



ROBERT MUIR



A duty to nurture

The attraction of investment, leadership and board expertise for start-up businesses is being hindered by legal action and expanded regulation.

ASIC sent another strong message to the Big End of Town this past month when it brought suit against the directors of James Hardie, hot on the heels of its investigations into HIH and AWB. These actions are typically based on failure of the twin duties of 'care' and 'diligence' under the Corporations Law and the Trade Practices Act. We very much seem to be following the American example of regulating after the damage is well and truly done -- the Sarbanes-Oxley (SOX) Act was set up in response to major corporate and accounting fraud by several companies, including Enron.

What is indeed being missed is the Smaller End of Town drama this is causing our 'gazelles' -- the next generation of emerging enterprises. The bar has been raised significantly higher for gazelles in their efforts to attract investment, leadership and experience to their Boards of Directors. Gazelles are traditionally serviced by non-executive directors (NEDs) some of whom include 'angel investors' who are willing to accept the much higher investment risks inherent in emerging enterprises in return for potentially greater rewards. There's always been quite a sting in the tail for both these groups who accept invitations to join gazelles -- they can not only lose their investment but also incur exposure to significant liabilities.

This is a significant impediment to attracting experienced people to sit on these boards and, as a result, a double whammy when it comes to getting early stage businesses across the chasm to the Big End of Town. Under these more parlous investigatory conditions, the gazelles are threatened with not only the deprivation of their funding, but also the leadership, knowledge and experience of these 'grey beards'.

Meanwhile the UK seems very much to be getting the message about the need to prime the economic pump through fostering 'small business'. Late last year, after consultation with business, the UK made major changes to its Corporation Law. Introducing the legislation, Lord Sainsbury, the Parliamentary Under-Secretary, said the changes were designed to enhance shareholder engagement and a long-term investment culture, ensure better regulation and a 'think small first' approach, make it easier to set up and run a company, and provide flexibility for the future.

The UK Act contains a statutory statement of directors' general duties, which are currently established in case law rather than in statute. Directors will only be liable to the company and shareholders for breach of duty and then only if the company can demonstrate that it has suffered loss as a

result of the breach. This is similar in concept to the roadmap approach found in US Delaware Corporations law which News Corp and a host of Fortune 500s can attest to as 'business friendly'.

While the UK changes certainly seem to be a step in the right direction, one has to ask are such laws reflective of what could be described as a uniquely Australian situation. The resources sector aside, Australia has often been described as science rich but business poor -- a country rich in innovation but lacking sufficient scale to build any serious size businesses. Part of getting our gazelles across the chasm is to ensure that we are able to attract experienced talent and early stage capital to build our businesses.

And given so many of our opportunities are science based, perhaps the bigger question we might ask in the Australian context is whether the 'Duties of Care and Diligence' should indeed evolve with the life of the enterprise. By the very early stage nature of the gazelles, non-executive directors are exposed to even greater corporate knowledge and with it a greater exposure to liability. The "I didn't know" defence becomes moot. When challenged, the onus then is on directors to prove that they in fact exercised appropriate care and diligence in managing the risks and affairs of an evolving enterprise.

Perhaps our national interests in attracting talent and expertise to the boards of our gazelles would be better served if we reversed the 'guilty until proven innocent' approach. Perhaps we should take a leaf out of the very science which is creating many of the opportunities -- the scientific research protocol. Perhaps we should indeed have a published 'gazelle directors' protocol' to facilitate and encourage the adoption of appropriate risk management structures.

Such a protocol could be designed to parallel the life of the enterprise, to ensure that directors are not liable for decisions made in good faith and with due care under the protocol while NOT reducing their level of accountability. Directors would benefit from the certainty that such a protocol would provide in terms of liability -- and in the process perhaps our bigger national interest of fostering economic growth by attracting experienced talent and early stage investment capital would also be served. •

A gazelle directors' protocol should be published to encourage the adoption of appropriate risk-management structures