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SHAREHOLDER PRIMACY ALREADY REQUIRES DIRECTORS TO ACTIVELY CONSIDER NON-SHAREHOLDER INTERESTS

The debate with a false premise and the downside of law reform

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INTRODUCTION

During the Banking Royal Commission, outgoing NAB chairman Ken Henry said directors should understand ‘their responsibilities to the community go beyond their obvious responsibilities for shareholders’.

That sparked a flurry of commentary suggesting Dr Henry’s remarks reflected a drastic shift in the existing ‘shareholder primacy’ approach, an interpretation dependent on the assumption that shareholder primacy requires directors to act *solely* in the interests of shareholders because the interests of shareholders and other stakeholders are necessarily *in conflict*.

More recently, on 19 August 2019, the US Business Roundtable released a revised ‘Statement on the Purpose of a Corporation’, with the Roundtable’s 181 CEO members (who represent some of the biggest companies in America) saying they ‘share a fundamental commitment to all our stakeholders’.

The Statement has been widely, but incorrectly, labelled as a ‘radical change to the mantra of corporate America’.¹ In reality, the Statement is nothing more than a distraction. In Australia, it has been used to give further impetus to calls for legislative change to reflect what is now falsely perceived to be a global movement away from prioritising shareholders and profits.

The debate about shareholder primacy and law reform is now somehow seen as urgent, fuelled by daily headlines and social media posts designed to capture attention and feed off the heightened community sensitivities that remain following the Banking Royal Commission. Yet behind the bluster lies a debate with an entirely false premise and misunderstanding of the existing law in Australia and what shareholder primacy actually means. While shareholder primacy is the standard that informs directors’ duty to act in the best interests of the company, it is a mistake to infer that, necessarily, the interests of shareholders and ‘other stakeholders’ are automatically in competition.

By ‘other stakeholders’, we mean not only a company’s contractual stakeholders, such as creditors, suppliers, employees and customers, but also the wider ‘public interest’, itself representing a broad range of environmental and social concerns relevant to the community in which a company operates and which may be impacted, positively or negatively, by a company’s activities.

Far from being in competition, in the current post-Banking Royal Commission climate of public mistrust and heavy scrutiny of the actions of corporate officers, along with lower consumer confidence in a slowing economy with an uncertain future global outlook, the interests of shareholders and other stakeholders will very often be aligned.

If directors fail to actively consider the interests of other stakeholders, both in pursuing general corporate social responsibility (**CSR**) measures designed to enhance a company’s reputation as a respected, trusted and responsible ‘corporate citizen’, in addition to identifying and responding to the direct costs to the company arising from various environmental, social and governance (**ESG**) market risks that specifically impact its operations, the company’s profits will inevitably take a hit as investors, customers, employees and suppliers take their business elsewhere. As a result, directors will prejudice the interests of shareholders and breach their duty to act in the best interests of the company.

Yet, on the current formulation of directors’ duties in Australia, there will still come a point at which directors may genuinely take the view, exercising their business judgment and the broad discretion the law affords them, that:

- any further investment in CSR measures will not on a cost-benefit analysis continue to increase profits as a function of enhanced corporate reputation; and
- the company has already implemented sufficient measures to mitigate the ESG risks specifically affecting it so that further ESG investment is also not necessary.

Once that point is reached, the profit-making objective must take priority and in that sense the interests of shareholders will ‘win out’ over other stakeholders.

The *possibility* of divergence between the interests of shareholders and other corporate stakeholders in these cases might then be used to support a call for legislative change to the current formulation of directors’ duties in Australia after all.

However, in our view, that would be a reactive and short-sighted response to what has been an emotive public debate. In saying that, we are not suggesting the *end* of protecting the interests of stakeholders potentially vulnerable to instances of corporate misconduct is not valid. Rather, our argument is simply that reformulating directors’ duties is not the most efficient *means* of achieving that end.

If further protection of other stakeholder interests is desired, it should be achieved by enacting specifically tailored, mandatory environmental, labour and consumer laws, so that directors must ensure the company complies with those laws as a direct cost in its unique ESG risk profile. Increasing the scope of directors’ personal liability through expanded duties would have a paralytic effect on directors’ willingness to take risks and pursue

innovative, value-creating activities, an outcome that would reduce corporate returns and growth to the detriment of not only shareholders but also the very ‘other stakeholder’ interests intended to be protected by legislative change.

THE SHAREHOLDER PRIMACY MODEL

In his 1970 essay, Milton Friedman, with reference to his earlier book *Capitalism and Freedom*, rejected the idea of the company as a ‘social enterprise’ existing to serve the interests of a broad range of community stakeholders, instead positing that:

there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, [it] engages in open and free competition without deception or fraud.²

Friedman’s expression of what has come to be known as the shareholder primacy model in turn reflects one of the traditional conceptions of the company, as a matter of corporate law theory, as a ‘nexus of contracts’ between private individuals, in contrast to broader ‘communitarian’ approaches which view the company as an instrument of social policy capable of being used to satisfy diverse public obligations.³ On that ‘contractarian’ view, recognition of the company as a separate legal entity supported by limited liability, while in one sense representing a ‘concession of the state’, is more fundamentally justified by economic efficiency.

TO WHAT EXTENT IS SHAREHOLDER PRIMACY PART OF AUSTRALIAN LAW?

In Australia, directors owe a duty both at general law and under section 181(1)(a) of the *Corporations Act 2001* (Cth) (**Corporations Act**) to act in good faith in the best interests of the company.

Provided a company remains solvent, ‘the company’ has been interpreted by courts to mean the company’s shareholders collectively.⁴ As Ward J (as she then was) said in *International Swimwear Logistics Ltd v Australian Swimwear Company Pty Ltd* (**International Swimwear**):

The consideration as to whether directors have complied with their duties involves determination of whether the conduct diverged from the interests of the company’s shareholders (often referred to as ‘the shareholder primacy norm’).⁵

Thus, ‘the company’ does not mean the company as a *commercial entity* distinct from its shareholders.⁶ Although some decisions reflect a willingness to allow directors to engage in ‘defensive tactics’ to preserve the existence of a company subject to a takeover offer,⁷ those decisions are best viewed not as examples of treating the company as a commercial entity but rather as permitting directors to, in acting in the best interests of shareholders, balance short-term gain (for example by shareholders receiving a price premium for their shares during a takeover) with long-term benefits that would accrue to outweigh any such gain.

With one exception, ‘the company’ also does not mean any corporate stakeholders other than shareholders. That exception occurs when a company is *insolvent*, or is at least in an ‘insolvency context’, at which point the company is properly seen to reflect the interests of creditors, being those who have the first claim to the distribution of whatever remains of the company’s property.⁸ Nevertheless, in this case, directors do not owe an *independent* duty to creditors, in the sense that creditors do not have a right to pursue proceedings in their own name against directors for any alleged breach of the duty to act in the best interests of the company. Rather, the duty is an ‘imperfect obligation’ only enforceable by a liquidator on the company’s behalf.²

Accordingly, provided a company remains solvent, the shareholder primacy model accurately describes what is currently expected of directors in Australia. It is a critical mistake, however, to assume that the correlation between ‘the company’ and shareholders means that other stakeholder interests are, *ipso facto*, irrelevant and can be ignored by directors. For the reasons explored in the next section of this paper, directors must consider those other interests *for the very purpose* of properly discharging their duty to the company.

ALIGNMENT BETWEEN THE INTERESTS OF SHAREHOLDERS AND OTHER STAKEHOLDERS

Promoting the interests of non-shareholder stakeholders, including the public interest, will mostly be consistent with, and not in competition with, the interest shareholders have in the company making a profit. That is because, if a company does not look after its employees, suppliers and customers, position itself more generally as a ‘good corporate citizen’ in the community and implement the measures required to address the specific ESG risks relevant to the company’s operations, its bottom line will be negatively impacted as key stakeholders, both current and future, turn away from an organisation they simply cannot trust.

Lumsden and Fridman aptly capture the issue:

[I]n a world of open, knowledge-based competition, ‘companies do not function in isolation from the society around them’. The success of a corporation depends upon the organisation’s ability to most effectively use capital, labour and natural resources to produce goods and services. That, in turn, depends upon ‘workers who are educated, safe, healthy, decently housed and motivated’ and operate in an environment with less waste, lower pollution levels and free from the outrage of the community about corporate ‘misconduct’.¹⁰

The importance of being seen as an organisation which does the ‘right’ thing and acts with fairness and integrity in its dealings in the community is the very reason for the proliferation of dedicated corporate CSR initiatives over the last two decades. Those initiatives are intended to enhance the company’s reputation as a proactive leader in the community on important social and environmental issues (even those that do not *directly* concern the company’s operations per se), such as climate change, gender diversity and LGTBI rights, generating trust and confidence among investors, customers and suppliers who are thereby incentivised to do business with the company.

The importance of CSR initiatives as a means of delivering stronger long-term profits for a company changes and evolves over time but the initiatives become especially critical following particular high-profile exposures of corporate misconduct, such as the James Hardie scandal involving a corporate restructure to avoid paying asbestos claimants, the misconduct precipitating the One.Tel and HIIH collapses, the corporate excesses of the global financial crisis and now the Banking Royal Commission revelations. Exposures of that kind drive community outrage and a desire for ‘crack downs’, with a strong incentive for companies to implement voluntary initiatives as a pre-emptive means of generating investor, consumer and supplier goodwill.

Equally important are employees, with millennials and the first of ‘Gen Z’ increasingly attracted to companies with a ‘social conscience’, a point recently emphasised by Qantas CEO Alan Joyce and Atlassian CEO Mike Cannon-Brookes.¹¹ To be able to entice and retain the most talented and skilled employees in future generations, which is a crucial driver of innovation, productivity and long-term profit, companies will need to continue to place a strong emphasis on CSR investment as part of their ordinary operations. As aptly put by one commentator recently, investment in ‘wine nights and yoga’ is no longer going to cut it.¹²

In that sense, CSR programs are an essential function of long-term, sustainable profit – a means for directors to respond to the *indirect cost* of a decline in profits through reputational damage.

CSR initiatives are entirely distinct from (despite often incorrectly being judged to have been somehow superseded by or subsumed within) the more recent dominant focus on ESG risks. Those risks result in quantifiable, direct costs unique to each company arising from various environmental, social and governance market factors, such as:

- compliance with mandatory climate, waste management, consumer, labour, whistleblower and anti-corruption and bribery regulations; and
- physical climate and technological changes that directly impact on how a company currently conducts its operations, such as the impact of drought on the viability of farming businesses and the impact of a shift to renewable energy on traditional mining businesses.

The alignment, rather than competition, between the interests of shareholders and other stakeholders in most instances has been identified in two previous inquiries commissioned by the Commonwealth Government, both of which reached the view that the alignment was such that any change to directors’ duties was not required.

First, in June 2006, the Parliamentary Joint Committee on Corporations and Financial Services (**PJC**) released its final report on various corporate responsibility and triple bottom line reporting matters. Among other things, the PJC was asked to consider ‘[w]hether revisions to the legal framework ... are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community.’

On that issue, the PJC said:

Almost any Australian company could find ways to increase its profitability by looking for ways to increase its corporate responsibility ...

[T]he most appropriate perspective for directors to take is that of enlightened self-interest. Corporations 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.¹³

Next, in December 2006, in response to a request from the Government to consider ‘the extent to which the duties of directors ... should include corporate and social responsibilities or explicit obligations to take account of the interests of certain classes of stakeholders other than shareholders’, the former Corporations and Markets Advisory Committee (**CAMAC**) said in its final report:

[T]he environmental and social matters referred to in the debate on corporate social responsibility are really factors that directors should already be taking into account in determining what is in the best interests of their corporation in its particular circumstances ...

[T]he 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.¹⁴

While some of the conduct revealed during the Banking Royal Commission was egregious and exploitative of customers, employees and investors, it is important to avoid reactionary legal responses to particular instances of misconduct (often fuelled by headline-grabbing public commentary).

As the Australian Institute of Company Directors (AICD) was careful to emphasise in its submission to the Governance Institute of Australia’s 2014 discussion paper on possible changes to the shareholder primacy model:¹⁵

The overwhelming majority of Australian corporations operate as good citizens, acting well beyond their legal obligations because ‘enlightened self-interest’ dictates that they do so to be sustainable in the long term: to manage reputation risk, to be profitable, to be able to hire suitably qualified staff, to identify and satisfy customer needs and to be welcome members of the communities affected by their activities.¹⁶

The importance of directors taking into account other stakeholder interests in complying with their general law and statutory duties has also been referred to in the case law.

For example, in *International Swimwear*, Ward J reflected on the need for a level of ‘community confidence in the management of commercial businesses by directors’.¹⁷ Even more directly, on appeal to the Western Australia Court of Appeal in the landmark *Bell* decision, Drummond AJA noted:

The impacts of corporate decision-making on a wider range of interests than shareholders are now being given more recognition. The need to ensure protection of those interests also I think serves to explain why modern company courts have become more interventionist, in reviewing the activities of directors than was traditionally the case.¹⁸

The *need* for directors to take into account other stakeholders, as distinct from the mere *possibility* of doing so, as a means of delivering long-term profits in the best interests of the company's shareholders, is even stronger following the Banking Royal Commission. Now, more than ever, there is an alignment between the interests of corporate stakeholders, with the reputational consequences for a company simply too great for directors to view profit generation as somehow divorced from the broader community in which the company operates.

It is clear that directors are beginning to understand the full implications of this position and the need to actively implement CSR and ESG measures as a 'now issue', not something for 'tomorrow's board' that directors can afford to bury their heads in the sand about. In the AICD's latest *Director Sentiment Index*, demonstrating respect for customers, clients and communities was ranked as the top matter boards should prioritise to rebuild public trust following the Banking Royal Commission.¹⁹ And in response to the AICD's April 2019 *Forward Governance Agenda* consultation paper, the most 'generally accepted understanding of the legislative duty' among directors and senior managers was that addressing the interests of non-shareholders is inherently part of acting in the best interests of shareholders, and therefore the company, as a whole.²⁰

A number of high-profile directors and business leaders have also openly spoken about the importance of CSR and ESG measures in driving long-term growth and sustainability in recent times. In addition to Alan Joyce and Mike Cannon-Brookes, BHP CEO Andrew Mackenzie has led the charge on reducing carbon emissions, while former chair of Macquarie Group and Origin Energy Kevin McCann, Boral chair Kathryn Fagg and Business Council of Australia Chief Executive Jennifer Westacott have emphasised that 'social issues' and profits are not mutually exclusive.²¹

Against this backdrop, the remarks of Assistant Minister to the Prime Minister Ben Morton at the Australian Chamber of Commerce and Industry Summit in September that 'big business', seduced by 'noisy elites', too often spends time 'virtue signalling' by advocating for niche 'social issues' instead of focusing on profits, jobs and the economy, are fundamentally misinformed, failing to appreciate the actual legal and risk framework directors must deal with in running their companies.²² Again, the assumption that profits and wider stakeholder interests are in competition simply misses the mark.

In light of the existing interpretation of the law in Australia, amending the *Corporations Act* to require directors to take into account nominated wider stakeholder interests, along the lines of section 172 of the *Companies Act 2006* (UK) (**UK Companies Act**),²³ would be redundant and would not advance the current position.

It has been suggested that there would still be benefit in such an amendment as a point of *clarification* for directors in Australia, expressly bringing other stakeholders to the forefront of their minds in making corporate decisions.²⁴ However, we believe a section 172 amendment in Australia would confuse, not clarify, the law, creating adverse

consequences that could be avoided by focusing on ongoing training and education for directors instead.

Specifically, adopting a provision similar to section 172 of the *UK Companies Act* is likely to create doubt about when a director may be said to have ‘considered’ and balanced non-shareholder interests and opens the door to non-shareholders asserting that directors owe them a legally enforceable, *independent duty*. That would paralyse directors’ ability to exercise their business judgment to balance different stakeholder interests to achieve an outcome they believe, in their considered view, to genuinely be in the best interests of the company. That balance that will never be ‘fixed’ and will evolve and change depending on the unique circumstances facing a company at any given point in time. The perpetual risk of litigation by any stakeholder unhappy with a decision made by directors, a risk heightened by the continued growth in corporate class actions in Australia supported by well-resourced litigation funders,²⁵ would compromise risk-taking and value-creating activity for individual companies and the broader economy. Those outcomes, discussed in further detail later in this paper, outweigh any benefit argued to arise from ‘clarifying amendments’ along the lines of section 172 of the *UK Companies Act*.

THE POSSIBILITY FOR DIVERGENCE

Nevertheless, while in the current climate of heavy public scrutiny and hypervigilance there will most often be a synergy between the interests of shareholders and other stakeholders, so that directors are incentivised to invest in general CSR initiatives as an essential function of long-term, sustainable profit, in addition to implementing tailored measures to address the particular ESG risks facing the company, it remains *possible* for the interests to diverge.

Specifically, in the absence of mandatory laws which impose *direct* compliance costs on a company as part of its unique ESG risk profile, there will come a ‘price point’ where additional investment in CSR measures which benefit wider stakeholder interests will not, on a cost-benefit analysis, produce any further reputational enhancements to drive increased profits. Nor will any further mitigation measures be required to reduce the *existing* specific ESG risks impacting on the company. In those cases, the interests of shareholders must take priority on the current formulation of directors’ duties.

As Austin and Ramsay note, ‘management may implement a policy of enlightened self-interest on the part of the company but may not be generous with company resources when there is no prospect of commercial advantage to the company’.²⁶

Likewise, in articulating the shareholder primacy model, Friedman emphasised that there can be no suggestion a director must

refrain from increasing the price of [a] product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of the corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation *or that is required by law* in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire ‘hardcore’ unemployed instead of better qualified available workmen to contribute to the social objective of reducing poverty ...

In each of these cases, the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending their money.²⁷

Alternatively, even where there are sufficient mandatory laws regulating environmental and consumer protection, labour conditions, workplace health and safety and other substantive matters reflecting the interests of non-shareholder stakeholders, there may still be an incentive for companies to cut corners or evade the law altogether in the absence of suitable penalties and robust, effective monitoring and enforcement by regulatory bodies. Perversely, this too becomes a cost-benefit matter, with the risk of 'getting caught' not enough to justify the compliance costs and deviation from profits. Again, in such a case, the interests of shareholders and other stakeholders will diverge.

Proponents of reformulating directors' duties may use the potential for divergence between the interests of shareholders and other stakeholders in these scenarios as the basis to argue that, rather than only being required to *consider* the interests of other stakeholders, directors must place those other interests on at least an equal footing, if not *prefer* those interests, to shareholders' interests.

And given the potential for corporate abuse so comprehensively exposed during the Banking Royal Commission, could it not be said that enhanced directors' duties of that kind would be a welcome development?

In our view, for the reasons outlined in the next section of this paper, the answer is no.

RESPONDING TO DIVERGENCE

We do not dispute that non-shareholders may be vulnerable to improper behaviour by companies and their officers, nor do we suggest that sufficient protection of those stakeholders is not a desirable *end goal* to pursue. Rather, we suggest that amending directors' duties is not the appropriate *means* of delivering that end.

Our argument proceeds on the basis that, absent agreement by investors to associate for a specific public interest cause, as for example in the case of a not-for-profit organisation, the best contribution a company can make to the community is through value-producing activity and long-term productivity and economic growth. This takes the form of investment, infrastructure, manufacturing, energy production, service delivery, job creation, the development of new products and technology through innovation and the generation of revenue which contributes to a greater tax base.

It is not up to private organisations to, in effect, formulate and implement *public* policy and community welfare, just as that is not the responsibility of private individuals. Why is the responsibility any greater just because an entity takes a corporate form?

The reformulation of directors' duties to require directors to act equally in the best interests of not just shareholders but also other stakeholders (or to prefer the interests of other stakeholders) effectively 'outsources' government to the private sector.²⁸ While that may be *politically* advantageous for the Government on some occasions, as for example in the case of what continue to be electorally divisive climate change reforms, increasing the

scope of directors' duties would prejudice the very interests said to be vulnerable to corporate misconduct by acting as a disincentive for directors to take risks and pursue innovative, value-creating, growth-focused activities for the benefit of the company and the broader economy. This impact would be felt in two ways.

First, on a pure resources level, reformulating directors' duties would divert directors from doing what they do best – creating value in their specific corporate sectors – to meet a requirement to make judgments about how to satisfy broad-based and ill-defined public policy interests they simply do not have any expertise in.

Secondly, imposing more regulations on directors, thereby enhancing the scope for direct personal liability, would add to what is already a highly regulated governance environment for directors, significantly reducing directors' appetite for risk-taking and even the willingness of highly qualified and experienced individuals to take up directorships in the first place.²⁹ This implication has been specifically referred to in two previous Government-led law reform inquiries.³⁰ It was also emphasised in a recent AICD report which highlighted just how risk-averse Australian directors have become, in contrast to their international counterparts, as the focus on the threat of personal liability has dominated board decision-making.³¹ As ANZ chairman David Gonski observes in that report, '[r]isk-taking, which is part of innovative thought, is becoming something that's quite dangerous to one's career'.³²

In an attempt to offset the negative consequences of over-regulation, Australia's insolvent trading laws, previously regarded as among the most severe in the Western economy,³³ were amended in 2017 to provide directors with a 'safe harbour' from personal liability where they pursue a restructuring plan likely to ensure the long-term viability of a company notwithstanding the company's current circumstances of financial distress. The safe harbour was designed to foster a stronger risk-taking and entrepreneurial culture in Australia, 'central to economic growth, job creation and future prosperity', effecting a shift from the existing 'fear of failure' entrenched in Australian businesses and which is so diametrically opposed to the culture seen in the United States.³⁴

It would be a backwards step for that considered policy approach which took decades to cultivate to be wound back by a reactionary response which assumes greater personal liability for directors – perhaps unfairly 'demonised' in some post-Banking Royal Commission commentary – is automatically the best approach.

The problem is not with the current formulation of directors' duties. If stronger laws are desired to address the vulnerability of various non-shareholder stakeholders to the potential abuse of corporate power, it must come through enhanced mandatory consumer protection, labour and environmental laws. Directors, on behalf of the company, will then be compelled to factor those mandatory laws into the company's unique ESG risk profile so that profit, and therefore shareholder wealth, will be subject to the direct, measurable cost of complying with the specific laws impacting on the company.

In that way, a stronger external regulatory framework, rather than the adjustment of internal governance in the form of modified directors' duties, is a means to ensure an alignment between shareholders' interests and those of other stakeholders while avoiding

the prejudice to value-creating activity and growth that would come through expanding directors' personal liability.

Similarly, incentives for a company to evade the law should be dealt with not by seeking to alter directors' duties but rather by enhancing penalties and devoting resources to greater investigation, compliance and enforcement. Those are measures the Government has already been actively pursuing this year, with:

- the passage of the Treasury Laws Amendment (*Strengthening Corporate and Financial Sector Penalties*) Act 2019 (Cth) enhancing the severity and scope of civil penalties and criminal offences under the *Corporations Act*; and
- the allocation of \$400 million in new funding to ASIC and \$150 million in new funding to APRA in the 2019-20 Budget²⁵ to strengthen their enforcement capability as the regulators look to pursue their respective new 'why not litigate?'²⁶ and 'constructively tough' enforcement approaches in response to criticism during the Banking Royal Commission of the 'friendly' settlement-focused approach previously taken by the regulators.²⁷ Time will tell just how successful ASIC and APRA are in their new enforcement efforts, but the immediate point in this paper is simply that from a *policy* perspective, stronger enforcement capability is an appropriate means to protect the interests of non-shareholder stakeholders.

CONCLUSION

Under Australia's existing laws, directors are required to act in the best interests of 'the company'. While, in periods of solvency, the company is deemed to correspond with the interests of shareholders, in a post-Banking Royal Commission climate of heightened scrutiny and community expectation for the companies they deal with to act responsibly, ethically and with integrity, the interests of shareholders and other stakeholders will most often align.

For a director (or the Government for that matter) to frame the issue as a choice between profit and growth on the one hand and taking into account other stakeholder interests on the other hand is to miss the point entirely. Taking into account the interests of non-shareholders by spending money on CSR measures to build trust, confidence and appeal to customers, employees, suppliers and investors, in addition to implementing specific risk mitigation measures to respond to the unique ESG risks facing the company, is a necessary component of directors properly discharging their duty to act in the best interests of the company. Failure to do so will inevitably impact on the company's financial performance and directors will be exposed to personal liability for breaching their statutory and fiduciary duties.

While it is possible for the interests of shareholders and other stakeholders to deviate where directors legitimately believe that further expenditure on CSR measures will not produce any additional reputational benefits and that sufficient mitigation measures have already been taken to respond to the specific ESG risks impacting on the company, that does not mean amending directors' duties to mandate the equal treatment of all stakeholders (or to place other stakeholders above shareholders) is the right answer.

As staunchly in favour of profit-making as a company's primary objective as Friedman was, he conceded that the pursuit of shareholder wealth is only ever justified to the extent a company 'stays within the rules of the game'.³⁸

If it is desired to afford further protection to non-shareholders to guard against the perceived risk of corporate misconduct, the protection should come in the form of new 'rules of the game' in the external regulatory environment specifically tailored to the circumstances of particular stakeholders. This ensures a coherent, rational legal policy approach that avoids stifling corporate risk-taking and innovative, value-creating activity – activity which is as much in the long-term interests of 'vulnerable' stakeholders as it is for shareholders.

Footnotes

- ¹ Simon Goodley and Rupert Neate, 'Leading US Bosses Drop Shareholder-First Principle', *The Guardian*, 20 August 2019. See also Alan Kohler, 'A Nail in Friedman's Coffin as America's Leading Companies Revise Their Game Plan', *The Australian Business Review*, 24 August 2019.
- ² Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits', *The New York Times Magazine*, 13 September 1970, 6.
- ³ For a good outline of the nexus of contracts approach, see Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, 1991. See also the earlier work of those theorists in Frank Easterbrook and Daniel Fischel, 'The Corporate Contract' (1989) 89 *Columbia Law Review* 1416. For other leading contractarian contributions, see Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 4(3) *Journal of Financial Economics* 305; Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386; and Barry Baysinger and Henry Butler, 'The Role of Corporate Law in the Theory of the Firm' (1985) 28(1) *The Journal of Law and Economics* 179.
- ⁴ See, for example, *Ngurli Ltd v McCann* (1953) 90 CLR 425 (*Ngurli*), [24], referring to Evershed MR's classic statement of principle in *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 (*Greenhalgh*), 291 that 'the company' means 'the incorporators as a general body.'
- ⁵ [2011] NSWSC 488, [102].
- ⁶ This was also noted in *Greenhalgh* and cited with approval in *Ngurli*.
- ⁷ See, for example, *Darvall v North Sydney Brick and Tile Co Ltd* (1989) 16 NSWLR 260. See also the Canadian decision in *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288, cited with approval by the Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.
- ⁸ The meaning of 'insolvency context' has not been precisely defined in the case law but is generally taken to require a real and not remote risk of insolvency – see, for example, *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1, [4445]; *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557, 589; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 10 ACLR 395, 403-404; and *Walker v Wimborne* (1976) 137 CLR 1, 6-7.
- ⁹ *Re New World Alliance Pty Ltd; Sycotex Pty Ltd v Baseler* (1994) 51 FCR 425, 444-445; *Spies v R* (2000) 201 CLR 603, 636.
- ¹⁰ Andrew Lumsden and Saul Fridman, 'Corporate Social Responsibility: The Case for a Self-Regulatory Model' (2007) 25 *Company and Securities Law Journal* 147, 167, quoting from Michael

- Porter and Mark Kramer, 'The Competitive Advantage of Corporate Philanthropy' (2002) *Harvard Business Review* 1.
- ¹¹ Phillip Coorey, 'Climate "Freight Train" Leaves CEOs No Choice', *Australian Financial Review*, 17 September 2019; Phillip Coorey, 'Qantas Need to be "Out There" On Social Issues', *Australian Financial Review*, 18 September 2019.
- ¹² Yolanda Redrup, 'Why Tech CEOs Can't Afford to Ignore Climate Change', *Australian Financial Review*, 23 September 2019.
- ¹³ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (June 2006) 51, 53.
- ¹⁴ Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (2006) [3.12].
- ¹⁵ Governance Institute of Australia, *Shareholder Primacy: Is There A Need for Change in Corporations Law?*, Discussion Paper (2014).
- ¹⁶ Australian Institute of Company Directors, Submission to the Governance Institute of Australia, *Shareholder Primacy: Is There A Need for Change in Corporations Law?* (December 2014) 2.
- ¹⁷ *International Swimwear*, [106].
- ¹⁸ *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1, [2051].
- ¹⁹ Australian Institute of Company Directors, *Director Sentiment Index: Research Summary – First Half 2019* (April 2019) 7.
- ²⁰ Australian Institute of Company Directors, *Forward Governance Agenda: Results of Member Consultation* (August 2019) 12.
- ²¹ For recent media reports of these remarks, see the sources referred to in footnote 11 above. See also Sally Patten and Patrick Durkin, 'Westpac Chairman Lindsay Maxsted Rejects Ken Henry's Call to Expand Directors' Duties', *Australian Financial Review*, 27 November 2018; Elizabeth Knight, 'Social Issues are No Longer Fringe for Business or Their Customers', *Sydney Morning Herald*, 20 September 2019; and Jennifer Hewett, 'Ben Morton Says He's Not Bashing Big Business', *Australian Financial Review*, 16 September 2019.
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- ²³ Jason Harris, 'Shareholder Primacy in Changing Times' (Paper presented at The Supreme Court of New South Wales Annual Commercial and Corporate Law Conference, 'Directors' Duties, Corporate Culture and Corporate Governance', Sydney, 20 November 2018) 17.
- ²⁴ For recent class actions statistics, see Vince Morabito, 'An Evidence-Based Approach to Class Action Reform in Australia: Competing Class Actions and Comparative Perspectives on the Volume of Class Action Litigation in Australia' (Research Report, 11 July 2018).
- ²⁵ Bob Austin and Ian Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis, 17th ed, 2018) [8.130].
- ²⁶ Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits', *The New York Times Magazine*, 13 September 1970, 2 (emphasis added).
- ²⁷ Andrew Lumsden and Saul Fridman, 'Corporate Social Responsibility: The Case for a Self-Regulatory Model' (2007) 25 *Company and Securities Law Journal* 147, 157.
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- Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66(5) *The Modern Law Review* 665.
- ²⁹ Corporate Law Economic Reform Program, *Directors' Duties and Corporate Governance: Proposals for Reform* (1997) 53-54; Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault* (September 2006) 2-3.
- ³⁰ Australian Institute of Company Directors, *Driving Innovation: The Boardroom Gap – 2019 Innovation Study* (September 2019).
- ³¹ Australian Institute of Company Directors, *Driving Innovation: The Boardroom Gap – 2019 Innovation Study* (September 2019) 4.
- ³² Law Council of Australia, Insolvency Practitioners' Association of Australia and Turnaround Management Association, Joint Submission, *Insolvent Trading Safe Harbour Options Paper* (March 2010) 7.
- ³³ Australian Government, *Improving Bankruptcy and Insolvency Laws*, Proposals Paper (April 2016) 3.
- ³⁴ Treasurer of the Commonwealth of Australia, The Hon Josh Frydenberg, 'Record Funding and Resources for ASIC and APRA to Help Restore Trust in Australia's Financial Sector', Media Release, 22 March 2019.
- ³⁵ After months of speculation and aspirational statements, ASIC provided further details on this approach, to be pursued by its new dedicated Office of Enforcement, in its 2019-2023 Corporate Plan.
- ³⁶ Further particulars of this approach are provided in APRA's 2019-2023 Corporate Plan.
- ³⁷ This point was emphasised by Alan Schwartz in his recent opinion piece, 'Why Milton Friedman Was Right', *Australian Financial Review*, 2 September 2019.