Corporate social responsibility and the best interest of the company

Submitted by: Tabitha Ponnambalam

During the CLERP 9 Parliamentary debates, the government, the opposition, and the Democrats agreed to changes that made directors of corporate boards more accountable. Not surprisingly, the opposition and the Democrats were of the opinion the government was not going far enough in regulating the actions and the accountability of directors.

The current discussion considers the appropriateness and wisdom of requiring the directors of a corporation to consider its social responsibilities over and above the traditional and rather narrower concept of the best interest of the corporation.

Directors of a company have long been required to act in the best interest of the company: *Percival v Wright [1902] 2Ch 421; Southern Cross Mine Management v Ensham Resources (2004) 22 ACLC 724.* One well-recognised exception is where a company is insolvent; then, directors are also required to consider the interests of the corporation's creditors: *Re Martco Engineering Pty Ltd (1999) 32 ACSR 487; Re Spedley Holdings (in liq); Re Aldershot (in liq) (1992) 10 ACLC 1,742.*

In this day and age is it appropriate for directors to act only in the best interest of the company? Is it necessary to draw a distinction between the duties of directors of small and medium sized companies and those of directors of large companies? Should the directors of large companies be required not only to act in the best interest of the company and its shareholders, but also to consider and act in the interests of its employees and the public interest in general?

When HIH collapsed the government used its funds, or more precisely public funds, to bailout the policyholders of a private company. Similarly, with the collapse of Ansett Airlines the government stepped in with public funds to assist employees with some of their lost employee entitlements. Even the bastion of free enterprise, the United States, has in the past used taxpayer funds to rescue corporate enterprises by bailing out

Chrysler and United Airlines. The fact that governments have deemed it appropriate to bailout private corporations is surely recognition by government of the public interests involved in rescuing or supporting large private enterprises, or at least in ameliorating the harmful effects of their failure. At present times, the idea that it is appropriate for directors of large companies to act only in the best interest of the company appears increasingly outmoded.

The modern corporation is a very different entity from that which was first envisaged under the first Companies Act of the 1860s. The collapse of a mega- modern corporation can have huge economic and social implications; the thousands of employees, shareholders and policyholders hurt by the collapse of HIH and Ansett are but recent examples. The collapse of some of these mega corporations can help bring down governments as happened in Western Australia and Victoria in the early 1990s. Is it not time to give recognition to employee interests when the boards of these corporations make their decisions? It is not suggested that the employee interests be the primary interest, but certainly as important participants whose interests are at stake they ought to be considered.

The largest companies in Australia invariably have employee share plans. Thus making employees also shareholders. In view of this, requiring directors to also consider the interests of employees when considering the best interest of the company is a proposal or step worth considering. In the early 1990s, when Westpac ran into difficulties and its commercial viability and solvency was threatened, Westpac relied on its employee pension funds to help work itself out of its difficulties.

The issue is whether it is appropriate or realistic for the directors of these large corporations to not take into consideration the interests of employees, who are also invariably shareholders, when purporting to act in the best interest of the company?

Civil and criminal penalties for corporate breaches

Since the early 1990s more and more civil penalties and criminal sanctions have been imposed for a breach of the Corporations laws. Criminal sanctions were historically reserved as sanctions for a breach of the public interest or of public laws. Civil remedies existed for a breach of civil wrongs between parties. The relatively recent imposition of civil penalties and criminal sanctions for a breach of the Corporations laws is surely recognition of the public interest in regulating the actions of those running these corporations, or of a public duty on the part of those running the affairs of the modern corporation.

In view of this modern trend to recognise the public interest or public duty on the part of those running the large modern corporation, is it not time for us to be realistic about the public duty and/ or public interest as stake and require the board to also consider these interests in making their decisions for and on behalf of the modern corporation?

Formal recognition of employee interests and the public interest may help reduce the problems faced by public corporations with dominant personalities at the helm. These dominant personalities tend to run these corporations as their personal fiefdoms, despite the fact that they are utilising public shareholder funds. HIH insurance was a public company, which could not distinguish the corporation's interests from that of its founder Ray Williams. Bernie Ebbers, the founder and former CEO of Worldcom, too could not dissociate his interests from that of the company, as was the case with Ken Lay and Enron.

German corporate governance code

The German corporate governance code provides an alternative model for corporate governance. We have in the past been willing to learn from the Civil law countries. Our system of Torrens title registration was based on the Austrian system of land registration. We should be willing to be open to new ideas and ways of dealing with changing circumstances.

The corporate governance principles for a German corporation are set forth in the German Stock Corporation Act (Aktiengesetz), the German Co-Determination Act (Mibestimmungsgesetz) and the German Corporate Governance Code (Deutscher Corporate Governance Kodex, as amended in May 2003).

A German corporation is required to have a dual board system: a supervisory board and a management board. The two boards are separate and no one can serve on both boards simultaneously. The supervisory board appoints, advises, supervises and dismisses the members of the management board. Fundamental decisions of policy are the responsibility of the supervisory board. The management board is responsible for the day-to-day management of the company. The directors of both boards owe a duty of care and loyalty to the company, and are supposed to act in the interest of the company. The chairman of each board is responsible for coordinating the work of their respective boards.

Shareholders at the general meeting elect the members of the supervisory board. Employee representatives are entitled to one third of the supervisory board positions on corporations with more than 500 employees in Germany, and to half the supervisory board positions on corporations with more than 2000 employees in Germany. The chairman of the supervisory board with more than 2000 employees is usually a representative of the shareholders and has a casting, or deciding, vote on important resolutions. However, both the employee representatives and the shareholder representatives on the board are expected to act in the corporation's interests.

The dual board structure is common in Europe, although having employee representatives on the supervisory board does not appear to be that common. Yet, this dual board system with employees serving on the supervisory board seems to have worked for the German corporations. The large German corporations such as Volkswagen AG, BASF AG, Bayer AG, Allianz AG, seem to have been able to operate effectively with at least 50% of their supervisory board positions reserved for employees. For instance, the BASF supervisory board has 10 shareholder

representatives and 10 employee representatives, as does the supervisory board of Allianz AG and Bayer AG.

An article in the *Economist* credits the rapid economic development of Germany after the destruction of World War II to having employees on the boards of these large corporations. At the same time, it holds the employee representatives on these boards as being responsible for the delay in making some fundamental and necessary changes to German Labour laws in modern times: *Economist -"How to pep up Germany's economy"*, 6 May 2004. In view of this criticism, it is recommended that consideration be given to reserving only 25% of board positions for employees of the large or mega-modern corporation.

The way forward

The German dual board structure can be seen as having some similarities to our corporate law system in that, usually, we have an executive management team that is responsible for the day to day running of the company. However, our corporate law system does not give the executive management team the formal recognition that the German management board appears to have under German law. It is not suggested that we implement a dual board structure, only that we consider having employee representation on the boards of large corporations employing over 500 employees. This concept is not entirely new in Australia, some of our statutory corporations such as the *Australian Broadcasting Corporation Act 1983* authorises the election of a staff elected director to the board of the ABC.

It is submitted that having employee representation on the board is a realistic recognition of the employees' interest in the continued success and viability of the large modern corporation. At present times, when most large corporations have employee share plans, which are also recognition of an employees' interest in the corporation, is it not time to more formally recognise the employees' interest in the corporation?

In conclusion, it is suggested that:

- the Corporations Act be amended to draw a distinction between the duties and responsibilities of directors of small or medium sized companies and those of large companies because of the greater public interests at stake with respect to the large or mega-modern corporation;
- we formally recognise that while those running our large public corporations must act in the best interests of the corporation, that this requires the board of directors to consider not only the interests of the shareholders, but also the interests of the employees, and also the greater public interest in general such as economic and environmental matters;
- the corporation's social responsibility must be directly commensurate and correspond to the corporation's power, wealth and influence; and finally,
- with respect to the large modern corporation that we consider reserving a quarter of the board positions for employee representatives, a quarter for management representatives and half for shareholder representatives.

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