



*Australian Institute of Company Directors  
WA Division Winter Dinner*

*People Behaving Badly:  
Business, politics, football codes  
and the regulatory response*

The Hon Wayne Martin  
Chief Justice of Western Australia

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Burswood Entertainment Complex

## **Introduction**

I would like commence by acknowledging the traditional custodians of these lands, the Nyoongar people, and by paying my respects to their Elders.

It is both an honour and a pleasure to have been invited to address this gathering of the Australian Institute of Company Directors. The Institute is the peak organisation representing company directors throughout Australia, with more than 20,000 members drawn from industry, commerce, the professions, government, and not for profit organisations.

Your Institute's website announces that the Institute "is dedicated to making a positive impact on the economy and society by promoting professional directorship and good governance". It is I think impossible to overstate the importance of that laudable objective.

In September 2005, the Board of your Institute adopted a Code of Conduct applicable to its members. Included in that Code is a duty which is central to the theme I wish to address this evening. That is the:

"... obligation, at all times, to comply with the spirit, as well as the letter, of the law."

## **The HIH Royal Commission**

I gained direct experience of the profound importance of that notion in the course of my duties as Counsel Assisting the Royal Commission into the collapse of the HIH Group of Companies. The collapse of that Group

is generally thought to have been the largest collapse, in dollar terms, in Australia to date. The collapse occurred at about the same time as a number of other major collapses which had profound ramifications for Australian consumers, including Harris Scarffe, Ansett and One-Tel. This rash of unexpected major collapses at a time of apparent economic prosperity took many by surprise, and properly focused community attention on the soundness of our mechanisms and structures of corporate governance.

HIH was Australia's second largest general insurer. The ramifications of its collapse were extensive. Almost nobody in the community was immune to its consequences. Because it dominated the market in the provision of builders' warranty insurance, many building projects around the country were stopped overnight and new projects were delayed while other insurance was obtained. Many were put out of work in the building industry and in the many industries that supply that industry. Some of those stoppages endured for up to two months. People who had been seriously injured and who depended on insurance payments for their very survival were thrown on to the meagre benefits provided by social welfare. Even people who had no direct dealings with HIH were seriously disadvantaged - one example being the farmers in the wheat belt of this State whose claim against the local Shire for damages arising from a fire which spread from the local tip went unresolved for a very long time, largely because the Shire, in common with many local government bodies around the country, was insured by HIH.

The question which jumped to a lot of people's lips was "how could this have happened?" HIH had all the apparent trappings of success - large and opulent corporate offices in every State, a fabulous programme of

entertainment, gifts, donations and corporate sponsorship. Its CEO was feted as one of Australia's most successful self-made men. Perhaps even more significant than these superficial indicators, was the fact that it had a Board of Directors composed of highly regarded, senior and experienced representatives of the business, legal and accounting communities. It was audited by a highly respected accounting firm - one of the then big five, although its later demise has left us with the big four. The provisions it made for future claims liabilities were the subject of advice from a number of actuaries, and perhaps most significantly of all, it operated in an industry which is subject to the most intensive form of prudential regulation available in Australia, by a recently created and apparently well credentialed regulator - namely, APPRA. So what went wrong? Why did all the mechanisms that are supposed to reduce the risk of this kind of collapse apparently fail?

Now of course Justice Owen has delivered a lengthy three-volume report answering that question in great detail. And it would try your attention after a nice dinner if I were to try to cover in any meaningful way the broad ground which he has covered in that report.

But the main reasons for the collapse of HIH might be pithily summarised by drawing upon the well-known analogy - "a fish rots from the head". Although HIH had firmly in place all the traditional governance structures including a well-credentialed board, an audit committee, independent auditors and actuaries, the best legal advisors a lot of money could buy and so on, all of those checks and balances failed because of an undue focus upon the letter of the law (although in a number of instances that was also breached), and a failure to give any thought whatsoever to the purpose or objective of the law, or the moral component of the issues

which they were addressing. And what struck me perhaps most profoundly, was that although the fish had undoubtedly started to rot at the head, by the time the liquidators were called in, the rot had spread through almost all levels of the corporate group, infecting officers at relatively junior levels, whose key focus was almost always upon whether or not they could get away with what they were doing, rather than upon whether or not what they were doing was right.

Let me try and give you some indication of the dimensions of this problem with some admittedly superficial examples. The profligate expenditure of the Managing Director, unchecked by the Board, set an appalling example of irresponsible leadership. He spent \$380,000 of the company's money buying gold watches. He provided an unsecured and interest-free loan from the company to a friend in an amount of \$500,000. He gave \$1,600 worth of cigars to that man, purchased by the company, at the time the loan was outstanding and no interest was being paid on it. In the last year before the company collapsed, he organised a company Christmas party in Sydney that cost \$800,000. He was regularly giving away about \$5 million per annum of the company's money to charities of his choice, most of whom reflected his generosity with other people's money by bestowing honours and accolades upon him personally.

It was in that context that a story emerged which is perhaps one of the best known of the Royal Commission. The Managing Director to whom I refer was Mr Ray Williams, although he had taken to calling himself Dr Williams in light of the honorary doctorate conferred by Monash University after he gave large amounts of HIH's money to that university. The amounts expended on travel by him and the other senior executives of the company were extraordinary - there was never any question but

that they and their wives would travel, at company expense, in the best available class. Michael West, who as you may know, is a journalist writing for *The Australian*, produced a tongue-in-cheek piece in which he suggested that I had cross-examined Mr Williams to the effect that when he traveled internationally he had always traveled with a companion called Casey Williams, for whom he had also purchased a first class ticket, so that he could put his briefcase on the seat next to him, when his wife wasn't traveling with him. That story was converted into an email which spread like wildfire, and has now translated itself into mythical transcript which exists on a number of websites. But unfortunately I have to tell you that none of its true. So, the irony of it is that my role in that Commission will probably be best remembered for a line of cross-examination which never took place!

Now you might say that I am being a bit petty by criticising these personal extravagances, when obviously they were not of an order of magnitude which could have caused Australia's largest commercial collapse, leaving a deficit of many billions of dollars. And of course that's right. And nor were the extravagances to which I refer illegal. But the lack of respect for proper systems of governance, and the lack of a proper sense of stewardship of the shareholders' funds, came to characterise the major business decisions made at the most senior levels of the company, and also spread like an internet virus through all levels of the company.

At the senior levels, a number of utterly disastrous decisions were taken without proper due diligence and evaluation. They included undertaking major reinsurance business in the UK, embarking on a disastrous insurance venture into the US and another into China, and the acquisition

of FAI. At lower levels in the company, it included writing what was described as film insurance, which was in fact a form of underwriting the profitability of film ventures in circumstances where the underwriters had no idea what the film was, or as to its likely profitability. That ill-fated venture lost over \$100 million. At even lower levels still, it extended to providing insurance against a particular outcome in the European Football Cup, which is of course nothing more than gambling; the provision of personal injury insurance to members of the Taiwanese Military Forces at a time of extraordinary tension between Taiwan and China; and the provision of reinsurance to Israeli motor vehicle insurers at a time when terrorism in that country was having a significant impact on motor vehicle damage. So you can see that although this fish started rotting at the head, the rot spread through the major organs and riddled the flesh. And the mortal illness was concealed from shareholders and investors by the adoption of accounting techniques most but not all of which were legal, but unethical and immoral. Although those accounting techniques differed in detail from those adopted in the United States by Enron, they were implemented by people who had the same lack of commitment to disclosure of the truth in both instances. They might have been the smartest guys in the room, but they didn't have a moral compass.

I think we can extract a number of principles of general application from this example. The first is that corporate leadership and governance is vital to the health and soundness of corporate activity. That is why your roles as directors of corporate entities are vital to the health and wellbeing of commercial activity in this country, which is in turn so vital to the health and wellbeing of our community. And it is why the role of your Institute, as a body which provides focus for the aspirational goals of good governance is also so important.

A second lesson we can learn from the HIH example is that prescription and regulation simply does not work unless it succeeds in nurturing ethics and morality as core commercial principles. And I think there is a very great danger that over-prescription and over-regulation can be counterproductive, by distracting attention from the fundamental question of whether what is being done is right, ethical and morally sound. Over-prescription, and over-regulation inappropriately focus undue attention upon whether or not something can lawfully be done, distracting attention from the real question, which is whether it should be done, from an ethical and moral perspective. And decisions which might be technically correct, and even commercially sound in the short term, might prove to be disastrous in the long term. Take for example the decision of the Board of James Hardie to relocate the corporate base and substantial funds of that company off shore. While there was of course nothing illegal in that decision, and it may have appeared commercially sound, in the long term the adverse consequences of that decision were profound for the company and its shareholders. The point I make here is that there is no necessary tension, and often a positive synergy between sound ethics and good business.

And there is a real danger of the development of a "tick-a-box" mentality in relation to corporate regulation and governance. What I mean by that is a mentality under which boards of directors go through a list of pro-forma questions and tick the box if they can answer the questions affirmatively. Questions such as: "Do we have an independent qualified board?" "Do we have an audit committee?" "Do we have independent auditors?" and so on. HIH could have answered all those questions affirmatively, but it was rotten to the core.

These propositions were well expressed by Dr Fred Robins in a recent paper dealing with corporate governance in the light of the increased regulation reflected by the passage of the Sarbanes-Oxley legislation in the US. He observed:

"At some point we are obliged to recognise that it is ultimately impossible to regulate for ethics and common sense of the sort that might have saved us from HIH, or for that matter, from Enron. Prescriptive rules can provide important bench marks for good corporate governance, but cannot by themselves do much to raise levels of actual performance. No rules would automatically prevent misleading or deceptive conduct any more than they will prevent outright fraud. Nor will the best rules in the world compensate for negligence, ignorance, apathy or stupidity. So the governance debate has to move beyond the checklist template."<sup>1</sup>

The third principle which I extract from this example is the theme with which I opened - that is the obligation, embraced in your Code of Conduct, to comply with the spirit as well as the letter of the law. The purpose of a set of accounts is to provide a true and fair view of the financial position of the relevant entity. The rules governing the formulation of sets of accounts have become so complex in response to the evolution of so many exotic forms of commercial transaction as to almost inevitably admit of manipulation by the unscrupulous. So each and every set of accounts must be tested by the fundamental question of whether or not they give a true and fair view of the financial position.

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<sup>1</sup> Robbins, F - "Corporate Governance after Sarbanes-Oxley: An Australian Perspective" Published in "Corporate Governance" Volume 6, No 1 2006.

The question of whether or not a myriad of technical accounting rules have been complied with is, in my view, much less important.

Now you might think it's a bit rich for a lawyer to address of group of businessmen and businesswomen on the merits of substance over form, when many of you see the law as the epitome of the triumph of form over substance, in much the same way as a second marriage is the triumph of optimism over experience. But I think astute observers of courts and the legal system over the last few decades will have noticed a distinct trend towards substance over form, and that is certainly a trend which I aim to reinforce and accelerate. And if we lawyers can succeed in putting substance over form, it should be easy for business people.

So far I have addressed my remarks to law and business, but of course the importance of an ethical and moral dimension is not limited to law or commerce. During my lifetime, this State has seen many regrettable examples of political leaders who have displayed a conspicuous failure to bring an ethical and moral dimension to their important governance roles. During the WA Inc era, there was an extremely unhealthy synergy between government and commerce in this State - a virus of immorality and greed which spread from one group to another and back again, to the detriment of the entire community. And, regrettably, it seems that the lessons that were learnt from the exposure of that conduct need to be reinforced from time to time through the agency of bodies like the Corruption and Crime Commission. While the work of that Commission has no doubt caused some political pain in the short term, I am optimistic and perhaps naïve enough to think that those pains will be reflected in long term gains in terms of shaping an ethos and culture of morality which will hopefully underpin government at all levels - Local, State and

Federal. Just as in commerce, political representatives need to constantly remind themselves why they are there, which is of course to protect and advance the interests of those they govern, just as your role, as directors, is to protect and advance the interests of your shareholders. Just as you are required by law to test every action you take against that standard, so should our politicians test their actions against the fundamental question of whether their actions will protect and advance the interests of the community as a whole, and eschew personal and party political interests. But perhaps I am being naïve. But there is a basic similarity between the roles and duties of our commercial leaders, and our political leaders. Each are stewards, trustees if you like, exercising powers and responsibilities on behalf of others, be they shareholders or voters. And that creates a moral duty to protect and preserve the interests of those others.

And of course the moral and cultural ethos of our community is not shaped only by commercial leaders and politicians. Prominent sports men and women are increasingly seen as occupying leadership roles and as mentors whose conduct will influence many, for good or for bad. I must say that I have some sympathy for Chris Judd's view on this topic when he points out, correctly, that all he is paid to do is play football on an oval. There is no reason why somebody who is good at sport should have any particular insight into appropriate standards of behaviour or conduct. The fact that Chris Judd is the best footballer I have seen in almost 50 years of avidly following the game doesn't of itself oblige him to act as a general role model for the entire community. Recent experience regrettably tells us that if you give young men who are extremely fit and extremely competitive by nature, lots of money and celebrity status, and not a lot to do with their time other than prepare for

sporting events, there is a significant risk that trouble will follow. For my part, when those risks eventuate, I don't find it terribly surprising. But, unfortunately for Chris Judd's view, I think it is perhaps too late to retreat from the unrealistic expectations which we have developed in relation to the off-field behaviour of our sporting heroes. And so, however irrational it may be, they too, like our political and commercial leaders, must now also take some responsibility for shaping the moral ethos of our community. And that's why my cockles are warmed every time I see Adam Gilchrist walk – even though he has been given "not out". That really is the triumph of substance over form - if the batsman knows he's out why should he stay at the crease just because the umpire hasn't seen it?

And umpires can't see everything. Courts as legal umpires, see only a tiny fraction of commercial conduct, and cannot be expected to review and scrutinise every commercial transaction in the same way as a cricket umpire scrutinises every ball delivered. So, at best, we can only hope to have a significant impact on behaviour if we encourage the development and maintenance of a sound community ethos, based on moral behaviour, and the capacity to distinguish right from wrong – a capacity sometimes inhibited by regulatory complexity.

And that community ethos will be easier to sustain if all sectors of society, commerce, politics, sport and so on, each adhere to that ethos. And our leaders must accept the responsibility of demonstrating their commitment to that ethos in their own personal behaviour.

So that's the challenge I throw down to you, as commercial leaders, to set examples to the people who work with and for you. There have been

some very bad examples in corporate Australia – such as the massive, some would say obscene, golden handshakes, or severance payments paid to departing executives, sometimes justified on the basis that their performance was so bad, that it was in the company's best interests to pay a lot of money to get rid of that person. Now what sort of message does that send – the worse you are, the more we can justify paying you to go away!

And there has probably never been a better place or time than here and now for the corporate and government sectors to provide moral leadership and authority. This State is undergoing an unparalleled period of economic prosperity – business is flourishing at all levels. But history tells us that these are precisely the times at which the gap between the privileged and the deprived in our community tends to widen, rather than narrow, and this boom is no exception. It is ironic that homelessness is at record levels. There are two big shortages in Perth at the moment, one is in basic housing for the less affluent, and the other is for pens for luxury motor yachts.

I believe that we must seize the opportunities which come with prosperity to provide the community services and infrastructure in health, education and welfare which we cannot afford in harder times. Now is the time to finally do something about the worse than third world conditions in which many of the descendants of the first inhabitants of this country live - in remote communities not far from the great resource projects that are generating so much wealth.

We can't leave these important responsibilities entirely to government, although of course government must play a role. We all know that

government is not that good at delivering services efficiently and maximising returns from expenditure. Partnerships between public and private enterprises, motivated by a spirit of personal and corporate philanthropy, underpinned by a real commitment to use our many advantages to make a lasting difference to the quality of life and health enjoyed by all the members of our community seem to me to offer the best chance of creating the kind of Western Australia in which we, and our children, and their children, will feel happy and proud to live.

Thank you for your attention this evening.