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Companies, corporate officers and public interests: Are we at a legal tipping point?

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The new CGPR

- In May 2018, ASC Corporate Governance Council released its proposed new 4th edition of the Corporate Governance Principles and Recommendations (CGPR)
- This included a significant change to Principle 3 and an increase in the number of recommendations from 29 to 38
- It purports to address ‘emerging issues in corporate governance’; the first two identified are ‘social licence to operate’ and ‘corporate culture’
- It has sparked a real catfight over the heart and soul of corporate law

On the one side…

On Tuesday, David Murray said that he would "not be guided by the ASX corporate governance principles where they either weaken accountability or distract the company to less important issues", claiming the guidelines had "contributed to what happened to AMP and others in the financial sector" and had made boards meddle too far into management issues (Source: AFR)

And on the other?

David Gonski has led the push for banks, including ANZ, to "step outside our traditional role as solely shareholder-focused organisations, and work in new ways that also put our customers and our communities at the centre of everything we do". (Source: AFR)

And there's this…

And this…

So what is the law about public interests?

- For today's purposes, 'public interests' goes beyond the interests of immediate stakeholders, to encompass the broader community's interest in the proper conduct of the affairs of companies
- To what extent may, or must, directors and officers of a company have regard to public interests in the management of the affairs of the company? Is it all about shareholder primacy, or is the debate over Principle 3 the sign we are at a legal tipping point?

The question concerns…

The question concerns two distinct but related public interests:

- The directors' and officers' duties to ensure the company complies with the law, and
- The directors' and officers' concern to ensure that the company goes beyond the law to 'do what is right', and to preserve its 'social licence to operate'

Remember that the Australian law of directors' duties has some distinctive features that are pertinent. These features mean that shareholders are not the final arbiters of what is required of directors. Directors' duties have a public character, derived from ASIC's enforcement powers and confirmed in *Cassimatis*

Complying with the law

- Companies, like all other legal persons, must comply with the law and there is a public interest in them doing so. The public interest lies not only in achieving the policy outcome intended by the particular law, but also in upholding the rule of law
- Companies cannot deliberately disregard or disobey the law, even where it might benefit them to do so. The point is well made in *Cassimatis* and is worth repeating
- This has implications where companies (and regulators) talk about adequate compliance systems and processes (and non-financial risk)

Directors' duties and compliance

- Directors do not have any generalised duty to ensure that the company always complies with the law
- Directors must not deliberately cause or allow the company to contravene the law. This would be a breach of their duty to act in good faith in the interests of the company and for a proper purpose, and make the director an accessory to the wrongdoing
- Directors also have a duty to take reasonable care to achieve compliance if:
  - specific legislation imposes that obligation on them (for example, the reasonable steps requirements in s 344 or s 601FD(1)(f) of the Corporations Act), or
  - the potential for non-compliance creates a foreseeable risk of harm to the company, for example exposure to regulatory action or reputational damage.

Negligence and compliance failures

- *Avestra*: the necessary requirement for liability in such a case is that the director failed to exercise reasonable care and diligence in circumstances that caused or failed to prevent the company from contravening [the relevant law] and where it was reasonably foreseeable that such contravention might harm the interests of the company

- Interests goes beyond financial interests: *Cassimatis*
- What about a failure by directors to monitor? The business judgement rule does not apply: *Rich*
- What about a failure to follow up? *Flugge*

Going beyond the law

- Does the law require directors to protect or advance public interests, along with or above those of the company? Does it allow them to?
- Or is it enough that their company complies with the law?

- Consider three significant themes:
  - Regulatory jawboning
  - Social licence to operate
  - Corporate culture
- Role of codes of conduct, institutional investor expectations and voluntary ESG commitments – including ASX CGPR

Regulatory jawboning

- There has always been a fair bit of this, but there are dangers for regulated entities and for the rule of law
- What about enforcing the existing law?
- Is the current law inadequate? Or is law itself inadequate?

Now, I know there may be some in the audience who may be interpreting my comments about the need for more professionalism as just another lecture from a regulator. That could not be further from the truth; I want, today, to give you some of ASIC's views on the behaviours we want to see …

Second, that the providers of financial services prioritise the consumer's interests and put the consumer's interest before their own…. Third, financial providers look to do the right thing and act with integrity and fairness, not just comply with the law….

ASIC Chair James Shipton, April 2018

Codes and commitments

- This is what John Farrar calls the ‘self-regulatory penumbra’
- There is now a plethora of codes and ESG commitments
- Institutional investors’ stewardship codes focus on investee companies’ performance in areas such as human rights and environmental sustainability
- Remember the distinction in ASX CGPR between Principles, Recommendations and commentary

Proposed rewording of Principle 3

- A substantial redraft of principle 3, currently worded as “[a] listed entity should act ethically and responsibly”. This is proposed to be re-worded as “[a] listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner”.
- There are (many) flow-on changes proposed
- The Council wants to ‘recognise the fundamental importance of a listed entity’s social licence to operate and the need for it to act lawfully, ethically and in a socially responsible manner in order to preserve that licence. It also proposing to acknowledge that, in doing this, a listed entity must have regard to the views and interests of a broader range of stakeholders than just its security holders.’

Revised principle 3 is proposed to be supported by three new recommendations – recommendation 3.1 (core values), 3.3 (whistleblowing policies) and 3.4 (anti-bribery and corruption policies) … and by important amendments to:

- the commentary to existing recommendation 1.1 (role of board and management):
  - to add to the list of usual responsibilities of the board: defining the entity's purpose; approving the entity's statement of core values and code of conduct to underpin the desired culture within the entity; overseeing management in its implementation of the entity's business model, achievement of the entity's strategic objectives, instilling of the entity's values and performance generally; and ensuring that the entity's remuneration framework is aligned with the entity's purpose, values, strategic objectives and risk appetite; and
  - to clarify that the information provided to the board by the senior executive team should not be limited to information about the financial performance of the entity, but also its compliance with material legal and regulatory requirements and any material misconduct that is inconsistent with the values or code of conduct of the entity; and
- existing recommendation 3.1 (codes of conduct) – to become recommendation 3.2 in the fourth edition – to require the board to be informed of any material breaches of a listed entity's code of conduct by a director or senior manager and of any other material breaches of the code that call into question the culture of the organisation.

These new and amended recommendations are intended to assist a listed entity to set "the tone from the top" and to ensure that the board is provided with the information it needs to monitor the culture of the organisation.

Corporate Social Responsibility

Defined by CAMAC in these terms:

> *Some descriptions focus on corporate compliance with the spirit as well as the letter of applicable laws regulating corporate conduct. Other definitions refer to a business approach by which an enterprise takes into account the impact of its activities on interest groups (often referred to as stakeholders) including, but extending beyond, shareholders, and balances longer term societal impacts against shorter-term financial gains. These societal effects, going beyond the goods or services provided by companies and their returns to shareholders, are typically subdivided into environment, social and economic impacts*

But what is the law?

- In 2006, the now lost and much lamented Corporations and Markets Advisory Committee concluded that ‘directors have considerable discretion concerning the interests they may take into account in corporate decision-making, provided their purpose is to act in the interests of the company as a whole, interpreted as the financial well-being of the shareholders as a general body’.
- To my mind, this remains an accurate statement of the Australian position.
- If the community believes that the law should change, it is open to Parliament to amend it. Or if a company believes it ought to prioritise other interests, there is ample scope for it to do so through its constitution.
- The desire of ASX Corporate Governance Council to avoid law reform should worry everyone

Social licence to operate

- The idea of a ‘social licence’ has leapt over from mining and is becoming part of the zeitgeist. Directors talk about it often.
  - See Hanrahan (2016) Corporate governance, financial institutions and the “social licence”, *Law and Financial Markets Review*, 10:3, 123-126
- It’s really about a community’s ongoing tolerance of a particular business or way of doing business
- Directors should think about what losing that tolerance would mean for the company, and to shape their actions to take account of that – this is already part of their duty to act in the interests of the company

Corporate culture

- Can an entity ‘instil and reinforce’ a culture?
- Is culture something you can regulate? (Remember CGPR is a regulatory document)
- Isn’t doing the right thing more important that instilling a culture of doing the right thing?
- Don’t misunderstand the relevance of inquiries into a company’s culture in law

‘the implicit norms that guide behavior in the absence of regulations or compliance rules — and sometimes despite those explicit restraints’

Culture exists within every firm whether it is recognized or ignored, whether it is nurtured or neglected, and whether it is embraced or disavowed. Culture reflects the prevailing attitudes and behaviors within a firm. It is how people react not only to black and white, but to all of the shades of grey. Like a gentle breeze, culture may be hard to see, but you can feel it. Culture relates to what ‘should’ I do, and not to what ‘can’ I do’.

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