AUSTRALIAN INSTITUTE
*of* COMPANY DIRECTORS

Level 30
20 Bond Street
Sydney NSW 2000
companydirectors.com.au
ABN 11 008 484 197

T: +61 2 8248 6600
F: +61 2 8248 6633
E: contact@companydirectors.com.au

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Judith Fox
National Director, Policy & Publishing
Governance Institute of Australia
GPO Box 1594
Sydney NSW 2001

Dear Judith,

**Shareholder Primacy: Is there a need for change?**

The Australian Institute of Company Directors (Company Directors) has reviewed the Governance Institute of Australia (GIA) paper *Shareholder Primacy: Is there a need for change*? (the Discussion Paper).

Company Directors is one of the two largest member-based director associations worldwide, with over 35,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current issues in the policy debate.

As the Discussion Paper points out, Australia's corporate law currently allows directors to take account of the interests of stakeholders other than shareholders. We therefore do not see the need for another debate on proposed amendments to the law which allow directors to consider interests which they can *already* consider. This issue was comprehensively canvassed in at least two previous inquiries conducted by the Corporations and Markets Advisory Committee (CAMAC) and the Parliamentary Joint Committee on Corporations and Financial Services, both inquiries concluding that no further changes to the law were required. These inquiries found that the existing law regarding the interests directors could consider was sufficiently flexible to keep pace with changing societal expectations.

The report *Corporate Responsibility: Managing Risk and Creating Value* from the Parliamentary Joint Committee on Corporations and Financial Services stated: "The Committee finds that the Corporations Act 2001 permits directors to have regard to the interests of stakeholders other than shareholders and recommends that amendment to the directors' duties provisions within the Corporations Act is not required."[1]

Further, CAMAC's report *The Social Responsibility of Corporations* stated: "The established formulation of directors' duties allows directors sufficient flexibility to take relevant interests and broader community considerations into account. Changes of a kind proposed from time to time do not provide meaningful clarification for directors, yet risk obscuring their accountability."[2]

Despite our reservations about re-opening a debate in an area of the law that is clear, we have decided to comment on this paper so that the fundamental premise of Australia's directors' duties, that is *to whom* the duty is owed, is not at risk of being eroded.

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[1] June 2006 at page 63
[2] December 2006 at page 7

Changes to the Corporations Act based on a misunderstanding of the objectives and flexibility of the current law, or which impede effective director decision-making and accountability, would be a retrograde step for both Australia's corporate law and the economy.

## 1. Summary

In summary our comments are as follows:

a) the duty of directors to act in good faith and in the best interests of the company as set out in the Corporations Act does not require amendment;

b) it is unnecessary to change the law to permit directors to consider stakeholder interests that they can *already* consider;

c) the duty to act in the best interests of the company provides flexibility and allows directors to consider and balance the interests of stakeholders. This in turn, promotes effective decision-making and accountability; and

d) recommending that directors owe a duty to a wider group of stakeholders, is misconceived, unworkable and would be a retrograde step for Australia's corporate law.

Further, the overwhelming majority of Australian corporations operate as good citizens, acting well beyond their legal obligations because "enlightened self-interest" dictates that they do so to be sustainable in the long term: to manage reputation risk, to be profitable, to be able to hire suitably qualified staff, to identify and satisfy customer needs and to be welcome members of the communities affected by their activities. No further encouragement through legislation is required.

The existing legal accountability of directors to shareholders is essential to promote good financial performance, and that accountability should not be diluted. Good financial performance is the best platform for meeting the expectations of stakeholders. At the time when a company is a going concern the tension between the interests of different stakeholders must be resolved and those interests effectively balanced if the corporation is to be reputable and sustainable in the long term. It is at the point of insolvency that stakeholder interests truly diverge, and there are existing mechanisms in the Corporations Act to deal with this.[3]

Imposing a general obligation on companies to consider the interests of "stakeholders" (or specific classes of "stakeholders") especially through a change to directors' duties, will unsettle the fundamental "compass" of directors – the fact that they are stewards of other people's money and owe fiduciary duties to the company as a whole. Such a change may have a range of consequences which are unpalatable and undesirable from a policy perspective.

[3] In *Spies v R* (2000) the High Court found that directors did not owe a positive duty to creditors, however in circumstances where the company was approaching insolvency or insolvent, there was a limit on the extent to which the directors' conduct could be ratified by shareholders. We note, however, the decision of the Western Australian Court of Appeal in *Westpac Banking Corporation v Bell Group Ltd* (in liq)(No. 3)(2012) 89 ACSR 1, where the directors of the Bell Group were found to have breached their common law duty to act in good faith and in the best interests of the company by failing to consider a wider class of creditors. Legal commentators have questioned whether the issue in this case was correctly decided.

## 2. There is no need to change the duty of directors to act in good faith and in the best interests of the company

In Australia, it has been a longstanding principle of corporate law that directors have a duty to act in good faith and in the best interests of the company.[4] Courts have interpreted the interests of the company to mean the interests of shareholders as a whole. We do not see why this longstanding concept should be altered.

The Discussion Paper proposes two alternatives to the law as it currently stands:

- Insert a permissive clause equivalent to s 172 of the UK Companies Code into the Corporations Act; [5] or
- Expand directors' duties so that they are owed to a broader class of relevant stakeholders.

Company Directors does not agree with either of these two positions and supports the retention of the existing duty in its current form. We strongly recommend that the Corporations Act *not* be amended *to require or permit* directors to take into account specific classes of stakeholders or the broader community when taking their decisions.

### 2.1 *Directors can and do, already consider the interests of stakeholders*

The directors duties set out in the Corporations Act already allow directors to take into account the interests of stakeholders other than shareholders. In practice, determining what is in the best interests of the company necessitates that directors consider the interests of stakeholders. The stakeholder interests considered may include those of customers, employees, prospective employees, suppliers, the natural environment and the broader community. Not-for-profit directors may also consider the beneficiaries of their services, donors and volunteers.

The stakeholders interests considered will depend upon the particular company and will vary in number, identity and relevance depending on the company's industry and business operations. In considering what is in the best interests of the company, the directors' focus on a particular stakeholder group may be greater or less depending on the decision to be made, the likely consequences of the decision and the circumstances of the company at the time.

The duty to act in the best interests of the company provides flexibility and allows directors to consider and balance the multitude of competing interests to make decisions that are in the best interests of the company, being shareholders as a whole. It is important to emphasize that what is in the best interests of the company at any given time does not necessarily equate with immediate shareholder profit maximisation.

### 2.2 *Directors duties must be clear and should support effective decision-making*

Duties owed by directors should only be owed to the company itself; not to a broader class or classes of stakeholders. If duties are owed by directors to a range

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[4] Section 181 of the Corporations Act 2001 (C'th)

[5] We note that the Discussion Paper does not draw out the application of section 172 of the UK Companies Code in recent cases. In *Moore Stephens (a firm) v Stone Rolls Ltd* (in liquidation) (2009) UKHL 39, for example, the House of Lords carefully considered the potential clash of interests between stakeholders. The House of Lords made clear that the duty of directors was still owed to the company although creditors' interests should be taken into account by directors when the company was insolvent or approaching insolvency.

of stakeholders, conflicts between the interests of stakeholders will inevitably arise, complicating and encumbering decision-making and making it practically impossible for directors to make decisions.

By ensuring directors owe duties to the company, the law may then provide that the company has obligations to others (for example, pursuant to environmental protection, taxation, competition, consumer or occupational health and safety legislation). The exercise of the directors' duties in the best interests of the company will therefore require directors to take the company's obligations into account.

Allowing directors to serve only one master, the company, ensures that directors are able to make decisions that weigh up the interests of a range of stakeholders but which ultimately are in the company's best interests. Any change to this fundamental principle of corporate law would be a significant and retrograde step.

On numerous occasions we have raised concerns about legislation and regulation which creates risk aversion and stifles corporate decision-making. Our *Director Sentiment Index* for the first half of 2014 found that 70% of directors stated that there was a risk averse decision-making culture on Australian boards. Further, 62% of directors stated that the risk of personal liability caused them to frequently or occasionally take an overly cautious approach to business decision making.

If directors duties were amended so that in certain circumstances they were irreconcilable (owed equally to stakeholders with conflicting interests) decision-making would become impossible and Australia's risk-averse board decision-making would heighten. It is critical that directors are placed in a position where they can actually comply with their duties and responsibilities.

### 2.3 *Directors duties must support accountability*

If the law is changed so that directors owe a duty to "stakeholders" it may perversely mean that directors and corporate management become less accountable because their duty is too generalised and they obtain too wide a discretion in how they expend corporate funds. It would make it harder for the shareholders and regulators to call directors to account for poor performance and governance because having too many masters dilutes accountability.

Corporations have also proven to be an efficient vehicle for the collection and centralised investment of savings. It is bad public policy to shake the confidence of investors by using invested funds other than primarily for the benefit of the company (the shareholders as a whole), especially in an environment where compulsory superannuation contributions direct funds into equity markets.

Any change to whom the duties of directors are owed could disadvantage Australian companies as a destination for international funds and thereby impact employment opportunities by prejudicing the capacity to amass investment funds necessary for enterprise building and job creation in Australia.

## 3. Conclusion

Australian companies must be able to act flexibly to meet changing societal expectations and the legitimate interests of "stakeholders". Existing law accommodates this.

Given that directors already consider the interests of stakeholders, the duty of directors to act in good faith and in the best interests of the company as set out in the Corporations Act does not require amendment.

It is also unnecessary to change the law to *permit* directors to consider stakeholder interests that they can *already* consider. Making such an amendment, even for the purpose of "clarity" is unnecessary and dangerous. It is clear and well understood by the director community that directors have the capacity to take the interests of stakeholders other than shareholders into account.

For more detailed information about our views on the issues raised in the Discussion Paper, we refer you to our previous submissions to the following inquires:

- Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility dated 30 September 2005[6]
- Submission to the Corporations and Markets Advisory Committee Inquiry into Corporate Social Responsibility dated 3 March 2006.[7]

If you would like to discuss any of our views please contact us on (02) 8248 6600.

Yours sincerely,

John H C Colvin
Chief Executive Officer &
Managing Director

Professor Bob Baxt AO
Chairman
Law Committee

[6] Available at www.companydirectors.com.au
[7] Available at www.companydirectors.com.au