DIRECTORS' DUTIES AND CORPORATE SOCIAL RESPONSIVENESS

PAUL REDMOND*

I INTRODUCTION

The Australian suburban landscape is dotted with homes, schools and other buildings made from asbestos cement sheeting. Most Australians have more than a passing contact with 'fibro' and a sentimental fondness for its unpretentious simplicity. Australians were amongst the largest consumers of asbestos products and the James Hardie group was the largest Australian manufacturer. However, exposure to asbestos may result in fatal diseases which do not become manifest for decades. In view of this long latency period, compensation claims for asbestos related disease in Australia will continue for many years.

The James Hardie group ceased asbestos operations in 1987 because of these health concerns and rising compensation claims. It later developed a substitute building product – fibre cement without asbestos – which enjoys spectacular success especially in United States markets where the group generates the bulk of its revenue and its management is located. By the late 1990s, the group's future seemed bright, dampened only by what management saw as 'legacy issues' arising from compensation claims from its earlier Australian asbestos operations. Through litigation, Hardie had effectively quarantined legal liability for compensation in the two wholly-owned subsidiaries that had conducted the group's asbestos operations. Removing these subsidiaries from the group would, it thought, assist it to raise funds more easily in United States capital markets where investor sensitivity to asbestos liabilities had hindered the group's earlier capital raising attempt. So began a complex corporate restructuring.

On 15 February 2001 the board of directors of the parent company ('James Hardie' or 'Hardie') approved a management proposal to transfer ownership of the two subsidiaries to a foundation which it created to hold them and process future asbestos claims. The Hardie board approved the transfer and agreed to make some modest further payments to the foundation since the subsidiaries did not then have positive net worth after taking account of likely future asbestos claims.[1] The company informed the stock exchange that the foundation had

* Sir Gerard Brennan Professor, Faculty of Law, University of Technology, Sydney; Emeritus Professor, Faculty of Law, University of New South Wales.

'sufficient funds' to meet all legitimate compensation claims anticipated from people injured by asbestos products manufactured by the former subsidiaries, thus providing 'certainty for both claimants and shareholders.'[2]

It quickly became apparent, however, that the resources of the foundation and the subsidiaries would be exhausted in a relatively short time. Hardie refused the foundation's persistent requests for supplementary funding. When the foundation's parlous finances became known, the issue became one of wide community concern. A Special Commission was appointed to inquire into the restructure. When the hearings were well advanced, Hardie accepted that the foundation had been very significantly underfunded. Indeed, the Commissioner found that the net present value of likely asbestos-related claims in future years was about $1.5 billion and the foundation's net assets a mere $179.2 million.[3] During the public hearings probing the adequacy of the foundation's funding, Hardie came under intense public pressure to accept greater responsibility for claims and towards the close of the hearings, it responded by proposing a limited compensation scheme.[4] It later negotiated an agreement with the New South Wales Government to contribute up to 35 per cent of its annual net operating cash flow to a statutory compensation fund, until 2045 (although the term may be extended if needed). The agreement was approved by Hardie shareholders and lenders. It is undoubtedly the largest corporate settlement reached in Australia.

There are clear indications that Hardie directors perceived themselves as constrained by the law on directors' duties in any disposition they might have to contribute to compensation for asbestos victims especially in view of their litigation strategy of quarantining liabilities in the former subsidiaries. Through the long restructuring process, Hardie directors were advised by external lawyers 'that directors could not provide … "more than that for which [the parent company] was legally responsible, without honestly believing that … what [they] were doing was of benefit to [its] shareholders."'[5] When the inadequacy of the foundation's funding became clear, Hardie justified its refusal to contribute on the grounds that 'there can be no legal or other legitimate basis on which

1 New South Wales, Special Commission of Inquiry into the Medical Research and Compensation Foundation, *Report* (2004) vol 1, 162 [11.51] ('*Jackson Report*'). For these payments, the foundation indemnified the parent company against liability under any asbestos claims that might be made against it: at 331 [21.6], 530–3 [28.8]–[28.16]. See further Gideon Haigh, *Asbestos House: The Secret History of James Hardie Industries* (Scribe Publications, 2006); Matt Peacock, *Killer Company: James Hardie Exposed* (HarperCollins, 2009).

2 James Hardie Industries Limited, 'James Hardie Resolves its Asbestos Liability Favourably for Claimants and Shareholders' (Media Release, 228763, 16 February 2001) <http://www.asx.com.au/asx/statistics/announcements.do> quoted in *Jackson Report*, 29 [2.35]. Civil penalty proceedings were commenced against the non-executive directors for breach of their duty of care in approving the release. The Supreme Court of New South Wales made declarations of contravention, civil penalty orders and disqualification orders which were later set aside by the Court of Appeal. In May 2012, the High Court allowed appeals from that decision, setting aside the substantive orders made by the appellate court: *Australian Securities and Investments Commission v Hellicar* [2012] HCA 17.

3 *Jackson Report*, above n 1, 7 [1.2].

4 Ibid 559 [30.27].

5 Ibid 196 [14.45(d)] (testimony of chair of the James Hardie board).

shareholder's [sic] funds could be used to provide additional funds to the Foundation and the duties of the company's directors would preclude them from doing so.'[6] The chair of the James Hardie board later referred to the 'immense difficulty, … [and] immense complexity'[7] involved in adjusting conflicting expectations upon directors. Their understanding of available options reflected the legal advice the Hardie directors received on their duties from a first-tier law firm. It is reasonable to assume that such advice is given regularly in Australian boardrooms in similar contexts.

Through the restructure James Hardie sought to distance itself from responsibility for the health effects of the past asbestos operations of the group, a measure contrary to the interests of external stakeholders such as employees and others suffering or yet to suffer asbestos-related diseases. Its plan was defeated by community and political pressure grounded in a social consensus of rare intensity as to the impropriety of Hardie's refusal to accept responsibility. The incident directly raises the relationship between corporate social responsibility and directors' duties. The argument of this article is that the legal duty of Australian directors to act in the best interests of their company does not give directors clear guidance as to how they may or should respond to the myriad social norms and expectations that are powerful and generally beneficial moderators of corporate conduct. Further, the article argues that Australian law gives directors insufficient licence to respond to these norms in circumstances where doing so is not clearly to the financial benefit of their company. Whilst business practice appears to be shaped by the wider norms, the James Hardie incident indicates the inhibiting effect that directors' duties may have when the response to social expectation is or may prove to be profit sacrificing.

Part II looks at the web of social norms, expectations and sanctions that bear upon corporations. Part III examines the scope of permissible director regard for stakeholder interests under Australian law and the guidance and protection Australian law gives directors in situations like those in Hardie where voluntary assumption of responsibility for its social harms is profit or shareholder welfare sacrificing. Parts IV to VI sketch some reform options including an explicit discretion for directors to respond to negative social impacts and stakeholder expectations despite profit sacrifice.

II CORPORATE RESPONSES TO SOCIETAL EXPECTATIONS

Modern business operates within a milieu of social norms and expectations with respect to its conduct and relationships. Two distinct groups of norms are especially significant – those referred to as norms of corporate social responsibility and norms of responsibility for the human rights impacts of

---

6 Ibid 557 [30.22] citing James Hardy Industries NV, 'Possible Asbestos Funding Shortfall Suggests Significant Change in Claims' (Media Release, 29 October 2003).

7 Fiona Buffini, 'Calls to Protect Corporate Conscience', *The Australian Financial Review* (Canberra), 23 November 2005, 4.

business operations and relationships. Both rely upon business self-restraint grounded in enlightened self-interest.

A Corporate Social Responsibility

1 *The Meanings of Corporate Social Responsibility*

While definitions abound,[8] corporate social responsibility ('CSR') is, in sophisticated modern conceptions, understood as 'the responsibility of enterprises for their impacts on society'.[9] The term CSR is sympathetically used to refer to a range of voluntary measures undertaken by companies to integrate social, environmental and business concerns in their operations and their interaction with stakeholders.[10] Stakeholders are variously defined as those with an interest in or dependence relationship with the company or those upon whom the company depends for its survival. They include, in addition to shareholders, employees, creditors, customers, suppliers, local communities or the wider community from which the corporation draws support. CSR represents a form of enlightened management practice, voluntarily adopted and extending beyond legal obligation because it is seen as being in the long-term interest of the corporation and its shareholders. A leading Australian practitioner describes CSR as 'rational, enlightened and self-interested business behaviour'.[11] In its strongest form it is not an optional add-on but is fully integrated into and shapes all aspects of corporate operations.

This dominant form of CSR has the advantage of enabling companies to manage the considerable non-financial risks of their operations; it also enables them to meet wider community expectations with respect to their conduct and to protect their 'social licence to operate'. CSR initiatives protect firm goodwill or brand name and intangible assets that generally comprise a major part of the balance sheet of any corporation dealing in public product, services or investment markets. CSR also offers the prospect of strategic social or ethical differentiation from competitors and broad legitimacy in consumer and investor markets and society generally.

2 *The Norms and Sanctions of Corporate Social Responsibility*

The modern CSR movement is an apparent paradox – a self-imposed discipline assumed by firms that forgoes some of globalisation's freedoms. CSR initiatives have proliferated over the past two decades and it is unusual for a major corporation from a developed country not to have adopted a policy that

---

8 Alexander Dahlsrud, 'How Corporate Social Responsibility is Defined: An Analysis of 37 Definitions' (2008) 15 *Corporate Social Responsibility and Environmental Management* 1.

9 European Commission, 'A Renewed EU Strategy 2011–14 for Corporate Social Responsibility' (Communication No 681, European Commission, 25 October 2011) 6.

10 See, eg, Commission of the European Communities, 'Corporate Social Responsibility: A Business Contribution to Sustainable Development' (Communication No 347, Commission of the European Communities, 2 July 2002) 5–8.

11 Westpac, Submission No 94 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Corporate Responsibility*, September 2005, 15.

addresses the negative social and environmental impacts of its operations and those of its supply chain. Most major firms and industries have now promulgated codes of responsible behaviour. It has been estimated that more than 3000 global firms issue reports on their social and environment performance and that there are more than 300 industry or product codes.[12] Corporate social responsibility is 'the tribute that capitalism everywhere pays to virtue.'[13]

In these instruments, firms make voluntary commitments dealing with labour standards and working conditions, respect for human rights, social and environmental impacts and corruption avoidance. Codes range from initiatives by individual firms, industries and sectors, to those created with wider stakeholder input and some with the further legitimacy of government participation. Other voluntary instruments cover reporting, compliance and verification. These commitments go beyond the firm's legal obligations; indeed, that is their ostensible purpose – to signify commitment to standards *beyond* those required by the legal systems of the countries in which they operate. They create a vast governance network of voluntary obligation, or 'soft law', embracing most industries and sectors of global business. This is not CSR as philanthropy but rather CSR as avoidance of social and environmental harm and responsiveness to the expectations of stakeholders and the sanctions that may accompany breach.[14]

CSR's origins were national but the movement has flourished under modern economic globalisation in response to instances of demonstrated governance failure in the global economy.[15] Although voluntary, CSR is socially and economically driven. The pressures to which firms respond are based on social or market-based sanctions, not legal. Code adoption reflects the advocacy capacity of civil society organisations, especially with the 'naming and shaming' leverage of global communications technology, to hold firms to standards of conduct. They draw upon the sanctions of concerned consumers, socially responsible investors, and pension funds and other investors also concerned with non-financial risk in long-term investment. Civil society organisations are typically non-profit with a values-based agenda; often they form part of transnational advocacy networks, 'activists beyond borders',[16] partners in the 'NGO-industrial

12 David Vogel, 'The Private Regulation of Global Corporate Conduct' in Walter Mattli and Ngaire Woods (eds), *The Politics of Global Regulation* (Princeton University Press, 2009) 151, 158.

13 Clive Crook, 'The Good Company', *The Economist* (online), 20 January 2005 <http://www.economist.com/node/3555212>; see also Doreen McBarnet, 'Corporate Social Responsibility Beyond Law, Through Law, For Law – The New Corporate Accountability' in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press, 2007) 10–11 ('the institutionalisation of corporate social responsibility as a business issue').

14 See David Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution Press, 2005) 17–24.

15 See Paul Redmond, 'International Corporate Responsibility' in Thomas Clarke and Douglas Branson (eds), *The SAGE Handbook of Corporate Governance* (SAGE Publications, 2012) 588–90.

16 See generally Margaret E Keck and Kathryn A Sikkink, *Activists Beyond Borders: Advocacy Networks in International Politics* (Cornell University Press, 1998).

complex',[17] and occupy one corner of a 'governance triangle' with firms and states in this network of international civil regulation.[18] The limits of effective civil society advocacy define the contours of the reputational risk to which CSR responds.[19] While these sanctions are uneven and contingent, for most firms CSR is not a wholly voluntary add-on to business strategy.

B Corporate Responsibility to Respect Human Rights

The United Nations 'Protect, Respect and Remedy' framework for business and human rights includes the principle that all business firms have a responsibility to respect the human rights of those affected by the firm's activities.[20] The framework was developed because of recurrent human rights abuses arising in the liberalised trading and investment regimes of the global economy. Business operations or supply relationships confront situations where there is a divergence between the licence effectively available in host states and the social expectations of the firm's consumers, investors and home state communities. These problems are ubiquitous and not confined to large international firms; 'few companies today … do not confront human rights problems'.[21]

The corporate responsibility to respect human rights does not derive directly from international law but from the assumption of responsibility by business

---

17 See generally Gary Gereffi, Ronie Garcia-Johnson and Erika Sasser, 'The NGO-Industrial Complex', *Foreign Policy* (Online), 1 July 2001 <http://www.foreignpolicy.com/articles/2001/07/01/the_ngo_industrial_complex>.

18 See generally Kenneth W Abbott and Duncan Snidal, 'Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit' (2009) 42 *Vanderbilt Journal of Transnational Law* 501.

19 Redmond, above n 15, 595–600.

20 John Ruggie, *Protect, Respect and Remedy: A Framework for Business and Human Rights*, UN GAOR, 8th sess, Agenda Item 3, UN Doc A/HRC/8/5 (7 April 2008) 9 [24] ('*Business and Human Rights Report*'). The other principles of the framework are the duty upon state parties to human rights instruments to protect against breaches by third parties (including business corporations) and the need for more effective access to remedies. The 'Protect, Respect and Remedy' framework is the most recent in a series of initiatives by the United Nations to identify standards of corporate responsibility for global business: Paul Redmond, 'Transnational Enterprise and Human Rights: Options for Standard Setting and Compliance' (2003) 37 *International Lawyer* 69, 96–102. The corporate responsibility is to respect internationally recognised human rights understood, 'at a minimum', as those expressed in the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights and the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work: *Business and Human Rights Report*, UN Doc A/HRC/8/5, 15–6 [52]–[53]. The responsibility applies independently of the host state's particular human rights commitments.

21 Sir Geoffrey Chandler, 'Keynote Address: Crafting a Human Rights Agenda for Business' in Michael K Addo (ed), *Human Rights Standards and the Responsibility of Transnational Corporations* (Kluwer Law International, 1999) 40.

itself.[22] According to the principal architect of the framework and erstwhile Special Representative of the UN Secretary-General on Business and Human Rights, the responsibility is grounded in social norms and social expectations that have acquired 'near-universal recognition by all stakeholders, including business'[23] so that the notion that companies possess human rights responsibilities is 'recognized by virtually all voluntary initiatives companies have undertaken, and … stipulated in several soft law instruments'.[24] The corporate responsibility is to respect the human rights of those affected by the firm's activities: '[this] essentially means not to infringe on the rights of others – put simply, to do no harm';[25] it applies to all companies in all situations. The responsibility includes both legal obligations and social norms and expectations:

> failure to meet this responsibility can subject companies to the courts of public opinion – comprising employees, communities, consumers, civil society, as well as investors – and occasionally to charges in actual courts. Whereas governments define the scope of legal compliance, the broader scope of the responsibility to respect is also defined by social expectations – as part of what is sometimes called a company's social license to operate.[26]

The responsibility to respect is a specific, non-discretionary norm to be distinguished from voluntary initiatives subsumed under the broad umbrella of CSR; it has greater normative force as part of the international human rights system and sharper definition in the content of its norms. The two concepts share a foundation in sensitivity to social expectation and, from a firm and investor perspective, long-term risk management.

III THE SCOPE OF DIRECTORS' DISCRETION TO RESPOND TO SOCIETAL EXPECTATIONS OF CORPORATE CONDUCT

Does Australian law on directors' duties permit directors to respond to social expectations of responsible corporate conduct? Or, do the CSR movement and the corporate responsibility to respect human rights grind against corporate law

---

22 *Business and Human Rights Report*, UN Doc A/HRC/8/5, 8 [23]. Ruggie cites as examples the International Labour Organisation's Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, the Organisation for Economic Co-operation and Development Guidelines on Multinational Enterprise, the United Nations Global Compact and company codes as instances of firm collaboration in international voluntary standards that evidence acceptance of these norms of responsibility.

23 John G Ruggie, 'Remarks by SRSG John G. Ruggie Public Hearings on Business and Human Rights Sub-Committee on Human Rights European Parliament', (Remarks delivered at the European Parliament, Brussels, 16 April 2009) < http://www.ohchr.org>.

24 John G Ruggie, 'Business and Human Rights: A Political Scientist's Guide to Survival in a Domain where Lawyers and Activists Reign' (Remarks delivered at the Annual Conference International Law Association (British Branch), London, 17 May 2008) < http://www.ila-hq.org/en/branches/british-branch/british_branch_2008.cfm>.

25 *Business and Human Rights Report*, above n 22, 9 [24].

26 John Ruggie, 'Mandate of the Special Representative on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises' (Preliminary Work Plan, UN Human Rights Council, 10 October 2008) 3.

norms like giant tectonic plates? The UN *Guiding Principles on Business and Human Rights*, elaborating the 'Protect, Respect and Remedy' framework, suggest as much, asserting that the implications of corporate and securities laws for human rights 'remain poorly understood' and that 'there is a lack of clarity in corporate [law] … regarding what companies and their officers are permitted, … to do regarding human rights' and in their guidance on respect for human rights.[27] James Hardie's lawyers advised directors that their duties set limits to any generosity they might wish to extend to victims of their subsidiaries' asbestos operations (see above, p 318). If directors were found to have been too generous and breached their duties, they would be personally liable to compensate the company for loss suffered; directors would be unable to protect themselves by seeking prior judicial relief and might hope only for *ex post* relief.[28] What then is the state of Australian law on the issue?

A The 'Unconfirmed Regulatory Consensus' on Permissible Regard for Stakeholder Interests

An 'unconfirmed regulatory consensus'[29] exists in the Australian legal and regulatory community on the tolerable regard that directors may extend to stakeholder interests.[30] This consensus rests on a very modest doctrinal foundation, little of recent origin; it is, however, a widely and confidently shared professional and regulatory opinion. The consensus is that directors may have regard for non-shareholder stakeholder interests within some uncertain limits, but not independently of consequential corporate benefit.[31] This consensus is 'unconfirmed' since it does not rest on explicit legislative direction or authoritative judicial decision: these questions have simply not arisen directly in a modern case coming before an Australian court for decision. The case law on the directors' duty to act bona fide for the benefit of the company as a whole has been almost entirely concerned with the exercise of power by directors for corporate control manipulation or other self-interested motives or purposes.[32] The scope of directors' discretion to consider and act by reference to social expectations or a stakeholder's interest, without personal benefit, has not been specifically addressed.

---

27 John Ruggie, *Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework*, UN GAOR, 17th sess, Agenda Item 3, UN Doc A/HRC/17/31 (21 March 2011) 8.

28 *Edwards v Attorney-General* (2004) 60 NSWLR 667.

29 Bryan Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practises Across Government, Law and Business* (Edward Elgar, 2010) 203.

30 For simplicity's sake this paper refers to directors only. However, the term is used here to include those senior managers who owe the same general law and statutory duties as directors.

31 See, eg, R P Austin, H A J Ford and I M Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) 281–2 [7.13]; Commonwealth, The HIH Royal Commission, *The Failure of HIH Insurance* (2003) vol 1, 118–9; CAMAC, 'The Social Responsibility of Corporations' (Report, Australian Government, 2006) 111–13 [3.2] ('*Social Responsibility of Corporations Report*').

32 See, eg, *Mills v Mills* (1938) 60 CLR 150; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285.

1 *The Structure of the Directors' Duty to Act in the Best Interests of the Company*

There is a long-standing general law duty upon directors expressed in the formulary that they must act bona fide for the benefit of the company as a whole.[33] This formulary comprises three distinct but related duties: a subjective duty of good faith, that is, to act honestly in the company's interests as the directors perceive them; a duty to exercise powers for a proper purpose; and a duty to consult and act by reference to interests that the law recognises as the 'interests of the company'.[34] The general law duties are supplemented by duties in similar terms contained in the *Corporations Act 2001* (Cth): directors must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.[35] These duties are expressed to apply in addition to the general law duties (section 185) but have been interpreted as expressing the older general law doctrines.[36] Both the general law and the statutory duties are owed to (and enforceable by) the company, the corporate entity, and not, save in exceptional circumstances, by individual shareholders.[37] By long tradition, courts are reluctant to interfere with directors' business decisions and to substitute their assessments; the tradition acknowledges the limitations of judicial capacity.[38]

The general law and statute also impose duties of care and diligence upon directors: *Corporations Act 2001* (Cth), section 180(1). For directors to enter into an arrangement with an outsider without any consequential corporate benefit would ordinarily breach the duty of care. However, the issue of when and to what extent directors may consider and promote outsider interests is determined under the duty of good faith and its statutory complement in section 181(1). That duty is accordingly the present focus.

2 *Whose Interests Are the 'Interests of the Company'?*

It is the duty of directors 'to consult [the company's] interests and its interests alone' in their decisions.[39] In Australia, the principal statement is the 1953 High Court decision in *Ngurli v McCann*, a decision concerning a director's exercise of the share issue power to retain voting control of the company.[40] The court quoted with approval from the judgment of Evershed MR in *Greenhalgh v Arderne Cinemas Ltd*, a case concerning the alteration of the corporate constitution:

> the phrase, 'the company as a whole,' does not (at any rate in such a case as the present) mean the company as a commercial entity as distinct from the corporators.

33 See, eg, *Ngurli Ltd v McCann* (1953) 90 CLR 425. The term 'general law' is used here to refer to the rules and principles of the common law and equity; see also *Corporations Act 2001* (Cth) s 9.

34 Austin, Ford and Ramsay, above n 31, 264–308.

35 *Corporations Act 2001* (Cth) s 181(1).

36 Austin, Ford and Ramsay, above n 31, 265–7 [7.2].

37 *Percival v Wright* [1902] 2 Ch 421.

38 See, eg, *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 NSWLR 68, 77; *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260, 281.

39 *Walker v Wimborne* (1976) 137 CLR 1, 7 (Mason J).

40 (1953) 90 CLR 425, 438–9 (Williams ACJ, Fullagar and Kitto JJ).

> It means the corporators as a general body. That is to say, you may take the case of an individual hypothetical member and ask whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.[41]

This statement identifying the company's interests with the welfare of shareholders as a collective body has been described judicially as an 'obscure and incomplete guidance to the interests.'[42] Recently, in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)*, Owen J further qualified the statement by Evershed MR's:

> 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 interests of 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. ...
>
> [I]t 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.[43]

It is not clear whether Owen J was referring only to the interests of creditors in a situation of actual or threatened insolvency where it is well established that directors must take account of creditor interests although they are not necessarily paramount.[44]

Master of the Rolls Evershed excluded from consideration the interests of the company as a commercial entity. However, as the parenthetical words indicate, this exclusion was in the specific context of a shareholder resolution to amend the constitutional contract between members, an issue solely concerning their *membership* interests and not raising any question of benefit of the company as a commercial entity. Different considerations apply when directors are exercising management oversight and operational powers and wider interests are engaged. Indeed, there is some recognition of the claims of the company as a commercial entity where directors' decisions are reviewed. Thus, in *Darvall v North Sydney Brick & Tile Co Ltd* Hodgson J said that 'it is proper [for directors in a contested takeover] to have regard to the interests of the members of the company, as well as having regard to the interests of the company as a commercial entity.'[45] Other authority permits directors to consider the interests of future shareholders, balancing them against those of present shareholders;[46] the interests of future shareholders may cogently be seen as a proxy for the interests of the entity itself

41 [1951] Ch 286, 291.

42 *Kirwan v Cresvale Far East Ltd (in liq)* (2002) 44 ACSR 21, 56 (Giles JA).

43 (2008) 39 WAR 1, 534.

44 Ibid 544–5; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722, 730 (Street CJ).

45 (1987) 12 ACLR 537, 554; affirmed in *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 230.

46 *Gaiman v National Association for Mental Health* [1971] Ch 317, 330 (Plowman J); see also *Provident International Corp v International Leasing Corp Ltd* [1969] 1 NSWR 424, 440; *Darvall v North Sydney Brick & Tile Co Ltd* (1987) 12 ACLR 537, 554.

to continuity and growth. The meaning of the 'interests of the company' for solvent companies, so integral to the scope of legitimate board response to social expectation, remains elusive and context dependent but appears to signify something more than the interests of the existing body of shareholders from time to time. No Australian case, however, appears to have held directors in breach of duty for considering only the short-term interests of current shareholders.

The question of the scope of legitimate regard for outsider interests has arisen in cases on ex gratia payments to employees. Payments to current employees of a going concern present no great difficulty in view of likely corporate benefit; at least if they are reasonable in quantum.[47] It is in relation to payments to former employees and their families,[48] or to employees on the cessation of company operations, that difficult issues arise. In *Parke v Daily News Ltd*,[49] a newspaper publisher sold its two newspapers resulting in the disposal of substantially all of its assets and the redundancy of most employees. The directors proposed to apply the balance of the sale money as ex gratia payments to redundant workers. A minority shareholder's challenge to the payment was upheld:

> The view that directors, in having regard to the question what is in the best interests of their company, are entitled to take into account the interests of the employees, irrespective of any consequential benefit to the company, is one which may be widely held. ... But no authority to support that proposition as a proposition of law was cited to me; I know of none, and in my judgment such is not the law.[50]

The authority of these ex gratia payment cases is clouded by uncertainty as to whether the decisions were made under the ultra vires doctrine rather than directors' duties. The ultra vires doctrine in its application to corporations formed under Australian companies legislation was abolished from the mid-1980s.[51]

3 *What Nexus is Required Between Social Responsibility Expenditures and Corporate Benefit?*

Australian law does not appear to impose on directors a duty to maximise profits and shareholder wealth despite the language of the statutory obligation to act in 'the *best* interests of the company'.[52] A leading text concludes that directors may 'implement a policy of enlightened self-interest on the part of the company but [they] may not be generous with company resources when there is no prospect of commercial advantage to the company.'[53] The requirement of consequential corporate benefit from expenditures upon others is clearly stated in

---

47 *Hampson v Price's Patent Candle Co* (1876) 45 LJCh 437.

48 See, eg, *Re Lee Behrens & Co Ltd* [1932] 2 Ch 46.

49 [1962] Ch 927, 962 ('*Parke v Daily News*').

50 *Parke v Daily News* [1962] Ch 927, 962 citing *Hutton v West Cork Railway Co* (1883) 23 Ch D 654, 671.

51 *Corporations Act 2001* (Cth) s 124(2).

52 J D Heydon, 'Directors' Duties and the Company's Interests' in P D Finn (ed), *Equity and Commercial Relationships* (Law Book Company, 1987) 120, 134–5.

53 Austin, Ford and Ramsay, above n 31, 281–2 [7.13].

the ex gratia employee payments cases but is expressed in other contexts also.[54] A parliamentary committee expressed the nexus in terms of the directors' *purpose* of gaining a benefit for the company.[55] Other commentators suggest that the main legal restriction on directors' discretion is that 'there be the possibility of *some* eventual return to shareholders which justifies a departure from short-term profit maximization'.[56] What is unclear is what commensurability, proportionality or balance, if any, is required between corporate expenditure and benefit. It is on this question that the Australian consensus becomes especially unclear. Although it is widely assumed that Australian law on directors' duties requires that stakeholder interests must pass through the eye of the needle of shareholder value, the question is not addressed specifically in judicial decision concerning companies which are not insolvent or facing the immediate threat of insolvency.

Consider the significance of this issue for the James Hardie restructure. If Hardie's businesses were entirely operated in Australia, the voluntary provision of funding to meet the shortfall in the asbestos subsidiaries' resources might have been unproblematic since it would be matched by a significant reputational boost for the company. However, with only 15 per cent of its revenue derived in Australia, and the company's future even more firmly directed offshore, the derivative benefit to the company might be disproportionate to that provided to Australian asbestos victims. When James Hardie ultimately agreed to the compensation settlement, its agreement was subject to approval by its shareholders. Presumably, this was done because of stock exchange listing rules in view of the size of the commitment made in the settlement, rather than because its entry would involve breach of duty by the directors requiring shareholder ratification and forgiveness. Such ratification was not sought in the shareholder resolution. Although no shareholder challenged its settlement, James Hardie demonstrates the constraints that directors' duties impose on directors and their uncertainty.

4 *Australian Directors' Understanding of Their Duties*

A survey of the practices and understanding of Australian directors indicates a discrepancy between legal norms and director practice.[57] A majority of respondent directors indicated that they understood that their primary obligation to act in the best interests of the company required them to balance the interests of all stakeholders (55 per cent). A further 38.2 per cent equated 'the best

---

54 *Woolworths Ltd v Kelly* (1991) 22 NSWLR, 226 (corporate generosity 'only if, essentially, it be for the benefit or for the purposes of the company').

55 Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989) 83 [6.3].

56 Richard Mitchell, Anthony O'Donnell and Ian Ramsay, 'Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labour Law' (2005) 23 *Wisconsin International Law Journal* 417, 437.

57 Malcolm Anderson et al, 'Evaluating the Shareholder Primacy Theory: Evidence from a Survey of Australian Directors' (Legal Studies Research Report No 302, University of Melbourne, 2007) 10–11.

interests of the company' with the interests of all stakeholders as a means of ensuring the long-term interests of shareholders. Only a very small proportion (6.6 per cent) believed that they were required to act in the long-term interests of shareholders only. Nearly all directors (94.3 per cent) believed that the law on directors' duties is broad enough to allow them to take the interests of stakeholders other than shareholders into account.

The beliefs of the two largest respondent groups as to the legitimate place of stakeholder interests are not supported by legal doctrine unless their views are qualified by assuming derivative corporate benefit, a tortured construction. At first blush, this data suggests that the law on directors' duties is not having an inhibiting effect on social responsiveness. Rather, it has no influence at all upon director conduct which is more likely shaped by business imperatives and social and ethical norms. Certainly, the data indicates ambiguity amongst directors as to the permissible scope of their duties. In larger decisions involving profit sacrifice without clear prospect of equivalent corporate benefit, taken with legal advice, the inhibiting effect is more obvious. James Hardie is the exemplar.

5 *Assessing the Australian Licence for Corporate Responsibility through Directors' Duties*

The James Hardie incident generated two inquiries into directors' duties and corporate social responsibility. The reports from both inquiries encouraged directors to incorporate social concerns into decision-making but considered that this is already permitted under Australian law. Both inquiries preferred social protection to be effected through targeted legislation outside corporate law. Both committees preferred an approach which they called 'enlightened self-interest'. To the Parliamentary Joint Committee on Corporations and Financial Services, this meant that 'directors may consider and act upon the legitimate interests of stakeholders to the extent that those interests are relevant to the corporation.'[58] The Corporations and Markets Advisory Committee ('CAMAC') would permit stakeholder accommodation which is likely to be in the company's own commercial interest as part of a strategy to maximise shareholder value over the long-term.[59] Both reflect the Australian legal consensus on the issue.

(a) The Litigation Process is Unlikely to Deliver Suitable Cases for Rule Elaboration in Australia

CAMAC thought that 'the courts, through their interpretation of the law … can assist in aligning corporate behaviour with changing community expectations.'[60] This seems an excessively benign view of the past influence and future prospects of judicial regulation of corporate social responsiveness through directors' duties. That is no reproach of the courts but recognition of the realities

58 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006) 52–3 [4.32], [4.39].

59 *Social Responsibility of Corporations Report*, above n 31, 77–9 [2.5].

60 Ibid, 111–13 [3.12].

that drive litigation. Most Australian decisions on the duty to act in the interests of the company have arisen in internal contests for corporate control and have not raised any question of stakeholder interests. Privative provisions were inserted into the *Corporations Act* in 2000 which oust the jurisdiction of courts in takeover disputes during the bid period (section 659B(1)), effectively stifling this path for rule development. In any event, CSR issues are by their nature not readily litigated. Shareholders do not have any formal power to force directors to take such initiatives because of the immunity directors enjoy from shareholder direction.[61] Further, it is difficult to see grounds for individual shareholder suit to compel board or management action. Effectively then, shareholder remedies exist only for the *restraint* of CSR action, by those who, as in *Parke v Daily News*, oppose decisions taken in response to stakeholder interests. Even here, information asymmetry and rational apathy militate against litigation initiative, especially since the benefits of a successful derivative suit are shared but the burdens are individual. The need for judicial approval for suit under the statutory derivative procedure introduced in 2000 is a further obstacle to shareholder suit. As a reform strategy, waiting for judicial resolution and renewal of these questions in Australia pits hope against long experience.

(b) Lack of Rule Clarity and Guidance for Directors

Even beyond these judicial process considerations, there are substantive flaws in the body of directors' duties as regulator of director discretion in responding to wider responsibilities. These result in lack of guidance as to the scope of director licence and the principles that should shape its exercise. The lack of guidance results in uncertain director protection and weakens incentives for corporate social responsiveness. Legal doctrines governing the discretion are poorly resolved, for example, as to whether and to what extent the interests of the company as a commercial entity may influence recognition of external claims. Where interests other than those of members are involved, conceptualising 'the company' as *enterprise* rather than simply as *membership* recognises the wider interests that are implicated in business success.[62] Looking only through the lens of current shareholder interest misses the time and institutional dimensions of enterprise.

Second, the Australian consensus assumes a nexus between corporate social expenditure and corporate advantage that is not grounded in clear doctrinal authority and lacks clarity as to character and quantum, whether of parity, proportionality or simply some derivative albeit disproportionate benefit. The assumption is also made that courts possess the institutional capacity to quantify, and weigh against the more readily calculable cost outlays, long-term future benefits of CSR measures such as reputational gains or avoidance of reputational damage. The nexus requirement precludes corporate response that involves net

61 *Automatic Self-Cleansing Filter Syndicate Company Ltd v Cuninghame* [1906] 2 Ch 34.

62 L S Sealy, 'Directors' "Wider" Responsibilities – Problems Conceptual, Practical and Procedural' (1987) 13 *Monash Law Review* 164, 174.

profit sacrifice, that is, outlays that exceed demonstrable corporate benefit. Its effect is also to inhibit corporate responses that are not comfortably supported by a plausible business case. This is a negative consequence since 'it is implausible to think that *all* socially beneficial corporate conduct conveniently happens to be profit-maximizing.'[63] James Hardie's lengthy refusal, upon legal advice, to contribute to asbestos claims exemplifies the baleful effect of this inhibition.

Third, while the case law generally identifies the interests of the company with the collective shareholder interest, it does not specify that the interest must be a *financial* interest solely or primarily as the nexus with corporate benefit.[64] Shareholders also have social preferences that affect their interests as investors including the satisfaction derived from enterprise activities. For pension and endowment funds and socially responsible investors in particular, investment is likely to have an important social dimension which is elided by focus on financial wellbeing only.

Fourth, the Australian legal consensus takes a narrow view of the regulatory forces shaping corporate conduct. It takes no account of the social norms and sanctions that moderate human behaviour generally. The restrictive licence for directors to respond to social norms inhibits their beneficial effect on corporate behaviour and arguably diminishes shareholder welfare. This consideration is explored in the next following part.

IV LEGISLATING TO LICENSE, AND SPECIFY THE PERMISSIBLE SCOPE OF, STAKEHOLDER ACCOMMODATION

What options are available to provide clearer guidance, encouragement and protection to directors minded to respond to social expectations upon their firms? A legal obligation might be imposed on directors to maximise corporate profits and shareholder wealth. However, none of the principal legal systems adopts such a legal norm which would be antithetical to long standing traditions of judicial deference to disinterested and informed business judgment. A diametrically opposed option is to *require* directors to have regard to the interests of shareholders *and* other stakeholders. These two options raise the larger question whether according primacy to shareholder or to stakeholder interests generally maximises aggregate social welfare, an issue beyond the scope of this article. Instead, three modest proposals are briefly sketched in this and the next two parts. Each more or less assumes the continuing primacy of shareholder interests.

The first option is for a statutory provision permitting (but not requiring) directors to respond to social expectations and norms and have regard to

---

63 Einer Elhauge, 'Sacrificing Corporate Profits in the Public interest' (2005) 80 *New York University Law Review* 733, 745.

64 See also *Social Responsibility of Corporations Report*, above n 31, 84–9 [3.2].

stakeholder interests. The option would grant an explicit discretion for directors to sacrifice profits in the exercise of their business judgment as to the best interests of the company. In many cases, that sacrifice will be supported by a plausible 'business case' of net corporate benefit. The option's utility is that it would permit director discretion to respect and respond to social norms and expectations as to responsible conduct without putting directors to ex post proof of net tangible corporate benefit under the business case. The James Hardie experience indicates the inhibiting thrall that the prospect of such justification in a forensic context casts upon directors. The fuzziness and uncertainty of the current law's exactions aggravate the inhibition. Of course, the option assumes that the exercise of discretion is untainted by material personal interest on the part of directors.

A majority of states in the United States grant directors discretion to promote stakeholder interests. 'Constituency' statutes have been enacted permitting, but generally not requiring, directors to consider the interests of other corporate constituencies such as employees, customers, suppliers, creditors, the community and society at large in deciding what is in the best interests of the corporation; most are not limited to responses to hostile takeovers but apply to any management decision.[65] Some statutes say that directors are not required to give primacy to any particular set of interests; some explicitly permit profit sacrifice. All assume that directors will use their business judgment in determining the weight to be given to particular stakeholder interests. Although it is sometimes argued that these statutes permit stakeholder regard only to the extent that doing so promotes long-term profitability, the better view appears to be that the licence is not so constrained.[66] The statutes do not give non-shareholder stakeholders standing to take enforcement action against directors for breach of duty and make no special provision for representation of their interests in corporate governance.[67] Even in those states like Delaware that do not have such a statute, the courts have recognised broad director discretion to have regard for the interests of non-shareholders even when not profit enhancing.[68]

A Recognising that the Beneficial Effect of Social Norms and Sanctions Improves Corporate Behaviour

Two principal arguments support such an explicit discretion to sacrifice profits. The first is that such discretion improves corporate behaviour by promoting responsiveness to social norms and sanctions that are beneficial moderators of conduct. In corporate firms these norms bear upon directors rather

65 The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (American Law Institute, 1994) vol 1, 75 ('*Principles of Corporate Governance*'); For a summary of constituency statutes, see Kathleen Hale, 'Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823.

66 Elhauge, above n 63, 766–7.

67 See Corporations and Markets Advisory Committee, Parliament of Australia, *Corporate Social Responsibility: Discussion Paper* (2005) 66–9 [3.2.3].

68 The American Law Institute, above n 65, 64–9.

than shareholders; enabling directors to respond by explicit discretion allows these norms fuller play. The drivers of human behaviour include the social norms of the communities in which we live (that is, the rules and practices that shape daily life but are not expressed in legal norms), the informal sanctions that accompany their breach and the personal impulses shaped by the moral compass within each of us. The regulation of human behaviour by law relies for its effectiveness upon these complementary norms and impulses: 'optimal regulation of behaviour has always required supplementing necessarily imperfect legal sanctions with social sanctions and internalized moral norms.'[69] Indeed, 'imperfect legal sanctions are in fact optimal'[70] since 'under inclusion cannot be eliminated without increasing the over inclusion of desirable conduct.'[71]

The Australian inquiries into directors' duties and corporate social responsibility proceeded with a narrow focus upon law and markets as the primary or sole regulators of corporate behaviour. Corporations operate, however, in a complex milieu of social norms, expectations and sanctions that can be powerful moderators of conduct. Consider first the impact of norms on directors themselves. The dramatic elevation of standards of care among company directors evident in the United States after the hostile takeover boom of the 1980s appears explicable not in terms of changing legal rules (which largely relaxed director obligation) but of changing social norms among directors as to the obligations assumed with directorial office. That shift in turn reflected a changed belief system among directors prompted by their recognition of the degree of management slack that permitted takeover offers with bid premiums of 50 per cent above market price.[72] The web of social norms is even greater for firms themselves. As noted in Part II, corporations are subject to multiple social norms, expectations and sanctions with respect to responsible conduct that go well beyond their legal obligations. This is especially so under economic globalisation where host state incapacity and home state unwillingness to regulate offshore activities leave much regulation of corporate conduct to social norms.

Two peculiarities of corporate structure insulate shareholders from the impact of social norms and make it important to preserve director discretion to respond to their impulse and sanctions. In publicly held companies without a controlling shareholder, shareholders are distant from enterprise operations. Sanctions for norm breach fall instead upon directors and managers responsible for or associated with offending conduct. Second, the scale of information asymmetry between directors and shareholders, and the collective action problems that deter close monitoring and intervention, further distance shareholders from social sanctions and the knowledge that is a prerequisite to moral responsibility. If social and moral norms are to have their beneficial effect within corporate firms,

69 Elhauge, above n 63, 740.
70 Ibid 748.
71 Ibid 740.
72 Melvin A Eisenberg, 'Corporate Law and Social Norms' (1999) 99 *Columbia Law Review* 1253, 1266–71.

directors need some discretion to respond to them including by appropriate profit sacrifice if necessary.

B It May be in Shareholders' Interests to Permit Directors the Discretion to Sacrifice Profits to Comply with Social Norms and Expectations

A second argument is that director discretion to sacrifice profits enlarges aggregate shareholder welfare since it enables the firm to engage in dealings that generate trust and exchange that are not conditioned upon discrete transaction advantage. Elhauge argues that a 'social understanding that actors are likely to comply with social and moral norms … leads to a social reciprocity that is profit-maximizing for each actor.'[73] It is the very prospect that the corporation will engage in profit sacrificing that encourages those with whom it deals to treat it liberally in anticipation of future reciprocal benefit. If, however, directors are denied discretion to sacrifice profits in business dealings, the firm will be excluded from otherwise beneficial exchanges. Elhauge's conclusion on aggregate shareholder welfare is persuasive where it may be assumed that managers represent the views of a majority of shareholders in the decision to sacrifice profits, especially where those views are confirmed by shareholder resolution.[74] The position with respect to aggregate shareholder welfare in other circumstances is less easily demonstrated.

C Protective Limits to Discretion to Sacrifice Profits

All power needs be held to account. Several limiting devices are available to police the exercise of discretion to sacrifice profits including devices grounded in reasonableness (as to the quantum of profit sacrifice involved or its relation to projected benefits), rational benefit to shareholders, and connection to the company's business (a measure adopted in the ex gratia employee benefits cases, above at p 327).[75] The American Law Institute's *Principles of Corporate Governance* permit the allocation of corporate resources for social considerations such as public welfare, humanitarian, educational and philanthropic purposes without a showing of expected profits or compliance with ethical norms; however, a reasonableness test is imposed which depends on all the circumstances of the case with the principal factors to be considered being 'the customary level at which resources are devoted to such purposes among comparable corporations in proportion to earnings and assets, and the strength of the nexus between the use of corporate resources and the corporation's business'.[76] Another protective limit might require justification in terms of

73 Elhauge, above n 63, 781.
74 Ibid 776–96.
75 Horrigan, above n 29, 205.
76 The American Law Institute, above n 65, 63. Although the 'case law is evolving and not entirely harmonious ... there is direct or indirect authoritative support for all of the principles embodied' in the *Principles of Corporate Governance* with respect to the permitted allocation of resources for social considerations: at 55.

widely accepted soft law standards under human rights or voluntary instrument. Proposing such a pre-condition, however, assumes the crystallisation of such a standard for every situation; it is not clear that a specific standard was available to guide the James Hardie board in their decisions about the foundation's funding from 2001. There is the further difficulty that existing soft law standards often do not address the responsibility of parent companies for conduct by subsidiaries, affiliates and suppliers in its global value chain. That issue was, of course, also at the core of the legal and ethical choice for the Hardie board.

D Some Objections to an Explicit Licence to Sacrifice Profits

Two critiques might most strongly be made about the proposed licence, one that it weakens director accountability to shareholders and the other that it is likely to have limited or no effect in view of the social norms shared by directors as to their role and responsibilities and the structure of the incentives driving their conduct. The critiques are, of course, antinomic.

1 *Enlarging Discretion is at the Cost of Director Accountability*

A Senate committee in 1989 rejected a formalised discretion in directors to have regard for outside interests in their own right on the basis that it would weaken 'shareholders' ability to bring directors to account for failing to act in the interests of the company'.[77] However, a permissive provision need not necessarily weaken director accountability – much depends on the protective limits adopted to preserve scope for judicial review (see above, text accompanying nn 71–3). The absence of clear doctrinal differences in the United States between 'constituency' states and others such as Delaware indicates that permissive statutory provisions need not involve the surrender of judicial control nor undermine the tradition of judicial deference to disinterested and informed business judgment. Further, this objection assumes that accountability to shareholders should trump other forms of accountability and responsiveness.

2 *Limited Practical Impact?*

The contrary critique is that United States experience suggests that such a reform is unlikely to have a significant impact on director practice.[78] That concern reflects the influence of social norms among directors that corporate profit and shareholder value are the key performance measures. These norms are reinforced by incentive systems especially the structure of executive remuneration, the increasing use of share options and shareholder value metrics generally. The focus on shareholder value is bolstered by the performance incentives upon fund managers competing for investment mandates from institutional investors and, for directors and managers, the constant threat of a

77 Senate Standing Committee on Legal and Constitutional Affairs, above n 55, 96 [6.44].

78 Horrigan, above n 29, 207 ('how [little] the regulatory, business and legal cultures in each state have perceived and used these laws').

hostile takeover bid should share price fall.[79] These are formidable forces. Yet, the rationale for a permissive provision is not the radical overhaul of corporate culture but the modest one of opening that culture to the wholesome influence of social norms and sanctions that moderate human behaviour generally.[80]

V REQUIRING DIRECTORS TO CONSIDER STAKEHOLDERS IN SHAREHOLDERS' INTEREST

A second reform option is a statutory provision such as that adopted in the United Kingdom *Companies Act 2006* that requires directors to have regard to specified stakeholder interests and social impacts in discharging their duty to promote *shareholder* welfare. This 'enlightened shareholder value' approach reflected concerns that shareholder primacy, especially in an active takeover market, might place directors under pressure to focus narrowly on short-term shareholder interests at the expense of the longer term value of the enterprise to shareholders.[81] The review found evidence that 'the obligation to look beyond the short term was not widely recognised by directors or members.'[82] The solution it proposed retained the primacy of shareholder interests but adopted an 'inclusive' approach to the reformulation of directors' duties that seeks to cultivate cooperative relationships with other participants. A second element of its approach was to require disclosure of the value of those relationships to shareholders. The two elements are 'mutually reinforcing'.[83]

The formulation of duty follows the traditional expression in terms of the collective shareholder interest: '[a] director of a company must act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole'.[84] The enlightened shareholder value approach refines this duty by requiring the director to 'have regard, (amongst other matters)' to the long-term consequences of business decisions, the company's reputation for standards of business conduct and the impact of decisions on employees, on its business relationships with suppliers and customers, and on the community and environment: *Companies Act 2006*

79 Simon Deakin, 'The Coming Transformation of Shareholder Value' (2005) 13 *Corporate Governance* 11; Paul Redmond, 'The Thrall of Shareholder Value: Implications for CSR and Directors' Duties' (2006) 58 *Keeping Good Companies* 79; Lynn A Stout, *The Shareholder Value Myth* (Berrett-Koehler Publishers, 2012).

80 Deakin, above n 79, 16.

81 The Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: The Strategic Framework' (Consultation Document, The Company Law Review Steering Group, February 1999) 39 [5.1.17].

82 The Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Completing the Structure' (Consultation Document, The Company Law Review Steering Group, November 2000) 39 [3.18].

83 The Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Developing the Framework' (Consultation Document, The Company Law Review Steering Group, March 2000), 15 [2.22].

84 *Companies Act 2006* (UK) s 172(1).

(UK) section 172(1). The duty is owed to the company: *Companies Act 2006* (UK) section 170(1). Only the company may enforce breach of duty although a shareholder may bring a derivative action in the company's interest in certain circumstances.

This approach addresses the problem of indeterminate decision-making criteria by privileging the collective shareholder interest over that of other stakeholders but only after directors consider the consequences of the decision for those interests. Consideration of non-shareholder interests is instrumental in that those interests are considered only to the extent that they promote shareholder interests. Where the impact on stakeholders is negative it is not, as in multi-fiduciary stakeholder models, weighed directly against shareholder benefit. 'The weight to be given to particular matters will remain a matter for the judgment of the directors.'[85] The *enlightenment* in this model of shareholder value lies in the forced scanning of stakeholder impact for the purpose of extracting maximum shareholder advantage in corporate decision-making. The model might more accurately be called *enhanced* shareholder value, or enlightened self-interest, since its purpose in requiring directors to pay regard to impacts on other stakeholder relationships is to ensure that the negative effect of these impacts is not overlooked in the calculation of shareholder advantage. A company that is attentive to these interests, relationships and impacts is more likely to maximise profit and shareholder value.

The model has the advantage of legitimising current good board practice, 'namely far-sighted managers considering the interests of non-shareholder stakeholders so far as it fosters corporate profits.'[86] It creates an environment in which directors can make decisions that respect social norms and human rights with greater assurance that they are not exposing themselves to suit in doing so. It guides directors in what they should consider and respects their business judgment as to what will best promote the success of the company. The explicitness of the provision offers in a shorthand form guidance otherwise locked away in legal texts and decisions.

Both of the James Hardie-inspired Australian reviews declined to follow this model. CAMAC considered that since courts 'can assist in aligning corporate behaviour with changing community expectations … no worthwhile benefit is to be gained' from the provision.[87] The Parliamentary Joint Committee thought that the provision 'introduce[d] great uncertainty into the legal expression of directors' duties … and therefore gives no guidance to directors on what they must do in order to comply'.[88] Curiously, these grounds posit as virtues what are in truth the central weaknesses of Australian law in this area – the absence of

85 Justice Mary Howarth Arden, 'Companies Act 2006 (UK): A New Approach to Directors' Duties' (2007) 81 *Australian Law Journal* 162, 167.

86 Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29 *Sydney Law Review* 577, 600.

87 *Social Responsibility of Corporations Report*, above n 31, 111–13 [3.12].

88 Parliamentary Joint Committee on Corporations and Financial Services, above n 58, 55 [4.46].

modern decision on the question and the resulting lack of guidance to directors (see above, p 330).

This measure differs from the first reform option both in its retention of the traditional identification of company interests with those of shareholders and the mandatory character of its requirement, namely, to scan for stakeholder impacts. While the specified stakeholder interests include many that are important to business success, they are not framed by reference to the universe of norms applying to business. For example, they do not include the corporate responsibility to respect human rights elaborated just two years after the United Kingdom provision was enacted. If specific stakeholder interests are identified, even inclusively as in the United Kingdom provision, this risks ossifying the range of norms and sanctions that may legitimately be considered, especially in a time of rapid rule elaboration.

VI A SAFE HARBOUR FOR BUSINESS JUDGMENTS RESPONDING TO SOCIAL NORMS AND EXPECTATIONS

A third option is to create a safe harbour from liability for directors' business judgments taken in response to social norms and expectation. United States courts have created a business judgement rule which operates as a presumption or burden of proof issue, requiring a shareholder who seeks to bring a derivative suit for breach of duty to establish first that one of the conditions to which the protection of the rule is subject has not been satisfied. The presumption is that disinterested directors make business decisions on an informed basis and with the good faith belief that their decision will best promote the company's interests; a person challenging the conduct of a director for breach of the duty of care (which includes the United States counterpart to the duty to act in the best interests of the company) has the threshold burden of displacing the presumption by showing that the director either had a personal interest, was insufficiently informed or lacked a rational belief that the business judgment was in the best interests of the company.[89] The business judgment rule gives directors considerable latitude to make both profit-enhancing and profit-sacrificing decisions.

A business judgement rule was introduced by statute in Australia in 2000 but applies only to the director's duty of care and not the duty to act in company interests.[90] The Australian reform proposal was based upon the United States business judgment rule as restated by the American Law Institute; it sought to provide 'an explicit *safe harbour* for directors, such that they would know with some certainty that, if they fulfilled the requirements [of the presumption], they

89 The American Law Institute, above n 65, 134–5.
90 Corporations Act 2001 (Cth) s 180.

would effectively be shielded from liability for breach of their duty of care'.[91] The enacted provision has, however, been interpreted to operate only as a defence to an action for breach and not, as in the United States, a threshold obstacle to the commencement of shareholder suit.[92]

There is merit in a statutory rule that would apply to the director's duty to act in the interests of the company with a view to promoting corporate social responsiveness. To achieve its protective purpose, it would need to be framed so as to operate as a threshold protective presumption and not as a defence to be raised in a substantive action. Under this option directors would be protected from suit for breach of duty in responding to stakeholder claims and social expectations unless a plaintiff first establishes the absence of one of the elements of the presumption. The first two elements of the presumption – personal interest in or insufficiency of information with respect to the business judgment – are unproblematic; the third needs be refined if the harbour is truly to offer safety for directors. To require rational belief as to corporate benefit would undermine the goal of encouraging director responsiveness to social expectation and responsibilities for human rights and other social impacts: the purpose of safe harbour is to protect directors against the risk that socially responsive decisions ultimately prove profit-sacrificing. This consideration suggests that the measure might best operate in conjunction with an explicit statutory licence to consider stakeholder interests under the first option (see above, Part IV) and that the rational belief test needs be recast, either in terms of the feasible long-term reputational and other benefits to the company or by reference to the broad legitimacy of the social norms, human rights or other standard by reference to which the board acts.

VII CONCLUSION

A quarter-century ago a distinguished scholar concluded that 'company law (at least as it stands, but probably in any form it could potentially take) must acknowledge that it has no mechanism to ensure the fulfillment of obligations of social responsibility.'[93] While this pessimism may prove well founded as far as 'ensured' fulfillment is concerned, it should not discourage attempts to remove unnecessary obstacles. This article shows that gaps in the Australian law on directors' duties result in poor guidance to directors on their proper response to social expectation and stakeholder claim, discourage corporate social

---

91 Corporate Law Economic Reform Program, 'Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors' (Proposals for Reform Paper No 3, Corporate Law Economic Reform Program, 1997) 28; See also Explanatory Memorandum, *Corporate Law Economic Reform Program Bill 1998* (Cth) 18 [6.9].

92 See, eg, *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, 146–50 [7258]–[7270].

93 Sealy, above n 62, 176.

responsibility initiatives and deny directors the clarity of protection from liability that they are entitled to expect.

The past quarter-century has seen the extraordinary efflorescence of corporate social responsibility standards and norms of responsibility for human rights impacts of business operations and relationships. These soft law developments respond to the emergence of the global economy and the weakening of nation state capacity and incentive to address 'the governance gaps created by globalization – between the scope and impact of economic forces and actors, and the capacity of societies to manage their adverse consequences.'[94] The implications of this new civil regulation for corporate law and practice 'remain poorly understood' by business, especially the legitimate boundaries of director responsiveness to wider norms and expectations of conduct. The James Hardie imbroglio points to the dangers when directors' duties stand in the way of responsiveness to social norms of corporate responsibility and proper conduct.

The article sketches three options to promote director and manager responsiveness to norms to which long-term shareholder value and non-financial risk management are hostage in the global economy. Effectively, these resolve into a choice between two reform models. The first, statutory permission for directors to weigh stakeholder interests against those of shareholders, faces entrenched social norms among directors that define the corporate objective and success measures in terms of shareholder value; executive remuneration and financial market incentives reinforce these group norms and bias the time horizon towards the short-term. Such a statutory provision permits but only modestly promotes social norm responsiveness; its incentives, however, are strengthened if it were combined with a statutory safe harbour for board decisions taken in response to social norms. The second model is the United Kingdom recasting of the director's duty to act in the company interests in terms of promoting shareholder welfare through mandatory 'enlightened' scanning of stakeholder impacts for their effect on shareholder value. Neither model is flawless; each warrants closer study.

94 *Business and Human Rights Report*, above n 22, 3 [3].