Should Australia Replace Section 181 Of the Corporations Act 2001 (Cth) With Wording Similar to Section 172 of the Companies Act 2006 (UK)?

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1. Introduction

In 1776, Adam Smith asked in the 'Inquiry into the Origins and Causes of the Wealth of Nations',

- is it possible for corporations to maximise profit and at the same time serve the public interest by contributing to human, social and environmental capital?
- Is it desirable?
- Is it foolish to try?[1]

Since that time, the 'corporate social responsibility of companies' has been periodically debated throughout the world. Although there is no agreed definition of 'corporate social responsibility, it can generally be described as the ability of a corporation to consider, manage and balance the social, economic and environmental impact of its activities.[2] There are plenty of examples of large multi-national companies engaging in practices to maximise profit at all costs. Some of these include Nike operating in factories in third world countries with extremely poor working conditions and employing children, Nestle engaging in unethical marketing practices and utilizing child labour and Enron manipulating electricity supply to maximize profits at the expense of Californian citizens.[3]

Due to these types of examples, there have periodically been calls to place more control over companies to ensure that such occurrences are prevented in the future. One obvious place to start seems to be the directors' duties. Traditionally, as directors have been seen to be guardians of shareholder money, case law and Australian legislation have provided that they must act in the best interests of the company (and therefore the shareholders as a whole). However, debate exists as to whether the directors' duties in Australian law allow directors to act in the interests of stakeholders other than shareholders. As stated by Austin J, the question of whether Australian company directors may take into account other stakeholder interests 'has been a vexed one for many years'.[4]

In 1989, this issue was reviewed in Australia by the Senate Standing Committee on Legal and Constitutional Affairs (the '*Senate Committee*'), which reached the conclusion that the corporations legislation at the time was sufficiently flexible for directors to consider all relevant stakeholder interests. However, recent events such as James Hardie's Chairman Ms Meredith Hellicar calling for

[1] Noel Purcell, 'The Good, the Bad and the Ugly of Corporate Social Responsibility', (Speech delivered at the 7th National Business Leaders Forum on Sustainable Development, Brisbane, 15-16 May 2006).

[2] Parliamentary Joint Committee on Corporate and Social Responsibility, Parliament of Australia, '*Corporate Responsibility: Managing Risk and Creating Value*' (2006) xiii.

[3] Kim Kercher, 'Corporate Social Responsibility: Impact of globalisation and international business' (2007) *Corporate Governance eJournal*, *Bond University Facility of Law*, 1, 4.

[4] Austin J, 'Remarks on the launching of the Company Directors and Corporate Social Responsibility: UK and Australian. Perspectives' (Speech delivered at the launching of Company Directors and Corporate Social Responsibility: UK and Australian Perspectives, Sydney, 16 March 2007).

a clarification of directors' duties[5] and the Australian Shareholders Association questioning of whether the decision of some company directors to make donations to the tsunami victims was legal,[6] have preceded two further parallel reviews by the Commonwealth government as to whether amendments to the *Corporations Act 2001*(Cth) ('*Corporations Act*') are required. These included the Parliamentary Joint Committee on Corporations and Financial Services ('*PJC*') inquiry into corporate responsibility and the Corporations and Market Advisory Committee ('*CAMAC*') report on the social responsibility of corporations. Once again, both reviews concluded that the law as it is currently drafted in section 181 of the Corporations Act is flexible enough and does not require amendment.

In the United Kingdom, the opposite outcome has been reached. The issue of the extent to which directors can take into account interests other than shareholders was reviewed by the UK Department of Trade and Industry ('*DTI*'). This review ultimately led to the introduction of the *Companies Act 2006* (UK) ('*Companies Act*'), which included the first codification of directors' duties in the United Kingdom. Controversially section 172 of the Companies Act provides for mandatory consideration by directors of certain interests other than shareholders, including, amongst others, employees, customers, suppliers and the environment. However, this provision maintains that directors must act in the way that ultimately 'promotes the success of the company', thereby retaining the focus of directors' duties on protection of shareholder interests. Several submissions to the recent Australian government reviews advocated the use of similar wording in the Corporations Act.

This essay will explore whether the conclusions of the Australian government reviews were correct, or whether Australia should take the United Kingdom's lead and amend section 181 of the Corporations Act to similar wording as section 172 of the Companies Act. To do so, parts 2 and 3 of this essay will discuss the directors' duties and the meaning of the phrase 'the best interests of the company'. Part 4 will discuss the previous government reviews and explore the current ability of directors in Australia to consider the interests of stakeholders other than shareholders. Finally, part 5 will consider the adequacy of the wording of section 172 of the Companies Act. Through the above discussion, it will be submitted that the outcome of each Australian review of section 181 of the Corporations Act (or its predecessors) so far has been correct on the grounds that the current directors' duties are adequate. Furthermore, it will be submitted that the wording of section 172 of the Companies Act should not be adopted as it adds unnecessary complication and uncertainty to directors' duties.

For the purposes of this essay, the term 'other stakeholders' will be used to describe the interests of all stakeholders other than shareholders.

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[5] Fiona Buffini, 'Calls to Protect Corporate Conscience' *Australian Financial Review* (Sydney), 23 November 2005, 4.

[6] Peter Henley, 'Were corporate tsunami donations made legally?' 30 *Alternative Law Journal*, 4 August 2005, 154, 154.

2. Directors' Duties and Powers

2.1 Directors' Duties Generally

To consider whether the current statutory directors' duties require amendment, and specifically section 181 of the Corporations Act, it is first necessary to understand the current directors' duties under the general law and statute. In most cases the power to manage the company is granted by the company to its directors.[7] This power is derived from both the Corporations Act and the company's constitution. Section 198A of the Corporations Act, a replaceable rule, states that the business of the company is to be managed by or under the direction of the directors. Although section 198A is a replaceable rule, many company constitutions contain a similar provision, delegating authority to manage the business of the company to its directors.[8] Consequently, absent a specific provision in the company constitution limiting this power, it is up to the directors to determine how and why corporate funds are to be spent. In large companies, this can mean that directors have power over a large amount of assets.

The directors' power to manage the business has been interpreted by courts to be very wide. As stated by the Senate Committee in 1989 'directors are the mind and soul of the corporate secto*r'.*[9] In fact, as was confirmed by the Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd*,[10] directors can make decisions against the majority shareholders' wishes. Similarly, in *Imperial Hydropathic Hotel Company Blackpool v Hampson*,[11] it was held that a resolution of the members is ineffective to override a decision by the directors if the power to manage the business of the company is granted to them. This means that once such a power is granted, the shareholders' only choice is to alter the constitution and limit the directors' powers, thereby preventing future similar decisions being made.

This does not mean that decisions made by directors are unchallengeable. Due to the immense power of directors, the general law imposes several duties on them. As directors' managerial powers are the result of a delegation from the shareholders, the role of directors' duties has historically been focused on the promotion of shareholder interests. Directors owe common law duties to the company both through contract and tort.[12] In addition, directors owe fiduciary duties to the company in equity.[13] The general law requires directors to act for a proper purpose and in the interests of the corporation.[14] This means that decisions made in breach of directors' duties can be challenged by shareholders.

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[7] CCH, *Australian Corporations Commentary*, vol 1 (41-040).

[8] Ibid.

[9] Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989), 7.

[10] [1974]AC 821.

[11] (1882) 23 Ch D 1.

[12] Professor Ian Ramsay, Professor H A J Ford and Justice R P Austin, 'Fords Principles of Corporations Law'. Current to November 2008, LexisNexis (Online Resource), (8.010).

[13] *Aberdeen Railway Co* v *Blaikie Bros* (1854) 1 Marcq 461.

[14] Ramsay, Ford and Austin, above n12, (8.010).

Strong remedies exist for the company if directors breach their duties even if it has suffered no actual loss. In fact, as is the case of all beneficiaries, the company can obtain a windfall remedy in equity if profits are improperly obtained by a director in breach of their duties.[15] This is due to the fact that fiduciary law aims to prevent improper conduct rather than to remedy its consequences.[16]

The general law directors' duties are reinforced by the statutory duties in sections 180-184 of the Corporations Act. The codification of directors' duties is in addition to and not in derogation of the general law duty.[17] Codification of directors' duties, first introduced into Australian legislation by the *Companies Act 1958*(Cth), was the first of its kind in the English speaking world.[18] Codification not only enhanced the duties owed by directors to companies, it has also provided an avenue for government, via the Australian Securities and Investments Commission ('*ASIC*'), to enforce a breach of directors' duties, which could previously only be enforced by the company.

2.2 Sections 180-184 of the Corporations Act

As explained by the Senate Committee, the purpose of the directors' duties is:

> to protect people (such as shareholders) who entrust their interests to the care of others (such as directors). It does this…by imposing standards of conduct the breach of which will always give rise to liability.[19]

Similarly, the PJC stated that these provisions:

> allow investors to invest in a company on the understanding that the company directors will manage the company in the interests of its shareholders. When a shareholder invests in a company, they are in one sense investing in the capacity of the directors and managers to operate the company.[20]

As stated above, the directors' duties in the general law and the Corporations Act are intended to protect the corporation from directors misusing their powers. Furthermore, as directors are fiduciaries, they must exercise their duties for the benefit of their beneficiary, the company, rather than in their own interest or the interests of a third party. To complement the general law duty, section 181(1) of the Corporations Act states that:

> A director…must exercise their powers and discharge their duties:
> (a) in good faith in the best interests of the corporation; and
> (b) for a proper purpose.

[15] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 45.
[16] Ibid, 46.
[17] s 185 *Corporations Act 2001*(Cth).
[18] Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder primacy revisited: Does the public interest have any role in statutory duties?' (2008) 26 *Companies &Securities Law Journal* 355, 360.
[19] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 45.
[20] Parliamentary Joint Committee on Corporate and Social Responsibility, n2, 44.

Similarly, section 182 of the Corporations Act provides that:

> A director…must not improperly use their position to:
> (a) gain an advantage for themselves or someone else; or
> (b) cause detriment to the corporation.

As one can see, all these duties are meant to ensure that directors act in the interests of the corporation. The 'corporation' in this context has been interpreted to mean 'the shareholders as a whole'.[21] Consequently, generally directors do not owe a duty to individual shareholders. Although this may seem strange, it is important to remember that the company is a separate legal entity from its shareholders.[22] As stated by Handley JA in *Brunninghausen v Glavanics*,[23] there are good reasons for this general rule; if each shareholder had a personal right, directors would be exposed to a large amount of actions.[24] This of course means that directors can make decisions that are in the best interests of the corporation but are not in the best interests of some of the shareholders. This includes spending some of the company's funds to achieve long term profits at the expense of short term gains.

There are exceptions to this general rule that directors always owe their duties only to the company. For example in the New Zealand case *Coleman v Myers*,[25] the court held that the directors owed fiduciary duties to certain shareholders because of the personal relationship between them, including the shareholders' dependence on the directors for investment advice. Another example is where a company is near to or in fact insolvent. In that case, the directors must consider the interests of creditors instead of shareholders.[26]

Although debated by some academics, directors are not bound to only take into account the short term interests of shareholders. For example, in *Provident International Corporation v International Leasing Corp Ltd*,[27] Helsham J held that directors should consider the interests of future as well as existing shareholders.[28] How such short and long term interest is balanced, is a matter for the directors.

Directors' duties do not only protect the company against misuse of their powers. Equity, contract and tort require directors to discharge their duties with proper care and diligence. Section 180 of the Corporations Act codifies this duty. Nevertheless, courts have traditionally been reluctant to interfere

[21] *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, 291 per Evershed M.R., *Percival v Wright* [1902] 2 Ch 421.
[22] *Salomon v Salomon & Co Ltd* [1897] AC 22.
[23] (1999) 46 NSWLR 538.
[24] Ibid, 547.
[25] [1977] 2 NZLR 225.
[26] Ramsay, Ford and Austin, above n 12, (8.100).
[27] [1969] 1 NSWR 424.
[28] Ibid, 440.

with business decisions made by directors.[29] In *Re Smith & Fawcett Ltd*,[30] Lord Greene M.R. said in relation to the manner in which directors must discharge their duties '*They must exercise their discretion bona fide in what they consider - not what a court may consider - is in the interests of the company, and not for any collateral purpose'.*[31] Rather, the courts have traditionally been more concerned that a director's power has been exercised for a proper purpose – i.e. that the directors believed that they were acting in the interests of the company.[32] Correspondingly, it is a defence to a breach of section 180, if directors can show that they rationally believed that the decision was in the best interest of the corporation (section 180(2) Corporations Act).

3. 'The Best Interests of the Company'

Directors' duties under Australian law currently clearly focus on the 'interests of the company'. As stated in the introduction, there have been numerous calls for statutory directors' duties to be amended to clarify the extent to which directors can undertake activities in relation to corporate social responsibility or take into account the interests of other stakeholders. This is especially so following James Hardie's recent interpretation that a director would fail in their duties if consideration was given to factors other than profit maximisation.[33] Whilst the general law duty and section 181 of the Corporations Act both focus on the director acting in the 'interests of the company', case law shows that this does not mean that directors can not take the interests of other stakeholders into account.

The question of when a director can take into account the interests of other stakeholders often arises in relation to gratuitous payments. There are a number of key cases, discussed below, which are often referred to when considering the interpretation of the words the 'interests of the corporation'. Each of them considers when a company can make a gratuitous payment to benefit the interests of other stakeholders. Case law over the last hundred or so years has held that such payments can be made provided there is some benefit to the company.

3.1 Hutton v West Cork Railway Co (1883) 23 Ch D 654

One of the key and most often quoted cases regarding the 'interests of the company' is the English case *Hutton v West Cork Railway Co*[34] *('Hutton')*. That case involved a company which had transferred its business to another company and was in the process of being wound up. After the business had been transferred, the seller held a general meeting of its shareholders which passed a resolution to apply some of the sale money towards compensating certain employees for lost employment. This action was proposed by the directors despite the fact that the employees had no

[29] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 22.

[30] [1942] Ch 304.

[31] Ibid, at 306.

[32] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 41.

[33] Parliamentary Joint Committee on Corporate and Social Responsibility, n2, 47.

[34] (1883) 23 Ch D 654.

legal claim for compensation. A shareholder opposed the resolution, arguing that the company could not pass such a resolution as it was ultra vires.

The English court of appeal held that the resolution was invalid. In that case, Bowen L.J. made the point that the directors had done nothing wrong; they had done what most companies would have done.[35] But bona fides was not held to be enough because, as Bowen L.J. pointed out, you could have a 'lunatic' conducting the affairs of the company.[36] Bowen L.J. drew attention to that fact that the money resolved to be spent was money which belonged to the company. Therefore, it could only be spent for purposes which were reasonably incidental to carrying on the business of the company[37].

Whilst discussing what sort of payments could be authorised by the company, Bowen LJ said:

> you cannot say the company has only got power to spend the money which it is bound to pay according to law, otherwise the wheels of business would stop, nor can you say that directors who have got all the powers of the company…are always to be limited to the strictest possible view of what the obligations of the company are. They are not to keep their pockets buttoned up and deft the world unless they are liable in a way which would be enforced at law or in equity. Most businesses require liberal dealings. The test there is…[whether] it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit'.[38]

Bowen CJ went to state famously in that case 'the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company'.[39]

[35] Ibid, 670
[36] Ibid, 671
[37] Ibid
[38] Ibid, 672
[39] Ibid, 673

This case is often cited by critics arguing that the current corporations' law is too restrictive and that directors should be allowed to take into account the interests of other stakeholders. Further, the quote above is often used to question whether corporations can act in the interests of its employees, or engage in philanthropic or other corporate social responsibility activities. However, this is erroneous, as Bowen CJ did not state that the interests of stakeholders other than shareholders could not be taken into account. Even in 1883, Bowen CJ stressed the importance of treating the company's employees well, stating that 'a company which always treated its employees with Draconian severity, and never allowed them a single inch more than the strict letter of the bond, would soon find itself deserted'.[40]

However what was important in *Hutton* was that the case involved a 'dying company'. Consequently, both Bowen CJ and Cotton LJ held in that case that this meant that providing a gratuitous payment to employees would have no *prospect* of a future benefit to the company at all.[41] As there was no such prospect, the directors were engaging in philanthropic activities with money that didn't belong to them and had no benefit to those that it did belong to. Cotton LJ further said that as the company was no longer carrying on business, the money that it resolved to pay to its employees could not be seen as an 'inducement to them to exert themselves in the future or as an act done reasonably for the purpose of getting the greatest profit from the business of the company but must be looked upon simply as a gratuity'.[42]

3.2 Parke v Daily News Ltd [1962] CH 927

Another English case often referred to when the meaning of the 'interests of the corporation' is considered is *Parke v Daily News Ltd*. Although this case also involved the sale of a business, unlike *Hutton*, in that case the defendant company only sold its newspaper business, leaving some other minor publishing interests. The defendant company attempted to convene a general meeting for the shareholders to pass a resolution devoting a substantial part of the sale price of the newspaper to the company's former employees by giving them compensation and pension benefits. The company was not legally bound to make those payments. A shareholder objected, claiming that the proposed resolution was ultra vires.

Amongst other things, the plaintiff in that case argued that the proposal to pay compensation to the former employees was driven by a mix of purposes other than the best interest of the company.[43] These alternative purposes were alleged by the plaintiff to include a wish to underline the financial sacrifice made by the Cadbury family (who were directors and major shareholders of the company), a desire to ward off criticism and to avoid political repercussions.[44] The court held in that case that the

[40] Ibid.

[41] Ibid, 666 (per Cotton L.J.), 678 (per L.J. Bowen)

[42] Ibid, 666

[43] Parke v Daily News Ltd [1962] CH 927, 954.

[44] Ibid.

payments were purely gratuitous and were not for the benefit of the company and therefore could not be made.

This case did not involve a 'dying company' and an argument could be made that the gratuitous payments to the redundant workers could have inspired workers which were left to work in the company. However, as discussed above, there were doubts as to the purposes for which the resolution was proposed. Even though this case is often cited as an example of the limitations of directors' abilities to consider other stakeholders, it should be confined to its facts.

3.3 Re Lee, Behrens & Co Ltd [1932] 2 Ch 46

A further important English case is *Re Lee, Behrens & Co Ltd*. In that case the court considered the situation where the directors of a solvent company resolved to grant an annual pension of 500 pounds to a widow of a former director. The payment was objected to by a shareholder and therefore the court was asked to determine whether the directors' powers, express or implied, had been validly exercised. In that case, Eve J held that 'all such grants involve expenditure of the company's money and that money can only be spent for the purposes reasonably incidental to the carrying on of the company's business'.[45]

Building on Bowen CJ's reasoning in *Hutton*, Eve J proposed the following test to be applied to determine whether a proposed payment was in the interests of the company:

i) is the transaction reasonably incidental to the carrying on of the company's business;
ii) is it a bona fide transaction; and
iii) is it done for the benefit and to promote the prosperity of the company?[46]

Based on this test, Eve J held that as there was nothing but charitable motives behind the decision as it had no benefit to the company and therefore the payment could not be made without a shareholder resolution approving the payment.[47] Interestingly, although the articles of association of the company in question in that case allowed gratuitous payments to employees and the family of employees to be made, the court held that as a director is not an employee, a resolution was required because it was a payment agreed to by 'the directors to one of their own group'.[48]

3.4 Australian application

As pointed out by Austin J, there has been no appellate decision in Australia about the extent to which directors can take into account the interests of other stakeholders.[49] However the above cases have been followed in Australia. For example in *Woolworths v Kelly*,[50] Mahoney JA held that:

[45] *Re Lee, Behrens & Co Ltd* [1932] 2 Ch 46, 51.
[46] Ibid.
[47] Ibid, 52.
[48] Ibid, 49.
[49] Austin J, n 4.

> A company may decide to be generous with those with whom it deals. But – I put the matter in general terms – it may be generous or do more than it need only if, essentially, it be for the benefit of or for the purposes of the company that it do so.[51]

Although the outcome of the cases discussed above may seem harsh, when they are considered in the context of all of the directors' duties, it can be seen the principles they propose are correct. Directors have a very wide discretion as to how the company's assets are to be used. Therefore, it is essential that when they exercise their powers, they do so for proper purposes and for the benefit of the company and not for themselves or a third party. Directors can not disregard entirely the interests of the company, as after all, the directors are using the company's money.

4. The Ability of Directors to Act in the Interests of Other Stakeholders

4.1 Government Reviews of Whether the Law Should be Changed

The extent to which the current Australian law allows directors to take into account the interests of other stakeholders has been reviewed by the Australian government numerous times. So far, all reviews have recommended no change as they have generally determined that the current law is adequate and flexible enough to allow directors to take into account all relevant interests. A recommendation to the contrary would have meant that the directors' duties now contained in sections 180-184 of the Corporations Act would require amendment. As a minimum, section 181 of the Corporations Act would require amendment.

4.1.1 Senate Standing Committee on Legal and Constitutional Affairs

In November 1989, the Senate Committee considered whether or not the statutory directors' duties should be amended so that directors could formally look beyond the interests of the company whilst exercising their duties. After going through the existing law regarding directors' duties, the Senate Committee considered whether there was any duty to consider what it called 'outside interests'. The Senate Committee pointed out that where the law specifies what conditions corporations must provide for employees, how they must treat the environment, occupational health and safety measures, directors must accommodate those conditions *because* they have a duty to act in their company's interests.[52]

Importantly, the Senate Committee pointed out that although directors must act in the interests of the company, this does not mean that directors must not consider other stakeholders. This is because

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[50] (1991) 22 NSWLR 189.

[51] Ibid, 226.

[52] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 83.

considering those interests includes considering the *continuing wellbeing* of the company.[53] The Senate Committee went on to state that 'the law permits many interests and purposes to be advantaged by company directors, as long as there is a purpose of gaining in that way a benefit to the company'.[54] In this vein, the Senate Committee stated there are situations where gratuitous payments, for example to employees or charity, will not amount to a breach of director's duties – e.g. where it is part of doing business or confers some benefit to the company.[55]

The Senate Committee concluded that widening director's duties to protect other stakeholders, other than employees, could place directors beyond the effective control of shareholders without enhancing the rights of other stakeholders.[56] The Senate Committee went on to note that as it is the shareholders' investment that creates the company, directors' duties are designed to protect that investment.[57] Consequently, the Committee recommended that matters external to the company should be dealt with in separate and specific legislation.[58]

4.1.2 PJC and CAMAC

Recently, there have been two parallel inquires in relation to corporate social responsibility and the ability of directors to consider other stakeholder interests in their decision making process. The first was the PJC inquiry into corporate responsibility completed in June 2006. Like the Senate Committee before it, the PJC concluded that the law was adequate and did not require amendment. Furthermore, it stated that it did not support the approach taken in section 172 of the Companies Act as it introduced great uncertainty. The PJC went on to state, in relation to section 172 of the Companies Act:

> the committee considers that a law which imposes a duty should give those upon whom the duty is imposed a clear guidance as to whom the duty is owed and how it is to be discharged. A law which does not is bad law, and at the very least magnifies the uncertainties faced by directors'.[59]

The second inquiry was conducted by CAMAC, after the then Parliamentary Secretary to the Treasurer, the Hon Chris Pearce, MP asked it to consider, amongst other things:

1. Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of shareholders or the broader community when making corporate decisions?
2. Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

[53] Ibid, 83.
[54] Ibid, 84.
[55] Ibid, 85.
[56] Ibid, 97.
[57] Ibid, 98.
[58] Ibid, 99.
[59] Parliamentary Joint Committee on Corporate and Social Responsibility, n 2, 56.

A positive answer to either of these questions would of course have meant that section 181 of the Corporations Act required some form of amendment, whether it is in the form of section 172 of the Companies Act 2006 or otherwise. After considering the current law and the various submissions, CAMAC came to a similar conclusion as the Senate Committee and the PJC.

CAMAC concluded that the Corporations Act is sufficiently flexible to allow directors to take into account the relevant interests of stakeholders.[60] In fact, similarly as argued in this paper, CAMAC concluded that 'changes of the kind proposed from time to time do not provide meaningful clarification for directors, yet risk obscuring their accountability'.[61]

4.2 Directors' Ability to Consider Interests Other Than Shareholders

Almost all submissions to CAMAC generally agreed that the directors' duties under the general law and statute allowed directors to at least choose to consider a range of factors external to shareholders if this benefits the shareholders collectively. However, the PJC noted that there were various interpretations in the submissions and evidence provided to it of the current ability of directors to consider the interests of other stakeholders.[62] After analysing each interpretation, the PJC concluded the most appropriate interpretation was that of 'enlightened self-interest', which provides that careful and appropriate corporate responsibility, is almost always in the interest of the corporation and therefore directors are allowed to do it. The PJC further noted that directors' duties were meant to provide protection for shareholders, not a safe harbour for corporate irresponsibility.[63]

However, in its submissions to the PJC and CAMAC, the Finance Sector Union of Australia ('*FSU*') argued that there does not appear to be a clear cut view as to whether the current law permits directors to consider issues wider than financial performance and the future of the company itself.[64] Although the FSU's argument was intended to be submitted as a limitation, it in fact highlights that directors must consider the repercussions of their actions on stakeholders in order to ensure the future of their companies.

Milton Friedman once argued that the only corporate social responsibility companies have is to maximise profits.[65] Since then, this statement has been heavily criticised as supporting the idea that corporations should try to make profits at all costs. However, even Milton Friedman stated that

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[60] Corporations and Markets Advisory Committee, Parliament of Australia, The *Social Responsibility of Corporations, Report* (2006), 7.

[61] Ibid.

[62] Parliamentary Joint Committee on Corporate and Social Responsibility, n 2, 46.

[63] Ibid, 48

[64] Finance Sector Union of Australia, Submission to Corporations and Markets Advisory Committee, Parliament of Australia, 15 September 2005, 2

[65] Milton Friedman, 'The social responsibility of business is to increase its profits' *New York Times Magazine* 13 September 1970.

corporations must make their profit within the rules of the game.[66] Arguably, in order to maximise profits, companies must properly consider all relevant stakeholder interests. They do not operate in a bubble. The corporation sells goods and/or services to consumers. To do so, they need a workforce. Furthermore, the community within which they operate influences the opinions of consumers, employees and the regulatory environment. Consequently, even corporations that hold the more restrictive interpretations of directors' duties must consider other stakeholder interests to survive in the long term. Indeed, many Australian companies go beyond the bare minimum as they consider that in order to be sustainable they must maintain a reputation for ethical conduct and accommodate legitimate external interests.[67]

Research referred to by the PJC indicates that the number of companies which report on their corporate social responsibility activities has been steadily increasing since 1995, due to the increasing number of companies realising the importance of such activities to their business.[68] There are many important reasons why a corporation must take into account the interests of its various stakeholders. Many corporations believe that taking into account what consumers and the community find important can have many positive benefits to the company financially. Paying attention to consumer needs can allow for greater learning and innovation and can increase a company's competitiveness. Furthermore, being a 'good corporate citizen' is seen by many companies to result in increased public approval and goodwill.[69]

Furthermore, taking into account the interests of employees can have many positive results.[70] A happy and skilled workforce arguably benefits the corporation via increased efficiency, attracting talented individuals, lower turnover and over the longer term increased profits. Alternatively, an employer who disregards the interests of employees may have increased inefficiencies, interrupted production, distribution and ultimately damage to its sales. In addition, submissions to the PJC indicated that employee engagement was not only a result of positive working conditions.[71] Numerous submissions showed that one of the reasons that corporations engage in corporate social responsibility activities was to attract and retain employees, many of whom found these activities important.[72]

For these reasons, many corporations believe that doing more than the minimum required under legislation will increase shareholder value in the long term.[73] For example, both Westpac's and BHP's

[66] Ibid.

[67] Australian Institute of Company Directors, Submission to Corporations and Markets Advisory Committee, Parliament of Australia, 3 March 2006, 3.

[68] Parliamentary Joint Committee on Corporate and Social Responsibility, n 2, 14.

[69] Ibid, 14, 21, 23 and 36.

[70] Ibid, 26.

[71] Ibid, 27.

[72] Ibid.

[73] Juliette Overland, Submission to Corporations and Markets Advisory Committee, Parliament of Australia, 1 March 2006, 2.

websites display their contributions to the community. Both these companies made submissions and gave evidence to the PJC. Westpac, stated in evidence to the PJC that nothing it had done over the last ten years in relation to corporate social responsibility had not added shareholder value. In fact, it stated that even those activities which had cost in the short term, such as environmental improvements, had had such a short payback period that they had also helped the company's bottom line.[74] Giving very similar evidence, BHP Billiton also stated to the PJC that its activities in corporate social responsibility had been critical to its success.[75] Henry Bosh, who has been on over 30 boards, noted in his submission to CAMAC that all boards that he was aware of already recognize the interests of stakeholders, as ignoring them could negatively impact sales.[76] In order to continue to grow and adapt companies must at least consider the concerns and expectations of all stakeholders.[77]

Thus, a corporation that pretends that it is operating in a social bubble is not managing its risk properly and its directors are arguably in breach of their duty to act with due care and diligence. The potential risks include:

a) labour risks (such as strikes, reduced efficiency, staff turnover, recruitment, attracting and retaining employees);

b) reputational risk (devaluing brand and corporate images); and

c) risk of adverse litigation and increased chance of regulatory intervention.

There are plenty of recent examples of companies that did not manage their relationships with internal and external stakeholder effectively, and therefore their risk. This effected their corporate image and ultimately shareholder wealth. As mentioned earlier, Nike's and Nestlé's attempts to maximise profits by moving manufacturing facilities to low-wage countries and the resultant alleged exploitation of workers had a strong negative effects on their reputations. In another instance, James Hardie's controversial restructure of its corporate group in an attempt to quarantine itself from liability for its asbestos products not only hurt its reputation but also led to a government inquiry. Similarly AWB Ltd's actions in relation to alleged payments to Iraqi government officials also led to a government enquiry and negative media scrutiny.

However, adverse publicity and government intervention are not the only negative results which can occur if the company does not adequately consider the interests of other stakeholders. As stated by the Senate Committee and as will be discussed below, specific legislation already mandates minimum requirements in relation to many other stakeholder interests. Directors cannot ignore this legislation without being in breach of their duties, as a breach of such laws would ultimately reduce shareholder

[74] Corporations and Markets Advisory Committee, n. 60, 21.

[75] Ibid.

[76] Henry Bosch, submission to Corporations and Markets Advisory Committee, 24 February 2006, 1.

[77] Group of 100, submission to Corporations and Markets Advisory Committee, 27 February 2006, 1.

value. Furthermore, it is difficult to imagine a situation where a breach of legislation would be in the interests of the company.

5. Section 172

As discussed in the section above the interpretation of companies as to the extent to which they can consider the interests of other stakeholders differs. Many corporations have incorporated corporate social responsibility activities into their business practices whilst others, as the submissions to PJC show, have taken a more restrictive interpretation.[78] This has led the NSW Attorney General, in its submission to CAMAC, to state that reform of Australian directors' duties is necessary to clarify that the 'James Hardie interpretation' is not the current law.[79] The NSW Attorney General called for the existing practices of prudent directors who act responsibly to be codified into the Corporations Act.

In the United Kingdom, a recent review by the DTI was also completed of, amongst other things, directors' duties. This review led to the introduction of the Companies Act, containing the new section 172. Prior to the review by the DTI, directors' duties in the United Kingdom had never been codified. Although designed to support the United Kingdom's general law directors' duty to act in the interests of the company and capture the current law, the new section 172 has taken a very different approach to section 181 of the Corporations Act. The wording of section 172(1) is as follows:

> A director of a company must act in the way he considers, in good faith, would most likely promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct,
> (f) the need to act fairly as between members of the company.

At first glance, this wording appears to solve many of the issues raised in relation to section 181 of the Corporations Act. It 'raises' the bar for all directors to act the way that responsible directors do, just as the NSW Attorney General called for. It maintains the importance of shareholder interests whilst directing directors to take into account other stakeholders. In addition, it requires directors to consider the company's long term interests and to act fairly between the interests of different shareholders of the company. In fact, some submissions to the PJC advocated replacing section 181 of the Corporations Act with similar wording to section 172 Companies Act.[80]

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[78] Parliamentary Joint Committee on Corporate and Social Responsibility, n 2, 46.

[79] NSW Attorney General, submission to Corporations and Markets Advisory Committee, February 2006, 1

[80] Parliamentary Joint Committee on Corporate and Social Responsibility, n 2, 54.

Yet, upon further analysis, the actual wording of the section is ambiguous and difficult to apply. The UK government has stated that the purpose of codifying in this way was to make the directors' duties clearer to directors, who may not be aware of the case law. Unfortunately, due to the section's ambiguity the UK government has decided to publish a plain English guidance on what directors must do to comply with the new codified plain English duties. The section has many flaws, some of which were pointed out in submissions to the DTI, as well as to the PJC and CAMAC. Australia should not follow the lead of the United Kingdom and replace section 181 with section 172. Some of the reasons are discussed below.

5.1 The Ambiguity of the Wording

5.1.1 'Promoting The Success Of The Company'

Section 172 requires directors to act in the way that they consider would most likely 'promote the success of the company'. At first this seems logical – directors should *want* companies to succeed. However, the term 'success' is ambiguous. In its submission to the DTI, the Law Society of the United Kingdom ('*Law Society*') stated that the term 'success' is likely to create significant practical problems.[81] Similarly, in the Confederation of British Industry's ('*CBI*') submission to the DTI, it asked 'what does "success for the benefit of its members" mean?' and 'how is success to be measured?'[82] Is success intended to be measured short or long term? Is it by reference to financial performance or other criteria? Definitions of success will be different depending on who is interpreting this term. As argued out by Traidcraft in its submission to the DTI, there are companies that are financially successful that pay little regard to social and environmental concerns.[83]

The uncertainty surrounding the word 'success' is compounded by the fact that it is different from the traditional duty to simply 'act in the best interests of the company'. The deliberate choice of the UK government to use alternative words arguably indicates that this is intended to be somehow different from a director's duty to act in the best interests of the company. Furthermore, as pointed out by the Law Society, unlike 'in the best interests of the company', this phrase is not supported by any case law.[84] In response to the ambiguity surrounding the definition of success, the UK Ministerial Statements on the Companies Act state that this term is a starting point, as members of the company should define the objective they want to achieve.[85] With respect, this does little to clarify the meaning of the phrase. In addition, if the Ministerial Statements are to be followed, this ultimately means that

[81] Law Society's Company Law Committee, the Company Law Sub-Committee of the City of London Law Society and the Law Reform Committee of the General Council of the Bar, submission to UK Department of Industry and Trade, June 2005, 6.

[82] Confederation of British Industry, submission to UK Department of Trade and Industry, June 2005, 25.

[83] Traidcraft, submission to UK Department of Trade and Commerce, June 2005, 3.

[84] Law Society, n 81, 5.

[85] UK Department of Trade and Industry, Ministerial Statements to *Companies Act 2006* (UK). June 2007. Per Lord Goldsmith, Lords Grand Committee on 6 February 2006, 7.

a company may still view profit maximisation at the expense of all other stakeholders as promoting the company's narrow definition of success.

Compounding the confusion surrounding section 172 of the Companies Act is the inconsistent messages from the UK government regarding whether this section is intended to change the status quo or whether it merely codifies existing law. The Explanatory Notes to the Companies Act state that section 172 codifies the current law and enshrines the principle of 'enlightened shareholder value'.[86] However, in the introduction to the UK ministerial statements to the Companies Act, the Hon. Margaret Hodge states that section 172 'marks a radical departure in articulating the connection between what is good for a company and what is good for society at large'.[87] If the section is meant to maintain the status quo, then as pointed out by CAMAC, on one view, the amendment to section 172 is unnecessary if all it does is codify the common law.[88]

5.1.2 'For The Benefit of its Members as a Whole'

The uncertainty surrounding section 172 is further compounded by the requirement that directors act for the benefit of the 'company's members as a whole'. This is a departure from the general law requirement that the director act in the best interests of the corporation or the company as a whole. The requirement to act in the best interests of the corporation has never before directly referred to the shareholders. Similar to the ambiguity surrounding 'promoting success', the departure from traditional wording makes application of previous case law questionable.

Moreover, as mentioned in the previous sections, directors in Australia have a duty to act in the interests of the company, rather than its members.[89] Although these interests are usually one and the same, this leads to questions as to whether directors' duties in the United Kingdom would now be owed directly to members regardless of special factual circumstances.

5.1.3 The Requirement to 'Have Regard To' Certain Interests

One of the most controversial aspects of section 172 is that it contains a mandatory requirement for certain interests to be taken into account. Grant Thornton argued in its submission to the DTI, that there should be no reference to such interests.[90] Similarly, PricewaterhouseCoopers argued in its submission to the DTI that the requirement to take into account the interests of a wider body of

[86] Explanatory Notes to the Companies Act, note 325.

[87] UK Department of Trade and Industry, n 85, June 2007, per Margaret Hodge, 1.

[88] Corporations and Markets Advisory Committee, n. 60, 106.

[89] *Percival v Wright* [1902] 2 Ch 421.

[90] Grant Thornton, submission to UK Department of Trade and Industry, 7 June 2005, 3.

stakeholders adds unnecessary and untested complexity to the section.[91] There are numerous issues with the new requirement of directors to take into account the interests listed in section 172. Firstly, it is unclear what the requirement to 'have regard to' entails and, as argued by ASIC in its submission to CAMAC, the section provides little guidance how to prioritise between the listed interests in the event of a conflict. For example, if directors were considering upgrading machinery in a factory which would ultimately lead to redundancies although it would also result in greater environmental benefits, increased efficiencies and benefit the company financially, would the directors be in breach of the duty if after considering the interests of employees they decide to dismiss them anyway? What if the company was simply considering outsourcing the work which would also be financially beneficial but result in loss of jobs? Although often the interests of stakeholders will coincide, there will inevitably be some circumstances where directors will need to trade off the interest of some stakeholders for the benefit of others.

Secondly, by listing certain stakeholders, the section could arguably by implication be excluding a requirement for directors to consider any other stakeholders. This of course removes future flexibility. The list of factors that directors take into account can now be so varied, creating a shortlist of factors for directors to concentrate on seems inappropriate. Although it is not exhaustive, it is highly likely that directors will concentrate on the interests listed. Furthermore, one set of interests noticeably missing from the listed interests is creditors. Section 172(3) of the Companies Act does protect them to some extent by providing that section 172(1) operates subject to any enactment or rule of law requiring directors to act in the interests of creditors. However, this means that unlike the other listed interests, arguably creditors interests need only be considered when the law requires them to be (for example in the case of insolvency).

Thirdly, the section requires directors to consider the likely impact of their activities on 'the community'. However, this term is not defined. Which community is the act referring to? The local community? The country in which the company operates? Lastly, amongst the considerations listed in section 172 is the requirement for directors to act fairly as between members. Similarly to the new requirement to promote the success of the company, this new requirement adds further confusion as it is has no previous case law. This requirement could at least imply a duty to enquire about the interests of various groups of shareholders. It is arguable that this helps ensure that minority shareholder interests are considered by directors. However shareholder interests could be very diverse, especially in large corporations. In its submission to the DTI, CBI argued that it is not always possible for directors to know what the different interests of its members are. For this reason, they argue that this aspect of the duty is quite onerous. It does not seem appropriate for the Corporations Act to be amended to include such a duty, especially as minority shareholders are protected in other areas of the Corporations Act. Furthermore, as pointed out by Andrew Keay, it is arguable that the

[91] Pricewaterhousecoopers, submission to UK Department of Trade and Industry, 14 June 2006, 14.

requirement for directors to consider the effect of their decisions on the long term may mean that directors should favour future shareholders over current shareholders.[92]

5.2 Increased Business Costs and Restraint of Decisions

Due to the mandatory requirement to take into account the interests listed in section 172, directors will arguably need to document how this requirement was met when they are making decisions. This may lead to changes in the way board proposals are made and documented, resulting in added bureaucracy in companies and increased reporting costs and perhaps auditing costs. Deloitte & Touche LLP, in its submission to the DTI, argued that this would place a heavy burden on directors due to the added cost of the time and effort of this excessive bureaucracy.[93]

Due to the concern by many companies of this increased burden, the Hon. Margaret Hodge stated in the Ministerial Statements to the Companies Act that clause 172 does not impose a requirement on directors to keep records in circumstances where they would not do so now.[94] However, many law firms in the United Kingdom are advising otherwise on their published websites.[95] Furthermore, note 328 of the Explanatory Notes to the Companies Act states that is not enough for boards to just pay 'lip service' to the decision. This would indicate that records definitely need to be kept by directors as evidence that due consideration was taken of the required interests. Nevertheless, note 328 does state that it would not be possible for a director to be held liable for a process failure.

5.3 Enforceability of the New Duty

One of the biggest concerns with section 172 of the Companies Act is that it will make decisions easier to attack by shareholders and other stakeholders. As noted in the preceding sections, courts have traditionally been reluctant to interfere with decisions made by a company's management. This is because, amongst other reasons, directors are expected to have more knowledge and expertise of the companies they manage than judges. Yet section 172 of the Companies Act appears to make it easier for courts to question a decision made. In fact the requirements in section 172 can arguably be compared to those when public law decisions are made. These entitle courts to review a decision if the decision maker did not take into account the required relevant considerations. Note 327 of the Explanatory Notes to the Companies Act states that as decisions are one for the director's good faith judgement this ensures that business decisions are ones for directors and not subject to decisions by

[92] Andrew Keay, Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach', 29 *Sydney Law Review*, 577, 585.

[93] Deloitte & Touch LLP, submission to UK Department of Trade and Industry, 10 June 2005, 2

[94] British Department of Trade and Industry, n 85, per Margaret Hodge on 11 July 2006, 8.

[95] E.g. Martin Scott, *Companies act 2006: the impact on directors – update,* (2007), Norton Rose, <http://www.nortonrose.co.uk/knowledge/publications/2007/pub5860.aspx?lang=en-gb> at 20 November 2008.

the courts[96]. However, this has not alleviated concerns that the provision of the extra criteria makes decisions easier to attack. The Australian Bankers Association argued in its submission to CAMAC that creating a legal requirement to take into account other stakeholders created a risk that board decisions will be challenged by minority shareholders representing those interests and possibly increase vexatious litigation.[97]

Whilst the section arguably makes directors' decisions more easily reviewable, enforceability of a breach of the new director's duty is arguably much harder due to the formulation of section 172. In fact, in its submission to CAMAC, ASIC argued that a requirement for directors to take into account other stakeholders could impact its enforcement abilities.[98] This is because, the less clear the duty and to whom it is owed, the harder it is to prove a breach of the duty. Moreover, in 1989, the Senate Committee argued that shareholders' abilities to enforce a breach of director's duties would be weakened due to an expanded list of interests directors were required to consider.[99] Due to the list of interests that the directors can take into account (with no legally ordered set of priorities) the director could arguably argue that it acted in the interests of one of the groups, thereby absolving themselves of responsibility that another group's interests were not taken into account.

This is not the first instance of corporations legislation in the United Kingdom requiring directors to take into account 'outside' interests. Section 309(1) of the Companies Act 1985 (UK) (now superseded by the Companies Act) provided that 'the matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members'. However, section 309(2) of the Companies Act 1985 (UK) made it clear that the duty was owed to the company (and the company alone). Therefore, it was only enforceable by the company (or a member via a derivative action). This provision has never really had any bite, which is shown by the fact that there have never been any cases involving a breach of the provision.[100] Similarly the duty in section 172 of the Companies Act is owed to the company. Situations where the company will enforce the duty on behalf of other stakeholders may be limited and as argued by the Senate Committee in 1989, an unenforceable duty is of questionable value. Consequently, as pointed out by Andrew Keay, there are only a few instances where such a provision would be enforced by a member.[101] One such example could be a long term shareholder who feels that the future interests of the company have not been adequately taken into account or where a member is also one of those stakeholders, such as an employee or a supplier.

[96] Explanatory Notes to the *Companies Act 2006* (UK).

[97] Australian Bankers Association, submission to Corporations and Markets Advisory Committee, 8 March 2006, 14.

[98] Australian Securities and Investments Commission, submission to Corporations and Markets Advisory Committee, November 2005, 1-2.

[99] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 97.

[100] Andrew Keay, n 92, 593.

[101] Ibid, 607.

5.4 The Inappropriateness of the Corporations Act

Furthermore, it is questionable whether the Corporations Act is the appropriate medium for a requirement for the interests of stakeholders such as employees, the community and the environment to be taken into account. As argued by the Senate Committee, ASIC and CAMAC, this belongs in specialised targeted legislation. And there is plenty of such legislation. For example specialised consumer protection legislation regulates the sale of goods and services, workplace relations legislation, discrimination and occupational health and safety legislation protects employees and environmental legislation protects the environment. This legislation enshrines clear rights and often contains civil or even criminal enforcement provisions. Consequently, there is no reason to amend the directors' duties to cater for these stakeholders. As the Association of Investment Trust Companies importantly pointed out in its submission to the DTI, regulating in separate legislation would mean such legislation would be subject to a separate consultation process and a cost/benefit analysis.[102] This of course would mean that the legislation would be much more refined to cater for those interests rather than a vague requirement for directors to consider them.

Furthermore, as argued by the Australian Institute of Company Directors ('AICD') and BHP Billiton, there is no justification for applying corporate social responsibility requirements to companies and not to other entities such as partnerships, individuals, joint ventures and unincorporated associations.[103] This is exactly what replacing section 181 of the Corporations Act with wording similar to section 172 of the Companies Act would result in, as it would only be targeted at the behaviour of companies. Targeted legislation directed at the area of concern is more likely to produce a consistent approach across all types of entities.

5.5 Removing the Flexibility of Section 181

Currently, section 181 of the Corporations Act is quite flexible. Each board of directors can adapt the duty to their present situation. This flexibility is essential because of the varying nature of companies. There are over 1.4 million companies in Australia.[104] Many companies vary in size and operate in very diverse circumstances. The majority of Australian companies are actually small. Some companies are well established, some are just starting up, some are members of a large corporate group, some are foreign owned and many operate in different industries. One size does not fit all and therefore replacing section 181 of the Corporations Act with wording similar to section 172 of the Companies Act would be inappropriate. As argued by Professor Finn, as quoted by the Senate Committee, 'it seems to be to be a hazardous enterprise, to put it moderately, to try simply to reduce this part of the law into a straitjacket – particularly into a legislative straitjacket – unless the terms in

[102] Association of Investment Trust Companies, submission to UK Department of Trade and Industry, 2

[103] Australian Institute Of Company Directors, n 67, 16. and BHP Billiton, submission to Parliamentary Joint Committee on Corporate and Social Responsibility, 5.

[104] Parliamentary Joint Committee on Corporate and Social Responsibility, n2, 12.

which legislation is framed are so broad as to allow the very flexibility that currently exists within the common law'.[105]

A much better approach is that taken by the ASX Principles of Good Corporate Governance and Best Practice Recommendations ('*ASX Guidelines*'), which already apply to listed corporations in Australia. The ASX Guidelines set out 'Good Corporate Governance Principles'. Principle 3 recognises the need for companies to have regard to the expectations other legitimate key stakeholders.[106] The principle further provides that companies should establish a code of conduct which guides how they comply with obligations to stakeholders. Box 3.I of the ASX Guidelines provides an example of what could be included in a code of conduct. The example includes things like responsibilities to clients, customers, consumers, commitment to shareholder value and employment practices. Whilst this covers similar areas to section 172, it can be adapted by each company as suitable for its needs. The Principles are supported by Recommendations which companies must either comply with or, if they believe that the Recommendation is inappropriate to their circumstances, explain why they don't.[107] Via the 'if not why not' mechanism, the ASX Guidelines provide a much more flexible approach for listed companies than section 172. Similarly, there are standards of conduct for non-listed companies. For example, Standards Australia publishes a set of standards on corporate governance.[108] These are intended for use by for non-listed companies, not-for-profit organisations and government departments.

Furthermore, as noted above, many companies are already taking corporate social responsibility seriously and as noted by the PJC, this number is growing. One danger to amending section 181 to introduce corporate social responsibility principles is that it will possibly create a negative culture of compliance.[109] In relation to this, the PJC noted that once legislation is enacted, it is likely that corporate responses will be driven by 'compliance managers' who wish to meet the requirements set out in the legislation.[110] Similarly, those corporations which do not already engage in such activities, may look for loopholes or do the bare minimum necessary.

In addition, the way in which many corporations have dealt with corporate social responsibility has changed over the last decade and is still evolving. For example, in its submission to the PJC, BHP Billiton stated that its approach had 'evolved over time, in step with our own experiences and perceptions of the environment in which we operate, community expectations…and in some

[105] Senate Standing Committee on Legal and Constitutional Affairs, n 9, 44.

[106] ASX Corporate Governance Council, Principles of Good Corporate Governance and Good Practice Recommendations, December 2007, 19.

[107] Ibid, 6.

[108] James McConvill, 'Directors' duties to stakeholders: A reform proposal based on three false assumptions', 18 *Australian Journal of Corporate Law*, 1, 88, 93.

[109] St James Ethics Centre, submission to Corporations and Markets Advisory Committee, 26 February 2006, 1.

[110] Parliamentary Joint Committee on Corporate and Social Responsibility, n2, 56.

instances, regulatory requirements'.[111] Similarly, the National Australia Bank and the Australian and New Zealand Bank referred to the evolution of corporate social responsibility as a 'continuing journey'.[112] As argued by the Australian Banking Association in its submission to CAMAC, an amendment similar to section 172 in Australia could have a negative impact on such evolving processes.[113]

For the very reason that the law may lose its ability to adapt to changes in circumstances, courts have traditionally been resultant to be too prescriptive in the way they deal with a company's affairs.[114] As Chief Justice David Malcolm argued, 'there is in this principle…a lesson for our legislators'.[115] He further argues that legislation is best stated in broad terms as this allows courts to apply them on a case by case basis.

5.6 The Effect on Australia as a Place for Business

It is arguable that replacement of section 181 of the Corporations Act with section 172 of the Companies Act may have other negative impacts on business in Australia. For example, it may affect Australia as a place of incorporation. In its submission to CAMAC, the AICD argued that a provision requiring directors to take into account other stakeholders may have a negative impact on investor confidence.[116] They argued that currently investors know that funds will be invested primarily for their benefit and any dilution of this would affect shareholder confidence.[117] This would even be the case if a section such as section 172 was introduced which still requires the directors to act in the interests of members as a whole, due to the introduced uncertainty.

Additionally, it was argued by the London Stock Exchange in its submission to the DTI that the 'further duties' in section 172 could dissuade some talented people from becoming a director.[118] Similarly, Deloitte & Touche LLP argued that the section may lead to a perception that directions can be easily litigated against in relation to every decision that make, stifling entrepreneurial activity and inhibiting company growth.[119] A follow on effect of this could also be a reduction in the availability of insurance.[120]

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[111] BHP Billiton, submission Parliamentary Joint Committee on Corporate and Social Responsibility , 1.

[112] Parliamentary Joint Committee on Corporate and Social Responsibility, n2, 40.

[113] Australian Bankers Association , n 97, 5

[114] Ian Ramsay (ed), *Corporate Governance and the Duties of Companies Directors*, (1997) Centre for Corporate Law and Securities Regulation, the University of Melbourne, 60

[115] Ibid.

[116] Australian Institute Of Company Directors, n 67, 65.

[117] Ibid.

[118] London Stock Exchange, submission to UK Department of Trade and Industry, 10 June 2005, 2.

[119] Deloitte & Touche LLP, n 93, 2.

[120] Law Council of Australia (Corporations Committee, submission to Corporations and Markets Advisory Committee, 23 February 2005, 2.

6 Conclusion

Section 181 of the Corporations Act should not be amended to similar wording as section 172 of the Companies Act. Directors' are guardians of shareholder money. Consequently, directors' duties have evolved to protect their interests. Section 181 requires directors to act in the best interests of the corporation and for proper purposes. The lack of mention of other stakeholders does not mean that directors can not take such interests into account. Companies do not operate in a vacuum. Indeed, in order to be sustainable in the long term, directors must take other stakeholder interests into account. Directors that do not are not managing their risks adequately and are arguably in breach of their duty to act with due diligence and care. Although there are many examples of companies which arguably engaged in profit maximisation activities at the cost of all other stakeholders, one only needs to look at the negative repercussions for some of those companies to see that any argument that their actions were in the best interests of their corporation is fairly weak. Blatant disregard to relevant interests can not only lead to an adverse community reaction, but also to litigation, government inquiries and regulatory intervention.

Whilst section 181 has been criticised as not clearly spelling out directors' obligations to all other stakeholders, it is the flexibility of this section that is one of its greatest strengths. All decisions made by directors must be in the best interests of the company. The what and the how, quite rightly, are up to the directors, who have the business knowledge and expertise to make the decisions. It is essential that directors' duties remain flexible over time and are able to evolve as community expectations and values change. On the other hand, although section 172 appears to set out clear guidelines of expected behaviour of directors, it is marred with a myriad of problems. The section incorporates many phrases and concepts that are unclear and untested by case law. Furthermore, the prescribed listed interests that directors must take into account adds bureaucracy to the decision making process with little added benefit. Worst of all, the list of required considerations for directors clouds their accountability to the company and threatens the enforceability of the duty.

Although an easy target, the Corporations Act is not the right place for the interests of other stakeholders to be taken into account by business. There is no reason for obligations to other stakeholders to apply to companies and not other business entities. In addition, as stated by the Senate Committee, CAMAC and the PJC, such interests should be dealt with in separate targeted legislation, that specifically caters to those interests and has been the subject of separate consultation and review. It is not without reason that every Australian government review so far has led to the conclusion that section 181 does not require amendment. Any further request for change to it should be resisted.

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