparisons*, 32 DENV. J. INT'L L. & POL'Y 175, 226 (2004) (citing F. Robert Buchanan, *International Accounting Harmonization: Developing a Single World Standard*, 46 BUS. HORIZONS 3 (2003)).

131. *See* McDermott Will & Emery, *SEC Proposes Roadmap for U.S. Issuers to Switch to IFRS*, (Nov. 25, 2008), *available at* http://www.mwe.com/info/news/wp1108b.pdf (interpreting the differences between IFRS and U.S. GAAP regarding off-balance sheet transactions); Luzi Hall, Christian Leuz & Peter Wysocki, *Global Accounting Convergence and the Potential Adoption of IFRS by the United States: An Analysis of Economic and Policy Factors* at 35 (Feb. 2009) (reprinted in a letter by the Financial Accounting Foundation, which oversees the FASB to the SEC, dated Mar. 11, 2009, *available at* http://fasb.org/FAF_SEC_Roadmap_Response_Final_with_Appendix.pdf) (explaining how bright line rules regarding off-balance sheet transactions could lead to abuse).

132. SOX, *supra* note 2, § 404.

133. *See* Regulation of the International Securities Markets, Securities Act Release No. 33-6807, 42 SEC Docket 284 (Nov. 30, 1988).

134. *See* Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Reporting Standards Without Reconciliation to U.S. GAAP, Securities & Exchange Acts Release Nos. 33-8879; 34-57026, 92 SEC Docket 825 (Jan. 22, 2008), *available at* http://sec.gov/rules/final/2007/33-8879.pdf.

135. *See* Hall, Leuz & Wysocki, *supra* note 131, at 35. For a discussion of the other differences between U.S. GAAP and IFRS, which are less relevant to the specific accounting scandals preceding SOX, *see id.* at 52–54 (fair value accounting, revenue recognition, share-based payments, financial liabilities and equity, and consolidations).

certain officers to certify, to some degree, the accuracy of the financial statements. In the United States, CFOs and CEOs must certify that financial reports "fairly present" their company's financial position and do not contain any untrue statement or omission of any material fact necessary to make other statements made not misleading.[136] Similarly, under the Australian Corporations Act, CFOs and CEOs of listed entities must certify to the board that the financial statements present a "true and fair" view of the company's financial position.[137]

Last, both countries have instituted new requirements regarding the continuing obligation to disclose certain information or events that may be material to investors. In the United States, each reporting public company must disclose to the public on a "rapid and current basis" any material information concerning changes in its financial condition which is "necessary or useful for the protection of investors and is in the public interest."[138] Likewise, in Australia, a disclosure must be made if a reasonable person would expect the information to have an effect on the price of the security.[139] But, in a deviation from American law, Australian law dictates that the amount of time within which the company must disclose the information depends on the size of the company. Certain unlisted public companies must disclose the information "as soon as practical," but all others must make the disclosure "immediately."[140]

5. *Related Party Transactions*

Loans to corporate executives were at the center of many of the corporate scandals that precipitated Sarbanes-Oxley. Many executives exercised stock options and accumulated large equity positions with cheap loans from their companies. As a result, there is a general prohibition on personal loans from a public company to directors and executives of that company.[141] However, this ban is subject to some exceptions. Neither the ASX Listing Principles nor the Australian

136. SOX, *supra* note 2, §§ 302, 906.

137. Corporations Act, 2001, § 295A (Austl.).

138. SOX, *supra* note 2, § 409.

139. ASX Listing Rules, *supra* note 89, § 3.1; Corporations Act, 2001, pt. 6CA, § 674(2) (Austl.).

140. ASX Listing Rules, *supra* note 89, § 3.1. A delay of 72 minutes in the release of information concerning acquisition negotiations by Rio Tinto Ltd. resulted in a $100,000 infringement. ASIC Media Release 08-117, Rio Tinto Complies with ASC Infringement Notice, (June 5, 2008),http://www.asx.com.au/supervision/pdf/asic_media_release_08_117_ rio_tinto.pdf.

141. SOX, *supra* note 2, § 402.

Corporations Act contains an outright prohibition on loans to public company directors or executives. Yet, the Australian Corporations Act requires public companies to obtain member approval for loans to related parties.[142] This prohibition is also subject to a number of exceptions.

6. Enforcement

The SEC has a variety of tools available to enforce the provisions of the federal securities laws which relate to corporate governance. Perhaps the most fundamental tool is the general prohibition on fraud in connection with the purchase or sale of securities, embodied in Rule 10b-5. Because Rule 10b-5 prohibits material misrepresentations in SEC filings and statements made to the public, it acts as a strong curb on corporate malfeasance. The SEC may seek civil penalties for violations of Rule 10b-5 and other securities laws. Sarbanes-Oxley also broadened the availability of and sentencing guidelines for criminal penalties for violating securities laws.[143] It increased the maximum prison sentence for falsifying or destroying audit records to ten years.[144] Additionally, the implied private right of action associated with Rule 10b-5 augments the use of the tool by the SEC or the Department of Justice.

The SEC also has available tools that are tailored to executive compensation, sales of company stock, and service on a board of directors. New regulations have targeted executives that receive lucrative compensation packages based on improper or fraudulent financial reports. Specifically, CEOs and CFOs must forfeit any bonuses and profits received from the sale of company securities during the twelve month period following the filing of a financial report for which an accounting restatement was required due to accounting or reporting misconduct.[145]

Finally, the SEC may prohibit any person from serving as an officer or director if they have violated certain anti-fraud provisions and their conduct demonstrates "unfitness" to serve.[146]

The Australian enforcement scheme also provides for disqualification from board membership and civil penalties. A person can be disqualified

142. Corporations Act, 2001, ch. 2E (Austl.).
143. SOX, *supra* note 2, §§ 802 (criminal penalties for altering documents), 805 (sentencing guidelines), 807 (criminal penalties for defrauding shareholders).
144. SOX, *supra* note 2, § 802.
145. SOX, *supra* note 2, § 402.
146. SEC Act, *supra* note 109, § 240.10(b).

under the Corporations Act from managing corporations for convictions for certain serious offenses; for involvement in failed corporations; for awaiting discharge in bankruptcy; and for repeated contraventions of the Corporations Act.[147] The civil penalty provisions of the Corporations Act now provide a maximum civil penalty for corporate offenders of up to $1 million (up from the previous $200,000). Compensation for losses may also be provided.[148]

7. Auditing Functions and Auditing Independence

As the wave of accounting scandals rolled past the millennium, with building agitation, legislators and investors looked to the independent auditors—the "public watchdogs"[149]—for an explanation of how these frauds remained undetected. The regulation that resulted from these inquiries reveals the perception that auditors have failed to maintain their independence from their clients. Consequently, both Australia and the United States have assumed a greater role of supervision over the audit profession and have attempted to remove, or at least diminish, several frequently occurring situations perceived as likely to undermine an auditor's independence.

i. Heightened Supervision of the Audit Profession

Both Australia and the United States concluded that it was no longer appropriate for the auditing profession to remain fully self-regulating. Sarbanes-Oxley created the Public Company Accounting Oversight Board (PCAOB), a five-member board partially independent of the accounting profession, and overseen by the SEC, to set auditing, quality, control, and independence standards.[150] Instead of creating a new regulating entity, Australia, in CLERP 9, expanded the responsibilities of the Financial Reporting Council to oversee the setting of auditing standards, advise and monitor auditor independence, promote the teaching of professional and business ethics, and monitor the adequacy of disciplinary procedures.[151]

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147. Corporations Act, 2001, pt. 2D.6 (Austl.).

148. Corporations Act, 2001, pt. 9.4, § 1317G (B1) (Austl.).

149. *See* United States v. Arthur Young & Co., 465 U.S. 805, 818 (1984) (characterizing auditors as "public watchdogs").

150. SOX, *supra* note 2, § 101. Only two members of the board may be certified public accountants. *Id.* at (e) (2).

151. Australian Securities and Investments Commission Act, 2001, pt. 12, div. 3, subdiv. A (Austl.) [hereinafter ASIC Act].

Despite the differing approaches, however, both countries are clearly taking a more proactive role in overseeing the auditing profession.

ii. Potential Conflicting Interests

The accounting scandals revealed that auditors had repeatedly failed to maintain independence from their clients. In investigating the cause, several characteristics of the auditor-client relationship were illuminated as potential sources of conflicting interests. Authorities, both in the United States and Australia, tailored regulations to specifically address the problematic areas.

For instance, the external auditor is charged with the responsibility of maintaining independence from its client, but the client hires and fires the auditor and pays the audit fees. The conflicting interests inherent in such a relationship potentially enable the client to improperly influence its auditor. While both Australian and American law address this issue, Sarbanes-Oxley does so more specifically. In the United States, an officer or director of a public company is prohibited from fraudulently influencing or coercing any independent, public auditor that is performing an audit on the company.[152] In Australia, general principles, rather than specific rules, govern the improper influence of auditors. Since 2004, the Corporations Act provides that there should be auditor independence; that auditors are required to annually declare to the board that the auditor has maintained its independence; that financial relationships between the auditor and the audit client are restricted; and that Professional Standards on Independence are applied, requiring the auditor to identify threats to independence and safeguards to be employed.[153]

In a more recent development, during the 1990s, public accounting firms began deriving increasingly substantial proportions of their revenue from non-auditing services, particularly consulting services.[154]

152. SOX, *supra* note 2, § 303; SEC Act, *supra* note 109, §§ 240.13b2-2 (b) (1), (b) (2), (2) (c).
153. Corporations Act, 2001, §§ 307A–C, 300(11B), 307C (Austl.).
154. *See* Dep't of the Treasury, *Final Report of the Advisory Comm. on the Auditing Profession*, *in* SEC SPEAKS IN 2009 693, 704 (2009) (committee co-chaired by Arthur Levitt., Jr., and Donald T. Nicolaisen) ("Pre-Sarbanes-Oxley, audit fees were on average approximately only 50% of total fees charged to audit clients. That percentage increased dramatically to approximately 80% by 2006.").

Under such a compensation structure, the client boasts greater leverage when negotiating disputes with its auditors because the accounting firm stands to lose not only its audit revenue, but also its more lucrative consulting revenue. Likely to compromise auditor independence, this situation was ripe for reform. The United States, compared to Australia, took a more hard-line approach. Sarbanes-Oxley prohibits independent auditors from performing non-auditing services, such as consulting contemporaneously with an audit, unless the non-audit services amount to less than 5% of the total annual fees.[155] The act exempts a few types of services, all of which require pre-approval by the audit committee.[156] In Australia, the Professional Standards on Independence, since 2004, require the auditor to identify threats to independence, as well as any appropriate safeguards to be employed. In some situations, Australian companies must disclose that they are performing non-audit services and explain why those services do not compromise its independence.[157]

Not only are auditors limited in the *type* of services that may be provided, but new regulations also restrict *who* may provide those services. Today, an audited company may be so large that its audit requires the full-time attention of a partner at an audit firm. Recognizing the risk that a partner may become subservient to such a client and tempted to sacrifice ethics to retain the company as a client, both Australia and the United States now require "rotation" of the auditor (within the same accounting firm) every five years.[158] The only major difference between the two laws is that in the United States, only the audit partner must rotate,[159] but in Australia, all auditors with a "significant role in the audit" must rotate.[160]

Likewise, both Australian and American legislatures recognize the potential conflicting interests that arise when employees of an independent auditor become employees of its client, or vice-versa. To limit the effects of intertwined staffs, Sarbanes-Oxley prohibits an accounting firm from auditing a public company if a senior finance executive of the client was employed by the accounting firm and that person participated in the audit of the company during the preceding year.[161] Similarly, in Australia, since 2004, a professional member of an

155. SOX, *supra* note 2, § 208.
156. *Id.*
157. Corporations Act, 2001, §§ 324 CA–324 CH (Austl.).
158. SOX, *supra* note 2, § 208; Corporations Act, 2001 § 324 DA (Austl.).
159. SOX, *supra* note 2, § 208.
160. Corporations Act, 2001, § 324 DA (Austl.).
161. SOX, *supra* note 2, § 208.

audit firm is prohibited from becoming a director or other responsible officer of an audited company within two years from departing the audit firm.[162]

IV. IMPLICATIONS FOR DIRECTORS AND OFFICERS LIABILITY INSURANCE IN THE U.S. AND AUSTRALIA

A. United States

Directors and Officers (D & O) liability insurance is a product that emerged in the 1930s, shortly after the enactment of the Securities Act of 1933 and Securities Act of 1934.[163] Publicly held corporations, however, did not widely purchase this coverage in the United States until the 1970s. At that time, judicial interpretation of liability under federal securities laws brought increased exposure to directors, officers, and the corporation itself.[164] Today, almost all publicly held corporations hold D & O policies.[165]

The market for D & O liability insurance historically has been a cyclical one, with both "hard" and "soft" cycles.[166] In a hard market, underwriters become more selective, more interested in higher attachment points, less willing to offer high limits, less willing to

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162. Corporations Act, 2001, §§ 324 CI, 324 CJ (Austl.).

163. *See* M. Martin Boyer, *Three Insights from the Canadian D & O Insurance Market: Inertia, Information and Insiders*, 14 CONN. INS. L.J. 75, 77 (2008); Joseph P. Monteleone, *Directors' and Officers Liability Insurance: The Sarbanes-Oxley Act of 2002 and other Topical Issues*, *in* ENRON, WORLDCOM, AND THE SARBANES-OXLEY ACT OF 2002: CORPORATE GOVERNANCE, FINANCIAL DISCLOSURE, AUDITING, AND OTHER ISSUES 313, 315 (2002) [hereinafter Monteleone].

164. Monteleone, *supra* note 163.

165. *See id.*; Towers Perrin, *Directors and Officers Liability Survey: 2006 Survey of Insurance Purchasing and Claims Trends* (2006) [hereinafter Perrin Survey], http://www.towersperrin.com/tp/getwebcachedoc?webc=HRS/USA/2007/200704/DO_Survey_Report2006_040507.pdf; Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, n.2 (2007).

166. Gary Lockwood, *D&O Insurance: The Cycle of Change*, 16 PROF. LIABILITY UNDERWRITING SOC'Y J., 1, 3 (Oct. 2003), *available at* http://www.lordbissell.com/Newsstand/Lockwood-D&OInsurance-PLUS_10-2003.pdf; Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 507 (2007) (The D&O insurance market went through this hard phase in the mid-1980s and again in 2001–2003. More recently, the D&O insurance market has been shifting to the soft phase.) (footnotes omitted).

negotiate contract terms, and able to command dramatically higher prices for what amounts to less coverage.[167] During the 1980s, the insurance industry entered a hard cycle where premiums rose dramatically and it was difficult for some corporations to secure D & O coverage.[168] The opposite occurs during a soft cycle, as was experienced during the 1990s, where insurers competed for business and broader coverage was available at a better price.[169]

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167. Baker & Griffith, *supra* note 165, at 507.

168. Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 415 (2005); *see* Michael D. Sousa, *Making Sense of the Bramble-Filled Thicket: The "Insured vs. Insured" Exclusion in the Bankruptcy Context*, 23 EMORY BANKR. DEV. J. 365, 374–75 (2007) (stating that the Van Gorkom decision caused insurance companies to become "skittish" about issuing liability insurance coverage for a corporation's directors and officers); Jack. B. Jacobs, *The Vanishing Substance-Procedure Distinction in Contemporary Corporate Litigation: An Essay*, 41 SUFFOLK U. L. REV. 1, 8 (2007) ("*Van Gorkom's* . . . impact was to create a national directors and officers (D&O) liability insurance crisis. The insurance industry reacted to the decision by raising the cost of D&O liability insurance to almost prohibitive levels, and in some cases, stopped providing D&O insurance altogether."); Henry N. Butler, Smith v. Van Gorkom, *Jurisdictional Competition, and the Role of Random Mutations in the Evolution of Corporate Law*, 45 WASHBURN L.J. 267, n.19 (2006) ("The initial effect of *Van Gorkom* was to increase directors and officers (D&O) insurance rates or to make D&O insurance unavailable."); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, n.49 (2001) (noting that after *Van Gorkom*, the D&O insurance industry sharply increased their premiums, and in some cases threatened to stop writing D&O insurance policies); *see also* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Lloyd L. Drury, III, *What's the Cost of a Free Pass? A Call for the Re-Assessment of Statutes that Allow for the Elimination of Personal Liability for Directors*, 9 TRANSACTIONS: TENN. J. BUS. L. 99, 105–07 (2007); Florence Shu-Acquaye, Smith v. Van Gorkom *Revisited: Lessons Learned in Light of the Sarbanes-Oxley Act of 2002*, 3 DEPAUL BUS. & COM. L.J. 19, 19 (2004). The 1985 case, *Smith v. Van Gorkom*, was a landmark decision in the United States as it clarified the requisites for a breach of the fiduciary duty of care. *Van Gorkom* involved the sale of Trans Union Corporation. Jerome Van Gorkom, the CEO and a significant stockholder of Trans Union, discussed selling the company with some of his fellow executives, but only preliminarily. As part of these discussions, he received basic financial data on financing the buyout. Using this information, Van Gorkom approached the potential buyer who offered to purchase Trans Union. Van Gorkom called a meeting of the Trans Union board on only two days notice. At the meeting, he gave an oral presentation but did not provide financial analysis or any written documentation, and did not disclose the circumstances of the negotiation process. The board asked very few follow-up questions before approving the merger. The Delaware Supreme Court found that the board's actions violated the duty of care and that the board acted in a grossly negligent manner in deciding to accept the offer. The court based its conclusion on the finding that he board did not act on an informed basis when making its decision to proceed with the acquisition. Before *Van Gorkom*, courts did not find directors personally liable absent a conflict of interest. However, in *Van Gorkom*, the court found the directors liable based solely on the breach of the duty of care.

169. Lockwood, *supra* note 167, at 3.

The unprecedented number of highly publicized securities fraud class action lawsuits and accounting scandals in the early twenty-first century rocked the D & O insurance industry.[170] The number of lawsuits naming individual directors and officers increased dramatically, and damages, settlements, and the costs of litigation and regulatory proceedings soared.[171] Sarbanes-Oxley brought about more risk by further exposing directors and officers to liability.[172] As a result, premiums increased approximately 30% in 2001 and 30% in 2002.[173] In 2003, premiums increased 33%.[174] Premiums for the largest companies, those with market capitalizations of $5 billion or more, increased as much as 70% in 2004.[175] In an attempt to quantify the costs of Sarbanes-Oxley, a survey of mostly mid-cap companies found that the cost of being a public company almost doubled, from $1.3 million to almost $2.5 million.[176] Mid-cap companies generally have a market capitalization between $2 billion and $10 billion. The increased costs were attributed to the added liability of the chief executive officer, who is required to personally sign off on the company's financial statement.[177] According to the survey, almost two-thirds of the increased expense was D & O liability insurance,

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170. Anjali C. Das, *The ABCs of D & O Insurance: An Illinois Lawyer's Guide*, 93 ILL. B.J. 304, 304 (2005); *see also* Fairfax, *supra* note 168, at 415; Kate Burgess, *Directors' and Officers' Insurance Demand and Cost Set to Rise: Kate Burgess Analyses the Impact of Scandal*, FIN. TIMES (Eng.), April 25, 2006, at 3; Randy Paar, *Insurance Coverage in the World of Sarbanes-Oxley*, *in* PRACTICING LAW INSTITUTE: COMMERCIAL LAW AND PRACTICE COURSE HANDBOOK SERIES 217, 221 (2003) (Address before the Practicing Law Institute: D&O Liability & Insurance in a Sarbanes-Oxley World (June 3, 2003)); Mairi Mallon, *U.S. D & O Lulled into a False Sense of Security?*, REINSURANCE MAG., Nov. 1, 2006, at 20; Sousa, *supra* note 168, at 375 (noting an increase in premiums after the Enron, Adelphia Communications, and Tyco scandals).

171. Securities Class Action Case Filings 2002: A Year in Review, *available at* http://securities.stanford.edu/clearinghouse_research/2002_YIR/2002_yir_settlements.pdf (last visited Apr. 14, 2010); ROBERT W. HAMILTON & JONATHAN R. MACEY, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 970 (9th ed. 2005).

172. *Id.*; *see also* Sousa, *supra* note 168, at 377–78.

173. JOHN F. OLSON ET AL., DIRECTOR & OFFICER LIABILITY: INDEMNIFICATION AND INSURANCE § 4.26 (2007).

174. *Id.*

175. HAMILTON & MACEY, *supra* note 171, at 970. *But see* OLSON ET AL., *supra* note 173, at § 4.26 (stating premiums decreased in 2004).

176. J. Brent Wilkins, *The Sarbanes-Oxley Act of 2002: The Ripple Effects of Restoring Shareholder Confidence*, 29 S. ILL. L.J. 339, 347 (2005).

177. *See id.*

which averaged $329,000 prior to Sarbanes-Oxley and grew to $639,000 afterwards.[178]

As a result of Sarbanes-Oxley and increased shareholder litigation, some of the largest commercial insurance companies reduced their D & O coverage obligations by increasing deductibles and lowering limits on overall coverage, thus exposing directors to increasing liability.[179] As insurer capacity deteriorated and insurers left the market, a large number of new insurers emerged to offer D & O coverage to public companies.[180] Because demand rose between 2000 and 2003, more insurers entered the market, causing D & O premiums to fall.[181] In addition, class actions against U.S. listed companies declined, resulting in reduced premiums.[182] In a matter of just a few years, a post-scandal, hard cycle quickly went soft. Despite the current soft cycle, demand for protection remains unabated.[183]

A 2006 Towers Perrin Directors and Officers Liability Survey reported a continuing soft market for D & O insurance.[184] As a result, survey participants generally reported higher limits, slightly lower retentions and premiums, broader coverage, and fewer exclusions.[185] Interest in an organization's D & O program by potential directors increased.[186] In 2006, premiums decreased by 6.5%, and 31% of participants reported an increase in coverage enhancements.[187] In addition, over 99% of public companies purchased D & O insurance.[188]

The Survey also reported an increased interest in Side A of D & O insurance. Side A D & O insurance policies cover the individual directors and officers when they are not indemnified by their organization.[189] For public companies, 38% reported purchasing such a policy.[190]

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178. *Id.* at 348.

179. Fairfax, *supra* note 168, at 415.

180. *See* Mairi Mallon, *supra* note 170, at 20 (noting that Lloyd's of London virtually ceased providing D & O insurance to public companies).

181. *See* Burgess, *supra* note 170, at 3.

182. *See id.*

183. *See id.*

184. Perrin Survey, *supra* note 165 (The annual Towers Perrin D & O survey is based on a nonrandom, self-selecting sample of companies. It is also the only systematic source of information on D & O insurance purchasing patterns in the U.S.).

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*; Baker & Griffith, *supra* note 165, at. 487, n. 2.

189. *See* Sousa, *supra* note 170, at 379-80. Specifically, "Side A" Coverage provides liability coverage directly to the officers and directors of a corporation for claims asserted against them for their wrongful acts, errors, omissions, or breaches of duty. A-Side Coverage insures the corporate directors and officers in the event that the corporation does not or

Additionally, the Survey provided the following data representing the types of D & O allegations from shareholder claimants against public companies: accounting fraud 2%; breach of duty to minority shareholders 4%; dishonestly/fraud 3%; general breach of fiduciary duty 12%; inadequate disclosure including financial reporting 37%; and stock and other public offering 19%.

B. Australia

Most Australian public companies purchase D & O insurance.[191] Companies purchase D & O policies for the benefit of their directors and officers.[192] The company may pay the premium in full, or alternatively, have an agreement where the covered individuals also contribute, thereby giving the individuals privity of contract.[193] Subsections 300(8) and (9) of the Corporations Act require reporting entities who have paid all or part of the premium costs to disclose that fact in their annual report.[194]

Under a D & O policy, a company may obtain insurance coverage with respect to its directors and officers for any liability they may incur for wrongful acts committed by them in the conduct of their duties.[195] Although the definition of wrongful acts varies from insurer to insurer, a typical definition includes any actual breach of duty, breach of trust, neglect, error, misstatement, misleading statement, omission, or any

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cannot indemnify them under any applicable corporate documents or laws. A-Side Coverage is significant because it protects directors and officers where the corporation is financially unable to indemnify due to insolvency or bankruptcy, or is legally unable to indemnify due to prohibitions under state corporation law or the corporation's own by-laws or articles of incorporation. *Id.* In contrast, "Side B" coverage provides reimbursement to the corporation for amounts paid as indemnification to its directors and officers, and "Side C" coverage, also known as entity coverage, protects the company itself against various claims made directly against it. Marc H. Falladori, *Stock Option Backdating—Regulators and Plaintiffs Take the Controversy to the Next Level*, *in* PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS ch. 16, 666 (2007).

190. Perrin Survey, *supra* note 165.

191. Cheffins & Black, *supra* note 65, at 1437.

192. *See* CORPORATIONS AND MARKET ADVISORY COMMITTEE, DIRECTORS AND OFFICERS INSURANCE REPORT 6, June 2004, http://www.camac.gov.au/CAMAC/camac.nsf/0/04A9BFD9B3915EA7CA256ED9000DE5AD/$file/D&O_Insurance_report_Jun2004.pdf [hereinafter CMAC Report].

193. *Id.*

194. *Id.*

195. *See id.* at 6–7.

liability asserted against them solely because of their status as directors or officers of the company.[196]

Section 199B of the Corporations Act provides that D & O policies cannot cover (other than for legal costs) any liability by the directors or officers arising out of willful breach of duty in relation to the company; improper use of position; or improper use of information.[197] However, it is common for Australian D & O policies to have standard exclusions over and above § 199B including prospectus liability; professional indemnity; insider trading; claims brought by shareholders; claims arising from breaches of environmental or occupational health and safety regulations; and claims alleging dishonesty or fraud.[198]

Similar to the market in the U.S., the Australian D & O market entered a hard cycle after the HIH Casualty and General Insurance LTD collapse and other financial scandals.[199] Significant capital left the insurance market, although sufficient competition remains in Australia amongst twelve to fourteen Australia-based insurers.

Further, after the scandals earlier this decade, premiums increased markedly.[200] However, there was no hard and fast rule, as some insureds incurred little increase, while others experienced increases in excess of 300%. Brokers and underwriters surveyed by Clayton Utz speculated that organizations listed in the U.S. or Canada, or organizations with operations and assets in the U.S. and Canada, have generally been the most severely affected. Increases at the time ranged from 10% to 30%, with London based insurers averaging a 20% to 50% increase. However, the market has leveled off, as indicated by a general insurance survey conducted by JP Morgan Deloitte, finding that D & O premiums fell 6% in 2006.[201]

196. *See id.* at 7.
197. *Id.* at 7.
198. *Id.* at 7–8.
199. *See* Clayton Utz, *Directors and Officers Insurance: Survey Findings*, http://www.strategicsolutions.com.au/Pages/documents/April%202003%20-%20D&OInsurance%20-%20Market%20Survey%20conducted%20in%20collaboration%20with%20Clayton%20Utz.pdf at 3. The financial scandals included self-dealing between HIH Insurance and an outside director, insider trading by a non-executive director for Telstra, and three cases of out of pocket liability arising from insufficient vigilance by outside directors involving Clifford Corporation, One.Tel, and Water Wheel Holdings. Cheffins & Black, *supra* note 65, at 1441.
200. Utz, *supra* note 199, at 3; CMAC Report, *supra* note 192, at 3.
201. JP Morgan, *2006 General Insurance Industry Survey*, at 5 (2006) http://www.deloitte.com/dtt/cda/doc/content/JPMorgan_Deloitte_Survey_06_low_res(2).pdf; CMAC Report, *supra* note 192, at 6.

The Clayton Utz survey reported that insurers did not withdraw coverage from 2002 to 2003.[202] However, during the hard cycle, insurers underwrote more selectively, focused on pricing, and limited conditions of coverage.[203] Further, recent developments such as the ASX Corporate Governance Guidelines and the extent of a company's compliance with these guidelines have the ability to impact an insurer's decision to provide coverage, as well as the terms and conditions of that coverage.[204]

Despite these developments, for both Australia and the U.S., a soft market exists that has loosened terms of coverage. For example, in Australia, one can now obtain coverage for civil fines and penalties where such coverage was not available previously.[205] In the U.S., soft markets have ultimately proved advantageous for directors seeking to protect their personal assets and for those seeking to fill previous gaps in coverage, such as non-rescindability.[206] Also, in both countries, changes to liability have pushed for improved coverage in order to lure desirable candidates to serve on boards. Both countries cite difficulty, proving that new liability has actually encouraged a potential candidate to decline a position, but the fear remains.[207]

V. ANALYSIS AND CONCLUSIONS

Both the United States and Australia have focused on a duty of care and a climate of disclosure and trust in order to ensure a fair marketplace. Despite these efforts, both countries experienced scandal in the last decade and the credit crisis today, revealing gaps in corporate regulation. Corporate collapses in Australia of HIH, Harris-Scarfe, and

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202. Utz, *supra* note 199, at 3.
203. *See* CMAC Report, *supra* note 192, at 39.
204. *See id.*
205. Paul Stock, *With Great Power . . .* , RISK MAG., May 19, 2008, http://www.riskmanagementmagazine.com.au/articles/49/0C056949.asp?Type=124&Category=1240.
206. *See* Stephen J. Weiss & Thomas H. Bentz, Jr., *The D & O Insurance Market is Soft: What You can do to Take Advantage of Changing Market Conditions*, DIRECTORS & BOARDS, (Sept. 22, 2007), http://goliath.ecnext.com/coms2/gi_0199-6900927/The-D-O-insurance-market.html#abstract.
207. *See* Berna Collier, *Current Corporate Governance Issues: An ASIC Perspective*, Sept. 19, 2003, *available at* http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/nt_bus&prof_women_corp_gov190903.pdf/$file/nt_bus&prof_women_corp_gov190903.pdf (Berna Collier, Commissioner, ASIC, addressed the Northern Territory Chapter of the Business & Professional Women's Chapter and the ASIC Women's Network).

One.Tel, however, resulted in legislative reforms and stronger corporate governance standards.[208] Sarbanes-Oxley has similarly ushered in new standards.[209] As the impact of the credit crisis continues to emerge, new corporate governance standards will likely experience their first real test.

Past and present scandals have also affected directors and officers liability and the availability of coverage for such claims. Increased shareholder class action lawsuits, high damage awards in those lawsuits, and claims related to the restatement of earnings for both countries have had strong impacts on carriers. Nonetheless, the D & O market has softened faster than many would have expected, driving coverage for claims up and the cost for coverage down for both countries. Such similarities in the D & O marketplace have the potential positive outcome of creating predictable, and similar, risk management practices for companies operating in both markets—a silver lining perhaps.

Despite this similarity, there are key differences that may prevent a true synergy and may impact regulatory response to the scandals that have led to the recent economic downturn. First, there appears to be fear in Australia that rampant liability will prevent top candidates from taking directorships. There is speculation that this fear will drive regulators to loosen the stronghold on directors and officers' liability. While this fear exists in the United States as well, it appears to be less pronounced and will be less likely to serve as an impetus for minimizing governance standards.

Second, there are distinctions between how liability is assigned in the United States and Australia. The U.S. channels most of its corporate reforms through Sarbanes-Oxley with regulators and exchanges playing supporting roles. Australia, on the other hand, relies more heavily on regulators and exchanges in addition to employing many no-fault provisions that the United States does not. Also, Australian law incorporates the business judgment rule into their code[210] while the rule remains largely entrenched in the common law of the United States. For Australia, these factors combine with a soft D & O market to favor directors and officers with regard to increased coverage and a push to expand the business judgment rule so that some directors can delegate

208. *See* von Nessen, *supra* note 47.

209. *See generally* Tomasic, *supra* note 3; von Nessen, *supra* note 47.

210. In Australia, an officer or director's decision is protected from interference by a court if it is made in good faith for a proper purpose; the officer or director does not have a material personal in the subject matter of the judgment; the officer or director informs themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and the officer or director rationally believe that the judgment is in the best interests of the corporation. Corporations Act, 2001, § 180(2).

more liability down to lower-level officers. The credit crisis may cause the push to lessen, however.

In the United States, these factors seem to have created a more traditional soft market response with D & O insurance—lower premiums and increased access to coverage. Also, the market is responding by allowing even better coverage for independent board members. Fundamental changes in liability law, however, do not appear forthcoming. On the contrary, a lack of successful prosecutions under Sarbanes-Oxley or the resulting regulations seems, in and of itself, to have alleviated much anxiety over the risk that directors and officers may bear. The current credit crisis may revive that anxiety. Nonetheless, the shared process of enduring scandal and reforming markets has, on the whole, brought much commonality to the American and Australian governance model—a positive for carriers and publicly traded companies worldwide who operate in either or both markets.

VI. APPENDIX A

The following chart summarizes the similarities and differences between the reform in the United States and in Australia.[211]

Reform	**United States**	**Australia**
Regulation of Boards, Committees, and Directors		
Director Independence	Independent directors *must* comprise a majority of the board.[212] An independent director is a director who has no material relationship, commercial or professional, with the corporation. Prohibited relationships include: (1) former employment by the company within three years; (2) former employment by the company's independent auditor within three years; (3) interlocking directorship within three years with the CEO on the compensation committee; and (4) any of the above relationships if maintained by any immediate family member of the director.[213]	Independent directors *should* comprise a majority of the board.[214] An independent director is a non-executive director who is not part of management and has no other relationship that could or could be perceived to materially interfere with the independent exercise of the director's judgment. The corporation *should* state its reasons for considering a director independent if that director: (1) is a substantial shareholder or associate; (2) was employed within the last three years as an executive of the company or group; (3) was, within the last three years, a principal of a material professional adviser or consultant (or an employee materially

211. An earlier version of this chart was published by Paul von Nessen, *see supra* note 47.
212. NYSE Manual, *supra* note 95, § 303(A) (1).
213. *Id.* § 303(A) (2).
214. ASX Recommendations, *supra* note 83, at recommendation 2.1.

		associated with providing the service); (4) was a material supplier or customer (or an officer or associate of such); or (5) has a material contractual relationship with the company or group.
Independence of the Chairman of the Board	The chairman need not be an independent director and may simultaneously serve as the CEO.[215]	The chair should be an independent director,[216] and should not simultaneously serve as the CEO.[217]
Board Committees	The company must have an audit committee, a nomination committee, and a compensation committee consisting *solely* of independent directors.[218]	ASX top 500 companies *must* have an audit committee.[219] All other listed companies *should* have an audit committee, a nomination committee, and a remuneration committee, each with a *majority* of independent directors.[220]

215. While no law or regulation in the United States prohibits the CEO from simultaneously serving as a non-independent director, some firms are moving towards the identification of a "lead independent director" in an effort to demonstrate strong governance. *See*, *e.g.*, Washington Mutual, *supra* note 106.

216. ASX Recommendations, *supra* note 83, at Recommendation 2.2.

217. *Id.* at Recommendation 4.2 (audit committees are required for all companies in the ASX 300 index by ASX Listing Rule 12.7).

218. NYSE Manual, *supra* note 95, § 303A.4–6; SEC Act, *supra* note 109, § 240.10A-3(b) (1).

219. ASX Recommendations, *supra* note 83, at Recommendation 4.2 (Audit committees are required for the ASX top 300 by ASX Listing Rule 12.7).

220. ASX Recommendations, *supra* note 83, at Recommendations 2.4, 4.1, 8.1.

Audit Committees	The audit committee of public companies must consist only of independent directors.[221] If applicable, SOX requires the reasons for declining to include at least one financial expert must be disclosed.[222] However, the NYSE requires the chair of the committee to have accounting or financial management expertise.[223] The committee must retain responsibility for the appointment, compensation, and oversight of auditors.[224] It must establish procedures for the treatment of accounting complaints; have authority and funding to engage independent advisors; and have authority to approve accounts.[225]	The audit committee should consist of at least three directors. All members should be non-executive directors; a majority of the members should be independent; and the chair, who should also be independent, should not also be the chair of the board. Companies must disclosure the names and qualifications of audit committee members. All members should be financially literate, and at least one member should have accounting or related financial expertise.[226] The committee should review the scope, results, and cost effectiveness of the audit; the independence and objectivity of the auditors; and all non-audit services provided by the auditors.[227]
Regulation of Internal Governance: Internal Controls and Ethics		
Assessment of Internal Control	An "internal control report" must be audited and filed annually, stating the responsibilities of management for	Companies should establish a sound system of risk oversight, management, and internal control.[229]

221. *See* SOX, *supra* note 2, § 301.
222. *Id.* § 407.
223. NYSE Manual, *supra* note 95, § 303A.07.
224. SOX, *supra* note 2, § 301.
225. *Id.*; NYSE Manual, *supra* note 95, § 303A.07; SEC Act, *supra* note 109, § 240.10A-3(b)(2)–(5).
226. ASX Recommendations, *supra* note 83, at Recommendations 4.2, 4.3.
227. ASX, Listing Rules, *supra* note 89, § 12.7.

	establishing and maintaining internal control.[228]	
Code of Ethics	Public companies must disclose in periodic reports whether or not they have adopted a code of ethics for senior financial officers.[230]	Companies should establish a code of conduct to guide the directors and key executives as to the practices necessary to maintain confidence in the company's integrity as well as the accountability of individuals for reporting and investigating reports of unethical practices.[231]
Disclosure Requirements		
Accounting Standards	Financial statements must be prepared in accordance with Generally Accepted Accounting Principles (GAAP), as promulgated by the Financial Accounting Standards Board (FASB)—an independent standard setting body.[232] However, a movement toward convergence with the International Financial Reporting Standards (IFRS), as promulgated by the International Accounting Standards	Australia has adopted the International Financial Reporting Standards (IFRS), as promulgated by the International Accounting Standards Board (IASB).[233]

229. ASX Recommendations, *supra* note 83, at Recommendation 7.1.
228. SOX, *supra* note 2, § 404.
230. SOX, *supra* note 2, § 406; NYSE Manual, *supra* note 95, § 303A.10.
231. ASX Recommendations, *supra* note 83, at Recommendation 3.1.
232. SOX, *supra* note 2, § 101.
233. ASIC Act, *supra* note 151, §§ 232–33.

	Board (IASB) is currently under way.	
Off-Balance Sheet Transactions	U.S. GAAP permits companies to enter into off-balance sheet transactions, subject to specified limitations. But, SOX requires all such transactions be disclosed.[234]	IFRS, the set of accounting standards to which Australia subscribes, effectively prohibits off-balance sheet transactions.[235]
Officer Certification of Financial Reports	The CFOs and CEOs of SEC registrants must certify that the financial reports "fairly present" the company's financial position and do not contain any untrue statement or omission of material fact.[236]	Since 2004, the CFO and CEO of listed entities must certify to the board that accounts present a "true and fair" view.[237]
Continuous Disclosure	Each reporting public company must disclose to the public on a "rapid and current basis" any additional information concerning material changes in its financial condition which is necessary or useful for the protection of investors and is in the public interest.[238]	ASX listing rules require listed companies to inform the ASX "immediately" when they become aware of any information which a reasonable person would expect to have an effect on the price or value of its securities. Certain unlisted public companies must inform ASIC "as soon as practical" in similar circumstances.[239]

234. SOX, *supra* note 2, § 404.
235. *See* McDermott Will & Emery, *supra* note 131.
236. *See* SOX, *supra* note 2, §§ 302, 906; SEC Act, *supra* note 109, § 240.13a–14a.
237. Corporations Act, 2001, § 295A (Austl.).
238. SOX, *supra* note 2, § 409.
239. ASX Listing Rules, *supra* note 89, § 3.1; Corporations Act, 2001, § 674 (2) (Austl.). Rio Tinto, *supra* note 140.

Related Party Transactions		
Loans to Directors, Executives, and Other Related Parties	Personal loans, with some exceptions, may not be given by a public company to directors and executives of that company.[240]	A public company must obtain member approval for loans to related parties, subject to a number of exceptions.[241] Regulation of non-recourse loans is currently under consideration.
Insider Trading Disclosure	Officers, directors and 10% shareholders are required to report changes in ownership of securities or the purchase/sale of a security-based swap agreement.[242]	Substantial shareholders (5% shareholding or more) must comply with statutory notice provisions.[243] Listed companies are required to notify the ASX of directors' holdings, and the ASX principles recommend formulation and disclosure of policies concerning trading in company securities by directors, officers, and employees.[244]
Consequences of Violations		
Executive Compensation	To be approved by shareholders. CEOs and CFOs must forfeit any bonuses and profits received from the sale of company securities during the 12 month period following the filing of a	For executives, ASX Principles recommend a combination of fixed remuneration, performance based remuneration, equity based remuneration and termination payments. Non-executives should

240. SOX, *supra* note 2, § 402.
241. Corporations Act, 2001, ch. 2E (Austl.).
242. SOX, *supra* note 2, § 403.
243. Corporations Act, 2001, pt. 6C.1 (Austl.).
244. ASX Listing Rules, *supra* note 89, § 3.19A; ASX Recommendations, *supra* note 83, at Recommendation 3.2.

	financial report for which an accounting restatement was required due to accounting or reporting misconduct.[245]	only receive fees.[246] A remuneration report for listed companies is statutorily required to be considered by shareholders, while equity based remuneration and termination payments are regulated by statute and by the ASX Listing rules.[247]
Disqualification of Directors and Officers	SEC may prohibit any person from serving as an officer or director if they have violated certain anti-fraud provisions and their conduct demonstrates "unfitness" to serve.[248]	A person can be disqualified under the Corporations Act from managing corporations for convictions for certain serious offenses; for involvement in failed corporations; while awaiting discharge in bankruptcy; and for repeated contraventions of the Corporations Act.[249]
Penalties and Disgorgement by Officers of Certain Profits	The SEC may seek civil penalties for securities laws violations, the proceeds of which will be diverted to accounts to compensate victims of related securities law violations.[250] SOX broadened the availability of and sentencing guidelines for criminal	The civil penalty provisions of the Corporations Act now provide a maximum civil penalty for corporate offenders of up to $1 million (up from the previous $200,000). Compensation for losses may also be provided.[253]

245. SOX, *supra* note 2, § 304.
246. ASX Recommendations, *supra* note 83, at Recommendation 8.2, (Box 8.1).
247. Corporations Act, 2001, § 250SA, (Austl.) (remuneration report), ch. 2E (related party benefits), ch. 2D, pt. 2 (termination payments); ASX Listing Rules, *supra* note 89, § 10.11et seq. (securities issued to persons of influence).
248. SEC Act, *supra* note 109, § 240.10B1.
249. Corporations Act, 2001, pt. 2D.6 (Austl.).
250. *Id.*

	penalties for violating securities laws.[251] It increased the maximum prison sentence for falsifying or destructing audit records to ten years.[252]	
Regulation of Independent Auditors		
Prohibited Services	Registered accounting firms are prohibited from providing non-auditing services contemporaneously with an audit. Few specified exceptions exist, but only if pre-approved by the audit committee. Firms may provide non-auditing services to a company if the services do not exceed 5% of the total fees paid by the company to the auditor during the year.[254]	From 2004, Professional Standards on Independence require the auditor to identify threats to independence and safeguards to be employed. Where non-audit services pose too great a risk to independence, the provider of such services is prohibited from being involved in the audit. There are disclosure requirements on non-audit services and explanations of why certain services do not compromise auditor independence are required.[255]
Audit Waiting Period	A registered public accounting firm may not audit a public company if a senior finance executive of the company was	Since 2004, a professional member of an audit firm is prohibited from becoming a director or other responsible officer of the

253. Corporations Act, 2001, pt. 9.4B, § 1317G (1B) (Austl.).
251. SOX, *supra* note 2, §§ 802 (criminal penalties for altering documents), 805 (sentencing guidelines), 807 (criminal penalties for defrauding shareholders).
252. SOX, *supra* note 2, § 802.
254. SOX, *supra* note 2, § 208; SEC Act, *supra* note 109, §§ 210, 240, 249, 274.
255. Corporations Act, 2001, §§ 324CA–324CH (Austl.).

	employed by the firm and that person participated in the audit of the company during the preceding year.[256]	audited company within two years of their departure from the audit firm.[257]
Audit Rotation	The lead audit partner must be rotated every five years.[258]	Those with a significant role in an audit are to be rotated every five years.[259]
Audit Record Retention	Auditors must retain all audit and review work papers for at least seven years.[260]	Auditors must retain all audit working papers for at least seven years.[261]
Auditor Influence	An officer or director of a public company is prohibited from fraudulently influencing or coercing any independent public auditor that is performing an audit on the company.[262]	Since 2004, the Corporations Act states a general principal that there should be auditor independence. Auditors are required to declare annually to the board of directors of an audited company that the auditor has maintained its independence as required by legislation and professional standards. Financial relationships between the auditor and the audit client are restricted, and the auditor must identify threats to independence and safeguards to be employed.[263]

256. SOX, *supra* note 2, § 206.
257. Corporations Act, 2001, §§ 324CI, 324CJ (Austl.).
258. SOX, *supra* note 2, § 203.
259. Corporations Act, 2001, § 324 DA (Austl.).
260. SOX, *supra* note 2, § 103; SEC Act, *supra* note 109, § 210.2-06 (a).
261. Corporations Act, 2001, § 307B (Austl.).
262. SOX, *supra* note 2, § 303; SEC Act, *supra* note 109, § 240.13b2-2(b) (1), (b) (2), (2) (c).
263. Corporations Act, 2001, §§ 307AC, 300(11B), 307C (Austl.).

Accounting Oversight	SOX created the Public Company Accounting Oversight Board (PCAOB), a five-member board independent of the accounting profession and overseen by the SEC, to set auditing, quality control, and independence standards.[264]	In 2004, CLERP 9 expanded the responsibilities of the Financial Reporting Council to oversee the setting of auditing standards, advise on auditor independence, monitor the adequacy of the systems and processes used by audit firms to assure audit independence, promote the teaching of professional and business ethics, and monitor the adequacy of disciplinary procedures.[265]

264. SOX, *supra* note 2, § 101.
265. ASIC Act, *supra* note 151.