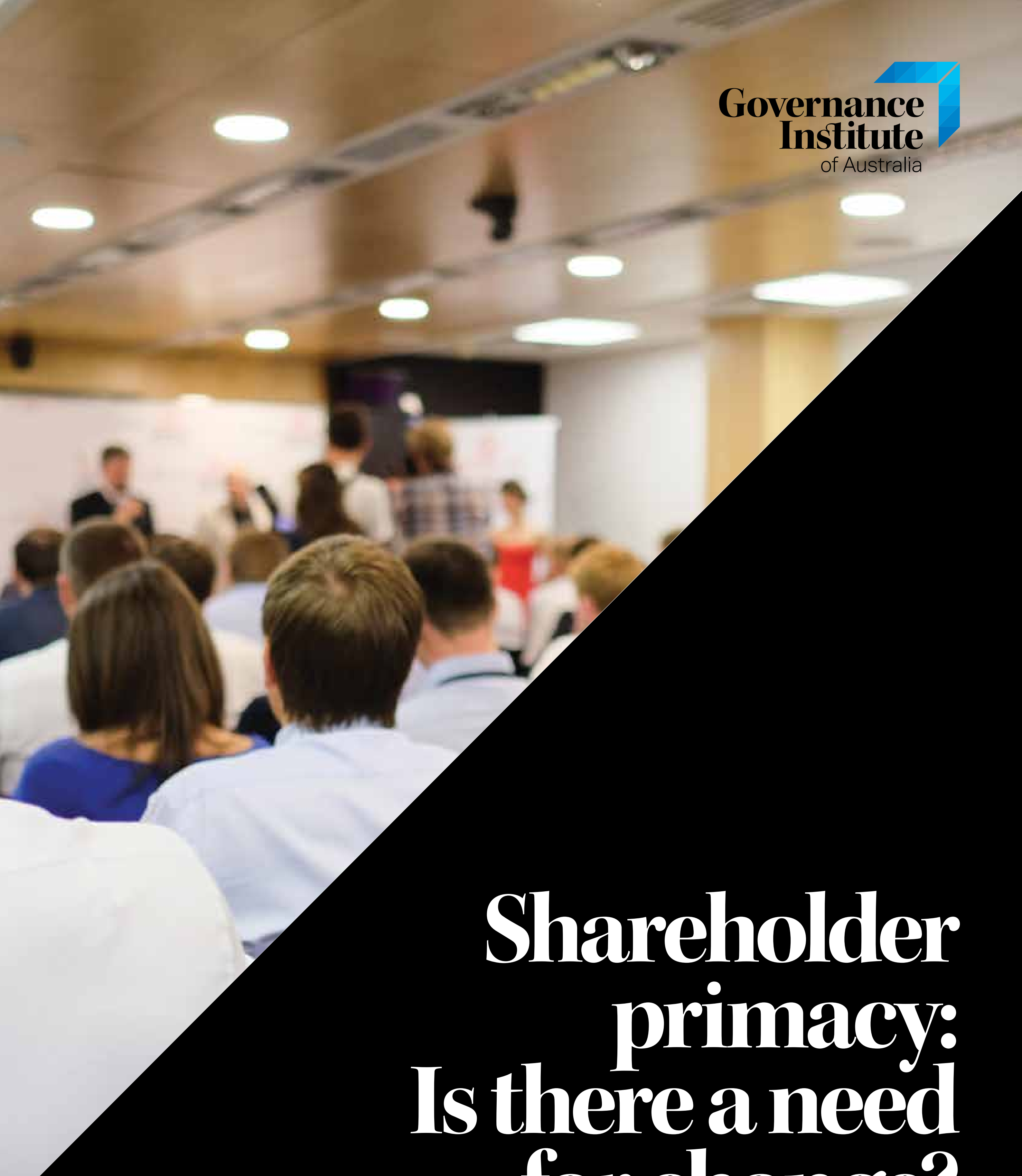

Governance Institute of Australia

Shareholder primacy: Is there a need for change?

A discussion paper

Shareholder primacy: Is there a need for change?

Written by Judith Fox FGIA

Governance Institute of Australia

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

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Background

Governance Institute convened the Governance Advisory Panel (the Panel) in 2012.

The purpose of the Panel is to assist Governance Institute to influence the continuing development and direction of corporate governance policy and practice. Governance Institute's mission is to promote and advance the effective governance of organisations in the private and public sectors and we believe that the Panel will play a vital role in supporting that mission.

Too often corporate governance changes in Australia have arisen as a reaction to corporate collapse or malfeasance on the part of those charged with fiduciary duties. However, Governance Institute believes that a better approach to sound corporate governance policy, direction and practice is to formulate ideas for improvements to corporate governance frameworks — a proactive rather than a reactive approach.

The Panel's objectives are to generate ideas and concepts that can be discussed and debated by all stakeholders. The Panel's aims are to foster frank and robust discussion about the future of governance and what could be done to drive improvements in policy and practices here and in other jurisdictions.

Governance Advisory Panel members

Professor Michael Adams FGIA
Dean, School of Law, University of Western Sydney

Mr Tony D'Aloisio AM

Mr Ray Finkelstein QC
Queen's Counsel

Ms Robyn Kruk AM

Ms Jane McAloon FGIA
Group Company Secretary, BHP Billiton Limited

Mr Tim Sheehy FGIA
Chief Executive, Governance Institute of Australia

Mr Ian Silk
Chief Executive, AustralianSuper

Mr Lindsay Tanner (Chair)

Ms Alison Watkins
CEO, Coca-Cola Amatil Limited

Project on shareholder primacy

In 2013 the Panel recommended that Governance Institute should explore with stakeholders the issue of shareholder primacy, to assess how the shareholder primacy rule should be positioned in the 21st century and if greater certainty needs to be introduced to the operation of the law in this regard.

Process

Two Roundtables on the topic were held in November 2013, one in Melbourne and one in Sydney. Participants were provided with a framework for discussion, with the idea of stimulating debate. The framework did not assume any position, but set out different positions for discussion.

The Roundtables were designed as the first step in a process to assess:

- How should the shareholder primacy rule be positioned in the 21st century?
- Should the explicit objectives of a company be solely about shareholders?
- Does the current law constrain a broader view of the best interests of the company?
- Do we need a wider view in law?
- Is greater certainty required as to the operation of the law in regard to shareholder primacy?

Governance Institute assessed how best to progress the views put forth at the Roundtable in conjunction with its Governance Advisory Panel and it was agreed that a discussion paper would be issued for public comment.

Discussion paper

The discussion paper explores the means by which societal expectations in relation to moderating the influence of corporate activity on the community and environment can best be met. It examines the misalignment that is often experienced between societal expectation and the impact of corporate activity and poses the following questions:

1. Is there a view that there is no need for a change to the corporations law, as it currently allows directors to take account of the interests of stakeholders other than shareholders?

2. Is there a need for a change to the corporations law, and should the equivalent of s 172 in the UK (permissive clause) be introduced to expand directors' duties so that they should have regard to the interests of stakeholders other than shareholders in promoting the best interests of the company?
3. Is there a need for a change to the corporations law, and should an explicit clause be introduced to expand directors' duties so that they must take account of the interests of stakeholders other than shareholders?
4. Is there a role for the government to play in protecting the interests of stakeholders — not through amendment to the corporations law, but through other forms of social policy?

These are options for consideration. There may be other options not canvassed in the discussion paper. The Panel and Governance Institute are not embarking on this project with any fixed views in mind nor any desired outcome other than to provide greater clarity for all stakeholders as to the role of shareholder primacy in corporate law and governance.

Acknowledgements

Governance Institute thanks the following participants in the roundtables whose input and contribution to the discussion paper have been invaluable.

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- Michael Crosby, National President, United Voice
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- Ray Finkelstein QC
- Belinda Gibson, Commissioner and Deputy Chairman, ASIC 2007–2013
- Douglas Gration, Barrister-at-law
- Charles Macek, non-executive director, Wesfarmers Ltd and Federation Ltd
- Eric Mayne, Chairman, ASX Corporate Governance Council and Head of Supervision, ASX 2006–2010
- Steven Munchenberg, Chief Executive Officer, Australian Bankers' Association
- Miranda Nagy, Special Counsel, Maurice Blackburn Lawyers Sydney; non-executive director, The Sunrise Project
- Professor Ian Ramsay, Centre for Corporate Law and Regulation, University of Melbourne
- Elana Rubin, non-executive director, Mirvac Group Ltd
- Rosemary Sainty, School of Management, University of Technology, Sydney; formerly head secretariat for the United Nations Global Compact Network Australia
- Catherine Walter AM, non-executive director, Australian Foundation Investment Company Ltd.

Request for submissions

Governance Institute of Australia welcomes submissions on all of the matters raised in the discussion paper and also on any further issues related to those matters that are not canvassed in the material.

Please send submissions either by email to
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or in hardcopy to:
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GPO Box 1594
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If sending a hardcopy, please also email your submission as a Microsoft Word file.

Any queries may be directed to Judith Fox at
judith.fox@governanceinstitute.com.au or on (02) 9223 5744.

Closing date for submissions

Please forward submissions by Friday, 5 December 2014.

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Introduction

As it stands, the law generally links the corporate interests to those of the shareholders, and only derivatively with those of the community, consumers, employees and other stakeholders. Nonetheless, a flourishing debate on corporate responsibility has promoted the idea that corporate management should take into account interests beyond the corporation's formal legal constituents, to that group known as stakeholders — employees, suppliers, distributors, consumers, creditors, government and the community.

Society and investors have a commonality of interests — it is in no one's interests for our corporations to fail. Our economic development benefits from entrepreneurial companies that can be financed, and where investors are rewarded for the risks they take in providing that capital. This allows companies to expand, and generate jobs and wealth for investors and society as a whole. This commonality of interests is extended by the fact that all working Australians are also shareholders through compulsory superannuation.

Yet many have questioned whether the law and community expectations sufficiently coincide, given that the law generally only derivatively links the corporate interests to those of stakeholders other than shareholders. And many have argued that only a change to directors' duties will ensure an alignment between the law and community expectations. The argument is that a change to directors' duties is essential to ensure that companies maintain their social licence to operate.

These questions were examined in two inquiries almost ten years ago: one inquiry was conducted by the Corporations and Markets Advisory Committee (CAMAC); the second was undertaken by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) and both reported in 2006. Yet the debate as to whether the corporations law should change to have directors take account of stakeholders other than shareholders has not abated. The patterns that were emerging at the time of both reports in relation to the impact of corporate activity on the community and the environment have since become mainstream preoccupations.

Heightening the focus on this issue is a number of other intersecting issues. Governments have been exiting from analysis of the social impacts of support for particular industries and concentrating on the economic impacts; sustainability issues and concerns about who bears the costs of the externalities of corporate activity are more acute than they were in the first ten years of the century; cross-border issues are more acute, which has put pressure on activities such as outsourcing; and corporations are now subject to increasingly intensified scrutiny both from investors and the public at large, with social media providing platforms for debate on corporate activity in a manner that was not feasible even a decade ago.

The term 'social licence to operate' now has prominence in a manner that it did not at the time of the CAMAC and PJC reports. The corporate social licence to operate has been described as stakeholder perception of the legitimacy of a company. As one commentator recently explained, 'The term "social licence" draws attention to the difference between a legal permit and the social acceptance or legitimacy that is essential for companies to be able to survive, prosper and ultimately be part of communities that advocate for and support [their] interests.'[1]

The concept of the social licence to operate includes but is not limited to:

- environmental performance — local communities and regulators are often concerned about issues such as air and water pollution, water extraction, impacts on biodiversity and waste management
- ethical business conduct and transparency — trust in companies is easily eroded if there is a perception of dishonest dealings or inappropriate collusion
- workers' rights and safety — failure to ensure that safety incidents do not occur can have a negative impact on corporate reputation
- community relationships — community issues can delay or even prevent projects from proceeding. Issues include disputes over land access and ownership and equitable sharing of benefits from corporate activity.

1 Black, L, 'Your social licence to operate: risk protection through sustainable community development', *Governance Directions*, Vol 66 No 1, February 2014

Despite the prevalence of the use of the term social licence to operate, the law does not contain an explicit statement of either the societal purpose of companies or what the interests of the corporation are. The debate about whether shareholder primacy should be retained or stakeholder interests become equally privileged is in effect a debate on those two matters.

Importantly, these are not academic issues. Each day, corporations in Australia and their directors have to deal with community expectations that they are accountable for the common good:

- Rural communities want the protection of aquifers and the preservation of agricultural land to take precedence over corporate interest in seeking to access coal seam gas or mining such land.
- Small rural communities want industries that provide a significant proportion of local employment to remain in place even if they are considered economically unprofitable for the company.
- Communities want to see banks provide loans to small businesses, as a public good, regardless of whether it would affect shareholder return negatively in particular economic conditions.

What is the societal expectation of a corporation? The corporation plays a vital role in a free market economy — does this itself suggest that its role needs to be broader? For whose benefit and at whose expense should the corporation be managed? Should stakeholders participate in determining the future direction of the corporation in which they have a stake, even if they do not provide capital? What would be the consequences of any change to capital allocation if this were the case? Are social constraints a matter for the corporation or the role of government?

The evidence available suggests that the decision makers in many companies in Australia are already having regard to the interests of stakeholders and regard these interests as integral to their business. At law, directors must already balance the interests of shareholders with their responsibilities under specific statutes regarding workplace health and safety, environmental impact and trade practices.

With companies arguing that they already take a broader view of what is in the best interests of the corporation, and that they do not operate exclusively in the interests of shareholders, does the current law constrain this broader view of the best interests of the corporation? Do we need a wider view in law? Or are the issues broader than any that a corporate law provision can address and ones for social policy intervention? Is determining the societal expectation of a corporation a role for government rather than a matter for directors to determine?

Gaining clarity as to how to respond to these questions ultimately goes to decisions concerning our corporate regulatory framework. Governance Institute is of the view, therefore, that it is important to test the arguments. Only through such a process can we illuminate whether stakeholder interests should be addressed through an expansion of directors' duties or through social policy intervention.

This discussion paper therefore explores the means by which societal expectations in relation to moderating the influence of corporate activity on the community and environment can best be met. It does this by:

- canvassing the law as it currently stands
- examining the link between corporate governance and the debate on whether shareholders' interests should take precedence over stakeholder interests or whether they can coincide
- providing real-life examples of where misalignment exists between societal expectations and the impact of corporate activity on stakeholder interests
- exploring different approaches to ensuring that companies maintain their social licence to operate
- asking what the societal expectation is of a corporation.

A fundamental question arises that needs to be considered and decided: Should decisions concerning further social constraints of the corporation be the role of directors or the role of government?

Executive summary

- The shareholder primacy view holds that the overriding goal of the corporation is to maximise shareholder value. Economists and market participants have also favoured shareholder primacy, viewing it as the key to the capital system, and this view is deeply entrenched in markets worldwide.
- The *Corporations Act 2001* does not state that directors and other officers must exercise their powers and discharge their duties in the best interests of shareholders, although case law has tended to grant primacy to shareholders' interests. The legislation states that directors have a duty to act in the best interests of the company, which generally coincide with the best interests of shareholders.
- A mapping of corporate law in multiple jurisdictions found that no system of corporations legislation requires directors to act in the best interests of shareholders only.
- The primary philosophy driving the modern corporate governance movement and much of the reforms undertaken to the Corporations Act in recent years has been investor protection. The ideas of directors as agents of shareholders and shareholders as owners of the company are central to prevailing conceptions of corporate governance. The argument against a shareholder primacy approach is that it is a corporate governance model that puts the private interest ahead of the public interest. This is therefore a key governance issue.
- In the past decade in Australia, two major inquiries have been conducted into the legal capacity of directors to take into account the interests of stakeholders (other than shareholders), including employees, creditors, suppliers, distributors, consumers, government, the environment and the community at large. Both inquiries concluded that no compelling case for change to directors' duties in the corporations law was presented.
- Despite these findings, the debate as to whether the corporations law should change to have directors take account of stakeholders other than shareholders has not abated. The corporate social licence to operate is seen to be under pressure due to a misalignment of societal expectations about the role of companies and the way in which they should conduct their affairs, and the social and environmental impacts of corporate activity designed to generate wealth.
- Importantly, these are not academic issues. Each day, corporations in Australia and their directors have to deal with community expectations that they are accountable for the common good. Examples of issues which make this a matter that requires resolution include:
  - fracking and coal mines — companies will seek to access and exploit coal seam gas or propose new coal mines to maximise value for shareholders. However, rural communities wish to protect groundwater resources like the Great Artesian Basin and productive agricultural land against coal seam gas and coal mine development, due to concerns about the contamination of water resources and the sacrifice of viable farmlands.
  - tax — companies will seek to minimise tax payments to maximise value for shareholders. However, communities are of the view that corporations should pay for the many years of employee productivity, and use of public infrastructure and public research that assisted in building their industries, and that companies should therefore pay full taxation.
  - employment in and future of rural towns — it is not unusual for industry changes to see a company closing down a business in a rural town when it is no longer profitable, even if that business is central to the town's identity and provides a high level of employment. However, the local townspeople are frequently of the view that the company had a geographically-based business need from which it profited, and therefore the company has a responsibility for the negative impacts of its departure, which can include contracting communities, and loss of property value and then population as people move to find work elsewhere.
  - poker machines — profit from poker machines is in the hundreds of millions each year for those companies involved in the industry. The community is critical of the fact that much of the profit derives directly from problem gamblers, and from a concentration of its machines in low-income areas, which sees people who are most disadvantaged being targeted for corporate profit.

- **obesity** — all big food companies are working hard to sell more products to more of the world. Many unhealthy products are very profitable. However, as populations become more aware of the risk of diabetes and obesity, the community is suggesting that the companies producing foods and drinks with high levels of sugar should be held accountable for their role in making such product available and investing heavily in product marketing, particularly to children.
- **retention of particular skills in the country** — certain industries seek to contain costs by outsourcing particular jobs to other countries, where wages are lower than in Australia. However, many in the community are of the view that such skills should be retained in Australia and that certain industries should put the employment needs of the country before profits.
- **purchasing power of corporations** — this can drive down prices (for example, $1 loaf of bread) but has an impact on other industries (bakers). Communities are increasingly critical of vertical integration, not only because of the price squeezing of suppliers, but also because of negative impacts on local communities where independent businesses are forced to close and are asking if it is economically healthy for a few companies to own the entire supply chain.
- **providing credit to small business** — banks may curtail the provision of credit to small business if such loans are seen to be unsustainable, and tighten their lending policies in light of changing economic conditions, which is good for shareholder returns. Banks will note that there is a balancing act between access and responsible lending. However, small businesses, which provide the majority of employment in Australia, generally say that it is precisely during changing economic conditions, particularly challenging ones, when lending to small business needs to at least be stable, if not expanding. They note that, after the global financial crisis, banks were slow to provide credit to small businesses and that this had an effect on the economy generally.
- **impact of plastic beverage containers on the environment** — companies that produce drinks in bottles and cans seek to contain production costs for the benefit of shareholders, and oppose container deposit schemes (CDS), which introduce a 10-cent refund on drink containers, with costs passed on to the beverage industry. However, communities argue that CDS will lift recycling, cut litter, and provide fundraising opportunities for local community groups and charities.

• Despite the prevalence of the use of the term social licence to operate, the law does not contain an explicit statement of either the societal purpose of companies or what the interests of the corporation are. The debate about whether shareholder primacy should be retained or stakeholder interests become equally privileged is in effect a debate on those two matters.

• Options for ensuring stakeholder interests are taken into account are:
  - An amendment could be introduced to the corporations law (s 181), which would *permit* directors to have regard to the interests of stakeholders other than shareholders.
  - Alternatively, an amendment could be introduced to the corporations law, which would *compel* directors to have regard to the interests of stakeholders other than shareholders.
  - Other forms of legislative intervention outside of the corporations law could be sought from the government, which would protect the interests of stakeholders other than shareholders.
  - Other forms of social policy intervention from the government could be implemented.

• Governments can build confidence and public trust and reduce uncertainty by creating policies and regulatory settings or putting in place other mechanisms that meet societal expectations concerning the costs attached to commercial activity when those costs are balanced against the financial benefits that flow from corporate endeavour. Deciding which approach to take is central to how we conceive and implement the settings for the regulation of corporations.

Part 1: Shareholder primacy at law

What is shareholder primacy?

The shareholder primacy view holds that the overriding goal of the corporation is to maximise shareholder value.

The acceptance that a corporation's sole reason for existence is to make money for its shareholders can be traced to an influential debate between two eminent academics in a series of articles published in the *Harvard Law Review* in 1932. On the side of shareholder primacy stood Professor Adolph A Berle, who argued that: 'all powers granted to a corporation or to the management of a corporation, or to any group within the corporation … [are] at all times exercisable only for the ratable benefit of all the shareholders as their interest appears'.[2] This view was expounded again strongly in the 1970s by Professor Milton Friedman, who argued that, 'There is one and only one social responsibility of business: to use its resources and engage in activities designed to increase its profits'.[3]

In 1932, Professor Merrick Dodd disagreed vehemently with Berle's shareholder primacy thesis. He argued for 'a view of the business corporation as an economic institution which has a social service as well as a profit-making function.'[4] This has become known as the stakeholder approach to the corporation.

In general, the influence of shareholders has tended to an uncritical push for profit-maximisation, which has been supported by company law giving primacy to shareholders' interests. Economists and market participants have also favoured shareholder primacy, viewing it as the key to the capital system, and this view is deeply entrenched in markets worldwide. Companies are seen to have three sources of capital: earnings, debt and equity. It is considered that it would be difficult for companies to rely increasingly on earnings or debt rather than equity, which in turn privileges equity holders. Equity holders are viewed as needing protection, or they will no longer invest and the economy will at best stagnate and at worst contract or flounder.[5] In terms of the board seeking to attract capital, it is acknowledged that the shareholder primacy rule has been successful.

Shareholder primacy is not enshrined in law

In Australia, the *Corporations Act 2001* (Cth) states, in s 181(1), that:

> A director or other office of a corporation 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.

It is important to clarify that the legislation does not state that directors and other officers must exercise their powers and discharge their duties in the best interests of shareholders, although case law has tended to grant primacy to shareholders' interests. The legislation foregrounds the best interests of the corporation, which generally coincide with the best interests of shareholders.

Equally of note is that the duties of directors are owed to the company — they are not considered public in nature.[6]

It has been pointed out that shareholder primacy is a social norm rather than law. As noted in a project being undertaken by a multi-jurisdictional team of legal academics, 'This norm springs out of the historically contingent focus of company law on the position of

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2 Berle, A, 'Corporate Powers as Powers in Trust', 44 *Harvard. Law Review*, 1049, 1931

3 Friedman, M, ' The Social Responsibility of Business Is to Increase Its Profits', *New York Times*, 13 September, 1970

4 Dodd, EM, 'For Whom Are Corporate Managers Trustees?',45 *Harvard Law Review*, 1145, 1148, 1932

5 Elson, C, 'Five Reasons to Support Shareholder Primacy', April 15, 2010 http://www.directorship.com/charles-elson-shareholder-primacy/

6 *Ailakis v Olivero* (No 2) [2014] WASCA 127. An extract from the case states that 'It is clear that the duties of a director have a number of sources, including common law, equity and statute. However, the fact that the scope of a director's duties, and the standards which must be met in the discharge of those duties, are embodied in a statute and can be enforced by the exercise of the remedies conferred by a statute does not of itself mean that the duties have a public character, analogous, for example, to the duty to attend court in answer to a subpoena … or the duty to care for a dependent child … The duties of a director are owed to the company and are enforceable by the company.'

shareholders (albeit one that varies across jurisdictions). Shareholder primacy has been allowed to develop because the law contains neither an explicit statement of what the societal purpose of companies is, nor of what the interests of the corporation are'.[7]

Development of shareholder primacy

In 1919, the Michigan Supreme Court's decision in the case of *Dodge v Ford Motor Corp* is said to have manifested the legal mandate of the shareholder primacy theory. The court stated: 'A business corporation is organised and carried on primarily for the profit of the stockholders.'[8] Importantly, in this case, the decision held that the primary duty was to shareholders rather than the community as a whole or employees.

Despite the stark nature of the pronouncement in this judgment, legal commentators note that 'Dodge does not stand for the proposition that courts will closely supervise the conduct of corporate directors to ensure that every decision maximises shareholder wealth…. courts generally will not substitute their judgment for that of the board of directors…. If a proposed course of action plausibly relates to long-term shareholder wealth maximisation, courts will not intervene'.[9]

In one of its reviews of corporate law, CAMAC examined the case law to ascertain if the interests of the corporation were construed to be those of shareholders. It noted that 'the phrase "the interests of the corporation as a whole" under the common law of directors' duties means the financial wellbeing of the shareholders as a general body. The overriding test is the wellbeing of the corporation and therefore the shareholders generally'.[10]

However, not all case law grants primacy to shareholders' interests. Justice Owen has observed:[11]

> This does not mean that the general body of shareholders is always and for all purposes the embodiment of 'the corporation as a whole'. It will depend on the context, including the type of corporation and the nature of the impugned activity or decision. And it may also depend on whether the corporation is a thriving ongoing entity or whether its continued existence is problematic. In my view, the interests of shareholders and the corporation may be seen as correlative not because the shareholders are the corporation but, rather, because the interests of the corporation and the interests of the shareholders intersect … It is, in my view, incorrect to read the phrase 'acting in the best interests of the corporation' and 'acting in the best interests of the shareholders' as if they meant exactly the same thing … it is almost axiomatic to say that the content of the duty may (and usually will) include a consideration of the interests of shareholders. But it does not follow that in determining the content of the duty to act in the interests of the corporation, the concerns of shareholders are the only ones to which attention need be directed or that the legitimate interests of other groups can safely be ignored.

Insolvency was a feature of this case, which saw Justice Owen pay particular attention to the needs of creditors, but his findings have import beyond the context of insolvency.

A recent Australian academic paper summarised the current position in corporate law in this jurisdiction as:[12]

> First, as a general proposition, acting in the best interests of the company generally means acting in the interests of shareholders as a general body. The directors are able, but not required, to consider the interests of non-shareholder stakeholders, and where they do, such consideration needs to be done with a view to the benefit of the shareholders.

7 Sjåfjell, B, Johnston, A, and Sørensen, L-A, News release, 'Shareholder Primacy: The Main Barrier to Sustainable Companies', 2014, p 2, http://www.jus.uio.no/ifp/english/research/projects/sustainable-companies/news/sustainablecompanies2pagesummarycompanylaw.pdf. The Sustainable Companies Project commenced in 2010 and has involved a team of more than 40 legal scholars mapping the law in 26 jurisdictions across the globe. Presentation of reform proposals and completion of publications is expected in 2014.

8 *Dodge v Ford Motor Company*, 170 N.W. 668 (Mich. 1919)

9 Professor Bainbridge's *Journal of Law, Politics and Culture* at www.professorbainbridge.com, Case law on the fiduciary duty of directors to maximise the wealth of corporate shareholders can be found at http://www.professorbainbridge.com/professorbainbridgecom/2012/05/case-law-on-the-fiduciary-duty-of-directors-to-maximize-the-wealth-of-corporate-shareholders.html

10 Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations, Report*, December 2006, p 84

11 *The Bell Group Ltd (in liq) v Westpac Banking Corporation* [No 9] (2008) 39 WAR 1

12 Marshall, S and Ramsay, I, 'Stakeholders and directors' duties: Law, theory and evidence', *UNSW Law Journal* Vol 35(1), 2012, p 291

However, in some circumstances, directors can consider the interests of non-shareholder stakeholders without there being any derivative benefit for shareholders. The only such situation that courts have clearly identified is where the company is insolvent or is close to insolvency or some contemplated transaction threatens the solvency of the company. Second, in an insolvency context, there is an obligation on directors to take into account the interests of creditors. Finally, the only situation where the courts have clearly identified that the interests of non-shareholder stakeholders can be given higher priority by directors than the interests of shareholders is where the company is insolvent or is close to insolvency, or some contemplated transaction threatens the solvency of the company.

The global project that has mapped company law in 26 jurisdictions notes that 'No system of corporation law insists that boards should focus only on shareholder value'.[13]

Inquiries into directors' duties at law in relation to stakeholders other than shareholders

In the past decade in Australia, two major inquiries have been conducted into the legal capacity of directors to adopt a broader set of interests in pursuing corporate strategy.[14] That broader set of interests is called stakeholders (other than shareholders), and is constituted of those with a 'stake' in the corporation, including employees, creditors, suppliers, distributors, consumers, government, the environment and the community at large.

One inquiry was conducted by the PJC, which issued its report, *Corporate Responsibility: Managing Risk and Creating Value*, in June 2006. The other was undertaken by CAMAC, which published its report, *The Social Responsibility of Corporations*, in December of the same year.

The public debate in both inquiries revolved around whether a permissive clause (permitting directors to take account of the interests of stakeholders other than shareholders), or a positive clause (requiring directors to take account of the interests of stakeholders other than shareholders) is needed in the Corporations Act. Both inquiries noted the array of legislation and standards that currently exists regulating the centrality of stakeholder concerns in corporate decision making.[15] Both inquiries also concluded that no compelling case for a change to directors' duties in the corporations law was presented.

CAMAC took the view that 'the current common law and statutory requirements on directors and others to act in the interests of their companies are sufficiently broad to enable corporate decision-makers to take into account the environmental and other social impacts of their decisions, including changes in societal expectations about the role of companies and how they should conduct their affairs'.[16] It rejected proposals for changes to the Corporations Act, concluding that 'directors have considerable discretion over the factors they may choose to take into account in determining what will benefit the company. Although there may be no direct legal obligation in company law to take the interests of stakeholders other than shareholders into account (compared to statutes dealing with other areas of the law), this does not preclude directors from choosing to do so'.[17]

13 Sjåfjell, B, Johnston, A, and Sørensen, L-A, News release, 'Shareholder Primacy: The Main Barrier to Sustainable Companies', 2014, p 2, http://www.jus.uio.no/ifp/english/research/projects/sustainable-companies/news/sustainablecompanies2pagesummarycompanylaw.pdf

14 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value*, June 2006, Canberra; Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations*, *Report*, December 2006, Ch 3

15 For example, companies are subject to various state-based environmental legislation — s 299(1)(f), requires companies to report on environmental performance; companies are subject to legislation regulating relationships with employees and workplace health and safety (WH&S) standards, both at the state and federal levels; consumers are protected under the *Competition and Consumer Act 2010* and the tort of negligence enables an individual to sue a corporation for a civil wrong caused by the actions of the corporation; corporations are subject to financial services and taxation legislation at the federal and state levels; and numerous voluntary codes of practice exist, such as the Minerals Industry Code, the AusBiotech and ASX Code of Best Practice for Reporting by Life Science Companies, the United Nations Global Compact, the Global Reporting Initiative (GRI), and Voluntary Principles on Security and Human Rights for the Extractive and Energy Sectors.

16 Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations*, Report, December 2006, p 111

17 Ibid at 82 and 86

The CAMAC report in effect restated shareholder primacy as it affirmed that directors can have regard to the interests of stakeholders other than shareholders in so far as it is in the interests of shareholders to do so.

The PJC arrived at the same conclusion that directors' duties were sufficiently broad to enable the interests of stakeholders other than shareholders to be taken into account, and also recognised that the interests of shareholders needed to be a clear priority in decision making. However, the PJC was not in accord with CAMAC as to whether shareholders ranked first in any interpretation of directors' duties.[18] It stated its view that the best interests of the company and the best interests of the shareholders do not automatically have the same meaning. This view is more aligned with that expressed by Justice Owen's in the judgment quoted above. It is also more aligned with what are called stakeholder inclusivity approaches to the corporation as it affirms that the interests of stakeholders other than shareholders should be taken into account as it is to the benefit of the corporation to do so.

The PJC used the term 'enlightened self-interest' in relation to directors' duties. It stated that: 'Under this interpretation directors may consider and act upon the legitimate interests of stakeholders to the extent that these interests are relevant to the company … The committee considers that the most appropriate perspective for directors to take is that of enlightened self-interest. Companies and their directors should act in a socially and environmentally responsible manner at least in part because such conduct is likely to lead to the long term growth of their enterprise'.[19]

In summary, CAMAC posited that stakeholders can be considered if they are instrumental in benefiting shareholders and the PJC posited that stakeholders can be considered without necessarily linking to shareholder benefit.

Why is this still an issue?

Despite the findings of the CAMAC and PJC reports that there is no compelling case for a change to directors' duties, the debate as to whether the corporations law should change to have directors take account of stakeholders other than shareholders has not abated. Critics argue that the external costs of the corporation — such as the cost to various communities or the natural environment — are opportunistically passed to society at large while shareholders benefit from increased wealth. These matters have become more rather than less pressing with the passage of time, as more voices from different sections of society engage in efforts to place restraints on corporate activity.

Heightened public scrutiny of corporate activity, aided by social media channels, and increased concern about the sustainability of the environment and the negative impacts of corporate activity on particular segments of the community have added to the agitation for changes to directors' duties.

Critics of Australian law refer frequently to s 172(1) of the Companies Act 2006 in the United Kingdom (UK), which provides that the interests of non-shareholder groups need to be considered by directors but only to the extent that such consideration promotes the interests of shareholders. Reference is also made to the United States, where 'corporate constituency' provisions were introduced some decades ago. As noted in the CAMAC report[20]:

> Statutes in a number of US states expressly permit directors to take into account the interests of various non-shareholder groups or broader community considerations in their decision-making, These 'corporate constituency' provisions, first introduced in the 1980s, are found in a majority of states (though not including Delaware, where many large US companies are incorporated). They were primarily intended to assist directors to defend against hostile takeover bids that were seen as detrimental to various non-shareholder groups, including employees, or to local state communities. The

18 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value: Report*, June 2006

19 Ibid at 52-53

20 Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations, Report*, December 2006, pp 99-100. The footnote on p 100 notes that: 'For a useful summary of the US state statutes, see K Hale, 'Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823

> corporate constituency statutes typically adopt a permissive pluralism approach by allowing, but not requiring, corporate decision-makers to consider the broader constituency. Approximately half of the statutes are confined to takeover or other change of control situations, while the remaining statutes are not so limited.

The argument therefore continues to be prosecuted that an elaboration of interests that the directors could take into account would not only improve the quality of corporate decision-making as various interests are weighed, prioritised or reconciled, but also assist in aligning corporate behaviour with changing community expectations.

Above all, the community is clear that *someone* needs to be accountable for the provision of the common good, and with the expanding power of multinational corporations and the perceived diminution in the role of governments in the economy, attention turns again and again to directors as those who should be held responsible for moderating the negative impacts of corporate activity.

How directors view their duty of acting in the best interests of the corporation

In 2012, a survey of Australian directors concerning the way they perceive their obligations to various stakeholders was undertaken and compared to the findings of the CAMAC and PJC inquiries[21], which provides insight into practice. The results show that directors view shareholders as a stakeholder group and accord them the highest priority. However, none of the survey group[22]:

> equated the 'best interests of the corporation' with the short-term interests of shareholders alone, and only a very small proportion of directors (6.6 per cent) equated the 'best interests of the corporation' with the best interests of shareholders in the long term. A significant proportion (38.2 per cent) equated the 'best interests of the corporation' with the interests of all stakeholders as a means to achieving the long-term interests of shareholders. Perhaps surprisingly, the majority of directors (55 per cent) understood acting in the 'best interests of the corporation' as requiring them to balance all stakeholder interests as an end in itself.

> Similarly, an overwhelming majority (94.3 per cent) of directors believed that the law of directors' duties was broad enough to allow them to take into account the interests of stakeholders other than shareholders…. Consequently, it would seem to be the case that where the shareholder primacy norm is influential, its influence does not stem from an understanding by directors that they are under a legal obligation to pursue shareholder-oriented strategies.

Shareholders as owners: a concept underpinning corporate governance

Although company law does not speak of shareholders as owners of companies, it does recognise that shareholders have proprietorial interests in the corporation. This underpins the notion of the separation of ownership and control that is a basic premise of company law.

Those in favour of shareholder primacy argue that shareholders can be identified as beneficial owners because they exercise control rights, and give control power to directors, who are in charge of the day-to-day business of the corporation. Their control rights include the power to elect and remove the directors and to vote on certain essential matters concerning the operation of the corporation, such as the scope of business. Given that directors are elected by shareholders, directors are regarded as the elected representatives of shareholders and owe a fiduciary duty to them. As a result, in this view, shareholders are entitled to have the corporation run in their interests: it is their company.

The primary philosophy driving the modern corporate governance movement and much of the reforms undertaken to the Corporations Act in recent years have been investor protection. Corporate governance reform has centred on providing greater accountability of boards and management to shareholders. Implicit in both corporate governance and legal reform is the notion of shareholder primacy — the concept that in ordinary circumstances, boards of directors owe their primary fiduciary duty to shareholders.

21 Marshall, S and Ramsay, I 'Stakeholders and directors' duties: Law, theory and evidence', *UNSW Law Journal*, Vo 35(1), 291-316

22 Anderson, M, Jones, M, Marshall, S and Mitchell, R, 'Evaluating the shareholder primacy theory: Evidence from a survey of Australian directors', http://www.law.unimelb.edu.au/files/dmfile/Evaluating_the_shareholder_primacy_theory_-__evidence_from_a_survey_of_Australian_directors__20_11_07_11.pdf, p 10

This can at times be stated explicitly, as in the report of the UK Hampel Committee on Corporate Governance, which contains the following[23]:

> 1.16 The single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders' investment. All boards have this responsibility and their policies, structure, composition and governing processes should reflect this.

In corporate governance discussions, the principle that shareholders own the company and directors run it on their behalf has found its way into influential reports such as that from the Cadbury Committee of the UK, which noted[24]:

> 6.1 The formal relationship between the shareholders and the board of directors is that the shareholders elect the directors, the directors report on their stewardship to the shareholders and the shareholders appoint the auditors to provide an external check on the directors' financial statements. Thus the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress. The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.

Economic models, which influence policy (as well as the media which also extends influence) tend to posit shareholders as owners of companies and point to the success of this model as the underpinning of the doctrine of western capitalism.

These views are strongly supported in the corporate governance literature, and in governance codes in Commonwealth jurisdictions. Accountability is central to corporate governance frameworks, and that accountability is viewed in general as accountability to shareholders. As also noted in the report of the UK Hampel Committee on Corporate Governance[25]:

> 1.17 ...the directors are responsible for relations with the stakeholders; but they are accountable to the shareholders. This is not simply a technical point. From a practical point of view, to redefine the directors' responsibilities in terms of the stakeholders would mean identifying the various stakeholder groups; and deciding the nature and extent of the directors' responsibility to each. That result would be that the directors were not effectively accountable to anyone since there would be no clear yardstick for judging their performance. This is a recipe neither for good governance nor for corporate success.'

The link with agency theory

Agency theory posits the corporation as a nexus of contracts where each party seeks to maximise their position. In this view, the corporation is an association of individuals — the nexus of contracts establishes the rights and obligations among the different parties: shareholders, creditors, employees and suppliers. The relationships between shareholders and the directors and corporate managers are therefore those of a principal/agent contract. Directors and the executives they oversee are agents for the shareholders, and therefore have an obligation to manage the corporation in the interests of the shareholders who are the principals.

This view has considerable traction in corporate governance, with much guidance on the governing role of directors positioning them as the agents of their shareholders. Principles-based corporate governance codes in Australia, the UK and various other Commonwealth jurisdictions are focused on what is known as the principal–agent problem, which concerns the difficulties in motivating the agent to act in the best interests of the principal rather than in their own interests. The governance guidelines are addressed to the problem of asymmetric information, where the agent has more information, such that the principal cannot directly ensure that the agent is always acting in the principal's best interests.

The overarching aim of the governance guidelines in various jurisdictions is to lead the corporation's decision-makers to focus on the shareholders' interests

23 Committee on Corporate Governance, *Final Report*, (known as the Hampel Report), The Committee on Corporate Governance and Gee Publishing Ltd, January 1998, p 11

24 Committee on the Financial Aspects of Corporate Governance (known as the Cadbury Committee), *Report of the Committee on the Financial Aspects of Corporate Governance* (known as the Cadbury Report), 1 December 1992 (page numbers not available), http://www.ecgi.org/codes/documents/cadbury.pdf

25 Committee on Corporate Governance, *Final Report*, (known as the Hampel Report), The Committee on Corporate Governance and Gee Publishing Ltd, January1998, p 12

and implement governance frameworks that confirm that directors are the delegates of shareholders and accountable to them as the owners of the company. Agency theory thus is central in the conception of shareholders as owners of the corporation and central to prevailing conceptions of corporate governance.

Concerns with shareholder primacy theory as a guiding principle in corporate governance

Concern has been expressed over decades with the shareholder primacy view. The argument against it stems from Professor Dodd's thesis that the proper purpose of the corporation (and the proper goal of corporate managers) is not confined to making money for shareholders, but also includes more secure jobs for employees, better quality products for consumers, and greater contributions to the welfare of the community as a whole. This position argues against the idea that shareholders should have a privileged position.

The argument against a shareholder primacy approach is that it is a corporate governance model that puts the private interest ahead of the public interest. Commentators have noted that in the shareholder primacy view '… the interests of shareholders are considered paramount by directors, over and above those of other stakeholders, such as employees. At its most extreme, this perspective suggests that directors will tend to favour the short-term financial interests of shareholders (shareholder value), being driven in that direction by capital markets fixed on share price and short-term returns'.[26]

Other criticisms of the concept of shareholders as owners come from both a legal and economic perspective. As noted in a well-known essay critical of the shareholder primacy view, the view of shareholders as owners is not supported in law:[27]

> …the shareholders do not, in fact, own the corporation. Rather, they own a type of corporate security commonly called 'stock'. As owners of stock, shareholders' rights are quite limited. For example, stockholders do not have the right to exercise control over the corporation's assets. The corporation's board of directors holds that right. Similarly, shareholders do not have any right to help themselves to the firm's earnings; the only time they can receive any payment directly from the corporation's coffers is when they receive a dividend, which occurs only when the directors decide to declare one. As a legal matter, shareholders accordingly enjoy neither direct control over the firm's assets nor direct access to them. Any influence they may have on the firm is indirect, through their influence on the board of directors. And (as Berle himself famously argued) in a public corporation with widely dispersed share ownership, shareholder influence over the board is often so diluted as to be negligible. Thus, while it perhaps is excusable to loosely describe a closely held firm with a single controlling shareholder as 'owned' by that shareholder, it is misleading to use the language of ownership to describe the relationship between a public firm and its shareholders.

The same article also questions the economic argument put forward for shareholder ownership:[28]

> Three years after Friedman made his argument in the New York Times, Fischer Black and Myron Scholes published their famous paper on options pricing.[29] This work, which provides the foundation for modern options theory, demonstrates that it is not only misleading to say that dispersed shareholders 'own' a public corporation, but that it is even questionable, from an economic perspective, to say that a single controlling shareholder 'owns' a closely held firm after the firm has issued debt. Options theory teaches us that once a firm has issued debt (as almost all firms do), it makes just as much sense to say that the debt-holders 'own' the right to the corporation's cash flow but have sold a call option to the shareholder, as it does to say that the shareholder 'owns' the right to the corporation's

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26 Anderson, M, Jones, M, Marshall, S, Mitchell, R and Ramsay, I, *Evaluating the shareholder primacy theory: Evidence from a survey of Australian directors*, University of Melbourne Legal Studies Research Paper No. 302 http://www.law.unimelb.edu.au/files/dmfile/Evaluating_the_shareholder_primacy_theory_-__evidence_from_a_survey_of_Australian_directors__20_11_07_11.pdf, p 1

27 Stout, L, 'Bad and Not-so-Bad Arguments for Shareholder Primacy', *Southern California Law Review*, Vol 75:1189, 2002, http://scholarship.law.cornell.edu/facpub/448

28 Ibid at 1191-1192

29 Black, F and Scholes, M, *The Pricing of Options and Corporate Liabilities*, 81 *J Pol Econ* 637, 637 (1973). Myron Scholes subsequently was awarded a Nobel Prize in Economics based on his work in this paper

> cash flow but has bought a put option from the debt-holders. Put differently, options theory demonstrates that bondholders and equity holders each share contingent control and bear residual risk in firms. How, then, can one describe a publicly held corporation that has issued debt as being owned by its shareholders? The short answer is that one cannot — at least not if one is interested in accurately describing the legal and economic structure of the firm.

Critics note that shareholder value maximisation is firmly entrenched in a moral framework. Shareholders are often described as the moral owners of the corporation, if not the legal owners, and directors are said to owe a moral duty to shareholders. Other arguments against shareholder primacy note that companies rely on various modes of finance, and that the focus on the capital provided by shareholders takes no account of other capital such as the manufactured, human, intellectual, social and natural capitals which are either supplied by stakeholders or the depletion of which affects stakeholders.

Despite the legal and economic arguments against the concept of shareholder ownership, the concept remains central to corporate governance approaches and underpins many corporate law reforms which view the best interests of the company as synonymous with the best interests of the body of shareholders.

Part 2: Should stakeholder interests be dealt with in corporations law or by social policy intervention?

Commercial activity can generate a range of social benefits, including not just financial returns to investors, but also jobs for employees, and desirable products and services for consumers. The general public also benefits from tax revenues and, less directly but no less importantly from the advantages of ongoing technological progress stimulated by competitive markets.

However, despite the reports from CAMAC and the PJC holding that the law as it stands is sufficiently flexible to permit directors to take into account the interests of stakeholders other than shareholders, there are many who advocate for reform to the Corporations Act. This is due to the fact that issues continue to arise, particularly in relation to the impact of corporate activity on particular and varying segments of the community and the environment. These discussions inevitably turn toward the need to amend directors' duties, to ensure that directors act in and for the common good, as well as in the best interests of the company.

Possible approaches to ensuring stakeholder interests are taken into account

This section examines whether a corporation should be run largely in the interests of those who provide capital or whether directors should be considered guardians of a common good. For example, it has been noted that 'Corporate activities contribute to a large extent to climate change, the loss of biodiversity and the threat to ecosystems, directly through pollution, land conversion and the extraction and exploitation of raw materials in the production process, and indirectly through the impacts of the use and waste of products'.[30]

However, it is possible that these are social policy issues that need to be dealt with by government rather than through an amendment to directors' duties.

Society has bestowed the privilege of incorporation and limited liability. The latter allows investors to provide capital and benefit from a return on that investment in the form of dividends and capital gains, and risk only the loss of the capital should the corporation fail. Importantly, it also means that shareholders have no responsibility not only for any debts incurred by the corporation, but also for any harm committed by the corporation.

Given that shareholders do not need to concern themselves with the possibility of corporate decisions that could expose them to personal liability, they can remain indifferent to how corporate profit is generated. For example, the victim of a toxic waste spill has not agreed to assume shareholders' limited liability and has not been able to seek safeguards from harm in contract. Shareholders are therefore in a position to shift some of the social costs of their business activity onto members of the public who have not agreed to bear those costs. Limited liability encourages shareholders to pursue profit maximisation without regard for the magnitude of possible social costs, which may be far greater than the benefits to the shareholder themselves.

However, the government, having introduced the privilege of incorporation and limited liability, also sets rules for how those in receipt of the privilege should operate. There is a social compact between the state and the corporation. On this basis, it can be argued that this is a social policy issue that government should deal with and not one for directors' duties. It is for the government to set the rules as to how the corporation should operate as well as consider how best to maximise the common good.

There are also precedents for dealing with the impacts of the corporation through laws other than the corporations law. An example of how such matters can be dealt with through other laws is workplace health and safety. It became accepted some decades ago that it was important to look after employees and not have them work in unsafe conditions. However, rather than change the corporations law, a new area of law was carved out — workplace, health and safety. Similarly, it was seen as important to control restrictive trade practices and monopolies, and to protect consumers from unfair commercial practices, ensure product safety and reduce prices and therefore trade practices legislation was introduced in the 1970s. In particular industries, legislation has been introduced to deal with

30 Dr Lambooy, T, 'Reforming Company Law for Sustainable Companies, Editorial', *European Company Law* 11, no. 2 (2014): 54–57, Kluwer Law International BV

particular impacts caused by the production of goods and services. For example, pollution controls have been introduced in the manufacture of motor vehicles. All of these legislative interventions are quite separate from the corporations law. The impact of corporations on particular segments of the community and the environment could be similarly carved out. Indeed, environmental legislation to which corporations are subject already exists at both the Commonwealth and state level, but as with all legislation, it can be subject to review and revision or addition.

If it is seen as the government's role to introduce social policy interventions to address the environmental impacts of corporations, as well as the impacts of corporate activity on society generally, it is also possible that there are other avenues to be explored other than the introduction of further law. Social policy intervention can range from the introduction of legislation to mass media campaigns. For example, the introduction of a law in the 1970s making it illegal not to wear a seatbelt in a car changed the behaviour of the entire population in that and the following decade, to the point where the vast majority of Australians in 2014 do not feel comfortable not wearing a seatbelt in a car. However, in the same period, there were marked annual increases in malignant skin cancers that could not be addressed by legislation but were the subject of a public health and mass media campaign: the 'Slip, Slap, Slop' campaign. It was recognised that people's behaviour in relation to applying sunscreen could be neither legislated nor policed, but it could be changed through education. The campaign was so efficient in achieving outcomes that the majority of Australians regularly apply sunscreen when outside.

Therefore, this paper seeks to set out the different approaches to the question of how best to deal with the impact of corporate activity on stakeholders.

It is important to bear in mind when considering these matters that there is no distinction in the corporations law between closely held or public corporations. Directors' duties are applied consistently, even though corporate governance and ownership structures vary widely, from the closely held firm with a few owners to the large public corporation with hundreds of thousands of shareholders.

Possible approaches that could be taken to ensuring stakeholder interests are taken into account are:

1. An amendment could be introduced to the corporations law (s 181), which would *permit* directors to have regard to the interests of stakeholders other than shareholders in corporate decision making. Although s 172(1) of the Companies Act 2006 in the UK sets out various environmental and social interests and stakeholder groups to which directors must have regard when making decisions, it is this provision which is most usually referred to when suggestions for including a permissive clause in the Corporations Act are formulated. This is because s 172(1) is clear that directors owe a duty to promote the success of the company for the benefit of its shareholders and not a wider group of stakeholders. The section provides that:

   > A director of a company must act in a way that he considers, in good faith, would be most likely to 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, and
   >
   > (f) the need to act fairly between the members of the company.

2. Alternatively, an amendment could be introduced to the corporations law, which would *compel* directors to have regard to the interests of stakeholders other than shareholders. Such a clause would expressly oblige directors to take into account various environmental and social interests and stakeholder groups when making decisions.

3. Other forms of legislative intervention outside of the corporations law could be introduced by the government, following public consultation, which would protect the interests of stakeholders other than shareholders.

4. Other forms of social policy intervention from the government could be implemented.

Examples of misalignment between societal expectations of the role of companies and what companies expect to do to generate wealth

Each day, corporations in Australia and their directors have to deal with community expectations that corporate activity should not take place at cost to stakeholders other than shareholders. The matters discussed in this paper are therefore not academic issues. They require considered thought, in order to achieve resolution as to how best to address the misalignment between what society expects of companies and what companies expect to do in order to generate wealth.

Examples of issues which make this a matter that requires resolution are set out in this section.

Hydraulic fracturing (fracking) and coal mines

Anglo American Anglo wants to extend its Drayton open-cut coalmine near Denman in the Hunter Valley in NSW to Drayton South. Dozens of new coal mines have been approved in the Hunter Valley during the past decade, encroaching on wineries, horse studs and tourism. Normally conservative rural residents have organised themselves to campaign against mining expansion and coal seam gas drilling. These include Minewatch, the Hunter Valley Thoroughbred Breeders Association, and the winemakers' Hunter Valley Protection Alliance. The current proposed extension by Anglo American is particularly opposed by two globally recognised horse studs, Darley and Coolmore, which point to the international reputation of the Hunter Valley thoroughbred industry which they say will be put at risk due to the close proximity of the proposed mine. Current mines are five kilometres away, whereas the new pit would be 500 metres from the studs, whose operators are of the view that coal dust, blasting and water quality issues will jeopardise the studs' operations. Vineyard owners are also opposed to the proposed extension of the Drayton coal mine, and local communities worry about air quality and their children's health. The Hunter Valley holds the second-largest concentration of horse studs in the world, behind Kentucky in the US. Both the mining company and the horse studs provide local employment, but those in the thoroughbred industry point out that it, winemaking and farming, 'are also major employers, are sustainable and are vital to the strong and diverse economy, which will be necessary when the resource has been extracted and the mining companies have moved on'.[31] Meanwhile, coal seam gas operations have seen 35 exploration wells open in the upper Hunter Valley, with residents worried about pollution, the damage to water sources from fracking to release the gas, as well as methane leaks from coal seams. Elsewhere, BHP Billiton and China Shenhua Energy Company both hold exploration licences for the Liverpool Plains, which sit on top of a coal seam that runs from Gunnedah, through the Hunter Valley, past Narrabi and up into the Darling Downs. Shenhua has been acquiring farms in the area for its proposed mines. Local farmers criticise the issuing of exploration licences, noting that one of the most significant water resources in the county sits under the plains and the plains are fertile, with a deep soil that is not necessarily usual for Australia. The national agricultural statistics show that the Liverpool Plains are 40 per cent above the national average for crop production every year. Locals also note that the area sustains one of the largest surviving koala populations in the country, whose numbers are increasing, which is in contrast to most other koala populations, which are in steady decline.

Tax

For the 2014 financial year IKEA paid just $7.7 million in tax after making a profit of $92 million in Australia. In 2013 Apple paid $36 million in tax despite making $6.1 billion in Australia, while Google paid just $7.1 million despite making $46.5 million. US tech giants

31 Collins, C, 'Don't risk 150 years of thoroughbred heritage for a 20-year mine in the Hunter Valley', *SMH*, 29 August 2014, http://www.smh.com.au/comment/dont-risk-150-years-of-thoroughbred-heritage-for-a-20year-mine-in-the-hunter-valley-20140831-109whu.html

Microsoft and Amazon have also been accused of making billions of dollars of profit in Australia, while paying minimal tax on that profit. Starbucks alleges it has not made any profit since it set up its franchise arrangements in Australia in 2000 and has therefore not paid tax. When multinational corporations pay little or no tax, local businesses, both small and large, point out that the competition is anything but a level playing field, given that local businesses do pay tax, with a corporate tax rate running at 30 per cent. However, a report issued in 2014 claims that 84 per cent of Australia's top 200 listed companies pay less than the 30 per cent company tax rate.[32] The report, *Who Pays for Our Common Wealth?*, prepared by the union United Voice and the Tax Justice Network, which is a group of charities, unions and churches, sets out the use by companies of subsidiaries in tax havens and 'thin capitalisation', where local entities carry debts to reduce tax liabilities in Australia. It notes the extensive use of trust structures, particularly in the real estate development and management industry, alleging, for example, that the Westfield Group effectively paid just eight per cent tax in the seven years to 2013, and its property arm, Westfield Retail Trust no tax at all.[33] The report notes that Westfield is not more tax aggressive than other companies.

Employment in and future of rural towns

The announced closure of SPC Ardmona in Shepparton in the Goulburn Valley created a storm of media commentary when the Federal Government refused to offer a package of $25 million in assistance to the facility early in 2014. The company, Coca Cola Amatil (CCA), noted that a combination of factors led to the decision: the high Australian dollar, which led to a decrease in exports and a significant increase in imported cheaper packaged fruit and vegetable products; a failure to be competitive in many export markets; and a shift in consumer demand. SPC Ardmona was reportedly the only arm of CCA running at a loss, which was an expense shareholders could do without. It was argued that Shepparton, Victoria's fourth-largest regional city with a population of 30,000, could not survive the demise of the 90-year old cannery, which would see hundreds of people become unemployed. Concern was expressed that fruit growers across the country would be forced out of the industry, as there would be a glut of unsold fruit on the domestic market, which would collapse the price in the Murray Darling Basin. Critics pointed out that packers, truck drivers, engineers, cleaners, bar staff, retailers and clubs would all be affected, and also pointed to the tragedy of farmers committing suicide in response to the consequences of future contracts disappearing from the only buyer remaining. Commentary centred not just on whether the government should assist the struggling company, but whether the company had a moral duty to continue, given the impact of the decision to close the cannery not just on the employment rate of one rural town but the fruit growing industry generally. The SPC announcement came after the company Heinz cut its Australian workforce by 20 per cent, closing down a plant in northern Victoria, cutting a quarter of the jobs at its Golden Circle cannery in Brisbane and also jobs at its plant in Wagga Wagga.

Poker machines

Woolworths owns or operates six per cent of the country's poker machines through the ALH Group, in which it is the major shareholder, which makes it the largest operator of poker machines in Australia. Profit is in the hundreds of millions each year. Criticism has been aimed at the company for the fact that much of the profit derives directly from problem gamblers, and from a concentration of its machines in in low-income areas, with allegations that the machines are targeting people who are most disadvantaged. Critics note that problem gambling is closely bound up with depression and anxiety, substance abuse, family breakdown, debt and suicide. The Woolworths board has been urged to take responsibility for the impact its products are having on Australian families, with activist groups putting forward proposals that would require Woolworths to make their machines safer by limiting bets to $1 and

32 http://www.unitedvoice.org.au/news/who-pays-our-common-wealth

33 Lanis, R and McLure, R, Westfield's stoush should shine light on tax paid by property trusts', *The Conversation*, 4 June 2014, http://theconversation.com/westfields-stoush-should-shine-light-on-tax-paid-by-property-trusts-27308

losses on their machines to $120 an hour. However, these proposals were not accepted by shareholders at the Woolworths annual general meeting. It has been noted that poker machine profits, legally acquired, allow responsible patrons to enjoy cheaper food and drink, clubs and hotels to employ more workers, and superannuation funds with direct or indirect shares in the gaming industry to provide better retirements for their members.

Obesity

McDonald's has been accused of business practices detrimental to the environment, such as the destruction of vast areas of the rainforest for the production of cattle to produce beef, as well as promoting unhealthy food with a risk of heart disease, taking advantage of children with its advertising and marketing, and cruelty to animals.[34] In 2006, PepsiCo in the United States decided to sell healthier products, including setting targets to reduce salt, saturated fat and added sugar in the company's products. In 2010, PepsiCo declined to advertise its sugary drinks during America's Super Bowl, launching a marketing campaign for social causes instead. Shareholders disagreed strongly with this move and advised that they wanted the company to concentrate on profitable products, healthy or not.[35] A special report in *The Economist* notes that 'Coca-Cola and PepsiCo control nearly 40 per cent of the world's fizzy-drinks market between them ... Sales of soft drinks across the world have more than doubled in the past decade, to $532 billion; in India, Brazil and China sales of fizzy drinks have more than quadrupled. This is troubling, given that sugary drinks accounted for at least 20 per cent of America's weight gain between 1977 and 2007, according to Gail Woodward-Lopez and her colleagues at the University of California, Berkeley'.[36] In Australia, overweight and obesity rates have also increased rapidly over the past two decades. National data shows that nearly two-thirds of adults and one-quarter of children are now overweight or obese, and research has established the link with type 2 diabetes, heart disease and stroke.[37] Much media commentary and community activism concentrates on seeking to make companies that produce fast food and sugary drinks accountable for the health risks associated with their products.

Retention of particular skills in the country

Qantas has reduced its workforce over the years as pressures on the bottom line from rising fuel costs, a strong Australian dollar and increased (and often subsidised) competition increase, and has also transferred some work either offshore or to global support companies. Not only did it split its international and domestic operations into two separate business units, but jobs in its maintenance division were particularly targeted, as the company sought to retain market share. In 2012, Qantas shut down its heavy maintenance facility at Tullamarine and it closed its maintenance facility at Avalon in 2014, resulting in the loss of hundreds of engineer and aircraft worker jobs. The company noted that automation has replaced many of the skilled jobs that were required in the aviation industry, and fewer engineers and technicians are required as modern aircraft become more reliable and maintenance intervals increase. Employees at Qantas came out strongly against the cutting of jobs in maintenance, noting that significant skills will be lost, making future recruitment and training problematic. Engineering staff point to the fact that, while modern aircraft and systems are technologically complex and may require fewer personnel and man-hours to operate and maintain, they nonetheless demand a more highly skilled workforce. Employees noted that the only way to maintain skills is to have continuity of work and the only way to have continuity of work is to retain maintenance facilities.

Purchasing power of corporations

The two giant supermarket chains, Coles and Woolworths, have been accused of using an aggressive strategy of buying sites in small towns and driving

34 Chief Justice Bell's Verdict, *McDonald's Corporation and McDonald's Restaurants Limited vs Helen Marie Steel and David Morris*, 19 June 1997, http://www.mcspotlight.org/case/trial/verdict/verdict4_sum.html

35 Special report, 'Food for thought: Food companies play an ambivalent part in the fight against flab', *The Economist*, 15 December 2012, http://www.economist.com/news/special-report/21568064-food-companies-play-ambivalent-part-fight-against-flab-food-thought

36 Ibid

37 MacKay, S, 'Legislative solutions to unhealthy eating and obesity in Australia', *Public Health* 125, 2011, 896-904

smaller operators out of business. Local communities accuse the two retail chains of predatory behaviour in relation to siphoning money out of local economies and allege that the strategies of both businesses is having a devastating human impact on independent business owners and local communities. Criticism is also aimed at the two retain chains for aggressive behaviour in relation to their market power, with allegations of price squeezing of suppliers, including supplier rebates, where the chains charge their suppliers for shelf space and other advantages or displace suppliers' goods with the chains' private labels. The vertical integration undertaken by the duopoly has been alleged to have a catastrophic effect on some industries, such as the dairy industry, where the two retail chains constrain the income of the dairy farmers and processors, which in turn creates a decline in farm investment and quality. Farmers say that they don't buy new equipment; downgrade quality through cutting costs on fertiliser and feed; employ fewer people; and reduce repairs and maintenance.

Providing credit to small business

After the onset of the global financial crisis and for many years afterwards, Australia's banks were accused of not providing credit to small business. Critics argued that small business is a vital and energetic part of our economy that plays a key role in the generation of jobs, new ideas, and the encouragement of entrepreneurial activity. Furthermore, critics pointed out, the banks had been protected by a taxpayer-funded guarantee to ensure they did not fail. The banks argued that the wholesale and deposit guarantees which were provided to banks 'calmed depositor nerves and prevented a rush of deposits from smaller financial institutions to the larger banks. The wholesale guarantee put Australia back on a level playing field in the competition for international wholesale funds, after other governments were forced to guarantee their banks. It meant our banks could continue to fund the economy, avoiding the widespread business failures and 10 per cent unemployment experienced in the US and UK.'[38] Critics argue that the social licence to operate is broader for banks than for the normal corporation, as banks play a critical role as a foundation of the economy and are central to most people's financial security. They note that commercial banks are the single most important source of external credit to small firms. Small businesses rely on banks not just for a reliable supply of credit, but for transactions and deposit services as well. The growth and jobs that an economy needs are not possible if small and medium-sized enterprises cannot access the finance they need.

Impact of plastic beverage containers on the environment

Coca Cola-Amatil, Lion, Schweppes, Coopers, Diageo and Fosters are the main producers of take-away beverages in Australia. The production of plastic beverage containers creates huge numbers of highly visible, branded litter. In 2013, Greenpeace produced a 'Stop Coca-Cola trashing Australia' video, showing young people drinking Coke before dead birds start dropping from the sky or washing up on the beach, killed by discarded plastics. The aim of the video was to pressure the company into agreeing to a national CDS. A common CDS proposed is a 10 cent refund deposit on eligible recycling containers. According to many, CDS will improve recycling, and vastly increase recycling rates for beverage containers used away from home, and will provide fundraising opportunities for local community groups and charities.

Examples of different approaches to ensuring stakeholder interests are taken into account

Permissive clause in directors' duties

If the examples above are addressed through a permissive clause in the corporations law, the provisions concerning directors' duties in the Corporations Act would change to state that:

38 Munchenberg, S, 'Myths of banking' Opinion Editorial for *Australian Financial Review*, 4 October 2010, http://www.bankers.asn.au/Media/Opinion-Editorials/Myths-of-Banking

> A director of a company must act in a way that they consider, in good faith, would be most likely to be in the best interests of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to —
>
> (a) the interests of the company's employees
>
> (b) the need to foster the company's business relationships with suppliers, customers and others
>
> (c) the impact of the company's operations on the community and the environment, and
>
> (d) the desirability of the company maintaining a reputation for high standards of business conduct.

Explicit clause in directors' duties

If the examples above are addressed through an explicit clause in the corporations law, the provisions concerning directors' duties in the Corporations Act would change to state that:

> A director of a company must act in a way that they consider, in good faith, would be most likely to be in the best interests of the company but must also have regard (among other matters) to —
>
> (a) the impact of the company on the environment, the protection of aquifers, viable agricultural land and endangered species and the production of non-biodegradable waste material
>
> (b) the obligation to pay the full amount of corporate tax
>
> (c) the interests of the company's employees, including skills retention
>
> (d) the impact of the company's operations on the community in which it operates
>
> (e) the protection of consumers from the effects and social consequences of products and services provided by the company
>
> (f) the impacts on suppliers when contracts are put in place and the need to foster the company's business relationships with suppliers, customers and others
>
> (g) the need for the company to maintain a reputation for high standards of business conduct, even if it impacts negatively on shareholder returns.

Other forms of legislative intervention

If the examples above are addressed through other forms of legislative intervention, they could take the form of:

- **fracking and coal mines:** water protection legislation could be introduced, where the government would seek to assess the long-term water and food security needs of the country and balance this against the existence of large deposits of coal seam gas and minerals that could be economically developed. The legislation may permit coal seam gas and coal mine development in certain parts of the country but not others
- **tax:** changes to taxation law could be introduced, where legislation would, for example, be introduced to make transparent the amount of tax that corporations pay, with the disclosure of all foreign subsidiaries in financial statements, the purpose of those subsidiaries and all related-party transactions made mandatory. A company may be making good revenues but pay lower amounts of tax for completely legitimate business reasons. But if it's doing this by using so-called 'black-box' arrangements, where transactions are designed for no commercial purpose at all, other than to avoid tax, then the taxation legislation would ensure disclosure of such practices and it would not be legal. It could be mandated for companies to disclose detailed information on where profits are made and taxes paid by jurisdiction. Fines for tax avoidance could be increased, stapled trust securities for tax arbitrage could be eliminated or restricted and the automatic exchange of information on tax matters between tax authorities of different countries could be implemented
- **employment in and future of rural towns:** preference clauses for rural employment opportunities in government purchasing contracts could be mandated; or livelihood insurance could be introduced to address the effect of loss of jobs in particular industries, in recognition that individuals go through a life cycle of livelihood where they train early for a particular occupation and rise and fall with that occupation
- **poker machines:** new laws could be introduced, such as those mandating pre-commitment devices for poker machines as a way of restricting machine gambling, or restricting the maximum prize to small amounts
- **obesity:** new regulations could be introduced, such as simplified food labelling systems (for example, color-coded food labels) and restricted marketing to children, with reference to laws introduced in relation

to smoking, where the argument was that taxing cigarettes, banning advertising, setting age limits for purchases, and restricting smoking in airplanes, workplaces, bars and restaurants made it easier for smokers to stop

- **retention of particular skills in the country:** livelihood insurance could be introduced to address the effect of globalisation on certain jobs or the loss of jobs to automation
- **purchasing power of corporations:** the *Competition and Consumer Act 2010* and the Australian Competition and Consumer Commission (ACCC) were introduced to deal with an uneven playing field and the legislation could be reviewed to assess if it is dealing adequately with the purchasing power of corporations in relation to competition 'level playing fields'
- **impact of plastic beverage containers on the environment:** legislation could be introduced that mandates that all beverage-producing companies are required to use biodegradable and recycled plastic to address the waste problem; or penalties and levies could be introduced on waste streams; or polluter-pays liabilities could be strengthened; or a requirement for environmental insurance could be introduced in planning approvals.

Other forms of social policy

If the examples above are addressed through other forms of social policy, this could take the form of:

- **fracking and coal mines:** Planning and Assessment Commissions may decide not to approve new mines in particular areas where established industries are providing employment and creating wealth for the economy generally
- **tax:** 'naming and shaming' of corporations that employ aggressive tax strategies to pay minimal or no tax could be introduced, which would damage corporate reputations
- **employment in and future of rural towns:** the Federal and State Governments could spend on infrastructure, for example, ensuring a regular rail connection between Shepparton and Melbourne, such as exists already between larger towns such as Ballarat, Bendigo and Geelong, which would fuel growth
- **poker machines:** ongoing support would be offered to the problem gamblers who lose money at great cost to themselves and sometimes their families, via government and not-for-profit services (funded by government), which would include access to professional psychologists and help agencies
- **obesity:** campaigns to persuade people, particularly children, to choose the healthy food or drink as the default would be supported. For example, research has shown that children are three times more likely to choose healthier meals if those meals come with a toy and the regular ones do not. Other forms of social policy could include intense media campaigns, on-site educational programs in stores, school gardens, worksite wellness programs, social marketing campaigns, new sport and recreation infrastructure
- **retention of particular skills in the country:** an intensive program could be devised between industry and the government to encourage undergraduates to spend some time in, for example, aviation-related companies, to experience the industry before they complete their studies, with a view to attracting a new generation of skilled employees when required
- **purchasing power of corporations:** other forms of social policy would be influenced by any gap analysis of where competition law is seen to fail
- **providing credit to small business:** one route might be to formulate policy based on the data collected in 2014 by the Australian Bankers' Association and the Council of Small Business, which assesses the credit needs of small business and whether small businesses in a particular sector, or of a particular size, or at a particular stage of development are experiencing trouble obtaining credit, and if so, why
- **impact of plastic beverage containers on the environment:** other options include those proposed by CCA for a National Bin Network, which includes the installation of recycling bins in major venues throughout Australia, in airports, rail and bus stations, entertainment venues, convention centres, sporting stadia and clubs, shopping centres, pubs and clubs — venues where people congregate and are likely to consume beverage containers and other packaging.

Arguments for and against amending the corporations law to provide for directors to take account of the interests of stakeholders other than shareholders

This section reviews the range of arguments currently posited for and against amending the corporations law to provide for directors to take account of the interests of stakeholders other than shareholders. These arguments need to be considered in light of the previous section, where the impact of addressing particular issues through directors' duties, other legislation or other social policy interventions was canvassed.

A permissive clause

Advocates note that if shareholder value is an end, not a means, inserting a permissive clause provides clarity as to directors' capacity to consider other stakeholders in decision making. They argue that this is an inclusive view, one which recognises the reality that the corporation that will succeed is the one that is focused not only on profit but also on the impact of the corporation on the society and environment in which it operates.

The reasons advanced for such reform include:

- directors may take the view that they could be breaching their duties to the company if they not only take into account but privilege the interests of stakeholders other than shareholders — the law is 'fuzzy' and guiding principles would assist to bring clarity
- a positive indicator that other interests exist is a matter of good risk management
- law can change behaviour
- it educates shareholders as to the fallacy that their interests are one and the same as those of the corporation
- it counters the legislative push in the last 20 years to grant further rights and protections to shareholders, which has further entrenched the shareholder primacy view
- the enlightened self-interest view, which contends that directors will take into account the interests of stakeholders other than shareholders in order to fulfil the best interests of the corporation, is insufficient to satisfy social needs
- the current law protects a narrow range of interests
- such a clause does not specify how directors should take into account other stakeholders, only that they consider them — as such it is relatively benign and those companies that already take the enlightened self-interest view will not be affected, while it provides an educational function for those companies that have not yet reached this view
- value includes profit but extends to obligation beyond profit and this needs to be considered when making decisions about the best interests of the corporation — hence corporate law should be adjusted, where necessary, in order to accommodate or even enforce these obligations
- the impacts that a corporation has on the natural environment and future communities was not considered when limited liability was put in place, but companies have an interest in social cohesion and there is growing unease about the impact of companies on the natural environment and various communities, including the impact on intergenerational equity — it is a proper purpose for directors to consider these impacts
- there is a public benefit test, because of the social licence granted to corporations to operate — it is not that directors have a public good obligation but that they are responsible for the impacts of the organisation they govern and the fact of those impacts makes them accountable
- companies are not responsible for all of society but only the impacts of the organisation on their stakeholders, so there is a clear difference between what the government is responsible for and what companies are responsible for.

The UK permissive clause

Advocates point to the UK, where s 172(1) in the Companies Act 2006 provides that directors owe their fiduciary duty to the 'members as whole' but then provides a broader context for this duty by listing other stakeholders to whom directors need to have regard to fulfil their duties. That is, s 172 may be said to impose a duty on directors to require them to be more inclusive in their decision-making in respect of seeking to benefit the members. The purpose behind s 172 was primarily to emphasise the fact that directors should not run a company for short-term gains alone, but to take into account long-term consequences.

An academic article notes that:[39]

> The only cases that have addressed the provision, albeit briefly, have stated that s 172 merely sets out the pre-existing law on the subject, that is, decided in relation to the duty to act bona fide in the best interests of the company.

Opposition to a broader view in law

Those opposed to inserting a permissive clause argue that:

- two inquiries have already found that the current law is sufficiently flexible to allow directors to take account of the interests of stakeholders other than shareholders
- in practice directors are already taking into account the interests of stakeholders other than shareholders and codification is not required
- companies behaving badly is a thing of the past — the advent of social media means that information is available instantly and globally and companies are already held to standards in ways that the law cannot impose. If companies operate out of step with communities, they will suffer
- the current model of investors entrusting their capital to strangers has worked well and stood the test of time — if this model is changed, for example, by introducing a need to take account of environmental concerns, it shifts the model of investment and competition for investment and that in turn will shift behaviour and we do not know what the consequences of that might be
- there is the question of protecting the rights of those who allocate the capital — it raises questions as to whether the investor is entitled to redress if directors take broader interests into account
- there are questions as to whether directors should regard all other stakeholders as equal, which means directors must judge between competing interests and risk having courts decide if the directors made the correct decision — we should be wary of asking directors to make value judgments of this kind
- it could lead to drawn-out litigation as actions are taken against directors' decisions — every board decision will need to be accompanied by a paper showing that directors considered all stakeholders
- it raises questions as to whether variations in enforceable obligations would be required, because it cannot be an empty rule and there must be sanctions, for example, should directors decide that employees are more important than creditors, there is the question of whether this is enforceable from a legal angle
- a wider view in law exposes companies to class actions and the unpredictability of what may happen in court when a class action is held needs to be taken into account. Importantly, critics note, a class action regime does not exist in the UK
- any legislative clarification of the current law would create the very problems such clarification could seek to ameliorate — if the law is changed, it may mean that directors become less accountable (they are stewards of other people's money and have fiduciary responsibilities to the corporation), because their duties becomes generalised. The dilution of accountability would make it harder for shareholders and regulators to hold directors responsible for their decisions
- such a clause will make corporate decision makers and investors risk averse, for example, investors will be unwilling to provide capital if the corporation cannot downsize at any time
- it is asking directors to interpret community standards and decide what is in the best interests of society — this is the role of government, not directors.

39 Keay, A, 'The duty to promote the success of the company: Is it fit for purpose?', www.law.leeds.ac.uk/assets/.../keay-the-duty-to-promote-the-success.pdf

Part 3: What are the societal expectations of the corporation?

The previous section sought to provide examples of how issues of concern in relation to corporate impacts on the community, the environment, employees or other stakeholders could be addressed through directors' duties, or other forms of legislative or social policy intervention.

This section addresses the question of whether the societal expectations of the corporation are a matter for the corporations law, or whether the government has a role to play.

Societal expectations of the corporation

In the twenty-first century, the relationship between business and society is considered an implicit social contract. Proponents of corporate responsibility note that social issues are not tangential to the business of business but fundamental to it. This perspective holds that corporate managers holding onto a one-dimensional view of the corporation will not survive, nor will the companies they manage.

For reasons of ethics and enlightened self-interest, those companies alert to the long-term impact of social issues and in a constant dialogue with their stakeholders have a competitive advantage. Shifts in social issues that ultimately feed into the fundamental drivers of corporate performance generate value-creation opportunities. Focusing on a 'business is business' approach can lead managers to emphasise short-term company performance, while neglecting longer-term opportunities and issues. There is, therefore, considerable incentive for a company to conduct its business in a socially responsible manner.

There are powerful social rewards and sanctions associated with responsible behaviour. Acting responsibly generates trust, loyalty and goodwill among customers and employees, not to mention business partners. Corporate irresponsibility, on the other hand, can result in disapproval and suspicion, public criticism, damage to customer loyalty, loss of brand equity and a tarnished corporate reputation. Responsible behaviour creates a sense of satisfaction and self-respect among employees, whereas irresponsible behaviour can result in feelings of embarrassment, guilt, shame, cynicism and poor morale and loss of commitment from employees. Disincentives, therefore, can include loss of reputation, incapacity to attract and retain good staff, shocks to the share price for listed companies, boycotting of products and services by customers and penalties imposed by regulators.

One organisation tracked expectations across 25 countries concerning corporate responsibility between 2001 and 2007.[40] Its findings were that 'more than eight in ten people across all countries surveyed say that companies should be held at least partially responsible for all 14 of the social, environmental, and economic actions tested' (these actions included matters such as not harming the environment, ensuring a responsible supply chain, treating employees fairly, improving education and skills in communities where they operate, reducing human rights abuses, helping to solve social problems).

At the heart of changing expectations of the role of the corporation is a view that generating profit must not come at cost to the common good. Yet the central role of the corporation in providing financial prosperity has not changed. Commercial activity confers many benefits on society. Diverse financial benefits include creating goods; services; processes; return on capital; work opportunities and remuneration for all those employed in the organisation and across its supply chain; a tax base that supports an array of public services and infrastructure (schools, hospitals, roads); the development of new technologies and dividends and interest that fund our superannuation.

All sorts of problems in society can be viewed as within the purview of corporate activity. But the means by which corporations address and solve problems (developing materials and ideas to produce goods and services for customers, other companies or public institutions that they do not want to produce themselves) are fundamentally different ways of addressing social problems from those utilised by governments, charities, churches, or families.

40 http://www.globescan.com/news_archives/bcccc_article/

As noted in one report:[41]

> Corporate responsibilities can not however, include solving all of society's problems. It is important to bear in mind that companies come and go, while many of society's fundamental institutions — the police force, the judiciary and armed forces, for example — are permanent functions that many citizens do not want to be dependent on commercial considerations.

What is the role of government in deciding the social expectations of the corporation?

The government is responsible for the regulatory settings concerning corporations. This paper has canvassed the arguments that are put forward for amending directors' duties in response to concerns that profit maximisation for shareholders might be at the expense of others.

Also central to corporate law is limited liability. It:

- enables aggregation of large amounts of capital from multiple small investors and protects even a small investor from liability for a substantial corporate obligation, which means that investment is encouraged
- promotes investment by transferring risk from investors to creditors which also encourages entrepreneurial activity.

Creditors, unlike other third parties, can factor the risk posed by limited liability (namely, that they will not get paid if the firm fails) into the interest rates they charge to corporate debtors and therefore are not compelled to accept the full cost of limited liability against their will. Unlike other stakeholders, a limited liability rule does not increase shareholder wealth at the expense of creditors.

Limited liability is seen as the cornerstone of capital formation, which has brought obvious benefits to society in respect of increased wealth overall.

However beneficial the limited liability subsidy may be to corporate shareholders and to society more generally, critics argue that it should not be so broad as to protect illegitimate behaviour. In particular, limited liability should not provide the occasion for shareholders to behave opportunistically toward third parties. Third parties who could suffer harm include stakeholders and the natural environment. Given that shareholders do not need to concern themselves with the possibility of corporate decisions that could expose them to personal liability, they can remain indifferent to how corporate profit is generated.

Critics argue that the external costs of the corporation — such as the cost to communities or the natural environment — are opportunistically passed to the community while the shareholders benefit from increased wealth. These concerns raise the question of whether a privileging of private rights (limited liability) is detrimental to society. The introduction of limited liability was undertaken on the basis that not only shareholders would benefit, but that it would lead to an increase in the stock of common good. However, those who question shareholder primacy argue that the balance has shifted to favouring shareholders at the expense of the common good.

Shareholders, in particular large institutional shareholders, however, point to their increased engagement with the boards of listed companies on governance matters that go beyond financial return in the short term.

A movement has been underway in large superannuation funds, which invest significantly in Australian listed companies, to discuss environmental and social matters with boards, either directly or through their fund managers, including discussions of the risks attached to these areas.

Institutional shareholders increasingly have concerns about the longer-term implications of the mismanagement of environmental and social risks by a company for the value of the investment. Even if

41 Confederation of Swedish Enterprise, *The role of business in society: Questions and answers on the role of business in society*, July 2004

there is no risk at present, these broader issues can have an impact on long-term investment. As long-term investors in economies and markets, institutional investors' consideration of investment decisions with an integrated approach to sustainability is intended to enhance returns while minimising risk. As such, they are considering the consequences and implications of the themes that will drive global economies over the next five, 10 and 15 years, such as potential resource scarcity, technology, aging population and population growth more generally.

Shareholders, themselves, therefore, are seeking corporate responsibility on a range of issues, based on their desire to protect their investment. Importantly, increasingly large institutional investors are not indifferent to how corporate profit is generated. They do not agree that profit maximisation should be at cost to third parties. This can arise as a judgment of the risk to value, rather than a values judgment, but the implications for investment and the call by shareholder for companies to be accountable for how they generate profits is an ongoing trend that is unlikely to disappear.

Public policy

Facilitating entrepreneurial activity while inhibiting business illegality is a key concern of corporate regulation. Corporations are already subject to a range of regulation imposed by the state. That includes permission to incorporate and the need to register; contract enforcement; consumer protection; employee protection; environmental protection; taxation; and investor protection.

The current regulatory settings have brought obvious benefits to society and fulfil the government's role of moderating the influence of business activity. As noted in one publication, government 'should provide the economic framework and the essential infrastructure for public and private enterprise. It should be concerned with the wellbeing of all citizens. It should protect the physical environment and it should act to alleviate the negative impacts of the marketplace on individuals, groups and the environment'.[42]

If concerns arise that shareholders profit at the expense of other third parties and society in general, that is, that there is insufficient moderation of the influence of business activity on the community and the environment, it is appropriate to ask whether decisions concerning further social constraints of the corporation are the role of government, rather than the role of directors. Equally important is to ask why stakeholders seek to impose obligations on directors rather than seeking government intervention on these matters, although addressing the latter question is beyond the scope of this paper.

Facilitating economic, social, physical, cultural and emotional community wellbeing is considered a role of government. The increased complexity of societal problems, including climate change, obesity and land degradation, are all matters that go to the heart of community wellbeing. Governments can build confidence and public trust and reduce uncertainty by creating policies and regulatory settings or putting in place other mechanisms that meet societal expectations concerning the costs attached to commercial activity and who should bear them.

Given the precedents of introducing legislative interventions to moderate the influence of business activity on employees, customers and the environment, none of which has proceeded through amendment to the corporations law, it is necessary to ask if forms of legislative intervention other than an amendment of directors' duties would be more appropriate to take account of stakeholder interests. A central question is whether it is appropriate for government to abrogate its responsibility for the wellbeing of citizens and the environment to one group of individuals.

Currently there is a dearth of public policy in this area. This discussion paper seeks to generate a discussion as to which forms of public policy would best articulate the societal expectations of corporations.

42 Henry, N, *The Role of Government in Australia*, p 1, January 2012, The Australian Collaboration: A Collaboration of National Community Organisations, http://www.australiancollaboration.com.au/pdf/FactSheets/Role-government-FactSheet.pdf

Part 4: Is there a need for change?

Respondents are asked to consider if there is a need for change to ensure that companies take regard of the interests of stakeholders. There might be no need for change, or the corporations law may be seen as the avenue to pursue to provide for change, or other forms of legislative or social policy intervention may be viewed as more appropriate avenues to pursue.

The options set out below may not be the only options available, and respondents should feel free to recommend other possible approaches and set out their rationale for suggesting such approaches.

1. There is no need for a change to the corporations law.

The law as it stands allows directors to take account of the interests of stakeholders other than shareholders. Two inquiries have confirmed this. Directors themselves have confirmed that they equate the best interests of the corporation with the interests of all stakeholders as a means to achieving the long-term interests of shareholders. At law, directors must already balance the interests of shareholders with their responsibilities under specific statutes regarding workplace health and safety, environmental impact and trade practices.

Do respondents agree? Why? Why not?

2. There is a need for a change to the corporations law and the equivalent of s 172 in the UK (permissive clause) should be introduced to expand directors' duties so that they should have regard to the interests of stakeholders other than shareholders in promoting the best interests of the company.

Inserting a permissive clause provides clarity as to directors' capacity to consider other stakeholders in decision making. The reasons set out in the paper against introducing such a clause are not compelling, in light of the fact that the UK enacted s 172(1) in 2006 and most of these points have not been an issue. Such a clause does not specify how directors should take into account other stakeholders, only that they consider them.

Do respondents agree? Why? Why not?

3. There is a need for a change to the corporations law and an explicit clause should be introduced to expand directors' duties so that they must take account of the interests of stakeholders other than shareholders.

Changing the corporations law to create a wider group to whom the director has a fiduciary duty should not cause any concern, given the impact of corporations on the environment and future communities was not contemplated at the time the concepts of shareholder primacy and limited liability were established. Requirements have changed, as the world has developed. Commercial activity and the generation of wealth cannot be for one group only (shareholders) at the expense of other third parties or the environment.

Do respondents agree? Why? Why not?

4. There is a role for the government to play in protecting the interests of stakeholders — not through amendment to the corporations law, but through other forms of social policy.

Concerns about issues such as air and water pollution, water extraction, impacts on biodiversity, waste management, workers' rights and safety and community relationships, including land access and ownership and equitable sharing of benefits from corporate activity are large social policy issues that should be a matter for the government. While directors should be encouraged to continue to equate the best interests of the company with the interests of all stakeholders as a means to achieving the long-term interests of shareholders, it is an abrogation of the role of government to suggest that such broad social policy issues should be a matter of director responsibility, particularly given that directors owe a duty to the company and it is not a public duty. The implications and unintended consequences of changing directors' duties or limited liability are very real and of concern, and fundamentally shift the role of protecting the interests of the community, the environment and employees to companies, when such matters are those which governments should address, including through other legislative interventions or forms of social policy.

Do respondents agree? Why? Why not?

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