Section 3 – Style, Substance, and Enforceability

How Plain English Rescued a Company

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This article is about how plain language communication helps Boards govern better by removing confusion about legal risk.

Many Boards are risk averse when it comes to dealing with legal risk. That includes both private sector company boards and public sector statutory boards. Most risk averse decisions are made because the decision maker inadequately understand the risks, and perceives that the cost of understanding what the law requires exceeds the benefit of "taking the risk".

In dealing with Boards that take this view, it has been my experience that communications to Board members of what the law requires have been anything but plain.

Consequently, the risk aversion arises out of confusion rather than a commitment to good corporate governance and sensible compliance practices.

If the people advising the board communicate the legal requirements by recommending doable management actions, and do so plainly, practicable governance strategies and legal compliance become part of the ordinary course of business.

There are many definitions of corporate governance. None of them is very plain.

To have effective corporate governance, and to be able to properly implement due diligence processes, the rules by which the Corporation governs itself must be set out in plain language so that they can be understood by everyone who is involved; shareholders, the Board of Directors, managers and staff.

Good and honest folk within the Corporation will disagree as to what corporate governance means. All too often the disagreement is left to fester. Broad concepts of "due diligence" frequently mask an undercurrent of confusion and mystique.

Rather than admit that today's Boards are not communicating well, organisations that represent Company directors have made representations to Government to the effect that too much corporate governance is required of boards, leaving not enough time for management.[1] The perceived conflict between the two is symptomatic of the need for plain and clear communication within corporations of what must be done and why. As a matter practical reality there need be no conflict.

Quite openly, directors of large companies argue that compliance with the law gets in the way of making money. They say that less compliance should be required of them.

The Australian Government's Corporate Law Economic Reform Program Proposals for Reform Paper acknowledged submissions by directors' representative bodies that:

> " ... directors intentions are increasingly being focused on compliance issues rather than on wealth creation for shareholders. In particular, concerns have been expressed that the Corporations Law contributes to risk-averse behaviour on the part of directors. If this is the case, the losers are not only directors personally, but also shareholders, whose returns on company capital will ultimately be diminished. The nation also loses as behaviour that is unnecessarily risk averse distracts from behaviour that could expand enterprise and therefore wealth and employment."[2]

Many Boards, for example, see the Trade Practices Act as a bogeyman; an operational problem to be dealt with by middle management rather than a strategic issue for the Board to address. They often are astonished to hear that section 52 of the Trade Practices Act applies to all businesses, that section 52 can be turned into appropriate rules tailored to their particular business, and most excitingly, that a competitor's noncompliance can be taken advantage of, with tangible commercial benefits.

When a Board understands these issues, two things usually follow. Firstly, the discussion turns from "why must we do this?" to "what must we do, and how do we do it as inexpensively and profitably as possible?" Secondly, legal risk management is understood as a tool for competitive advantage, and it comes to be seen as a Board level issue.

The Government does not agree that compliance with the law gets in the way of making money.

The Government's Corporate Law and Economic Reform Program Paper[3] asserts that:

> "the establishment of maintenance of effective corporate governance practices by Australian companies is essential to Australia's international competitiveness and economic growth."[4]

But neither the Government proposals nor the submissions of business leaders addressed the "how to" issues. Just how can good corporate governance contribute to competitiveness?

To address the "how to" issue, it is essential to appreciate the gap between the law on directors' duties and the reality of corporate life. The following example identifies a few of those "how to" issues.

The law does not adequately deal with the reality that there really are two tiers of responsibility that the owners of the Corporation should be interested in; the Board and the managers who report to the Board.

In modern corporations, control of the corporation is separated from ownership. Directors – not shareholders – govern the corporation. But the directors seldom own even a majority of the equity in the corporation, especially in large corporate entities. In recognition of this reality, the law sets certain standards of management accountability to protect the shareholders.

By management accountability, the law actually means the accountability of the Board of Directors. Yet there is a confusion here. Shareholders seldom have direct contact, or a direct relationship, with the people who manage the corporation. The managers are not the directors.

The law does not adequately deal with the fact that there really are two tiers of responsibility that the owners of the Corporation should be interested in; the Board and the managers who report to the Board.

In this author's experience, working closely with a number of large private sector and public sector corporations, the processes by which a corporation is governed, and the outcomes that are desired, are more than likely to be the subject of whispered misconceptions rather than plain, practicable and therefore profitable rules. The law is unclear as to the division of responsibility and of accountability as between directors and managers, and so its effect is diffracted.

A "need to know" mentality is bad for good governance, and is a symptom of poor communications.

In one "need to know" corporation, the Managing Director and the Company Secretary both knew what had been discussed and what had been resolved in relation to every paper that was presented to the Board. They had the advantage of being present, and the advantage of having vetted everything.

After the Board meeting, the General Managers would receive a briefing from the Managing Director. They would not receive a copy of resolutions because the Managing Director and the Company Secretary took the view that they did not need to know what those resolutions actually said. The Managing Director told the General Managers what was required of them. In this way, the General Managers received only an interpretation of the Board's decisions. Then they added their own gloss, and provided a briefing to the senior managers who reported to them.

Yet, those senior managers were expected to achieve compliance with the Board's resolutions. The best that those senior managers could do was to comply with the interpretation of their own General Manager's interpretation of the Managing Director's interpretation of the Board's resolution.

Problems arose when different divisions of the same corporation had to work together. The General Managers in different divisions often came up with different interpretations of what the Managing Director had said was required. Much corporate time was spent trying to resolve these differing interpretations. The time spent on doing so was not time spent on improving the corporate bottom-line.

Though no-one was game enough to admit it, bad corporate communication led to bad corporate governance, and in turn got in the way of good performance. Yet what people complained about was bad corporate governance and over-regulation.

One might well think that such appalling corporate governance would not last long. Surely, a well run Board would follow up on outstanding actions. It would discover that the activities of management and staff did not always deliver what the Board had resolved. In this particular corporation the Board did not follow-up at all adequately.

Where were the shareholders?

Like most major corporations in the "large public" category, a diverse group of shareholders had no control over the Board. The Board regularly re-nominated itself for election, and was regularly re-elected unopposed. The corporation ran what was essentially a monopoly business. Thus, neither shareholder pressure nor competitive pressure forced the Board to reform in order to make money.

Regulatory pressure did what the market could not do.

The Australian Competition and Consumer Commission (ACCC) came to conduct an investigation of alleged violations of the Trade Practices Act. The regulators had talked first with former employees and then with operational staff in the different divisions. The different divisions gave the investigators differing views of what was going on and of what "management" required.

As a result of its investigation, the ACCC gave the Board a stern warning. The ACCC said it would prosecute if the Board did not quickly correct ingrained illegal practices. "Get your compliance program together, or else" was the message.

So the Board called for help.

The Board accepted that its officers could not comply accurately with resolutions that were never shown to them.

The first step of course was to obtain the Board's agreement in principle that its resolutions were far from top secret. Once the Board resolved that its resolutions would be made available for General Managers and the senior managers who reported directly to them, managers began to cooperate.

The next challenge was to ensure that the General Managers and senior managers whose jobs it was to implement the Board resolutions had a common understanding of what was required.

A new process of drafting Board resolutions was adopted.

Common understandings require common language. Board members had to understand each other, rather than just say that they did. Managers had to understand the Board rather than just say that they did.

Only plain language could deliver a common understanding at both levels.

The history of documenting Board resolutions also had to be overcome. In the past, the Company Secretary would take minutes. The minutes would include the resolutions. These minutes would be drafted and presented to the Managing Director for review. The Managing Director would edit them. The Company Secretary would then send the edited version to the Chairman for further review. The Chairman would make further edits. This version would be sent to the other directors, and at the next Board meeting the Board would discuss what was actually said and done at the last meeting. This discussion would also form part of the next meeting's minutes. I observed three Board meetings and by the third meeting there was some consensus as to what was decided at the first meeting!

After the warning from the ACCC, the Board tried to express simply what it wanted done. The simple expedient of reading the resolution out aloud before it was voted on was reintroduced. Often listening to the resolution being read out led to further discussion and clarification. Directors were required to ask questions as a matter of duty if they thought that any part of the resolution was unclear.

After any clarification, the resolution was then passed and handed down. Yet only the first battle had been won.

It should come as no surprise that the team of General Managers would often disagree as to what was required by Board resolutions.

Now that the Board had decided that it was going to follow-up its resolutions it became apparent that any disagreement between General Managers would be picked up by the Board. If the General Manager's interpretation did not line up with what the Board expected, the disagreement would be resolved at the very next Board meeting.

And plain language was introduced.

Board papers began to be written in a much plainer way, so as to minimise the risk of adverse Board reaction. And managers took more care in preparing the substance of their proposals once they realised that the Board *wanted* to understand where they were coming from.

Regularly, the management view and the view of the independent directors as to what was required would differ. Either management misinterpreted the Board requirements and was disciplined for doing so, or very occasionally the Board acknowledged that the resolution as passed was imprecise. Gradually, plain English emerged in the text of each resolution. Gradually, the Board had to spend less time disciplining management, and was able to spend more time on strategic issues.

Things have not become perfect at this particular corporation, but they have become better. Indeed, two large divisions undertook plain English training so that inter-Divisional communication as well as communication with customers could be improved, with the usual positive results of better sales and fewer disputes.

Conclusion: Good communication and the use of plain language have contributed to more efficient and effective corporate governance.

Because the rules are more quickly understood, corporate performance happens more smoothly. Managers know what the target is and can achieve it. Multiple managers are able to work towards the same target because they no longer dispute the identity of the relevant target. Slowly, cooperation is replacing confrontation.

Ironically, the regulatory intervention has resulted in a more effective corporate governance system, and in a more communicative and efficient corporation.

In short, using plain language meant better governance which then improved corporate performance, and left the shareholders, directors, managers and staff better off.

Endnotes

1. Corporate governance gurus seldom talk about good communication and the use of plain language. Boards of Directors do not like such talk as a general rule. And the gurus who are their consultants cannot allow themselves to displease.
2. "Director's Duties and Corporate Governance" pp. 9-10
3. Ibid.
4. Id. Page 4 – Proposal 5.

Prior to returning to private practice, now at the Sydney Bar, ***David Knoll*** *spent much of the last decade in the corporate governance and legal risk management spheres. He has worked closely with boards seeking to proactively manage legal risk. He led the team that overhauled the Export Finance and Insurance Corporation's products and rewrote them in plain English. David more recently initiated the simplification of electricity contracts and contracting processes in the New South Wales energy sector.*