

STAKEHOLDERS AND DIRECTORS' DUTIES: LAW, THEORY AND EVIDENCE

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I INTRODUCTION

Policy prescriptions in Australia regarding in whose interests company directors should act have largely been based on views about whose interests directors ought to take into account. This article contrasts the results of a recent survey of Australian directors concerning the way they perceive their obligations to various stakeholders with current Australian corporate law¹ and two recent federal government inquiries. These two inquiries were conducted by the Corporations and Markets Advisory Committee ('CAMAC') and the Parliamentary Joint Committee on Corporations and Financial Services ('PJC'). The aim of this article is to assess whether case law and the outcomes of the two inquiries reflect directors' views. We also explore alternative proposals to the conclusions of the inquiries.

The push to reconsider the question in whose interests companies ought to be managed and directed has attracted strong interest due to the growing impact of the corporate social responsibility ('CSR') movement. The board of directors is the highest decision-making body in the company. As a result, it receives a great deal of attention within the CSR policy and academic literature and, in particular, in the sub-strand of stake-holding discourse.² Although debates concerning the stakeholder theory of the company have been exchanged since the 1930s, it was not until the 1990s that the idea that stakeholders who contribute to, benefit from and bear risk in companies should have their interests taken into account in corporate decision-making gained real influence in Australian public policy debates. Stakeholder models were seen as a means to moderate the shareholder

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1 We use the terms 'company law' and 'corporations law' interchangeably to refer to the body of statutory and common law which regulates the governance of companies.

2 See, eg, Lawrence E Mitchell, 'The Board as a Path Toward Corporate Social Responsibility' in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press, 2007) 279.

primacy model of corporate governance by which shareholder interests are privileged, sometimes at the expense of other stakeholders in the company, such as employees.

As we shall see in the account of the policy debate that occurred in relation to the two inquiries,³ it is generally assumed that a legal requirement that directors take into account the interests of stakeholders is unnecessary. Within the debates and policy literature two reasons gain most attention. First, it is often said that Australian companies largely follow a 'shareholder primacy' model, in which the interests of shareholders are pursued either over a short or long-term time frame. For some, this is seen to have wider economic benefits which would be diluted if companies were expected to pursue stakeholder interests as well. For others, it would be too complex and onerous to expect company directors and managers to change the way in which they operate so as to take into account interests other than those of shareholders. The second, more widely held view, is that current Australian company law permits directors sufficient freedom to pursue stakeholder interests without requiring that they do so.⁴ Rather than legislating, policy makers have shown a preference for allowing a more temperate adaptation to current practices and views through case law developments.

Against this, advocates of the stakeholder model of the company argue that the law should be changed so as to more clearly permit directors to take into account the interests of stakeholders. There has been concern that under the laws as they are currently constituted, directors may be breaching their duties to the company if they privilege the interests of non-shareholder stakeholders. Stronger advocates wish to require directors to take into account non-shareholder interests. These advocates hark to the lengthy development of the concept of 'stakeholding' in the sphere of company law and corporate management theory, where it has surfaced regularly in academic debates about corporate governance since the famous debate between Berle and Dodd in the 1930s.⁵ Stakeholding conceptions of the company are supported by the idea that companies need not and should not be operated solely in the interests of their shareholders. According to its advocates, changes in corporate management and company law should be made to ensure that, in their decision-making and policy formulation, company directors take account of the interests of not only shareholders but all those with a

3 See the text accompanying nn 35ff.

4 A mixture of these two reasons informed the view of the Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (Parliament of Australia, 1989).

5 A A Berle Jr, 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049; E Merrick Dodd Jr, 'For Whom are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145; A A Berle Jr, 'For Whom Corporate Managers are Trustees: A Note' (1932) 45 *Harvard Law Review* 1365. In the 1990s, there were a number of symposia on stakeholding which brought the idea back into academic purview: see, eg, Symposium, 'The Corporate Stakeholder Conference' (1993) 43 *University of Toronto Law Journal* 297; Symposium, 'Corporate Malaise – Stakeholder Statutes: Cause or Cure?' (1991) 21 *Stetson Law Review* 1.

'stake' in the company, including employees, creditors, suppliers, consumers, the environment and the community at large.⁶

Whether imposing a legal requirement that directors take into account the interests of stakeholders or taking the lesser step of permitting them to do so through amendments to corporate law would entail a re-conceptualisation of 'in whose interests the company operates', is a matter which lacks empirical evidence. This is because, until now, very little has been known about in whose interests Australian company directors seek to act.⁷ In this article, empirical evidence collected through a major survey of Australian company directors is examined concerning in whose interests directors consider themselves to be acting. This study is the most comprehensive of its type thus far conducted in Australia.

The remainder of this article is structured as follows: Part II provides a brief description of the stakeholder theory of the company; Part III considers the extent to which current Australian corporate law encapsulates a broader sense of directors' duties. In Part IV, the findings and recommendations of the reports of the two inquiries are outlined. In Part V of the article, empirical evidence regarding the way in which Australian directors perceive their obligations to various stakeholders is presented. In the concluding part of the article, the findings of the two inquiries and the law of directors' duties are critically assessed against this empirical evidence.

II STAKEHOLDER THEORY

The classical exposition of the stakeholder model of the company was developed by R Edward Freeman.⁸ Although the concepts of stakeholder, stakeholder model, stakeholder management and stakeholder theory have integrated themselves in business management and ethics parlance since the publication of Freeman's landmark book, the emerging literature sees these concepts explained and used by different authors in very different ways.

Donaldson and Preston outline three distinct uses for stakeholder theory that, when taken together, provide a theory of organisational management and business ethics that addresses morals and values in managing an organisation:

6 Paddy Ireland, 'Corporate Governance, Stakeholding, and the Company: Towards Less Degenerate Capitalism?' (1996) 23 *Journal of Law and Society* 287, 287–8.

7 Previous empirical studies include Ivor Francis, *Future Direction: The Power of the Competitive Board* (F T Pitman Publishing, 1997); S Bottomley and R Tomasic, *Directing the Top 500: Corporate Governance and Accountability in Australia* (Allen and Unwin, 1993).

8 Freeman supplies a history of the concept in R E Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, 1984) 31–42. Freeman explains that the concept is derived from the work of Adam Smith.

- (i) Descriptive: stakeholder theory is used to describe or sometimes explain specific corporate characteristics and behaviour.⁹
- (ii) Instrumental: stakeholder theory is concerned with management and used to identify the connections, or lack of connections, between stakeholder management and the achievement of corporate objectives such as growth and profitability. It is used in conjunction with descriptive/empirical data where available.¹⁰
- (iii) Normative: the theory is concerned with ethics and used to interpret the function of the company, including the identification of moral or philosophical guidelines for the management of companies.¹¹ It recognises the interests of all stakeholders are of intrinsic value. That is, each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as the shareholders.¹² Donaldson and Preston recognise this normative base as the core of stakeholder theory.

A Who is a Stakeholder?

The traditional or 'narrow' view of a company's stakeholders is limited to those concerned with the inputs (investors, employees, suppliers) and outputs (customers) involved in maximising value to the company and returning profits to shareholders. A wider view, taken in Freeman's 'stakeholder model', defines stakeholders as: 'Any group or individual who can affect or is affected by the achievement of the organization's objectives'.¹³

This approach is consistent with 'enlightened value maximisation',¹⁴ which recognises that value is not only created by 'inputs' and 'outputs', but also by the relationships between a company and its stakeholders. According to this view, stakeholders should have input into a company's decision-making processes for either instrumental reasons, for example in order to achieve buy-in, or for normative reasons, because the company has a moral obligation to those stakeholders to involve them in how the company is run.¹⁵

The normative definition has attracted criticism for being so expansive as to make it unworkable.¹⁶ Criticism has focused on the absence of agreed definitions within stakeholder theory about how stakeholders are identified, their views balanced and their interests taken into account in company decision-making.

9 Thomas Donaldson and Lee E Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications' (1995) 20 *Academy of Management Review* 65, 70.

10 Ibid 71.

11 Ibid.

12 Ibid 67.

13 Freeman, above n 8, 53.

14 Michael C Jensen, 'Value Maximization, Stakeholder Theory and the Corporate Objective Function' (2001) 14 *Journal of Applied Corporate Finance* 8, 9.

15 Ibid.

16 Eric W Orts and Alan Strudler, 'Putting a Stake in Stakeholder Theory' (2009) 88 *Journal of Business Ethics* 605, 607.

B Stakeholder Theory and Corporate Social Responsibility (CSR)

As the CSR movement has generated increasing discussion and debate, it has embraced both the normative and instrumental aspects of stakeholder theory, and stakeholder theory has become an essential process in the operationalisation of CSR: 'The notion of CSR is one of ethical and moral issues surrounding corporate decision making and behaviour'.¹⁷

In his most recent writings, Freeman argues stakeholder theory is consistent with an integrated, strategic view of CSR that focuses on value maximisation, as opposed to a residual view of CSR where activities are an 'added extra' rather than deeply embedded within a company's day-to-day business operations.¹⁸ The advancement of CSR practice has seen the development of open source tools such as the *Global Reporting Initiative Framework* and the *AA1000 Stakeholder Engagement Standard 2011* that provide companies with guidance on how a stakeholder approach can be integrated into strategic management decision-making.

At its most sophisticated level of practice, CSR is integrated with governance: ethics guide corporate decision-making and stakeholder views are considered in order to build long-term value maximisation. Freeman argues that CSR can help to reduce financial risk if it is properly integrated into the strategic decisions and operations of the company instead of an 'add-on':

The recent financial crises show the consequences of separating ethics from capitalism. The large banks and financial services firms all had CSR policies and programs, but because they did not see ethics as connected to what they do – to how they create value – they were unable to fulfill their basic responsibilities to their stakeholders and ended up destroying value for the entire economy.¹⁹

Much of the stakeholder and CSR literature has developed outside of jurisprudential discourse. Within the jurisprudential setting, discussion has centred on the responsibilities and duties of directors, with the proponents of the stakeholder model making a variety of different proposals for legal reform, most notably an extension of directors' duties, representation of stakeholders on the board of directors, voting rights for stakeholder groups, and greater disclosure of corporate information. Our focus in this article is on directors' duties.

III STAKEHOLDERS AND DIRECTORS' DUTIES UNDER AUSTRALIAN CORPORATE LAW

Section 181(1) of the *Corporations Act 2001* (Cth) ('*Corporations Act*') requires directors and other corporate officers to exercise their powers and

17 Manuel Castelo Branco and Lúcia Lima Rodrigues, 'Positioning Stakeholder Theory Within the Debate on Corporate Social Responsibility' (2007) 12 *Electronic Journal of Business Ethics and Organization Studies* 5, 5.

18 R Edward Freeman, 'Stakeholder Theory and Corporate Social Responsibility' in R Edward Freeman et al (eds), *Stakeholder Theory: The State of the Art* (Cambridge University Press, 2010) 235.

19 Ibid 241.

discharge their duties ‘in good faith in the best interests of the corporation’. There is an equivalent general law duty imposed on directors and senior executive officers.²⁰ What are the ‘interests of the corporation’? Do they extend beyond the interests of the company’s shareholders? A major argument used by those who are opposed to including stakeholder provisions in corporate law is that the law of directors’ duties is already permissive enough to allow directors wide discretion to take into account the interests of stakeholders.²¹ This interpretation of corporate law is also held by some proponents of the stakeholder model. For instance, Blair and Stout, who constructed the team production model of corporate governance,²² argue that ‘many features of corporate law in the United States are more consistent with our team production model than they are with shareholder primacy, at least if shareholder primacy is interpreted to mean maximization of shareholder value in the short term’.²³ For Blair, in the United States context, this is because the ‘prescriptions for directors’ duties under the team production model turn out to be very similar, and perhaps even ‘observationally equivalent’ in practice to the prescriptions that advocates of long-term share value maximization would make’.²⁴ For others, such as Sheldon Leader, the formulation of the company as an autonomous legal entity – separate from its shareholders as well as other stakeholders – creates the possibility that the legal conception of the company may already be largely consistent with the stakeholder conception.²⁵ The company has interests which are independent of any single set of people affected by it, including shareholders. Thus, the role of directors is to mediate a constantly shifting set of interests.

There is another view. The purpose of the company, according to a narrow conception, is to advance the interests of its owners (predominantly to increase their wealth), and the function of directors, as agents of the owners, is to faithfully advance the financial interests of the company because the company is

20 See R P Austin and Ian M Ramsay, *Ford’s Principles of Corporations Law* (LexisNexis Butterworths, 14th ed, 2010) [8.020], [8.070]–[8.150]. Contraventions of the statutory duty in *Corporations Act* s 181(1) are subject to different sanctions than contraventions of the general law duty. The former are subject to possible orders that impose pecuniary penalties and that disqualify the person who has contravened *Corporations Act* s 181(1) from managing corporations for a period the court considers appropriate: at [8.360].

21 This was the conclusion of both the CAMAC and the PJC reports: see the text accompanying nn 35–43. See also Austin and Ramsay, above n 20, [8.120]–[8.130] for elaboration of this interpretation of the law.

22 Margaret M Blair and Lynn A Stout, ‘A Team Production Theory of Corporate Law’ (1999) 85 *Virginia Law Review* 247. This is one of the more thoroughly developed, stakeholder-type, alternative models of corporate governance.

23 Margaret M Blair, ‘Directors’ Duties in a Post-Enron World: Why Language Matters’ (2003) 38 *Wake Forest Law Review* 885, 890.

24 *Ibid* 890–1.

25 S Leader, ‘Private Property and Corporate Governance Part 1: Defining Interests’ in F Macmillan Patfield (ed), *Perspectives on Company Law: 1* (Kluwer Law International, 1995) 85, 86.

the property of its shareholders.²⁶ The purpose of this part of the article is to assess the extent to which any of these contentions is accurate with regard to Australian corporate law.

Although it has not been discussed previously in the judgments of courts or the literature on Australian directors' duties, it can be argued that there has been a shift in the extent to which the interests of stakeholders other than shareholders can be considered by directors. Writing in 1967, Professor Parsons commented on what is meant by the interests of the company in the following terms:

It would seem that the interests of employees (cf, *Re William Brooks & Co Ltd and the Companies Act* (1962) 79 WN (NSW) 354) consumers and the public at large do not enter the calculation. The interests of creditors and debenture holders do not enter the calculation (*Richard Brady Franks Ltd v Price* (1937) 58 CLR 112; *In re Atlas Engineering Company* (1889) 10 LR (NSW) Eq 179).²⁷

Writing 20 years later, in 1987, Professor Sealy had a different interpretation of Australian corporate law – one that would allow the interests of non-shareholder stakeholders to be considered by directors, but only where shareholders benefited from such consideration:

Under the traditional rules of company law, directors' duties are regarded as being owed to the company and to the company alone; and for this purpose the company's interests are equated with the interests of the members collectively. Directors on this view are not entitled, still less bound, to consider the interests of other groups, such as the company's employees, creditors, customers and suppliers, or to have any concern for such matters as the community, the environment, welfare and charity, unless what they do has derivative benefits for their shareholders.²⁸

Three important questions can be asked. First, are there any circumstances when the interests of non-shareholder stakeholders can be considered by directors without there being any derivative benefit for shareholders? Second, are there any circumstances when the interests of non-shareholder stakeholders *must* be considered by directors? Third, are there any circumstances when the interests of non-shareholder stakeholders can be given higher priority by directors than the interests of shareholders? The questions relate only to the duty of directors to act

26 For elaboration of this view see Berle, 'Corporate Powers as Powers in Trust', above n 5; Berle, 'For Whom Corporate Managers are Trustees: A Note', above n 5. A court judgment that is frequently cited in support of this view is *Dodge v Ford Motor Co*, 170 NW 668 (Mich, 1919), where the Michigan Supreme Court stated that 'A business corporation is organized and carried on primarily for the profit of the [shareholders]. The powers of the directors are to be employed for that end': at 684. A more radical view is the contract conception of the company espoused by R H Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386. In adaptations of this model, the company 'tends to disappear, transformed from a substantial institution into [part of the market] in which autonomous property owners freely contract': W T Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo Law Review* 279, 265. For a development of the Coasian view see also: O Hart, 'An Economist's View of Fiduciary Duty' (1993) 43 *University of Toronto Law Journal* 299; Ronald Daniels, 'Stakeholders and Takeovers: Can Contractarianism Be Compassionate?' (1993) 43 *University of Toronto Law Journal* 315.

27 Ross W Parsons, 'The Director's Duty of Good Faith' (1967) 5 *Melbourne University Law Review* 395, 418, fn 99.

28 L S Sealy, 'Directors' "Wider" Responsibilities – Problems Conceptual, Practical and Procedural' (1987) 13 *Monash University Law Review* 164, 187.

in the best interests of the company. There may be other statutory obligations that require directors to consider the interests of particular stakeholders.

Justice Owen has provided insight into these questions.²⁹ In brief, there can be limited circumstances when the answer to all three questions is yes. Justice Owen observed that ‘a reflection of the interests of the company may be seen in the interest of shareholders’.³⁰ This is the established position. However, Owen J further observed:

This does not mean that the general body of shareholders is always and for all purposes the embodiment of ‘the company as a whole’. It will depend on the context, including the type of company and the nature of the impugned activity or decision. And it may also depend on whether the company is a thriving ongoing entity or whether its continued existence is problematic. In my view, the interests of shareholders and the company may be seen as correlative not because the shareholders *are* the company but, rather, because the interests of the company and the interests of the shareholders intersect ... It is, in my view, incorrect to read the phrase ‘acting in the best interests of the company’ 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 company, 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.³¹

Because of the nature of the case before him, Owen J gave particular attention to the interests of creditors. He stated that in an insolvency context, the duty to act in the best interests of the company includes an *obligation* on directors to take into account the interests of creditors.³² His Honour stated the obligation can arise in situations outside of actual insolvency, noting that:

a decision that has adverse consequences for creditors might also be adverse to the interests of the company. Adversity might strike short of actual insolvency and might propel the company towards an insolvency administration.³³

Moreover, according to his Honour, although the interests of creditors must be considered in an insolvency context, there is no rule that in this situation the interests of creditors are paramount.³⁴ They may be paramount in a particular situation but there is no rule that requires this conclusion.

Therefore, returning to our three questions, we can answer them as follows. 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. 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

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

30 *Ibid* 533 [4392].

31 *Ibid* 534 [4393]–[4395].

32 *Ibid* 540 [4418].

33 *Ibid* 546 [4445].

34 *Ibid* 544–5 [4436]–[4440].

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.

This brief examination of Australian corporate law has shown that directors are able to exercise significant discretion in executing their duties. This may be consistent with a limited stakeholder approach to corporate governance. However, it falls short of a fuller stakeholder approach which would allow directors to treat the discharge of employee and other stakeholder rights and interests as an end in itself, not as a means to some other ends, namely long term shareholder wealth creation.

IV TWO RECENT AUSTRALIAN INQUIRIES INTO CORPORATE GOVERNANCE

In this part of the article we review two recent Australian inquiries into corporate governance which had overlapping purposes. The first of these is the CAMAC inquiry and the second is the PJC inquiry. We document and then analyse the different interpretations of the duty to act in the best interests of the company adopted by the two inquiries.

A CAMAC Social Responsibility of Corporations Report

On 23 March 2005, the Parliamentary Secretary to the Treasurer requested CAMAC provide him with advice concerning to what extent the *Corporations Act* should include corporate social responsibilities or explicit obligations to take account of the interest of certain classes of stakeholders other than shareholders.³⁵

CAMAC's report, 'The Social Responsibility of Corporations', was released in December 2006. CAMAC decided no reform was required. However, in the course of its deliberations CAMAC identified its preferred interpretation of the scope of directors' duties based on the existing case law.

CAMAC stated that:

- the phrase 'the interests of the company as a whole' under the common law of directors' duties means the financial well-being of the shareholders as a general body. The overriding test is the well-being of the company and therefore the shareholders generally;³⁶

35 CAMAC, 'The Social Responsibility of Corporations' (Report, Australian Government, 2006).

36 Ibid 84.

- the phrase ‘the best interests of the corporation’ in section 181 of the *Corporations Act* obliges directors to act in the best interests of the shareholders generally. However, directors may take into account a range of factors external to shareholders if this benefits the shareholders as a whole;³⁷
- directors are also obliged to consider the financial interests of creditors when the company is insolvent or near-insolvent, though they have no direct fiduciary duty to creditors;³⁸
- directors are not confined in law to short-term considerations in their decision-making, such as maximising profit or share price returns. The interests of a company can include its continued long-term well-being;³⁹ and
- 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.⁴⁰

CAMAC rejected proposals for changes to the *Corporations Act*. The Committee 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.⁴¹

B PJC Corporate Responsibility Report

In June 2005, the PJC resolved to inquire into corporate responsibility. Its inquiry had particular reference to a number of questions which are relevant to this article. They included:

- The extent to which company decision-makers either currently have or should have regard for the interests of stakeholders other than shareholders and the broader community.
- The extent to which the current legal framework governing directors’ duties encourages or discourages directors from having regard for the interests of stakeholders other than shareholders, and the broader community.

37 Ibid 91–2.

38 Ibid 84.

39 Ibid 84.

40 Ibid 82 and 86.

41 Ibid 111.

- Whether revisions to the legal framework, particularly to the *Corporations Act*, are required to enable or encourage company directors to have regard for the interests of stakeholders other than shareholders, and the broader community.

The PJC's report, 'Corporate Responsibility: Managing Risk and Creating Value',⁴² was published in June 2006. The PJC concluded that no compelling case for change to directors' duties was presented during the inquiry. Further, the PJC considered that the existing network of social and environmental legislation provided sufficient regulation of the social and environmental performance of companies.

The PJC identified its preferred interpretation of the scope of directors' duties, although it is arguable that the PJC interpretation is different to that provided by CAMAC. The PJC stated:

Directors' duties as they currently stand have a focus on increasing shareholder value. This is important, because the provision is first and foremost intended to protect those investors who trust company directors with their savings and other investment funds. Directors' duties enable such investors to have some confidence that their funds will be used in order to increase the income and value of the company they part-own.⁴³

This resembles, to some extent, the interpretation of CAMAC – that the interests of the company are generally those of its shareholders. However, the PJC explicitly rejected what it termed the 'shareholders first' interpretation of directors' duties. The PJC defined this interpretation as follows: 'there is no particular objection to directors considering the interests of stakeholders other than shareholders, but the interests of shareholders must be the clear priority'.⁴⁴ The PJC stated that this interpretation of directors' duties is too constrained and stated that, in the view of the Committee, acting in the best interests of the company and acting in the best interests of the shareholders does not inevitably amount to the same thing.⁴⁵

Here we detect a difference with the interpretation of directors' duties adopted by CAMAC because CAMAC defined the best interests of the company as the best interests of the shareholders – while acknowledging that directors could take into account the interest of other stakeholders if this benefits the shareholders.⁴⁶

The PJC preferred what it termed the 'enlightened self-interest' interpretation of directors' duties. The PJC defined this as follows:

The enlightened self-interest interpretation of directors' duties acknowledges that investments in corporate responsibility and corporate philanthropy can contribute to the long term viability of a company even where they do not generate immediate profit. Under this interpretation directors may consider and act upon

42 PJC, 'Corporate Responsibility: Managing Risk and Creating Value' (Report, Parliament of Australia, 2006).

43 Ibid 59.

44 Ibid 51.

45 Ibid 52.

46 See the text accompanying nn 36–41 above.

the legitimate interests of stakeholders to the extent that these interests are relevant to the corporation ... The committee considers that the 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.⁴⁷

An important observation to be made about the interpretation of directors' duties adopted by the PJC is that the Committee does not define what it means by the company. According to the PJC, the enlightened self-interest interpretation of directors' duties focuses on 'the long term viability' of the company and the 'best interests of the company from a commercial perspective'. CAMAC defined the best interests of the company as those of its shareholders, basing this interpretation on existing case law. The PJC does not define what it means by the best interests of the company and therefore the Committee does not engage with the important question that arises concerning what stakeholders' interests receive priority if there are conflicting interests among stakeholders. The CAMAC definition does provide an answer to this question if (a) the conflict is between the interests of shareholders and some other stakeholder group, (b) the company is solvent, and (c) the conflict is to be resolved under the law of directors' duties and there are no relevant statutes other than the *Corporations Act* that impact upon the decision of directors.

C Conclusions Regarding Recent Inquiries in Australia

Both recent inquiries into whether reforms to directors' duties are required decided in the negative. Both did so on the basis that current corporate law is sufficiently permissive for directors to take into account non-shareholder interests. However, we also saw that the two inquiries adopted different interpretations of the scope of the duty to act in the best interests of the company.

V EMPIRICAL EVIDENCE IN AUSTRALIA

Other than the submissions of various companies and interest groups, the two Australian inquiries considered in the previous part of this article lacked empirical evidence regarding how directors understand their duties. Their determinations were based on whether the law reflected what directors ought to be doing or the scope of the discretion that directors ought to have to make business decisions. They had no sense of whether the law was out of step or consistent with wider practice. A survey of Australian directors sheds light on these questions.

47 PJC, above n 42, 52–3.

A Methodology

The survey was undertaken using a self-completion, mail-out survey form which was sent to 4000 company directors. Our sample was drawn from the Dun and Bradstreet 'The Business Who's Who of Australia' database.⁴⁸ Company directors were selected based on the following criteria:

- a roughly equal distribution of directors from companies in three sizes (by employee numbers): 50–100 employees; 101–250 employees and 250+ employees;
- a random mix from all states; and
- a random mix of all industries.

We achieved a final sample of 375 usable completed surveys. This is a low response rate but not uncharacteristically low for surveys of this kind, ie, of 'elite' personnel.⁴⁹ Around 200 surveys were returned due to incomplete or incorrect mailing details. A further 50 responded with apologies based on lack of availability of the directors or stated that company policy precluded the completion of surveys. The responses were from a cross-section of small and large companies based on employee numbers and income, and a mix of listed and unlisted public companies and proprietary limited companies: 75.5 per cent of respondents were from proprietary limited companies rather than public companies, and only 16.5 per cent of respondents were from listed companies. Twenty-eight per cent of the companies had earnings of less than \$20 million in the last financial year, 28.1 per cent had between \$20 and \$50 million, 12.7 per cent earned between \$50 and \$100 million, and 30.8 per cent had more than \$100 million in earnings. Thirty-two per cent of companies surveyed had less than 100 employees, 40 per cent had between 101 and 1000, and 30 per cent had more than 1000. Eighty-three per cent of companies had no foreign ownership and 95.3 per cent had their company headquarters in Australia.

B Directors' Understanding of their Duties as Directors

One of the central aims of the survey was to explore directors' understandings of their legal obligations and the way this might affect their approach to stakeholders. We were particularly interested in the extent to which shareholders were perceived to be the most important among several stakeholders. Do directors perceive that their primary obligation is to shareholders, either in the short term or long term, and, if so, is this partly a result of their understanding of the legal duties?

48 At the time of the survey the database was titled *The Business Who's Who of Australia*. It has now been retitled *Company360* and information about the database is available at *Company360* (2012) <<http://www.company360.com.au>>.

49 See, eg, Sanford M Jacoby, Emily M Nason and Kazuro Saguchi, 'The Role of the Senior HR Executive in Japan and the United States: Employment Relations, Corporate Governance and Value' (2005) 44 *Industrial Relations* 207, 216; Bradley R Agle, Ronald K Mitchell and Jeffrey A Sonnenfeld, 'Who Matters to CEOs? An Investigation of Stakeholder Attributes and Salience, Corporate Performance and CEO Values' (1999) 42 *Academy of Management Journal* 507, 513.

We asked directors to indicate which of four statements best represented their understanding of their obligation to act in the best interests of the company. We also asked them to indicate whether they believed the law required them to act only in the interests of shareholders or whether it allowed them to consider a broader range of stakeholders. Table 1 sets out the responses for these questions. A majority of directors understood that their primary obligation to act in the best interests of the company meant that they should balance the interests of all stakeholders (55 per cent). A further 38.2 per cent believed that they must, by means of acting in the interests of all stakeholders, ensure the long-term interests of shareholders.⁵⁰ No directors believed that they were required to act in the short-term interests of shareholders only and only a very small proportion (6.6 per cent) believed that they were required to act in the long term interests of shareholders only.

On directors' understanding of the parameters of their obligation, it is very clear (as shown in the bottom of Table 1) that most directors take a broad view. Nearly all directors (94.3 per cent) believed that the law is broad enough to allow them to take the interests of stakeholders other than shareholders into account.

Table 1: Directors' Understanding of the Scope of Directors' Duties

Primary Obligation: I must act in the best interests of the company and this means acting in the ...	Per cent Yes
Short-term interests of shareholders only	0.0
Long-term interests of shareholders only	6.6
Interests of all stakeholders to achieve short-term interests of shareholders	0.3
Interests of all stakeholders to achieve long-term interests of shareholders	38.2
Balancing the interests of all stakeholders	55
Parameters of Law on Directors' Duties	Per cent Yes
I must only be concerned with shareholders' interests	5.7
Allows me to take account of interests other than shareholders	94.3

n=368

These findings are in certain respects both consistent *and* inconsistent with the PJC and CAMAC determinations. On the one hand, they indicate that both Committees were correct in stating that the current law is not inhibiting the

⁵⁰ We did not in the survey ask directors to distinguish between types of shareholders (for example, whether shareholders were institutional shareholders) as this would have provided significant additional complexity to the responses and was not necessary given the purposes of the survey.

pursuit of stakeholder interests by directors. Almost all respondents thought the law allowed them to take account of interests other than shareholders. Based on our assessment (in Part III of this article) and also in the view of both inquiries, the respondents were justified in holding this opinion. On the other hand, it is the second most popularly held conception of directors' obligations that appears most consistent with the interpretation preferred by CAMAC. The understanding of obligations held by the majority of respondents to the survey (55 per cent) would seem to go beyond the preferred approach of CAMAC and possibly align more with the 'enlightened self-interest' interpretation of directors' duties preferred by the PJC.

C Stakeholder Ranking

An important question is whether directors acknowledge a primary obligation to the interests of shareholders. We tested this assumption in a number of ways. First, using a ranking exercise adapted from the Francis study,⁵¹ we asked directors to rank stakeholders in the order in which those stakeholders' interests were prioritised. Second, we utilised a scale to assess the relative influence of key stakeholders over the decision-making of directors. Third, we asked directors about the priority they assigned to certain specific shareholder-oriented matters such as dividend policy, share price and special dividends. These three tests enabled us to form an assessment of the shareholder orientation of the surveyed group.

Table 2 sets out the average ranking given to each stakeholder group, the percentage of directors who ranked that stakeholder group as their number one priority and the percentage of directors who included that stakeholder group as one of their top three priorities. It indicates that shareholders were most commonly ranked number one, followed closely by 'the company' according to both the average ranking and the percentage who ranked that group as their number one priority. Employees were highly ranked based on the average ranking given (2.87).⁵² However, very few directors (6.7 per cent) ranked employees as their number one priority.

Table 2: Priority Ranking of Company Stakeholders#

Stakeholder	Average Ranking	Percentage Ranked 1	Percentage included in Top 3
1. Shareholders	2.23	44.0	78.2
2. The Company	2.25	40.4	71.1
3. Employees	2.87	6.7	72.8

51 Francis, above n 7.

52 Ibid. Francis also conducted the ranking exercise in the US and Japan. The rankings made by respondents to our Australian survey sit somewhere between US and Japanese rankings. According to Francis, eight out of 10 US directors gave shareholders a number one ranking compared with one out of nine Japanese directors.

4. Customers	3.53	8.2	44.8
5. Suppliers	5.99	1.2	3.9
6. Lenders/Creditors	5.83	0.6	10.6
7. The Community	6.43	0.3	3.4
8. The Environment	7.07	0.6	2.0
9. The Country	8.41	0.3	1.1

n= 356

Directors were asked to rank the list of stakeholders in order of priority between 1 and 9 with 1 being highest priority. The smaller the average rank, the higher the priority.

These findings indicate that although directors believe their obligation is to balance the interests of all stakeholders, they nonetheless rank shareholders first amongst those stakeholders.

D Stakeholder 'Salience'

In order to obtain further information about what it means that shareholders are the highest ranking stakeholders, we measured the influence of shareholders, employees and creditors using a scale devised in research conducted in the US by Agle, Mitchell and Sonnenfeld into which stakeholders matter most to Chief Executive Officers ('CEOs').⁵³ Agle, Mitchell and Sonnenfeld sought to move beyond the assumption that stakeholders have a fixed position of influence in relation to the company and devised a model of salience (as they call it) or influence which is based on the assumption that salience depends upon managers' perceptions of the power, urgency and legitimacy of stakeholders.

Modifying Agle, Mitchell and Sonnenfeld's test somewhat, a series of propositions was presented to the surveyed group concerning the relative influence of shareholders, employees and creditors. The scale was comprised of seven items: directors were asked to rate the extent to which they agreed or disagreed with certain statements on a scale of 1 (strongly agree) to 5 (strongly disagree). Table 3 sets out both the proportion of directors who agreed with each proposition (in relation to shareholders) and the mean score for that proposition for shareholders, employees and creditors.

Table 3: Comparison of Shareholders, Employees and Creditors Salience

Statement	S/H per cent of Directors Agree*	S/H Mean score#	Emp'ees per cent of Directors Agree*	Emp'ees Mean score#	Cred's per cent of Directors Agree*	Cred's Mean Score#
Had the power to influence	81.2	4.03	78.0	3.74	23.6	2.44

53 Agle, Mitchell and Sonnenfeld, above n 49 (Table A, modified to avoid duplication).

Statement	S/H per cent of Directors Agree*	S/H Mean score#	Emp'ees per cent of Directors Agree*	Emp'ees Mean score#	Cred's per cent of Directors Agree*	Cred's Mean Score#
management						
Were active in pursuing demands or wishes which they felt were important	66.5	3.61	65.4	3.48	20.3	2.37
Actively sought the attention of our management team	64.6	3.54	70.5	3.60	21.6	2.39
Urgently communicated their demands or wishes to our company	48.8	3.20	47.0	3.14	19.6	2.35
Demands or wishes were viewed by our management team as legitimate	78.7	3.88	76.7	3.83	47.3	3.17
Received a high degree of time and attention from our management team	65.0	3.61	85.9	4.03	30.4	2.63
Satisfying the demands or wishes of this stakeholder group was important to our management team	83.3	4.02	87.9	4.04	54.7	3.22

* Includes responses 'strongly agree' and 'agree'

In this scale 5 is strongly agree and 1 is strongly disagree

The results in the table demonstrate that both the power of shareholders and the legitimacy of their interests remain a high priority in the perception of directors' interests. The items 'shareholders had the power to influence management' and 'satisfying the demands or wishes of shareholders was important to our management team' achieved the highest scores and had the largest proportion of directors who agreed. The item 'shareholders demands or wishes were viewed by our management team as legitimate' also scored highly. On the other hand, these high levels of legitimacy and power do not seem to be associated with similarly high levels of activity on behalf of shareholders as measured by the items 'shareholders were active in pursuing demands or wishes', 'shareholders actively sought the attention of our management team' and 'shareholders urgently communicated their demands or wishes to our company'. This suggests that shareholder power and the legitimacy of shareholder interests for directors arise, at least in part, independently of any direct pressure exercised by shareholders over directors in terms of governance strategy. In other words, shareholders have a level of power that is partly independent of their specific demand activity. Taken as a whole, though, these outcomes establish that 'shareholder primacy' is prominent in the attitudes of our respondent company directors.

When we further examine the break-downs for the items in the salience scale we see that with the exception of one item, the proportions and the scores are similar for both shareholders and employees. The exception to this is the item 'received a high degree of time and attention from our management team' with which 65 per cent of directors agreed in relation to shareholders compared with 85.9 per cent in relation to employees. Creditors are the least influential of the three stakeholders groups. The findings suggest that creditors have some degree of legitimacy (although lower levels of legitimacy than shareholders and employees) but low levels of power and urgency.

E Does High Shareholder Salience Make a Difference?

A key issue regarding the debate about the preferred formulation of directors' duties is to what extent a particular formulation affects corporate behaviour. There is very little detailed discussion on this point in policy debates. Advocates for a stakeholder conception of directors' duties believe such reforms will impact positively on corporate behaviour. This is particularly the case where directors are *required* to take account of non-shareholder stakeholder interests. Some of those who prefer the status quo with respect to directors' duties argue that reforms to directors' duties will not produce the desired results and in fact will have negative consequences.

Data from our empirical research provide further insights which may better inform this debate. First, the data discussed thus far shows there is a certain amount of decoupling of corporate practice and formal obligations. Second, it shows that, even within the scope of formal directors' duties, directors are always juggling and balancing interests. This is at the heart of their job as the chief strategists or stewards (depending on the conception of their role in the company)

of the business. Their sense of their obligations and priorities is not static, but depends on the particular challenges facing the business at any moment.

The results reported in this section provide further understanding of the extent to which shareholder salience (or influence) was consistent with particular business practices or priorities on behalf of directors. This is important from a public policy perspective because it is often assumed that having a 'shareholder primacy' corporate governance strategy will result in the privileging of shareholder interests to the detriment of other stakeholders. In particular, it is assumed that those directors who prioritise shareholder interests will be less responsive to employees' needs and implement policies which are detrimental to employee consultation, as well as pay and conditions. This is one of the bases for arguing for a stakeholder approach.

We asked directors to rate a series of items on a scale indicating the importance of the items to the director.⁵⁴ Table 4 shows the items that were important to directors. As can be seen, there are very few differences across the groups. Ensuring that customers and clients were satisfied was the most important item to directors (97.4 per cent of whole sample). Growing the business was also very important (95.4 per cent of sample) as was ensuring employees are fairly treated (94.2 per cent of sample), with improving productivity highly important as well (92.8 per cent). Interestingly, and contrary to the assumption that the shareholder primacy model of governance would lead to the prioritisation of shareholders' interests by directors, the results show that generally the items that relate to employees' interests (morale, fair treatment, safeguarding jobs and creating more job opportunities) were rated as more important by more directors than those relating to shareholders' interests (dividend policy, share price and special dividends).

Table 4: Importance to You as a Director

Item	Percent of whole sample important#
Dividend Policy	41
Growing the Business	95.4
Improving Employee Morale	87.3
Creating Job Opportunities within the Company	46.3
Improving Productivity	92.8
Ensuring Customers/Clients are Satisfied	97.4
Making a Contribution to Society	32.1

54 This question was adapted from Jacoby, Nason and Saguchi, above n 49. They present results for their key executive values for Japanese directors and for Japanese human resource executives, US human resource executives, and US chief financial officers.

Item	Percent of whole sample important#
Increasing Share Price	45.0
Diversifying and Expanding into New Markets	48.8
Safeguarding Existing Employee Jobs	66.2
Reducing Costs	80.1
Ensuring Employees are Fairly Treated	94.2
Ensuring Other Stakeholders are Satisfied	67.2
Special Dividends	6.6

Where rated either most or very important

Just as we asked directors about the company's relationship with its shareholders, we asked about the relationship with employees. If shareholders were seen to be important and influential, then employees' interests and demands might receive a lower priority from directors.

We asked directors to indicate the issues concerning employees below executive level which had been raised at board level over the past 12 months.⁵⁵ The most striking finding is that directors in the high range of the shareholder salience scale were significantly more likely to report that restructuring or retrenchments concerning employees below executive level had been considered by the board during the previous twelve months (18.9 per cent) than directors in the low range (4.8 per cent). A similarly significant and related finding is that directors in the high range of the shareholder salience scale were more likely to report that staff numbers had decreased in the past year (20.4 per cent) than those in the low range (7.9 per cent). This finding seems to provide some support for the view that a strong shareholder orientation in companies may lead to an emphasis on costs and job reduction.

We also examined differences between stakeholder and shareholder oriented directors in relation to their beliefs about the source of their obligation to employees and the role that the law plays in relation to the human resources strategy of the company.⁵⁶ We asked directors to identify which of four possible sources was the dominant source of their obligation to employees. Most directors reported that they derive their sense of obligation toward employees from sources other than law. Forty-two per cent reported that it was business imperatives that

55 For this analysis, we divided the directors into two groups – those in the high range of shareholder salience and those in the low range. The division was based on the directors' replies to questions about how importantly they view the interests of shareholders. We then evaluated the responses of these two groups to questions regarding the interests of employees.

56 For this analysis, we divided the directors into two groups – with this division being different to the division summarised in n 55. The 'stakeholder oriented directors' are those who responded that they are required to 'balance the interests of all stakeholders'. The 'shareholder oriented directors' are those who equated the best interests of the company with the long or short term interests of shareholders.

underpinned their obligation to employees. A further 24.8 per cent believed that they had ethical or social responsibilities to ensure the well being of employees and this was the dominant source of obligation. A slightly higher proportion of directors (16.9 per cent) believed that their obligations stemmed primarily from corporate law, than did so in relation to labour law (15.8 per cent). We cross-tabulated these findings with data regarding directors' understanding of their obligations. Table 5 shows the responses for both stakeholder and shareholder oriented directors.

Table 5: Dominant Source of Obligation to Employees by Director's Orientation

Dominant Source of Obligation to Employees	Stakeholder Oriented Group (n=195)	Shareholder Oriented Group (n=155)
Labour Laws	14.3	17.3
Corporate Law and Directors' Duties	16.3	17.9
Business Imperatives	39.9	47.5
Ethical or Social Values	29.6	17.3**

** significant at 1 per cent level

As can be seen, the stakeholder oriented group was statistically more likely to indicate that the dominant source of obligation to employees was ethical or social values (29.6 per cent) than were shareholder oriented directors (17.3 per cent). The dominant source of obligation for both groups was business imperatives (39.9 per cent of stakeholder oriented directors and 47.5 per cent of shareholder oriented directors).

F Conclusions Regarding Survey Data

To summarise then, one of the major purposes of the survey was to determine whether directors adhere to a 'shareholder primacy' understanding of their responsibilities, as is often believed to be the case with Australian directors. We expected that this understanding would derive from a number of sources, including understandings of legal obligations, institutional frameworks and business imperatives. Our findings in this regard were mixed, and it cannot be said that the data confirmed the 'shareholder primacy' view, regardless of how broadly 'shareholder primacy' is defined (that is, whether shareholder primacy is regarded as involving the prioritisation of shareholder interests in the short term or the long term, to the exclusion or detriment of other stakeholders' interests). The first of our findings in this regard was that the majority of directors surveyed had what might be termed a 'stakeholder' understanding of their obligations. Just over half of the respondents believed that acting in the best interests of the company meant they are required to balance the interests of all stakeholders.

Furthermore, whilst 44 per cent of directors perceived shareholders as their number one priority, almost as many (40 per cent) regarded the company as their number one priority. However, questions which sought to test the shareholder primacy thesis in a more complex way did provide support for the argument that shareholder interests are prioritised over those of other stakeholders in relation to business practices. When shareholder 'salience' (influence and ability to make demands) was measured relative to the salience of other stakeholders, shareholders had a higher level of salience than employees and creditors.

One of the main concerns of advocates of a stakeholder approach to directors' duties is that where directors perceive that their primary responsibility is to shareholders, the interests of employees and other stakeholders receive a lower priority. The evidence on this matter from our survey data was mixed. Questions regarding directors' understandings of their obligations under the law did not suggest that prioritising shareholders' interests resulted in a diminution or de-prioritising of employees' interests. However, when we tested this issue using the 'salience' scale as a measure of the orientation towards shareholders and cross-tabulated it with other measures, we found some evidence that employees' interests may receive a lower priority. For instance, those directors in the high range of the shareholder salience scale were more likely to indicate that matters relating to restructuring and retrenchment had been discussed at the board level over the past year than those directors in the low range of the scale. On the other hand, dividend policy and increased share price ranked relatively poorly as against job security and employee morale in the list of specific corporate agenda items put to directors.

VI ASSESSMENT OF THE REPORTS OF THE INQUIRIES AND THE LAW IN LIGHT OF THE EMPIRICAL EVIDENCE

The question of in whose interests directors of Australian companies should act is one which has not been settled satisfactorily in Australia. The CAMAC and PJC inquiries decided that maintaining the status quo was appropriate as the current law of directors' duties provides sufficient flexibility for directors to determine what they think is in the best commercial interests of the company. However, we also saw that while the two inquiries reached the same conclusion regarding whether any reform of directors' duties is needed, the two inquiries adopted different interpretations of the scope of the existing law of directors' duties.

When we compare the findings of the two recent inquiries with the results of the survey data reported in this article, a number of observations can be made:

1. The survey data indicated that 94.3 per cent of directors believe that the existing law of directors' duties allows them to take account of the interests of stakeholders other than shareholders. This is consistent with the interpretation of directors' duties adopted by both CAMAC and the PJC.

2. In relation to directors' understanding of the scope of their duties, the survey data indicated that 55 per cent believe that acting in the best interests of the company means balancing the interests of all stakeholders and 38.2 per cent believe that it means acting in the interests of all stakeholders to achieve the long-term interests of shareholders. The larger group of the directors (the 55 per cent group) adopts the interpretation of directors' duties preferred by the PJC – what the Committee referred to as the 'enlightened self-interest interpretation'. The smaller group of directors (the 38.2 per cent group) adopts the interpretation of directors' duties preferred by CAMAC.
3. These different interpretations also appear in other data from the survey. We saw that in terms of priority ranking of interests, shareholders and 'the company' were ranked almost equally by directors as the most important priority.
4. Other data from the survey indicated that shareholders and employees have approximately equal influence with company management (and much more influence than creditors), although a notable difference was that employees receive significantly more time and attention from management than shareholders.
5. There is also evidence that some matters relating to the interests of employees (such as improving employee morale, ensuring employees are treated fairly, and safeguarding existing employee jobs) are rated by directors as more important than some matters relating to the interests of shareholders (such as dividend policy and increasing the company's share price).

Do these results indicate any need for reform of directors' duties? As we have seen, proposals for reform of directors' duties have been widely debated. One possible approach, considered by CAMAC, is an amendment to section 181 of the *Corporations Act* that would expressly *permit* directors to take into account the interests of specific classes of stakeholders, extending beyond shareholders. An amendment was made in the UK in 2006 as part of a major reform of UK company law that refers to directors considering the interests of stakeholders other than shareholders. Section 172(1) of the *Companies Act 2006* (UK) imposes a duty upon a director to:

act in the way he or she 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 as between members of the company.

It is important to note the limited nature of this reform – section 172(1) of the *Companies Act* makes it 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.

There are critics of an approach that incorporates into directors' duties specific reference to the interests of stakeholders other than shareholders. Some prefer the status quo and argue such reform may only confuse directors as they try to work out how to balance various interests. However, our survey research shows that directors are already balancing the interests of stakeholders and they are not typically looking to the duty to act in the best interests of the company to guide them in this process. They are guided by business imperatives and other considerations. In any event, this type of reform only permits directors to take into account the interests of non-shareholder stakeholders – something they can already do under the current Australian law.

An extended approach which *compels* directors to take into account the interests of non-shareholder stakeholders, with the interests of these stakeholders possibly being given greater priority than the interests of shareholders, would require much more. Our research suggests that any such reform would need to address a number of issues. The first amongst these is whether the statute is to create enforceable rights for certain stakeholders and, if so, which ones and how they are to be enforced (that is, as derivative rights on behalf of the company or personal rights). Without enforceable rights, such a reform is likely to make little practical difference to stakeholders. Further, evidence from the US suggests there is a risk that without accompanying enforceable rights, such a reform may only entrench managerial power.⁵⁷

The main challenges with expanding directors' duties so as to create an obligation to take into account non-shareholder interests were succinctly identified in 1989 by the Senate Standing Committee on Legal and Constitutional Affairs:

2.19 To be successful, enterprises need as a rule to take into account their employees, their customers and the community, as well as their shareholders. Evidence before the Committee emphasised this: it was pointed out that, as a matter of reality, directors already take into account the various interests their decisions might affect. It was urged upon the Committee by some that the imposition of wider duties was therefore unwarranted.

2.20 To require directors to take into account the interests of a company's employees, its creditors, its customers, or the environment, as well as its shareholders, would be to require them to balance out what would on occasions be conflicting forces. It would also limit the enforceability of shareholders' rights if directors were able to argue that, in making a certain decision, they had been exercising their option to prefer other interests.

2.21 If contemporary public policy requires [this approach], then a re-think of some of the fundamentals of company law would be required.⁵⁸

57 James J Hanks Jr, 'Playing with Fire: Nonshareholder Constituency Statutes in the 1990s' (1991) 21 *Stetson Law Review* 97, 103; Kathleen Hale, 'Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823, 836.

58 Senate Standing Committee on Legal and Constitutional Affairs, above n 4, 12.

The fact that similar arguments were made almost 20 years later in submissions to the CAMAC and the PJC inquiries demonstrates the persistence and force of this debate.

The results of the survey indicate that directors do not typically look to the law of directors' duties for specific guidance concerning the interests they should pursue as directors. Rather, that specific guidance is found in a raft of statutes other than the *Corporations Act*, such as labour laws, if they look to the law at all. In any case, they are more likely to be guided by business imperatives and ethics. The findings of our survey suggest that directors are not guided by a static view of their obligations. They are engaged in a juggling act which results in the prioritisation of different interests depending on the challenges facing the business at any moment.

To some extent, in their interpretations of directors' duties, the courts have reflected business reality and offered flexibility to directors to consider a wide range of interests provided that the interests of shareholders are thereby served. The courts have also indicated how the interests of the company shift so that the interests of creditors can assume greater importance than the interests of shareholders when a company is insolvent or nearly insolvent.

An important finding of the study is that ambiguity exists among the directors surveyed concerning the permissible scope of their duties. We have also seen that the CAMAC and PJC inquiries adopted different interpretations of the scope of directors' duties. This may be an argument for some clarification of the law to indicate for directors which of the interpretations is to be preferred.

At the same time, we should be cognisant of what appear to be significant limitations on the influence of the duty to act in the best interests of the company on the actual decision-making of directors. The fact that large proportions of directors surveyed can adopt different interpretations regarding the scope of the duty to act in the best interests of the company and yet this has not apparently lead to significant litigation or other challenges to the decisions of these directors may tell us something about the limited role of this duty compared to other obligations and duties that influence decision-making by directors. The function of this duty may be to set very broad parameters within which directors operate and it will usually only be egregious cases where directors' decisions are successfully challenged under this duty. The duty therefore permits extensive balancing of stakeholders' interests by directors within the broad parameters set by the courts.⁵⁹

This does not mean the duty is unimportant. There are of course some notable cases concerning the duty to act in the best interests of the company. The often cited *Kinsela v Russell Kinsela Pty Ltd (in liq)*⁶⁰ is important because of the significance it places on the interests of creditors when a company is insolvent or

59 For further evidence based on interviews of directors that the law of directors' duties is not central to the decision-making of directors, see Bottomley and Tomasic, above n 7.

60 (1986) 4 NSWLR 722.

nearing insolvency.⁶¹ There is also an important series of cases on the meaning of the interests of the company when the company in question forms part of a corporate group.⁶² A notable feature of recent Australian cases in which the actions of directors have been held to breach the duty to act in the best interests of the company is that they often involve the director pursuing a personal interest at the expense of the interests of the company.⁶³ However, where such a personal interest is not present, courts will typically not interfere with a good faith decision of directors that balances stakeholders' interests provided the decision is within the broad parameters established by the courts. When directors privilege shareholder interests at critical times in the life of the company, this is likely to have more to do with competitive business pressures than corporate law.

61 See Andrew Keay, 'The Director's Duty to Take Into Account the Interests of Company Creditors: When is it Triggered?' (2001) 25 *Melbourne University Law Review* 315.

62 See, eg, *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50; *Maronis Holdings Ltd v Nippon Credit Australia Pty Ltd* (2001) 38 ACSR 404; *Lewis (as liq of Doran Constructions Pty Ltd (in liq)) v Doran* (2005) 219 ALR 555.

63 Cases in this category include *Lawfund Australia Pty Ltd v Lawfund Leasing Pty Ltd* (2008) 66 ACSR 1; *Australian Securities and Investments Commission v Warrenmang Ltd* (2007) 63 ACSR 623; *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557; *Australian Securities and Investments Commission v Maxwell* (2006) 59 ACSR 373; *Re PFS Wholesale Mortgage Corporation Pty Ltd*; *Australian Securities and Investments Commission v PFS Business Development Group Pty Ltd* (2006) 57 ACSR 553.