Pushing the limit for directors

Just how far do directors’ obligations extend, asks Ian Ramsay.

Recently the parliamentary secretary to the Treasurer announced that he would ask the Corporations and Markets Advisory Committee to consider whether the Corporations Act should be amended to require directors to take account of the interests of shareholders’ groups other than shareholders when making corporate decisions.

The CAMAC inquiry is part of the government’s response to the corporate law issues raised by the James Hardie special commission of inquiry.

The referral to CAMAC raises a fundamental question: for whom do directors of companies govern? Is it shareholders or is it a broader range of stakeholders?

As my co-authors and I state in a new book (Company Directors — Principles of Law and Corporate Governance, LexisNexis Butterworth, 2005) this is not an abstract question. Section 181 of the Corporations Act requires directors to exercise their powers and discharge their duties in good faith in the best interests of the company.

What is meant by “interests” of the company? Possibilities include: existing shareholders, future shareholders, creditors and employees, customers, suppliers, the environment and the community.

Courts have generally interpreted the interests of the company to mean the interests of existing shareholders.

Australia is not the only country considering these issues. On March 17, 2005, the British Secretary of State for Trade and Industry presented to the UK parliament a white paper on company law reform together with a draft Company Law Reform Bill. The bill proposes changes to the UK law of directors’ duties to incorporate into directors’ duties the concept of "enlightened shareholder value".

The bill proposes that directors must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole. In fulfilling this duty, directors must take account (where relevant and as far as reasonably practical) of the likely consequences of any decision in both the long and the short term, and any need of the company: (i) to have regard to the interests of its employees; (ii) to foster its business relationships with suppliers, customers and others; (iii) to consider the impact of its operations on the community and the environment, and (iv) to maintain a reputation for high standards of business conduct.

The noteworthy feature of the UK bill is that the primary duty of directors is still to shareholders, but if directors may take account, where appropriate, of the interests of other stakeholders.

The UK government states that the proposed new formulation of directors’ duties reflects wider expectations of responsible business behaviour and, in the opinion of the government, is most likely to drive long-term company performance and maximise overall competitiveness and wealth and welfare for society.

The proposed UK reforms are based on an earlier report of the Company Law Review Steering Group. In its final report, the CLR rejected what it termed the "pluralist" approach to directors’ duties under which directors would be empowered, or obliged, to set the interests of other stakeholders above those of shareholders. The reasons why the CLR rejected this approach included that it would confer a broad policy discretion on directors, funded by the company’s resources, that could lead to directors being less accountable; constitute an attempt to achieve external benefits that are often better secured by specific legislation bearing on business activity as a whole, such as employment, environmental, planning and fair trading and competition law; and allow directors to more easily frustrate takeover bids against the wishes of shareholders.

A fundamentally important issue is how directors balance the interests of various stakeholders in the company and the role of the law in this process. The critical question for CAMAC is whether the law of directors’ duties should be amended in the way proposed in the UK, or whether this balancing of interests is best left to the business judgement of directors and possible reform of specific laws that deal, for example, with employees’ interests, protection of the environment, etc. At the very least, as the UK debate tells us, we should be cautious about reform of directors’ duties that elevates the interests of other stakeholders above the interests of shareholders.

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“What is meant by the interests of the company?”
Traditional notions of a company director’s duties are being challenged.

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