

CORPORATE SOCIAL RESPONSIBILITY

SUBMISSION TO THE CORPORATIONS AND MARKETS ADVISORY COMMITTEE

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Introduction

1. The Committee has been requested to report on, amongst other things, the desirability of amendments to the Corporations Act, as to the nature and extent of company directors' duties.
2. Consideration is to be given to possible amendments, by which directors could be permitted (or required) to have regard to "*the interests of specific classes of stakeholders or the broader community*"; in distinction to the traditional company law formulation of "*bona fide for the benefit of the company as a whole*". That traditional formulation, in normal circumstances, is directed to the interests of the company's shareholders as a body; obviously being a narrower and better defined constituency than that of "*stakeholders*".
3. One possible form of amendment to the Corporations Act would involve the adoption of the approach taken by clause 156 of the Company Law Reform Bill 2005 (United Kingdom), in imposing a (limited) duty for directors to have regard to the interests of the company's employees, suppliers, customers, etc.
4. The Advisory Committee's request for submissions on these matters asks that attention be directed to the implementation and operation in practice of any change of this nature, as might be made to the Corporations Act.
5. The perspective from which the writer of this Submission views these questions is from 30 years of legal practice, in particular in litigating many forms of legal proceedings brought under and relating to corporations law issues. It is the writer's firm view that amendments to the Corporations Act, along the lines of the United Kingdom Bill, would not be conducive to the interests of the community as a whole, nor to any particular sector, such as company employees. On the contrary, such a change would, in all likelihood, create obscurity and confusion as to the legal content of company directors' duties, which under the existing law is well understood and satisfactorily defined.

The operation of the existing law in practice

6. The general duties of company directors are now described in Part 2D.1 Division 1, Corporations Act. Those statutory duties, as defined by reference to the phrase "*in good faith in the best interests of the corporation*" reflect the pre-existing general law, which in any event is expressly preserved by s.185.

7. The "*in good faith in the best interests of the corporation*" test was first laid down by the courts in the early development of the limited liability company and has operated satisfactorily ever since the 19th century.
8. The satisfactory working of this fundamental principle of company law is well demonstrated by the apparent absence of any critique or criticism of the application of the existing law to any reported case or specific factual situation. Indeed, it is submitted that, in the whole history of company law, there is yet to occur any reported case which would have been differently decided and with a fairer or better outcome had the traditional legal definition of company directors' duties been other than as it is.
9. The existing law does not prevent or inhibit company directors from proper regard to considerations of corporate social responsibility. The Committee's exposition of the law in section 2.2 of the Discussion Paper demonstrates that this is so. Moreover, even a casual observation of financial and commercial affairs in Australia is enough to show it to be commonplace that corporate decision-making is publicly justified and explained by reference to considerations of corporate social responsibility. It is thus clear that any inhibition to socially responsible action does not rest in the content of the existing law.

Dilution of the "*best interests of the corporation*" test

10. A redefinition of the duties of company directors, along the lines of the United Kingdom Bill, would subvert the law as it operates at present, by removing the simple and objective criterion, against which company directors' performance of their duties can be adjudicated upon.
11. The United Kingdom proposed legislation suffers from obscurity, even as a matter of drafting, in its reference in sub-clause (2) to the undefined concept of "*the purposes of the company ... other than the benefit of its members*".
12. More fundamentally, a statutory countenancing of an entitlement on the part of directors to pursue policies inconsistent with the economic welfare of the corporation would give free rein to directors to pursue, without legal sanction, almost any policy or action they choose.
13. A dilution of the requirement for directors to act in the best interests of the corporation would have particularly adverse ramifications in the practical operation of company law as it concerns companies in an insolvent or near insolvent condition. The position of unsecured creditors, in particular company employees, is disadvantageous enough under the existing law, as shown through practical experience and also illustrated in a variety of high-profile cases.
14. The problem can be demonstrated by a simple illustration from the case law. An early example of the modern phenomenon of the "*phoenix company*" was considered by McLelland CJ in Eq in Re Yorke (Stationers) Pty Ltd¹. The

¹ [1965] NSW 446

plaintiff company was insolvent in consequence of a judgment debt due to its landlord, which debt the company's directors did not feel was morally justifiable. In order to keep the company's business alive, the directors transferred its business to themselves, apparently for fair value, and using the purchase price to discharge the company's obligations to its remaining creditors, being its trade creditors.

15. The directors were held liable in the proceedings brought against them by the company (through its liquidator), upon the basis of their default in exercising their fiduciary powers for the benefit of the company as a whole; in accordance with the general principle stated in Ngurli Limited v McCann², etc.
16. In a case such as Re Yorke (Stationers), it is obvious that the actions of the company's directors may be highly beneficial to the interests of stakeholders, being its suppliers and its customers and its employees. Nevertheless, it is appropriate that the law should proscribe such transactions, upon the basis that they are undertaken other than for the benefit of the company as a whole.
17. A change in the law, along the lines of the United Kingdom Bill, would jeopardise this position and would thus be a retrograde step. Sub-clause 156(4) to the United Kingdom Bill does not protect the interests of creditors, since their protection derives from the directors' duty to act in the interests of the company and not from any duty towards the creditors³

Corporate governance

18. The ideal of corporate social responsibility is not to be disparaged, forming as it does, an important element in the overall corporate governance issue, being a matter of grave concern in Australia and worldwide.
19. Some people might perhaps think that the insertion into the Corporations Act of a sentiment exhorting the virtues of corporate social responsibility will, in itself, motivate action in that direction. However, in practical experience, company directors are not avid readers of the Corporations Act. It would be naïve in the extreme to think that the mere expression of the sentiment in the Act could be conducive to changed behaviour.
20. If the Corporations Act is to be amended with a view to facilitating the goal of corporate social responsibility, more is necessary than words of exhortation. The creation of legally enforceable rights and obligations would be necessary.
21. If the interests of stakeholders, other than shareholders, are to obtain legal recognition in the Act, then it would be necessary for the Act to lay down procedures whereby such stakeholders can enforce their rights against the company.
22. Thus, if the closure of a company's motor vehicle manufacturing plant, in prejudicing the company's employees, is potentially to be a breach of legal duty

² (1953) 90 CLR 425

³ Spies v R (2000) 201 CLR 603, referred to in footnote no. 109 of the Discussion Paper.

on the part of the company's directors, it would logically be necessary for the Act to make available a cause of action in favour of the employees.

23. Similar cases could be multiplied. Thus, in the case of a bank which closes its country branches, the customers would need to be given a cause of action under the Act. More generalised corporate social responsibility issues, such as environmental issues, would not have any obvious stakeholder representative, so that there would presumably need to be standing given to public interest groups to litigate the making of corporate decisions relevant to such issues.
24. At least in the case of Australian listed public companies and as a practical device, stakeholders could simply acquire a small shareholding in the company and, in the guise of shareholders, litigate corporate decisions not to their liking. It would not be desirable that the Corporations Act facilitate such stratagems. If stakeholders are to be given enforceable rights, those rights should be given to them directly and procedures for their enforcement expressly stated.
25. It is neither practical nor desirable that this should occur. The courts are not well placed to adjudicate upon business decisions, either as to their commercial merits or as to their corporate social responsibility impact.
26. The observations of Kirby P, as he then was, set out in footnote no. 115 of the Committee's Discussion Paper are in point: likewise, see Re Ansett Australia Ltd and Korda⁴.
27. Similarly, 200 years ago, the famous Lord Chancellor, Lord Eldon, explained that it was not the role of the Court in the resolution of partnership disputes to do more than require the bringing of the partnership business to an end, since otherwise there would be "*an expectation that this Court is to carry on every brewery and every speculation in the kingdom*"⁵

International considerations

28. A dilution or obscuring of the Corporations Act requirement that directors exercise their powers in the best interests of the corporation would be inconsistent with the general trend internationally in corporate governance.
29. The 2004 OECD Principles of Corporate Governance prescribe as the primary principle for the responsibility of boards of directors that:

"Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders."
30. The Statement on Global Corporate Governance Principles of the International Corporate Governance Network, expounding the OECD Principles, as revised on 8 July 2005, commences:

⁴ (2002) 40 ACSR 433

⁵ Waters v Taylor (1807) 15 VesJ 10; 33 ER 658 at 664

"1. **CORPORATE OBJECTIVE – SHAREHOLDER RETURNS**

1.1 ***Optimising Return To Shareholders.*** *The overriding objective of the corporation should be to optimise over time the return to its shareholders. Corporate governance practices should focus board attention on this objective. In particular, the company should strive to excel in comparison with the specific equity sector peer group benchmark. Where other considerations affect this objective, they should be clearly stated and disclosed.*

1.2 ***Long Term Prosperity Of The Business.*** *To achieve this objective, the board should develop and implement a strategy for the corporation which improves the equity value over the long term."*

31. The current provisions of the Corporations Act are consistent with the application of those objectives to Australian corporations. No change to the Corporations Act in this respect is necessary or desirable.

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