CLARIFYING THE OBJECT OF DIRECTORS' ENDEAVOURS: WHAT AUSTRALIA CAN LEARN FROM THE UNITED KINGDOM

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I INTRODUCTION

Today, it is an observed fact that in Australia, as in all other free market economies, most business activity is conducted through the instrumentality of the limited liability company. As such, it cannot be gainsaid that this institution has a profound impact on the lives of countless individuals as well as the functioning of the economic order of society as a whole. Indeed, commenting on this phenomenon, one distinguished corporate law scholar tellingly observed that

> [o]f all the institutions that shape … society, none are more dominant than business corporations. They supply most of the food that is eaten, most of the clothes that are worn, most of the shelters that are inhabited, and most of the entertainments that are enjoyed. They are also the largest providers of the wages and the workplaces that determine the quality of a large sector of many people's lives. Corporations' criteria for advancement or demotion rule perceptions of personal success or failure. Corporate dividend and interest payments sustain insurance and annuities and motivate most of the savings that finance capital investment. Corporations deliver most of the revenue of state and federal governments, partly by paying their own taxes and partly by collecting and remitting most of the income, social security, and excise taxes levied against their employees and customers.[1]

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1 Alfred F Conard, 'Theses for a Corporate Reformation' (1986) 19 *University of California Davis Law Review* 259, 260 (citations omitted).

Another equally prominent commentator has described the modern company as 'the most successful institution yet designed by any society to carry out the vital tasks of capital assembly, resource allocation, production, employment and distribution'.[2] An Australian corporate law don, Professor Bottomley, has similarly acknowledged the significant role that companies play in our society, observing that 'corporations accumulate, convert, produce and disperse economic resources'.[3] In light of this, issues concerning the management and control of this venerable institution assume particular significance.

One readily noticeable and interesting feature of the modern company is that, in most instances, the management function is removed from its members.[4] Under current Australian practice,[5] primary responsibility for the direction of the affairs of a company, including its business, is routinely vested in the board of directors.[6] This is done out of the belief that in order to promote the efficient and effective functioning of companies, especially large, complex public companies, it is imperative to delegate the management function to a select group of skilled and experienced corporate managers, rather than leave that vital task to members who may not be business persons in the sense of having any special knowledge or skills in the field of management and business administration.[7]

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2 Letter from Bayless Manning to New York Stock Exchange in Joel Seligman, *The One Share, One Vote Controversy* (Investor Responsibility Research Center, 1986) 21.

3 Stephen Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Ashgate Publishing, 2007) 111. See also Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006) 10–11 [2.34]–[2.40]; Andrew Lumsden and Saul Fridman, 'Corporate Social Responsibility: The Case for a Self-Regulatory Model' (2007) 25 *Company and Securities Law Journal* 147, 148; Michael Rawling, 'Australian Trade Unions as Shareholder Activists: The Rocky Path Towards Corporate Democracy' (2006) 28 *Sydney Law Review* 227, 228; L S Sealy, *Company Law and Commercial Reality* (Sweet and Maxwell, 1984) 1.

4 See Lynn A Stout, 'The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance' (2003) 152 *University of Pennsylvania Law Review* 667, 668–70.

5 Most Australian companies adopt the replaceable rule set out in the *Corporations Act 2001* (Cth) s 198A ('*Corporations Act*'). That rule relevantly provides:

> (1) The business of a company is to be managed by or under the direction of the directors.
>
> (2) The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting.

Once a company adopts a rule similar to this, shareholders cannot interfere with management decisions made by directors or dictate to them. See, eg, *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113, 134 (Greer LJ); *Automatic Self Cleansing Filter Syndicate Co v Cunninghame* [1906] 2 Ch 34, 38–9 (Warrington J); *National Roads and Motorists' Association v Parker* (1986) 6 NSWLR 517, 521 (McLelland J); R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis, 15th ed, 2013) 232–7 [7.100]–[7.123]; R P Austin, H A J Ford AM and Ian M Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis, 2005) 65 [2.8], 69–74 [2.15]–[2.17].

6 See, eg, *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 528 [4365] (Owen J); Joint Committee on Corporations and Financial Services, above n 3, 13 [2.52].

7 See generally James Mayanja, 'The Proper Role of Shareholders in the Decision-Making Processes of Modern Large Australian Public Companies' (2009) 24 *Australian Journal of Corporate Law* 9, 18 ff.

Whilst advantageous in many ways, the routine practice of separating the management of companies from their owners has given risen to one of the most controversial issues in corporate law scholarship to date: in whose interest must directors exercise the extensive powers so commonly conferred on them? This question which, as many lawyers will remember, stimulated a very vibrant public policy debate between two renowned scholars, Professors Adolf Berle and Edwin Merrick Dodd in the 1930s,[8] continues to occupy the minds of academics, the legal profession, the judiciary and policy makers to the present day.[9]

Opinion on this matter is still sharply divided. In one camp, there are many who, like Professor Berle, strongly adhere to the view that the essential, if not primary, responsibility of directors is to promote the interests of members of the company to the maximum extent possible. Indeed, in his now famous opinion, counsel appointed to advise the directors of the Berkeley Hotel during the takeover battle for the control of that company[10] advised that the directors' foremost obligation was to act so as to promote the interests of present and future members.[11] Significantly, this view is embraced by several scholars. For example, after making the observation that '[c]orporations are almost universally conceived as economic entities that strive to maximize value for

8 See 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 Are Corporate Managers Trustees: A Note' (1932) 45 *Harvard Law Review* 1365.

9 See, eg, Austin and Ramsay, above n 5, 429–46 [8.090]–[8.160]; Joint Committee on Corporations and Financial Services, above n 3, 43 ff; Corporations and Markets Advisory Committee, Australian Government, *The Social Responsibility of Corporations* (2006) 96–113; Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Developing the Framework' (Report, Department of Trade and Industry (UK), March 2000) [3.14] <http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/whatwedo/businesslaw/co-act-2006/clr-review/page25086.html> ('*Developing Framework Report*'); Lumsden and Fridman, above n 3, 156–61; David Kinley, Justine Nolan and Natalie Zerial, 'The Politics of Corporate Social Responsibility: Reflections on the United Nations Human Rights Norms for Corporations' (2005) 25 *Company and Securities Law Journal* 30; Lord Wedderburn, 'The Legal Development of Corporate Responsibility: For Whom Will Corporate Managers Be Trustees?' in Klaus J Hopt and Gunther Teubner (eds), *Corporate Governance And Directors' Liabilities* (Walter de Gruyter, 1985) 3; Lord Wedderburn, 'The Social Responsibility of Companies' (1985) 15 *Melbourne University Law Review* 4; Francis Dawson, 'Acting in the Best Interests of the Company – For Whom Are Directors "Trustees"?' (1984) 11 *New Zealand Universities Law Review* 68; F J Willet, 'Conflict between Modern Managerial Practice and Company Law' (1967) 5 *Melbourne University Law Review* 481.

10 See L C B Gower, 'Corporate Control: The Battle for the Berkeley' (1955) 68 *Harvard Law Review* 1176.

11 Ibid 1184. See further Austin and Ramsay, above n 5, 431 [8.095]; Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (Thomson Sweet and Maxwell, 7th ed, 2003) 372 ('*Modern Company Law 7th Edition*'); L S Sealy, 'Directors' "Wider" Responsibilities – Problems Conceptual, Practical and Procedural' (1987) 13 *Monash University Law Review* 164.

shareholders',[12] Professor Macey has gone on to venture the further opinion that 'any action by managers, directors, or others that is inconsistent with the goal of shareholder wealth maximization is … a form of "corporate deviance"'.[13] Similarly, leading economist Milton Friedman has argued that

> [i]n a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.[14]

For his part, Professor Birds has suggested that the obligation of directors under current law is to advance 'the long-term interests of the members of the company, usually of course the shareholders, and to give primacy to any other interests will be a breach of duty, regardless of the directors' honest belief'.[15] Quite worthy of note, this viewpoint enjoys some strong judicial support.[16]

At the same time, however, for quite some time now it has been suggested with increasing frequency that the powers of controllers of public corporations are exercisable in a fiduciary capacity, not merely for their stock-holders, but also for a wide variety of other constituencies – labour, suppliers, consumers,

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12 Jonathan R Macey, *Corporate Governance: Promises Kept, Promises Broken* (Princeton University Press, 2008) 2; For similar opinions, see, eg, Austin and Ramsay, above n 5, 431 [8.095]; Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law*, (Harvard University Press 1991) 36; Davies, *Modern Company Law 7th Edition*, above n 11, 372; Sealy, 'Directors' "Wider" Responsibilities', above n 11; Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgia Law Journal* 439; Bernard S Sharfman, 'Shareholder Wealth Maximization and Its Implementation under Corporate Law' (2014) 66 *Florida Law Review* 389, 391 ff.

13 Macey, above n 12, 2.

14 See Milton Friedman, 'The Social Responsibility of Business Is to Increase its Profits', *The New York Times Magazine* (online), 13 September 1970 <http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>. See also Ronald J Gilson, 'Separation and the Function of Corporate Law' (2005) 2 *Berkeley Business Law Journal* 141.

15 John Birds, 'The Reform of Directors' Duties' in John de Lacy (ed), *The Reform of United Kingdom Company Law* (Cavendish Publishing, 2002) 149, 152 (citations omitted). See also Austin and Ramsay, above n 5, 431 [8.095]; Austin, Ford and Ramsay, above n 5, 274 ff [7.6]–[7.8].

16 See, eg, *Hutton v West Cork Railway Co* (1883) 23 Ch D 654, 665–6 (Cotton LJ), 671–2 (Bowen LJ); *Re Lee, Behrens & Co Ltd* [1932] 2 Ch 46, 51 (Eve J); *Parke v Daily News Ltd* [1962] Ch 927, 960 (Plowman J); *Dodge v Ford Motor Co*, 170 NW 668, 684 (Ostrander CJ) (Mich, 1919).

and the community or nation at large.[17] Indeed, in their seminal work, *A Team Production Theory of Corporate Law*, Professors Blair and Stout have fervently argued that shareholder wealth maximisation is not the correct objective of a public company. According to them, the public company is nothing but a team of members who make firm-specific investments in the company with the goal of producing goods and services as a team.[18] They go on to suggest that in this setting, the role of the board of directors is to act as 'mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together'.[19]

Essentially, scholars of this genre argue that companies should not be run just to make money for their members but also to serve broader social purposes such as social wealth maximisation. It is further suggested that the law should endeavour to protect the interests of all parties who can be identified as stakeholders as these groups too contribute to the productive capacity of a company. For example, in this regard, it has been put forward that

> business is about putting together a deal so that suppliers, customers, employees, communities managers and shareholders all win continuously over time. In short, at some level, stakeholder interests have to be joint – they must be traveling in the same direction – or else there will be exit, and a new collaboration formed.[20]

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17 For judicial recognition of this view, see *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722, 729–32 (Street CJ); *Walker v Wimborne* (1976) 137 CLR 1, 6–7 (Mason J); *Teck Corporation Ltd v Millar* (1972) 33 DLR (3rd) 288 [104]–[117] (Berger J) (Supreme Court of British Columbia); *Peoples Department Stores Inc (Trustee) v Wise* [2004] 3 SCR 461, 481–2 [42] (Major and Deschamps JJ); *Evans v Brunner, Mond & Co Ltd* [1921] 1 Ch 359, 366–8 (Eve J). For some helpful academic discussion of this concept, see 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, 585 ff; H J Glasbeek, 'The Corporate Social Responsibility Movement – The Latest in the Maginot Lines to Save Capitalism' (1988) 11 *Dalhousie Law Journal* 363; Christopher S Axworthy, 'Corporation Law as if Some People Mattered' (1986) 36 *University of Toronto Law Journal* 392; Benjamin Pettet, 'Duties in Respect of Employees under the Companies Act 1980' (1981) 34 *Current Legal Problems* 199; Frank Iacobucci, 'The Exercise of Directors' Powers: The Battle of Afton Mines' (1973) 11 *Osgoode Hall Law Journal* 353; Robyn Lansdowne and Jillian Segal, 'The Social Responsibility of Modern Corporations' (1978) 2 *University of New South Wales Law Journal* 336; Christopher D Stone, 'Corporate Social Responsibility: What It Might Mean, If It Were Really to Matter' (1986) 71 *Iowa Law Review* 557; Lionel Hodes, 'The Social Responsibility of a Company' (1983) 100 *South African Law Journal* 468; Austin and Ramsay, above n 5, 429 [8.090]; Austin, Ford and Ramsay, above n 5, 276 [7.10]–[7.13]; Wedderburn, 'Social Responsibility of Companies', above n 9.

18 Margaret M Blair and Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247, 249, 271 ff. See also Max B E Clarkson, 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995) 20 *Academy of Management Review* 92.

19 Blair and Stout, above n 18, 281. See also Lynn A Stout, 'Bad and Not-So-Bad Arguments for Shareholder Primacy' (2002) 75 *Southern California Law Review* 1189.

20 R Edward Freeman, Andrew C Wicks and Bidhan Parmar, 'Stakeholder Theory and "The Corporate Objective Revisited"' (2004) 15 *Organization Science* 364, 365 (citations omitted). See also Roberta S Karmel, 'Implications of the Stakeholder Model' (1993) 61 *George Washington Law Review* 1156, 1171 ff; David G Yosifon 'The Law of Corporate Purpose' (2013) 10 *Berkeley Business Law Journal* 181, 228 ff; Andrea Corfield, 'The Stakeholder Theory and Its Future in Australian Corporate Governance: A Preliminary Analysis' (1998) 10 *Bond Law Review* 213, 215 ff.

In an effort to bring to an end debates over the meaning of 'the company' and 'in the interests of the company' in the context of the rules governing the exercise of directors' powers, the United Kingdom ('UK') has recently reformed its law applicable in this area. Under that reform, a new duty, imposing on directors an obligation to promote the success of the company, was introduced. That reform makes clear that in discharging this obligation, directors must pay their primary attention exclusively to the interests of the members of the company.

This study argues that the current state of the law governing the exercise of directors' powers in Australia is a bit problematic. That law, as presently framed and applied, does not provide an especially reliable guide regarding the very important question as to whose interest directors are bound to promote while exercising the very wide discretionary powers commonly conferred on them. Presently, actions taken by directors may be sustained by the courts if they are shown to have served the interests of the company as a separate economic/legal entity. In other instances, they may be upheld if it is established that they were taken for the benefit of the members of the company. At the same time, suggestions continue to be made that in exercising their powers, directors must not be guided solely by the interests of members or the corporate entity, but must also take into account the interests of other stakeholders such as employees, suppliers, consumers and the community generally.[21] This state of affairs is undesirable. It creates some uncertainty as to when any action taken by directors constitutes a permissible or impermissible exercise of power. This uncertainty, in turn, renders it difficult to challenge questionable director actions, except in cases of patently egregious conduct. Thus, there is a need to reform the law to remove that uncertainty and to make abundantly clear the interests that directors must seek to advance in the course of performing their duties.

This article suggests that in undertaking this important exercise, Australian policy-makers would be well advised to follow, at least in part, the lead established by their UK counterparts briefly outlined above. The solution adopted by the UK is helpful in some important respects. It provides clear guidance as to the advancement of whose interest directors' actions must be aimed at. This has the distinct advantage that it promotes certainty and predictability as to what constitutes acceptable conduct on the part of directors. In turn, this enables all parties concerned – members of the company, directors and other stakeholders – to organise their affairs with a reasonable degree of certainty. As such, the UK reforms provide a helpful model that, subject to some modifications and adaptations, Australia could well benefit from.

The remainder of this article is organised as follows. Part II provides a critique of the law currently governing the exercise of directors' powers in Australia. It highlights some of the weaknesses of the present state of the law, thus pointing to the need for reform. Following that, Part III reviews the

21 See, eg, the works cited in above n 17.

initiatives implemented by the UK to remove the uncertainty hitherto surrounding the exercise of directors' powers in that jurisdiction. Next, Part IV sets out some proposals for reform. Finally, Part V concludes the study.

II THE PROPER OBJECT OF AN EXERCISE OF DIRECTORS' POWERS: CURRENT AUSTRALIAN LAW

Under current Australian law,[22] the directors of a company are subject to the equitable doctrines of fiduciary law.[23] These principles impose an obligation upon directors to, at all times, act bona fide in the interests of the company.[24] Pursuant to this requirement, directors must, in exercising any of the powers conferred on them, put the interests of the company ahead of their own interests,[25] or those of any other party.[26] The same duty further enjoins directors to exercise their powers for proper purposes,[27] not to fetter their

22 The discussion in this Part has benefitted significantly from James Mayanja, 'No-Shop, No-Talk and Break-Up Fee Agreements in Merger and Takeover Transactions: The Case for a Fresh Regulatory Approach' (2002) 14 *Australian Journal of Corporate Law* 1.

23 See, eg, *Mills v Mills* (1938) 60 CLR 150, 185 ff (Dixon J); *Ampol Petroleum Ltd v R W Miller* (*Holdings*) *Ltd* [1972] 2 NSWLR 850, 856F (Street CJ in Eq); *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 345 [1951] (Drummond AJA).

24 See, eg, *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, 671–2 (Lindley MR); *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199, 217 (Isaacs J); *Re Smith and Fawcett Ltd* [1942] Ch 304, 306 (Lord Greene MR); *Pergamon Press Ltd v Maxwell* [1970] 1 WLR 1167, 1172 (Pennycuick J).

25 *Fodare Ltd v Shearn* (2011) 29 ACLC 738; *Parker v Tucker* (2010) 77 ACSR 525, 541–3 [68]–[75] (Gordon J); *Diamond Hill Mining Pty Ltd v Huang Jin Mining Pty Ltd* (2011) 84 ACSR 616, 646–50 [88]–[95] (Croft J); *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, 365 [458] (Santow J); *Woolworths Ltd v Kelly* (1991) 22 NSWLR189, 226 (Mahoney JA); *Ngurli Ltd v McCann* (1954) 90 CLR 425, 439–40 (Williams ACJ, Fullagar and Kitto JJ).

26 *Bailey v Mandala Private Hospital Pty Ltd* (1987) 12 ACLR 641, 646–8 (Kearney J); *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd* [1991] 2 Qd R 360, 372–3 (McPherson J); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 834–7 (Lord Wilberforce); *Re W & M Roith Ltd* [1967] 1 WLR 432, 439 (Plowman J); *Furs Ltd v Tomkies* (1936) 54 CLR 583, 589–90 (Latham CJ), 591 (Rich, Dixon and Evatt JJ), 600 (Starke J); *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 135–6 (Latham CJ), 138 (Rich J), 142 (Dixon J). See further Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties* (1989) 83–4 [6.3].

27 See, eg, *Re Smith & Fawcett Ltd* [1942] 1 Ch 304, 306 (Lord Greene MR); *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, 671 (Lindley MR); *Greenhalgh v Ardene Cinemas Ltd* [1950] Ch 286, 291 (Evershed MR); *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 293–4 (Mason, Deane and Dawson JJ); *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 218 (Ipp J); *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 548–50 [4456]–[4467] (Owen J); *Kokotovitch Constructions Pty Ltd v Wallington* (1995) 17 ACSR 478, 490 (Kirby ACJ); *Re Southern Ltd; Residues Treatment & Trading Co Ltd v Southern Resources Ltd* (1989) 15 ACLR 770, 787–8 (Perry J); *Pergamon Press Ltd v Maxwell* [1970] 1 WLR 1167, 1172 (Pennycuick J); *Mills v Mills* (1938) 60 CLR 150, 185 (Dixon J); *Australian Metropolitan Life Assurance Company Ltd v Ure* (1923) 33 CLR 199, 217 (Isaacs J); *Hindle v John Cotton Ltd* (1919) 56 Sc LR 625, 630–1 (Viscount Finlay).

discretion,[28] and to avoid any potential for conflict of interest.[29] These rules have been adopted and strengthened by section 181(1) of the *Corporations Act 2001* (Cth). That provision imposes on directors an obligation, at all times, to act honestly in the exercise of their powers and the discharge of the duties of their office, and for a proper purpose.[30] Further, although this is subsumed in section 181(1), section 182(1) of the *Corporations Act* goes on to explicitly impose on directors an obligation not to 'improperly use their position to gain an advantage for themselves or someone else; or cause detriment to the corporation'. In

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28 See, eg, *Thorby v Goldberg* (1965) 112 CLR 597, 605 (Kitto J), 616 (Menzies J), 617–18 (Owen J); *Russell v Northern Bank Development Corporation Ltd* [1992] 1 WLR 588, 592 (Lord Jauncey); *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd* [1991] 2 Qd R 360, 372–3 (McPherson J); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 834–7 (Lord Wilberforce).

29 See, eg, *Bray v Ford* [1896] AC 44, 51 (Lord Herschell); *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 67 (Gibbs CJ), 102–4 (Mason J), 142 (Dawson J); *Fitzsimmons v The Queen* (1997) 23 ACSR 355, 357 (Owen J); *Chan v Zacharia* (1984) 154 CLR 178, 198–9, 204 (Deane J); *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1, 3 (Lord Scarman); *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 377–8 (McTiernan J), 393–4 (Gibbs J); *Hydrocool Pty Ltd v Hepburn [No 4]* (2011) 279 ALR 646; *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 556–8 [4496]–[4503] (Owen J); *Gemstone Corporation of Australia Ltd v Grasso* (1994) 62 SASR 239, 240–2 (Matheson J), 252–5 (Olsson J); *R v Byrnes* (1995) 183 CLR 501, 517 (Brennan, Deane, Toohey and Gaudron JJ); *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239; *Jenkins v Enterprise Gold Mines NL* (1992) 6 ACSR 539, 551 (Malcolm CJ, Rowland and Franklyn JJ); *Green v Bestobell Industries Pty Ltd* [1982] WAR 1, 4–6 (Burt CJ), 10–11 (Wickham J), 16 (Kennedy J); *Transvaal Lands Co v New Belgium (Transvaal) Land & Development Co* [1914] 2 Ch 488, 496 (Astbury J); *Furs Ltd v Tomkies* (1936) 54 CLR 583; *Boardman v Phipps* [1967] 2 AC 46, 85–7 (Viscount Dilhorne), 103 (Lord Cohen), 105–6, 111– 12 (Lord Hodson), 123–4 (Lord Upjohn); *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461, 471 (Lord Cranworth LC). There is a substantial volume of literature on the directors' duty of loyalty. As a starting point, the following works may prove quite helpful: Austin and Ramsay, above n 5, 400 ff [8.010]–[8.300]; Paul L Davies, *Gower and Davies Principles of Modern Company Law* (Thomson Sweet and Maxwell, 8th ed, 2008) 599 ff ('*Modern Company Law 8th Edition*'); John H Farrar and Brenda M Hannigan, *Farrar's Company Law* (Butterworths, 4th ed, 1998) 377 ff; Bruce S Butcher, *Directors' Duties: A New Millennium, A New Approach*? (Kluwer Law International, 2000) 95 ff; R C Nolan, 'The Proper Purpose Doctrine and Company Directors' in Barry A K Rider (ed), *The Realm of Company Law* (Kluwer Law International, 1998) 1; J Kirby, 'The History and Development of the Conflict and Profit Rules in Corporate Law – A Review' (2004) 22 *Company and Securities Law Journal* 259; Sarah Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention' (1991) 18 *Melbourne University Law Review* 121, 133; Sealy, 'Directors' "Wider" Responsibilities', above n 11, 175 ff.

30 The requirement 'to act honestly' is a mere codification of the director's common law duty to act bona fide in the interests of the company. In *Marchesi v Barnes* [1970] VR 434, Gowans J was concerned with the interpretation of a forerunner of the present s 181 in the form of s 124(1) of *Companies Act 1961* (Vic). Justice Gowans held that

> to 'act honestly' refers to acting bona fide in the interests of the company in the performance of the functions attaching to the office of director. … In effect, the common law obligation in respect of acting honestly… has been made a statutory duty…: *Marchesi v Barnes* [1970] VR 434, 438.

Subsequent cases have adopted a similar approach. See, eg, *Corporate Affairs Commission v Papoulias* (1990) 20 NSWLR 503, 505–6 (Allen J); *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 56 SASR 455, 475–7 (Jacobs ACJ, Prior and Mulligan JJ). The same view was taken in the earlier case of *Byrne v Baker* [1964] VR 443.

addition, although again this is an integral part of the duty set out in section 181(1), section 183(1) expressly imposes on directors an obligation not to 'improperly use' any information obtained by virtue of their position as a director to 'gain an advantage for themselves or someone else; or cause detriment to the corporation'.

The limitations imposed on directors by statutory law and the equitable doctrines of fiduciary law seek to minimise the potential for them to act in abuse of the immense managerial powers conferred on them, so as to secure utmost protection of the interests of the company.[31] This is out of the recognition, as explained by Millet LJ in *Bristol and West Building Society v Mothew*, that

> [t]he principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.[32]

The effect of the duties imposed on directors is to render any action on their part that is not motivated by considerations of good faith concern for the interests of the company voidable and thus liable to challenge.[33] To this extent, statutory law and the equitable doctrines of fiduciary law go some way in protecting the interests of a company.[34] Nonetheless, they are not always very helpful in all situations involving disputed exercises of directors' powers. As the ensuing exposition endeavours to demonstrate, the guide they provide for determining whether or not a decision by directors constitutes a proper and valid exercise of their powers is not particularly helpful.[35]

A The 'Best Interests of the Company' Test

To determine the legality of the exercise of any of the powers conferred on directors, a court is required to ascertain whether any particular action was taken

31 *Mills v Mills* (1938) 60 CLR 150, 185 ff; *Ampol Petroleum Ltd v R W Miller (Holdings) Ltd* [1972] 2 NSWLR 850, 856 (Street CJ in Eq); *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR, 366–7 [2048] ff (Drummond AJA).

32 [1998] Ch 1, 18, cited in *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594, 599 (Henry J).

33 See *Gaiman v National Association for Mental Health* [1971] 1 Ch 317, 330 (Megarry J).

34 The fiduciary duty of loyalty is supplemented by the duty of care. This has, as its principal aim, the protection of the company by ensuring that directors do not shirk their responsibilities. As it is not directly relevant to the issues considered here, the duty of care is not discussed in this article.

35 See Richard Williams, 'Enlightened Shareholder Value in UK Company Law' (2012) 35 *University of New South Wales Law Journal* 360, 364; Davies, *Modern Company Law 8th Edition*, above n 29, 507; Birds, above n 15, 151; Austin and Ramsay, above n 5, 429–46 [8.090]–[8.160]; Austin, Ford and Ramsay, above n 5, 274 [7.6].

bona fide, in the interest of the company as a whole.[36] In theory, this test is not controversial at all, and is, indeed, quite laudable. However, its application presents some difficulty. This is so primarily because, as Dixon J famously observed in *Mills v Mills*, the edict that 'directors must act bona fide for the benefit of the company as a whole' is 'an indefinite phrase'.[37] As interpreted and applied by the courts, the concept of 'company' currently admits of different meanings.[38] Indeed, elaborating on this, the editors of the influential Australian company law treatise, *Ford's Principles of Corporations Law*, have noted that various interests could be considered to be the interest of the company. These include:

- existing members;
- future members;
- the company as a commercial entity distinct from its members;
- creditors;
- beneficiaries under a trust administered by the (trustee) company;
- employees, customers, contractors and the community.[39]

Earlier on, Heydon eruditely observed that

> [t]here are at least four ways in which the duty [to act in the best interests of the company] may be formulated. First, the duty may be analysed simply as an example of the general duties owed by a fiduciary. Secondly, the duty may be said to be to act bona fide for the benefit of the company. Thirdly, the duty may be said to be to act bona fide for the benefit of the shareholders. Fourthly, it may be inferred from some modern formulations, the duty is to act bona fide for the benefit of all who have relations with or interest in the company – not only those who hold shares in it, but those who have derivative interests in its shares, together with its creditors, employees, suppliers and customers.[40]

Because 'company as a whole' is an ambiguous term,[41] an exercise of power by directors, for example, a decision to enter into a particular transaction, may in some cases be upheld if it is in the interest of the company as a separate legal or

36 See, eg, *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, 671–2 (Lindley MR); *Mills v Mills* (1938) 60 CLR 150, 185–6 (Dixon J), cited in *Ampol Petroleum Ltd v R W Miller (Holdings) Ltd* [1972] 2 NSWLR 850, 857–8 (Street CJ in Eq).

37 (1938) 60 CLR 150, 188; See also Davies, *Modern Company Law 7th Edition*, above n 11, 371.

38 See *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 532–3 [4384]–[4387] (Owen J).

39 See Austin and Ramsay, above n 5, 429 [8.090]; On the possible different meanings of the term 'company', see Austin, Ford and Ramsay, above n 5, 276 ff [7.6]–[7.13]; Farrar and Hannigan, above n 29, 570 ff; Keay, 'Tackling the Issue of the Corporate Objective', above n 17, 601; Lumsden and Fridman, above n 3, 168; J D Heydon, 'Directors' Duties and the Company's Interests' in P D Finn (ed), *Equity and Commercial Relationships* (Law Book Company, 1987) 120; F G Rixon, 'Competing Interests and Conflicting Principles: An Examination of the Power of Alteration of Articles of Association' (1986) 49 *Modern Law Review* 446, 448 ff.

40 Heydon, above n 39, 120.

41 See *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016, 1035, where Oliver J poignantly observed that this term is not always used in the same sense. See also Davies, *Modern Company Law 7th Edition*, above n 11, 371 ff.

economic entity. This will be so even if that decision does not serve the interests of members. In other instances, it may be successfully challenged on the basis that it is not in the interest of members. The ensuing discussion attempts to bring out this difficulty.

1 Company as a Separate Legal or Economic Entity

It has been suggested that the powers of directors 'are conferred and are exercisable for the benefit of the company as a separate corporate entity, and the duty is owed to that entity and not to the individual shareholders whether assembled in general meeting or not'.[42] From this perspective, the obligation to act in the best interests of the company calls for a concentration on the interests of the company as a corporate commercial entity distinct from the interests of the corporators.[43] Quite significantly, this opinion has been accepted by the Joint Committee on Corporations and Financial Services. Commenting on section 181 of the *Corporations Act*, which is designed to regulate the exercise of directors' powers, the Committee stated that 'section 181 requires the duty of good faith in the best interests of the *corporation*, not in the best interests of the shareholders'.[44] On this view, directors are free to take any decision provided they have acted on an informed basis and honestly believe it to be for the benefit of the company as a separate legal entity.[45] Such a decision will be upheld so long as it was not entered into for 'purposes foreign to the company's operations, affairs and organisations'.[46] The decisive test is whether the directors exercised their powers in good faith and for a proper purpose.[47]

In effect, this line of enquiry permits directors to consider and balance a variety of factors in determining what is in the best interests of the company. Such factors include the effect of a decision on the corporation's essential economic prospects, its employees, suppliers, consumers, creditors and environmental protection. Because, as Professor Birds has astutely observed, the exhortations that 'directors must act in good faith and exercise their powers for a proper purpose… do not actually say what directors should do in the context of

42 B H McPherson, 'Duties of Directors and the Powers of Shareholders' (1977) 51 *Australian Law Journal* 460, 468 (citations omitted). See also G F K Santow, 'Defensive Measures Against Company Take-Overs' (1979) 53 *Australian Law Journal* 374.

43 Heydon, above n 39, 122; Austin and Ramsay, above n 5, 431–2 [8.095]; Austin, Ford and Ramsay, above n 5, 276 [7.9].

44 See Joint Committee on Corporations and Financial Services, above n 3, 44 [4.6].

45 See *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260, 329–30 (Mahoney JA), 338 (Clarke JA).

46 Heydon, above n 39, 122; *Ngurli Ltd v McCann* (1953) 90 CLR 425, 438 (Williams ACJ, Fullagar and Kitto JJ); *Mills v Mills* (1938) 60 CLR 150, 186 (Dixon J); *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722, 729 (Street CJ).

47 Peter Little, *Law of Company Takeovers* (Law Book Company, 1997) 535 [1404].

taking a particular decision'.[48] The current test renders an exercise of power by directors almost immune from challenge so long as it can be shown to have served some legitimate corporate purpose.[49] Members of a company cannot successfully challenge a decision taken by directors even if it does not serve their interest. The seminal case of *Darvall v North Sydney Brick & Tile Co Ltd* affords an excellent illustration of this quandary.[50]

In that case, a cash takeover offer of $10 per share was made for all the issued shares in the capital of the respondent company. Prior to this offer, the last recorded trading price of these shares was $0.87. The offer thus represented 'a tenfold increase in the value of the shares over their last sale'.[51] It provided those members who wished to accept it with an opportunity to realise a very substantial premium.

However, the directors of the target company were opposed to the offer. To stifle the takeover attempt, a strategy was devised whereby the directors of the offeree company caused it to transfer its crown jewel, a large parcel of land, to a wholly owned subsidiary. The subsidiary then entered into a joint venture agreement with a third party to develop the land. Further, the third party agreed to facilitate a rival takeover bid by the managing director of the target company but only at a marginally higher price than that offered by the takeover bidder.[52] These actions resulted in effectively thwarting the bidder's takeover attempt.

There can be no doubt that these actions were prejudicial to the interests of the offeree shareholders who wished to accept the offer and reap the handsome premium offered by the takeover bidder. Nonetheless, the majority of the New South Wales Court of Appeal upheld the disputed transactions. According to the majority, entry by the directors into the joint venture agreement to develop its property served to promote the interests of the company as a commercial entity. Concomitantly, the disputed actions were a valid exercise of the powers vested in the target company's board of directors.[53]

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48 Birds, above n 15, 151. See also Williams, above n 35, 364; Davies, *Modern Company Law 7th Edition*, above n 11, 371.

49 Sealy, above n 11, 176. The potential deleterious effects on law enforcement that lack of clarity in the law operating in this area can visit on the community has, indeed, been acknowledged by Australian law reform agencies: see, eg, Corporations and Markets Advisory Committee, above n 9, 112.

50 (1989) 16 NSWLR 260 ('*Darvall*').

51 Ibid 267 (Kirby P).

52 Significantly, the financing of the rival takeover bid was on terms particularly advantageous to the managing director of the target company. Indeed, the trial judge considered the arrangement as a no risk opportunity for the managing director to make large sums of money: ibid 315 (Mahoney JA).

53 Ibid 330 (Mahoney JA), 338–9 (Clarke JA). At first instance, Hodgson J also held that, in the discharge of their duty to act in the best interests of the company, directors may properly pay regard to the interests of the company as a separate entity: see *Darvall v North Sydney Brick & Tile Co Ltd* (1988) 6 ACLC 154, 176.

This decision is consistent with that of the High Court of Australia in the earlier case of *Australian Metropolitan Life Assurance Co Ltd v Ure*.[54] It will be recalled that in this case, the directors refused to register a transfer of shares which would have enabled the transferee to command a majority of the shares issued in the capital of the company. The directors also issued more shares to ensure that the appellant would not gain control of the company even if the disputed transfer was registered. These actions enabled the directors to retain control of the company.

In an action challenging the propriety of their actions, the directors averred that they acted as they did to prevent harm that they apprehended would be visited on the company if the appellant, who had been struck off the Roll of Solicitors, gained majority control and was appointed to the board. The High Court upheld the directors' actions. In the opinion of their Honours, the directors acted properly. In attempting to avert the feared harm, the directors were seeking to protect the interests of the company.[55]

On the approach taken by the courts in these decisions, it is apparent that a court will seldom interfere with an exercise of directors' powers that is shown to have served some defensible corporate purpose. As expounded in several other decisions, a court will confidently do so only if an impugned action is so unreasonable that no 'intelligent and honest [person] in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that [the action was] for the benefit of the company'.[56] From this, it is clear that the courts will ordinarily interfere with decisions of directors only if the conduct in issue is patently egregious.[57]

Granted, the cases discussed above involved actions taken in the context of contests for corporate control. Since these decisions were handed down, there have been some significant developments in the law governing the exercise of the powers of directors in such situations. In particular, the Commonwealth government has established a peer review body, the Takeovers Panel, to regulate the conduct of corporate control transactions in Australia.[58] Under current law, the Takeovers Panel is vested with power to declare certain conduct, including

54 (1923) 33 CLR 199 ('*Ure*').

55 For examples of other instances where actions of directors have been upheld by the courts on the basis that they were taken for the benefit of the company as a legal or economic entity, see *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483; *Teck Corporation Ltd v Millar* (1972) 33 DLR (3rd) 288 (Supreme Court of British Columbia).

56 *Charterbridge Corporation Ltd v Lloyd's Bank Ltd* [1970] Ch 62, 74 (Pennycuick J). See also *Wayde v NSW Rugby League Ltd* (1985) 180 CLR 459.

57 See Davies, *Modern Company Law 8th Edition*, above n 29, 510.

58 See *Australian Securities and Investments Commission Act 2001* (Cth) pt 10. For some discussion of the role and powers of the Panel, see Michael Hoyle, 'An Overview of the Role, Functions and Powers of the Takeovers Panel' in Ian Ramsay (ed), *The Takeovers Panel and Takeovers Regulation in Australia* (Melbourne University Press, 2010) 39; Austin and Ramsay, above n 5, 447 ff [8.025].

actions taken by directors to frustrate a takeover attempt, unacceptable.[59] In this context, the Panel has issued a guidance note for the benefit of participants in the takeover process regarding any conduct that may have the effect of frustrating a takeover bid. The guidance note makes the Panel's position abundantly clear: once a takeover offer has been made, and until its close, the directors of the target company may not take any action that may hinder the ability of the offeree shareholders from considering it.[60] It is thus probable that the actions complained of in the cases discussed here could well be disallowed if those matters arose today.

However, it needs to be recognised that, in the sphere of corporate activity, disputes do not arise solely out of takeover transactions. Because members can have divergent interests,[61] there is wide scope for disagreements to occur in other areas. One example which readily comes to mind is in relation to dividend policy. As the decision in *Re G Jeffrey (Mens Store) Pty Ltd* illustrates,[62] the controllers of a company may decide to pay dividends at a rate far below that justified by its profitability. Predictably, such a decision could cause some disquiet among members who would prefer to receive a higher dividend payment.[63] While, no doubt, the decision to pay lower dividends would not be in the interest of those members interested in receiving more of the company earnings as dividends, the dissatisfied members would find it quite hard to challenge the directors' decision if it is shown to serve a legitimate corporate purpose, for example, to fund the operations of the company or corporate growth.[64] Despite protections presently available to members against oppressive conduct,[65] such a decision is likely to be viewed as a matter of commercial judgment, which courts are loath to interfere with. Indeed, in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*, the High Court categorically stated that

> directors in whom are vested the right and the duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.[66]

President Kirby has provided a rationale for this:

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59 See *Corporations Act* ss 657A, 657D.

60 See Takeovers Panel, Australian Government, *Guidance Note 12: Frustrating Action*, Takeovers Panel <http://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=guidance_notes/current/012.htm&pageID=&Year=>. For an erudite discussion of this policy statement, see Emma Armson, 'The Frustrating Action Policy: Shifting Power in the Takeover Context' (2003) 21 *Company and Securities Law Journal* 487.

61 See below nn 185–8.

62 (1984) 2 ACLC 421.

63 See further Joint Committee on Corporations and Financial Services, above n 3, 44 [4.6]

64 Ibid. See also *Thomas v H W Thomas Ltd* [1984] 1 NZLR 686. See further Austin and Ramsay, above n 5, 1061 [18.040]–[18.050], [11.460].

65 See *Corporations Act* pt 2F.1.

66 (1968) 121 CLR 483, 493 (Barwick CJ, McTiernan and Kitto JJ).

> Courts properly refrain from assuming the management of corporations and substituting their decisions and assessments for those of the directors. They do so, inter alia, because directors can be expected to have much greater knowledge and more time and expertise at their disposal to evaluate the best interests of the corporation than judges … [67]

Because directors are often able to seek and obtain professional advice, they will often be able to structure transactions that they wish to effect in a way that serves some legitimate corporate purpose. In consequence, it will be in rare cases that a challenge to actions taken by directors will succeed, even if the disputed actions are not in the interests of members. Indeed, in those cases where the courts were prepared to interfere with exercises of directors' powers, it was manifest that the acts complained of were plainly unreasonable. The cases discussed below provide some insights into this predicament.

Australia Growth Resources Corporation Pty Ltd v van Reesema concerned a company which carried on a plant nursery business.[68] It entered into contracts with growers under which it provided them with consultancy services, materials and equipment to grow plants. It then purchased the plant stock from the producers for resale at a profit.

After investigating the company's mode of operation, the Corporate Affairs Commission of South Australia determined that this arrangement violated the provisions of the *Companies (South Australia) Code*, then governing the offer of prescribed interests. Instead of taking steps to ensure that the company complied with the applicable statutory requirements, the directors caused it to enter into an agreement pursuant to which all its business and assets were transferred to the first respondent, one of the directors, in consideration of the sum of $1 and an unsecured indemnity by that director in respect of the company's liabilities and future obligations.[69]

Following the cessation of its business and the appointment of a receiver, the company instituted an action against the directors in which it challenged the validity of the agreement entered into with the first respondent. It was contended, inter alia, that the agreement was entered into fraudulently and/or dishonestly, in breach of section 229(1) of the *Companies (South Australia) Code* then in force,[70] or, alternatively, in breach of the directors' fiduciary duties. An order was sought to recover the value of the business and assets received by the first respondent. In answer to this claim, it was argued on behalf of the directors that they honestly believed the agreement to be in the best interests of the company.

67 *Darvall* (1989) 16 NSWLR 260, 281.

68 (1988) 6 ACLC 529.

69 This statement of facts is taken from James Mayanja, 'Australia Growth Resources Corp Pty Ltd v van Reesema' in A Herzberg (ed), 'Current Developments – Legal and Administrative' (1988) 6 *Company and Securities Law Journal* 306, 307.

70 This provision stipulated that 'an officer of a corporation shall at all times act honestly in the exercise of his powers and the discharge of the duties of his office'.

Chief Justice King upheld the plaintiff's claim that the actions complained of constituted a breach of the directors' duty to act in the best interest of the company. His Honour reached the conclusion that the effect of the impugned transaction was to divest the company of all its business and assets and to leave it in a hopeless position of insolvency. His Honour went on to describe that transaction as a most improvident one.[71] His Honour further added that '[i]mproper purpose apart, no director, exercising reasonable care and diligence, could authorise an agreement such as the subject agreement'.[72]

Another good example of this phenomenon can be found in *Diamond Hill Mining Pty Ltd v Huang Jin Mining Pty Ltd*.[73] In this case, an influential member and director of the defendant company caused it to transfer its mining licence to another company of which he was also a member and director. At the same time, he instigated the transfer of its mining tenements to himself and his associates. No consideration was provided by the transferees in either instance. An action was later filed challenging the validity of these transactions. It was alleged that the actions complained of constituted a breach of that director's fiduciary obligations and a contravention of his statutory duties.

The trial judge held that by causing the transfer of the company's mining licence and land to a company partially owned by himself, for no consideration, and without the fully informed consent of the company's board of directors, that director was in breach of his statutory and fiduciary duties.[74] This followed from his Honour's earlier restatement of the law that 'where no reasonable board could consider a decision to be within the interests of the company, the making of the decision will be a breach of duty'.[75]

Fodare Ltd v Shearn similarly illustrates this idea.[76] Here, the sole director of a company that had sold its property caused part of the sale consideration to be paid directly to her. She then appropriated these monies to herself and her daughter. These funds were then applied by the recipients in ways which were of no benefit to the company. Subsequently, an order was made for the company to be wound up, on the ground that it was insolvent. The liquidator sought repayment of these monies on the ground that they were spent in ways which involved a breach of the director's duties to the company.

The defendant contended that she used the funds to pay debts that were owing and that she took out what was owing to her.[77] In relation to this, the trial judge found that there was an entire absence of records and information as to the disposition of the sale proceeds except that the money went into an account

71 *Australian Growth Resources Corporation Pty Ltd v van Reesema* (1988) 6 ACLC 529, 537.
72 Ibid 539.
73 (2011) 84 ACSR 616.
74 Ibid 650 [95] (Croft J).
75 Ibid 648 [73] (Croft J).
76 (2011) 29 ACLC 738.
77 Ibid 744 (Barrett J).

maintained by the director and that she subsequently withdrew the money from that account. His Honour also found that the director made no effort to identify the so-called debts that she allegedly paid, to demonstrate that they were owed by the company, or to show any basis on which any money was owed to her by the company. In these circumstances, his Honour found that the director caused the company's funds 'to be applied in ways that could not, on any objective basis, be seen to be consistent with Fodare's interests'.[78] Consequently, his Honour ruled that the director was guilty of a serious breach of her fiduciary and statutory duties.[79]

While still on this matter, it is worth noting that some overseas experience also points to the general difficulty in proving that directors have acted in breach of their duty of loyalty and good faith unless there is very cogent evidence that the actions challenged are clearly unreasonable. This is exemplified by the famous decision in *Dodge v Ford Motor Co*.[80] This decision, by the Supreme Court of Michigan, considered the validity of certain actions taken by the defendant company by reference to the law pertaining to the exercise of directors' powers in the state of Michigan in the United States. At the time of the decision, the law in Michigan was similar to that currently prevailing in Australia.

The defendant company was engaged in the business of manufacturing motor cars. It enjoyed particular success and over a number of years paid special dividends in addition to regular dividends. Later, through the influence of its president, Mr Henry Ford, it embarked on a program of expansion and reduction in the price of cars. A decision was made to put the greatest share of the company's profits back into the business and after 1916 the company did not pay any special dividends. According to Mr Ford, this decision was made so as to enable the company 'to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes'.[81] According to the Court, Mr Ford's testimony tended to show that he was of the view that the Ford Motor Co had 'made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken'.[82]

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78 Ibid.

79 Ibid. On this matter, see also *Carr v Resources Equities Ltd* (2010) 275 ALR 366; *Parker v Tucker* (2010) 77 ACSR 525; *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21. Of particular significance, in all of these cases, the courts found breaches of duty on the part of directors on the basis no reasonable director could consider the impugned actions to be for the benefit of the company involved.

80 170 NW 668 (Mich, 1919).

81 Ibid 683 (Ostrander CJ).

82 Ibid 684 (Ostrander CJ).

The plaintiffs, minority shareholders of the Ford Motor Co, commenced a suit to enjoin the expansion program. They also sought an order directing the company to continue the payment of special dividends as before. These orders were granted on appeal. Handing down its decision, the Court made a number of significant findings and declarations. First, it recognised that '[u]ndistributed profits belong to the corporation, and, so far as any limitation can be found … may be lawfully employed as capital'.[83] The Court also declared that 'it is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation and to determine its amount'.[84] More still, it went on to express the opinion that ordinarily, 'courts of equity will not interfere in the management decisions of directors'.[85]

In a very compelling manner, the Court also enunciated that

> when, therefore, the directors have exercised this discretion and refused to declare a dividend, there will be no interference by the courts with their decision, *unless they are guilty of a wilful abuse of their discretionary powers, or of bad faith or a neglect of duty*.[86]

Having done this, the Court proceeded to set aside the decision of the directors not to pay any special dividends. According to the Court, the majority had arbitrarily decided to withhold profits earned by the company and applied them to a use which was not authorised by the company, something which they had no authority to do. Elaborating on this, the Court poignantly observed that where a company has a large surplus of funds which could be declared and paid in dividends, 'a refusal to declare and pay further dividends appears to be not an exercise of discretion on the part of the directors, but an arbitrary refusal to do what the circumstances required [sic] to be done'.[87] Finally, the Court made clear that 'it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others'.[88] When this happens, it is the 'duty of the courts to interfere'.[89]

As can be readily observed, the Court was prepared to intervene in this case because it was convinced that the actions of the defendant company, through its president, were deeply and fundamentally flawed.[90] It was clear to the Court, from the evidence of its president, that the company had set out to make a donation of corporate funds

83 Ibid 681 (Ostrander CJ).
84 Ibid 682 (Ostrander CJ), quoting *Hunter v Roberts, Thorp & Co*, 47 NW 131, 134 (Loveridge J) (Mich, 1890).
85 Ibid, quoting *Hunter v Roberts, Thorp and Co*, 47 NW 131, 134 (Loveridge J) (Mich, 1890).
86 Ibid (emphasis added).
87 Ibid 683 (Ostrander CJ).
88 Ibid 684 (Ostrander CJ).
89 Ibid.
90 See further Davies, *Modern Company Law 8th Edition*, above n 29, 510.

> of an indeterminate amount to an unspecified number of unknown donees. If [the company] had been allowed to reduce the price [of cars] as a gift to society, the courts and the minority shareholders would have lost the ability to control the amount of the donation and its purpose.[91]

2 Company as the General Body of Members

The analysis above might lead one to believe that the obligation imposed on directors to exercise their powers in the best interests of the company simply enjoins them to act in the interests of the separate entity. However, there is a different perspective to this matter. Contrary to the concept of 'the company as a separate entity', discussed above, is the opposing view that the term 'company as a whole' does not mean company as a distinct commercial entity separate from the corporators.[92] This idea has been put forward in a number of cases, with *Ngurli Ltd v McCann* providing a quintessential example in Australia.[93] In that case, the High Court, applying the principle set out in the English case of *Greenhalgh v Ardene Cinemas Ltd*,[94] expressed the opinion that 'the phrase, "the company as a whole," does not … mean the company as a commercial entity, distinct from the corporators: it means corporators as a general body'.[95]

A similar view has also been espoused in other Commonwealth jurisdictions. For example, in the leading Canadian case of *Teck Corporation Ltd v Millar*, Berger J, while discussing this matter, declared with confidence that 'the classical theory is that the directors' duty is to the company.[96] The company's shareholders are the company and therefore no interests outside those of the shareholders can legitimately be considered by the directors'.[97]

According to these and similar cases, 'company as a whole' simply means corporators.[98] Indeed, in *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]*, Owen J emphatically proclaimed that 'it does no damage to the doctrine of separate corporate personality to recognise that a reflection of the interests of the company may be seen in the interest of shareholders'.[99] Accepting this, it

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91 Tamar Frankel, 'Fiduciary Law' (1983) 71 *California Law Review* 795, 827. See further Davies, *Modern Company Law 8th Edition*, above n 29, 510; Sarah Worthington, 'Reforming Directors' Duties' (2001) 64 *Modern Law Review* 439, 446.

92 These are commonly referred to as members. In a company which has share capital, members are more commonly called shareholders. Though not technically correct, these terms are sometimes used interchangeably.

93 (1953) 90 CLR 425 ('*Ngurli*').

94 [1951] Ch 286, 291 (Evershed MR).

95 *Ngurli* (1953) 90 CLR 425, 438 (Williams ACJ, Fullagar and Kitto JJ).

96 (1972) 33 DLR (3rd) 288 (Supreme Court of British Columbia), 299 [104].

97 Ibid.

98 *Provident International Corporation v International Leasing Corporation* [1969] 1 NSWR 424, 437 (Helsham J); *Greenhalgh v Ardene Cinemas Ltd* [1951] Ch 286, 291 (Evershed MR); *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 512 (Dixon J); *Parke v Daily News* [1962] Ch 927, 963 (Plowman J).

99 (2008) 39 WAR 1, 533 [4392].

follows that the obligation imposed on directors to exercise their powers bona fide for the benefit of the company as a whole is a duty to consult the interests of members to the exclusion of those of the separate legal entity, the corporation.[100] In other words, a reflection of the interests of a company is to be found in the interests of its members,[101] which, on current authority, connotes both present and future members.[102] Indeed, in *Gaiman v National Association for Mental Health*, Megarry J, while discussing this aspect of the duties of directors, accepted 'the interests of both present and future members of the association, as a whole, as being a helpful expression of a human equivalent'.[103] If this is accepted, it stands to reason that, in exercising any of their powers, it is the duty of the directors of a company to take all reasonable steps to obtain the best outcome for all members of the company, present and future. To do otherwise would be a breach of the directors' duty of loyalty.[104] Strong judicial support for this view can be found in the decisions considered below.

In *Hutton v West Cork Railway Co*, the majority shareholders, following the sale of the defendant company, passed a resolution directing that out of the sale proceeds, certain sums be applied to compensate some staff of the company who were set to lose their employment.[105] Significantly, the officials sought to be recompensed had no legal claim to such compensation under their work arrangements with the company. Neither were they entitled to any such payment under the law as it stood at the time.

By the same resolution, the majority shareholders further instructed the former directors of the company be paid for their past services. The directors had never received any remuneration before and the company's articles of association did not make provision for such payment.

A stock debenture holder who objected to the making of these payments commenced proceedings seeking an injunction to restrain the company from carrying out the resolutions. The Court of Appeal upheld the challenge. Ruling on the validity of the proposed payments, Bowen LJ declared that the majority who had passed the resolution 'can only spend money which is not theirs but the company's, if they are spending it for the purposes which are reasonably incidental to the carrying on of the business of the company'.[106]

100 Austin and Ramsay, above n 5, 431 [8.095]; Austin, Ford and Ramsay, above n 5, 274 ff [7.6]–[7.8]; Davies, *Modern Company Law 8th Edition*, above n 29, 603; Birds, above n 15, 159.

101 Heydon, above n 39, 123.

102 *Provident International Corporation v International Leasing Corporation* [1969] 1 NSWR 424, 440 (Helsham J); *Madoff Securities International Ltd v Raven* [2013] EWHC 3147 (18 October 2013) [187] (Popplewell J). See further Keay, 'Tackling the Issue of the Corporate Objective', above n 17, 601.

103 [1971] 1 Ch 317, 330. See also the opinion of counsel in the Berkeley Hotel matters in Gower, above n 10.

104 See Birds, above n 15, 159.

105 (1883) 23 Ch D 654.

106 Ibid 671.

Later on, in an oft-repeated statement, his Lordship expatiated 'the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company'.[107] So, according to his Lordship, in the discharge of their functions, directors may engage in any activity only if it is necessary to further the interests of the company.

An opinion similar to this was expressed in the subsequent case of *Re Lee, Behrens & Co Ltd*,[108] a case which also involved the payment of corporate funds in relation to services rendered to the company by a former employee.

Several years after the death of its managing director, the directors resolved to pay a generous annuity to his widow. This was, ostensibly, in recognition of the long, dedicated and loyal service that the deceased managing director had rendered to the company. Under its memorandum of association, the company was authorised to make a payment of the nature in issue in this case.

Following the voluntary liquidation of the company, the deceased managing director's widow lodged a proof for the sum of £8000, being the capitalised value of her annuity. The liquidator rejected this claim on the basis that the decision to pay her the claimed annuity was ultra vires the company and therefore void.

Justice Eve upheld the liquidator's decision. Considering the validity of the agreement to pay the annuity to the widow, his Honour opined:

> all such grants involve an expenditure of the company's money, and that money can only be spent for purposes reasonably incidental to the carrying on of the company's business, and the validity of such grants is to be tested … by the answers to three pertinent questions: (i) is the transaction reasonably incidental to the carrying on of the company's business? (ii) is it a bona fide transaction? And (iii) is it done for the benefit and to promote the prosperity of the company?[109]

More lately, in *Parke v Daily News Ltd*, the Court adopted a similar view.[110] As will be recalled, the defendant in this case ran a newspaper business. Following unsuccessful trading operations over a number of years, a decision was made by its directors to sell its newspaper business, plant and copyrights held by its subsidiaries. As a result of this decision, an overwhelming majority of the company's staff were dismissed. To assist the dismissed employees, the directors resolved that after discharging the costs relating to the sale transactions, proceeds from the sale of the company's undertaking would be applied towards paying compensation and accrued pension rights to the dismissed employees as well as providing them with several other benefits, including payments in lieu of notice and holiday entitlements.

The directors' decision was challenged by one of the company's minority shareholders. The plaintiff claimed that the proposed ex-gratia payments were ultra vires the company and illegal. The plaintiff further asserted that the

107 Ibid 673.
108 [1932] 2 Ch 46.
109 Ibid 51.
110 [1962] Ch 927.

directors could not make these payments to the detriment of the company's shareholders.

Once again, the Court had no difficulty in striking down the directors' actions. Doing so, Plowman J held that

> [t]he view that directors, in having regard to the question what is in the best interest 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.[111]

An open-mind reading of these decisions leaves no doubt that the courts in all of these cases considered 'interests of the company' as being synonymous with 'interests of the members of the company'.

As a matter of interest, it may be noted that in the now famous case of *Dodge v Ford Motor Co* discussed earlier,[112] the Court also proffered an opinion similar to those set out above. There, the Court held that

> [a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself …[113]

Quite significantly, the view that 'company' means 'members' was accepted by the Corporations and Markets Advisory Committee ('CAMAC') without argument.[114] Also, the same view enjoys some enthusiastic academic support. For example, the authors of *Corporate Law*, a significant study of Australian company law, have postulated that 'generally, interests of the company as an entity can be equated with the collective interest of members'.[115]

B Interim Conclusion

It can be discerned from this discussion that the current legal scheme for regulating the exercise of directors' powers presents some difficulties. The governing general statutory and equitable principles of fiduciary law permit directors in some circumstances to concentrate on the interests of the separate legal or economic entity, and in others on the interests of members.[116] This creates some degree of uncertainty in determining whether a decision by directors to take a particular action constitutes a proper exercise of directors'

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111 Ibid 962–3.

112 See above Part II(A)(1).

113 170 NW 668, 684 (Ostrander CJ) (Mich, 1919).

114 See CAMAC, above n 9, 96.

115 See Elizabeth Boros and John Duns, *Corporate Law* (Oxford University Press, 3rd ed, 2010) 211 [11.4]. See also Austin and Ramsay, above n 5, 431 [8.095]; Phillip Lipton, Abe Herzberg and Michelle Welsh, *Understanding Company Law* (Thomson Reuters, 17th ed, 2014) 390 [13.2.10].

116 *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 143 (Dixon J).

powers or not.[117] The lack of clarity resulting from the current state of the law is undesirable. It can be exploited by directors. They might agree to a decision in order to achieve an outcome favoured by them. So long as the decision serves some legitimate corporate purpose, it will almost certainly be immune from judicial attack, even if it is not in the best interests of members.

At the same time, the uncertainty caused by current law has the potential to serve as a useful tool for tactical manoeuvring by some other parties dealing with a company. Through its tendency to facilitate the manipulation of the control of the affairs of a company, current law risks abandoning all effective control over corporate decision-makers.[118] This is bound to impose substantial costs on members of companies and the community generally, given the critical role that modern companies play in the proper functioning of the economic order of society. To overcome this and its associated problems, it is desirable to reform the legal regime which presently regulates the exercise of directors' powers. This matter assumes particular significance considering that the two policy making bodies that have examined this issue in the recent past have adopted divergent views as to what the duty to act in the best interests of the company actually requires of directors. As will be recalled, CAMAC holds the opinion that the concept of company in the context of the present discussion means members.[119] On the other hand, the view of the Joint Committee on Corporations and Financial Services considers that this duty requires directors to act in the best interests of the separate entity, not members.[120]

III REFORMING THE LAW GOVERNING THE EXERCISE OF DIRECTORS' POWERS: ONE OVERSEAS SOLUTION

The concept of 'benefit of the company' as presently applied by the courts is not very satisfactory as an instrument for controlling the actions of directors. As Dr Rixon once bluntly put it, 'benefit of the company' is 'a Delphic term employed by different judges in different circumstances to signify different things'.[121] To promote certainty and predictability, which are essential to enable all parties affected by the actions of company directors to properly organise their affairs, there is need for dependable ground rules in this area. For this reason, the law governing the exercise of directors' powers in Australia needs to be reformed. That reform should have as its objective the introduction of distinct standards which articulate with clarity whose interests directors must seek to

117 Davies, *Modern Company Law 7th Edition*, above n 11, 371 ff.
118 See generally the discussion in Part II above. See also nn 211–12 of this article.
119 See CAMAC, above n 9, 96.
120 See Joint Committee on Corporations and Financial Services, above n 3, 44 [4.6].
121 Rixon, above n 39, 454.

promote in the course exercising their powers. As the Joint Committee on Corporations and Financial Services sagely observed:

> a law which imposes duties should give those upon whom the duty is imposed clear guidance as to whom the duty is owed, and how it is to be discharged. A law which does not is bad law, and at the very least magnifies the uncertainties faced by directors.[122]

In undertaking this exercise, Australian policy makers can draw some useful lessons from reform initiatives implemented in the UK, a jurisdiction with whom Australia shares a common legal system and similar business, economic and commercial experience. The ensuing discussion develops this matter.

A Reforms Undertaken in the United Kingdom

In the late 1990s, the UK embarked upon a programme of financial regulatory and corporate governance reform aimed at strengthening the competitiveness of its economy.[123] As part of this agenda, in March 1998 the government set up the Company Law Review Steering Group ('CLRSG') to undertake a review of the whole system of its core company law. The main objective of this review was to devise a simple, rational framework of company law which is modern and competitive, and which facilitates enterprise and promotes transparency and fair dealing.[124] Launching this review, the Secretary for Trade and Industry specifically hinted at the prospect of new legislation being introduced in the area of directors' duties.[125]

Once inaugurated, CLRSG announced that it saw its main task as the forging of

> a framework of company law that promoted the competitiveness of British companies, struck the proper balance between the interests of those concerned with companies, in the context of straightforward, cost-effective and fair regulation, and promoted consistency, predictability and transparency in the law.[126]

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122 See Joint Committee on Corporations and Financial Services, above n 3, 56 [4.47].

123 See Department of Trade and Industry (UK), 'Modern Company Law for a Competitive Economy' (Launch Document, March 1998) <http://webarchive.nationalarchives.gov.uk/20121029131934/http://www.bis.gov.uk/files/file23283.pdf> ('*Launch Document*').

124 Ibid 1–3, 9 [3.7]. For some discussion of this see Jonathan Rickford, 'A History of Company Law Review' in John de Lacy (ed), *The Reform of United Kingdom Company Law* (Cavendish Publishing, 2002) 3, 5 ff; John Parkinson, 'Inclusive Company Law Review' in John de Lacy (ed), *The Reform of United Kingdom Company Law*, (Cavendish Publishing, 2002) 43, 43 ff; Worthington, 'Reforming Directors' Duties', above n 91; Keay, 'Tackling the Issue of the Corporate Objective', above, n 17, 588 ff.

125 *Launch Document*, above n 123, 1–3, 9 [3.7].

126 Minutes of Evidence from the Treasury Select Committee, 'Memorandum Submitted by the Department of Trade and Industry and HM Treasury' HC (2001-02) 758-II [11] (02 July 2002); CLRSG, 'Modern Company Law for a Competitive Economy: Final Report' (Report, Department of Trade and Industry (UK), 2001) [1.3] ('*Final Report*').

Very importantly, as a major part of this review project, CLRSG set out to identify what the proper scope of company law should be and whose interests it should be designed to serve.[127] In this respect, CLRSG very early on identified the governance of companies, including 'the closely interrelated rules governing the respective functions, powers and duties, both collective and individual, of those who exercise authority and control within the company's constitutional structure', as one of the critical areas that needed to be addressed.[128] Quite noteworthy, CLRSG acknowledged at the outset that the question of 'for what purposes and in whose interests should companies be run?' was probably the most difficult, important and wide ranging of the areas it was to cover.[129] Commentators have claimed that, of all issues considered during CLRSG's review and thereafter, this matter gave rise to the most controversial, passionate and hard fought debates.[130]

In its *Developing Framework Report*, CLRSG observed that there was wide demand from company directors for clarity on what the law required of them.[131] To meet this challenge, CLRSG recommended the introduction of a statement of directors' duties.[132] To CLRSG, such a statement would serve to provide clarity and to make the law more accessible. Further, CLRSG expressed the firm view that the basic duties governing company directors should be covered by traditional legal rules. In addition, CLRSG advised that in order to encourage improved company governance, it was imperative that the statement of directors' duties adopted directly address the key question: 'in whose interest should companies be run?'.[133]

Turning its attention to this question, and after much consultation and deliberation, CLRSG ultimately concluded that, in order to achieve the overall objective of wealth generation and competitiveness for the benefit of all, the law should require directors to work to achieve the success of the company for the benefit of its members. Following on, CLRSG recommended that a statutory core duty be introduced as a means of achieving this objective. CLRSG also recommended that as part of this new measure, directors should be required to take decisions in an inclusive fashion to recognise best practice in relation to a

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127 CLRSG, 'Modern Company Law for a Competitive Economy: The Strategic Framework' (Report, Department of Trade and Industry (UK), February 1999) 19–20 [2.33] <http://webarchive.nationalarchives.gov.uk/20121029131934/http://www.bis.gov.uk/files/file23279.pdf> ('*Strategic Framework Report*') 33 [5.1.1].

128 Ibid 19–20 [2.33].

129 Ibid.

130 See, eg, Worthington, 'Reforming Directors' Duties', above n 91, 440; Andrew R Keay, 'The Duty to Promote the Success of the Company: Is It Fit for Purpose?' (Working Paper, School of Law, University of Leeds, 20 August 2010) 4 <http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/keay-the-duty-to-promote-the-success.pdf>.

131 See CLRSG, *Developing Framework Report*, above n 9, 21–2 [3.14].

132 Ibid 22 [3.16].

133 Ibid 32–5 [3.45]–[3.53].

broad range of stakeholder groups. CLRSG stated that directors should be obliged to

> achieve the success of the company for the benefit of shareholders by taking proper account of all the relevant considerations for that purpose. These include a proper balanced view of the short and long term; the need to sustain effective ongoing relationships with employees, customers, suppliers and others … and to consider the impact of its operations on the community and the environment.[134]

The approach preferred by CLRSG requires directors to run companies primarily for the benefit of members. This came to be popularly referred to as the 'enlightened shareholder value' theory. That approach puts the interests of members at the forefront. At the same time, however, it recognises that in order to achieve best practice, directors must take proper account of all relevant considerations.[135] Indeed, elaborating on this, Secretary of State for Trade and Industry Alistair Darling observed that CLRSG's proposal:

> recognise[s] that directors will be more likely to achieve long term sustainable success for the benefit of their shareholders if their companies pay attention to a wider range of matters … Directors will be required to promote the success of the company in the collective best interests of the shareholders, but in doing so they will have to have regard to a wider range of factors, including the interests of employees and the environment.[136]

In making its recommendation, CLRSG expressly rejected the pluralist theory which considers that companies should be run in a way which maximises wealth and welfare for all and not necessarily give inevitable primacy to shareholders. According to the proponents of this idea, shareholders are only one of a number of stakeholders which includes employees, customers, and local communities. As such, for those who share this view, company law should permit directors to give priority to one of these groups at the expense of shareholders if justified by circumstances.[137]

However, CLRSG decided against imposing pluralism in the sense of allowing directors a discretionary power to decide that other interests should override those of shareholders. In the words of CLRSG:

> The overall objective should be pluralist in the sense that companies should be run in a way which maximises overall competitiveness and wealth and welfare for all. But the means which company law deploys for achieving this objective must take account of the realities and dynamics which operate in practice in the running of commercial enterprise. It should not be done at the expense of turning company directors from business decision makers into moral, political or economic arbiters, but by harnessing focused, comprehensive, competitive business decision making

134 Ibid 13 [2.19].

135 Ibid 15 [2.22]. See also Worthington, 'Reforming Directors' Duties', above n 91, 445.

136 United Kingdom, *Parliamentary Debates*, House of Commons, 6 June 2006, vol 447, col 125.

137 See, eg, above nn 17–20.

> within robust, objective professional standards and flexible, but pertinent, accountability.[138]

Further, as CLRSG saw it, a pluralist approach giving directors power to override the interests of members was unacceptable. In the considered opinion of CLRSG, such an approach

> would confer a broad policy discretion on directors, funded by the company's resources: if directors had a power to decide that other interests should override those of shareholders, this discretion would be unpoliced; if directors had a duty to take other interests into account, the effect would be to give a similarly wide discretion to the courts.[139]

CLRSG's proposals were accepted by the Government, which believed that the 'enlightened shareholder value approach would be mutually beneficial to business and society'.[140]

Following the conclusion of the CLRSG review, and after subsequent consultation with all interested parties, the UK enacted the *Companies Act 2006* (UK). Among the measures included in this Act were new statutory measures adopted to regulate the exercise of directors' powers. These are set out principally in chapter 2, part 10 of the Act. One of these is section 172(1), which creates a duty of 'compliance and loyalty'. This provision relevantly provides that

> [a] director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:
>
> (a) the likely consequences of any decision in the long term;
>
> (b) the interests of the company's employees;
>
> (c) the need to foster the company's business relationships with suppliers, customers and others;
>
> (d) the impact of the company's operations on the community and the environment;
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
>
> (f) the need to act fairly between the members of the company.

According to Professor Davies, one of the members of the CLRSG, this provision was clearly introduced to take over the role previously played by the

138 CLRSG, *Developing Framework Report*, above n 9, 14 [2.21] (emphasis altered). See further Davies, *Modern Company Law 8th Edition*, above n 29, 508 ff.

139 Ibid 24 [3.24]; See Worthington, 'Reforming Directors' Duties', above n 91, 446. See also Lady Arden, 'Companies Act 2006 (UK): A New Approach to Directors' Duties' (2007) 81 *Australian Law Journal* 162, 164 ff. Significantly, both CAMAC and Australia's national corporate regulatory agency, the Australian Securities and Investments Commission ('ASIC'), share this concern: see CAMAC, above n 9, 111 ff.

140 United Kingdom, *Parliamentary Debates*, House of Commons, 17 October 2006, vol 450, col 789 (Margaret Hodge, Minister for Industry and the Regions).

duty to act bona fide in the best interests of the company.[141] Indeed, in reference to this, members of CLRSG themselves stated:

> We have not been able to think of any new principles, nor areas where it is desirable to leave scope for the judges to develop completely new ones. There would also be an objection of principle to the judges inventing wholly new bases of liability for company directors, with retrospective effect, rather than new obligations being imposed prospectively and after democratic debate by Parliament. We are therefore inclined to favour the proposed restatement being treated as exhaustive. *Our view at this stage is that the restatement should set out all the general duties which apply to directors in the exercise of their functions as such*. The only other duties which apply to them will be those which are imposed by other provisions of the legislation.[142]

In some of the few cases that have considered the content of the duty imposed by this provision thus far, the courts have expressed the view that section 172 merely sets out the pre-existing law on the subject of the duty to act bona fide in the best interests of the company.[143] However, the better view seems to be that the new statutory duty modifies the traditional duty imposed on directors to act bona fide in the interest of the company and for proper purposes,[144] and does not simply repeat the common law.[145] Certainly, this was the view taken by the government. In this respect, Lord Goldsmith, who was the government spokesperson on these matters, categorically stated that 'the statutory statement replaces the common law rule or equitable principle … once the Act is passed, one will go to the statutory statement of duties to identify the duty that the director owed'.[146]

Quite noteworthy, this approach was adopted by Mann J in *Eclairs Group Ltd v JKX Oil & Gas plc*.[147] Expressing his opinion as to the import of section 172, his Honour observed that '[s]ection 172 is in the nature of an overarching obligation which arises when the directors are considering the exercise of their powers'.[148] His Honour went on to elaborate that

> [i]n relation to any given power, it is necessary to identify the purposes for which the power is to be exercised (so far as possible), and having identified that purpose one then has to see whether the directors have exercised it for that purpose, and also whether it was exercised so as to 'promote the success of the company'. The

141 See Davies, *Modern Company Law 8th Edition*, above n 29, 506. See also Arden, above n 139, 163.

142 CLRSG, *Developing Framework Report*, above n 9, 47 [3.82] (emphasis added). See further Birds, above n 15, 154 ff.

143 See, eg, *LNOC Ltd v Watford Association Football Club Ltd* [2013] EWHC 3615 [63]; *McKillen v Misland (Cyprus) Investments Ltd (Rev 1)* [2012] EWHC 23–43 [488]; *Moore Stephens (a firm) v Stone Rolls (in liquidation)* [2009] UKHL 39, 96–7 [224]; *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72.

144 Worthington, 'Reforming Directors' Duties', above n 91, 446.

145 Davies, *Modern Company Law 8th Edition*, above n 29, 506.

146 United Kingdom, *Parliamentary Debates*, House of Lords, 6 February 2006, vol 678, col GC243 (Lord Goldsmith, Attorney-General).

147 [2013] EWHC 2631.

148 Ibid [208].

> first step is a necessary step, and is not rendered unnecessary by the existence of the second obligation.[149]

Under this new provision, directors of UK companies now have a primary duty to act within the law and for proper purposes, and to act in good faith to promote the success of the company, for the benefit of the members as a whole.[150] Decidedly, as Lord Goldsmith has reminded us, 'it is essentially for the members of the company to define the objective they wish to achieve'.[151] What this provision does very well is to specifically make clear that the promotion of the welfare of members is the primary criterion for an exercise of directors' powers. Given, the provision also obliges directors to consider other factors, but this is only to the extent that doing this will promote the success of the company for the benefit of its members.[152] Indeed, speaking for the government once again, Lord Goldsmith said:

> The Company Law Review considered and consulted on two main options. The first was 'enlightened shareholder value' under which a director must first act in the way that he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members … The Government agrees that this is the right approach. It resolves any confusion in the minds of directors as to what that the interests of the company are, and prevents any inclination to identify those interests with their own. It also prevents confusion between the interests of those who depend on the company and those of the members.[153]

The step taken by the government of the UK marks an interesting and important development in the law governing the exercise of directors' powers. The introduction of this measure is likely to ensure that better corporate governance is delivered. It states and, to a certain degree, clarifies the law on directors' duties. The new provision resolves a most important and contentious issue, namely in whose interests are the company's affairs to be run.[154] It makes absolutely clear that the overarching duty of directors is to promote the interests of the members of a company to the fullest extent possible.[155] Further, it provides clarity that no duty is owed to other constituencies. The persons who are to benefit from directors' actions are clearly identified as the company's members.[156] No doubt, the new duty requires directors to make decisions in an

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149 Ibid [210].

150 See Worthington, 'Reforming Directors' Duties', above n 91, 446.

151 United Kingdom, *Parliamentary Debates*, House of Lords, 6 February 2006, vol 678, col GC258 (Lord Goldsmith, Attorney-General). His Lordship also added that 'for a commercial company, success will usually mean long-term increase in value. For certain companies, such as charities and community interest companies, it will mean the attainment of the objectives for which the company has been established': at col GC258.

152 Worthington, 'Reforming Directors' Duties', above n 91, 446.

153 United Kingdom, *Parliamentary Debates*, House of Lords, 6 February 2006, vol 678, col GC255.

154 See further Davies, *Modern Company Law 8th Edition*, above n 29, 506.

155 Ibid 507. See also CAMAC, above n 9, 103 ff.

156 Davies, *Modern Company Law 8th Edition*, above n 29, 508.

inclusive manner. However, it is also plainly clear that this is to be done only to the extent that this is necessary to promote the success of the company for the benefit of the members.[157] By defining with a high degree of particularity whose interest directors may legitimately seek to advance, more certainty is promoted. In consequence, irrelevant actions on the part of directors are likely to be challenged more readily.[158] This reform will thus likely improve the standards of behaviour of directors.

It should be noted here that although it is now recognised and accepted that directors must pay due regard to the interests of creditors, especially where the solvency of a company is in doubt,[159] section 172(1) does not include a reference to this as one of the matters that directors must consider as part of their obligation to promote the success of the company. Certainly, there was some debate whether this should be the case. Ultimately, however, it was decided against taking that course of action. The decision finally made was that this issue should continue to be dealt with exclusively by reference to the specific rules that impose on directors a duty of care towards creditors, in particular the *Insolvency Act 1986* (UK).[160] In this regard, section 172(3) of the *Companies Act 2006* (UK) simply states that the duty to promote the success of the company imposed under that section 'has effect subject to any enactment requiring directors, in certain circumstances, to consider or act in the interest of creditors of the company'.[161]

Of late, there has been very vibrant debate in Australia concerning the effect of the duty to act in the best interests of the company on the protection of the interests of creditors. A perennial question so far has been whether, under this obligation, directors owe a distinct, separate duty directly to creditors. In this regard, the generally accepted view seems to be that this obligation does not impose an independent duty owed to and directly enforceable by creditors.[162]

157 Ibid.

158 Ibid 515. See also Keay, 'Tackling the Issue of the Corporate Objective', above n 17, 592, 600–1.

159 See, eg, *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722; *Walker v Wimborne* (1976) 137 CLR 1; *Australian Securities and Investments Commission v Somerville* (2009] 77 NSWLR 110; *Re World Alliance Pty Ltd; Sycotex Pty Ltd v Baseler [No 2]* (1994) 51 FCR 425.

160 Section 214 imposes potential liability on directors for wrongful trading. That provision requires directors to monitor the financial condition of the company and, if it appears that the company cannot avoid insolvent liquidation, to take all necessary steps to minimise potential loss to the company's creditors. In the event of failure to do so, any defaulting director may be ordered by the court to make a contribution to the assets of a company in the event of it going into insolvent liquidation. See further Vanessa Finch, *Corporate Insolvency Law, Perspectives and Principles*, (Cambridge University Press, 2nd ed, 2009) 299–304.

161 For some discussion of these see Davies, *Modern Company Law 8th Edition*, above n 29, 519 ff; Williams, above n 35, 369. For a discussion of the Australian equivalent see Austin and Ramsay, above n 5, 432 [8.100]; Keay, 'Tackling the Issue of the Corporate Objective', above n 17, 593–4.

162 See *Spies v The Queen* (2000) 201 CLR 603, 635–7 [93]–[95] (Gaudron, McHugh, Gummow and Hayne JJ). See also the cases cited in above n 159 of this article. See Anil Hargovan, 'Directors' Duties to Creditors in Australia after *Spies v The Queen* – Is the Development of an Independent Fiduciary Duty Dead or Alive?' (2003) 21 *Company and Securities Law Journal* 390.

However, it is also recognised and accepted that, in exercising their powers, directors must consider very carefully the likely impact of their actions on the interests on creditors, especially where the solvency of the company is in doubt.[163] Indeed, in his judgment in the recently concluded Bell Group litigation, Owen J went a step further and stated categorically that where the actions of directors have the potential to expose a company to the prospect of liquidation, then 'creditors are entitled to have their interests considered within (and not in addition to) the confines of the duty of the directors to act in the interests of the company'.[164] Quite significantly, on appeal, this view was approved of by the majority of the Western Australian Court of Appeal. Expressing his opinion on this matter, Lee AJA affirmed that in a situation of insolvency, the directors have a duty not to exercise their powers to cause the company to prejudice the interests of its creditors.[165] For his part, Drummond AJA went even one step further. He acknowledged 'the development of the principle that directors in discharging their fiduciary duties to their company must, if the company is sufficiently financially distressed, have regard and give proper effect to the interests of creditors'.[166] After this, his Honour went on to proclaim that 'courts will now intervene in an appropriate case, irrespective of the directors' beliefs and business judgments, to ensure that creditors are properly protected'.[167] According to his Honour, this is on the basis that the duty imposed on them

> will not ordinarily be satisfied by directors who consider the impact that entry into a particular transaction by the company will have on its creditors but proceed with the transaction even though it causes significant prejudice to those creditors. By doing that, the directors will usually, in my opinion, be in breach of their fiduciary duty to the company to exercise their powers for proper purposes and the transaction will be voidable at the election of the company or its liquidator.[168]

In light of the express recognition by the judiciary that, in exercising their powers, directors are subject to a distinct obligation not to act in disregard of the interests of creditors, a question arises whether in undertaking the reform advocated in this article, it would be desirable to include a statement specifically requiring directors to consider the interests of creditors when they exercise their powers.

In addressing this issue, it is worth bearing in mind that Australia, like the UK, currently has in place a specific regime for ensuring that the interests of creditors are not sacrificed by those responsible for controlling the affairs of

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163 *Spies v The Queen* (2000) 201 CLR 603, 635–7 [93]–[95] (Gaudron, McHugh, Gummow and Hayne JJ).

164 See *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 541 [4422].

165 *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 169 [920], 172 [948], 173 [952]. For a helpful discussion of this decision, see generally Anil Hargovan and Jason Harris, 'For Whom the Bell Tolls: Directors' Duties to Creditors after *Bell*' (2013) 35 *Sydney Law Review* 433.

166 See *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 363 [2031].

167 Ibid. On 15 March 2013, the High Court of Australia granted special leave to appeal this decision: *Westpac Banking Corporation v Bell Group Ltd (in liq)* [2013] HCATrans 49.

168 *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 365 [2042].

companies. This can be found in the *Corporations Act*, part 5.7B division 3. In particular, section 588G of the *Corporations Act* imposes on directors a duty to prevent insolvent trading by their company. Non-observance of this duty constitutes a contravention of the Act and attracts both criminal and civil liability.[169] In addition to this, the *Corporations Act* contains provisions pursuant to which certain persons are disqualified or may be disqualified from managing corporations.[170]

The disqualification regime prevents any person from getting involved in the making of decisions that have the capacity to significantly affect a company's financial standing where that person has been convicted of an offence: that concerns the making, or participation in making, of decisions that affect the whole or a substantial part of the business of the corporation; that is a contravention of the *Corporations Act* and punishable by imprisonment for a period greater than 12 months; that involves dishonesty and is punishable by imprisonment for at least three months; or that is against the law of a foreign country and punishable by imprisonment for a period of greater than twelve months.[171] Further, where a declaration is made under section 1317E of the *Corporations Act* that a person has contravened any civil penalty provision of the Act,[172] the court is vested with the power, following an application by ASIC, to disqualify that person from managing corporations for a term determined by the court.[173] These measures go further to protect the interests of creditors. Given this, it may serve Australia well to follow the lead established by the UK and reform its law relating to the duties of directors to make clear that so long as a company is financially stable and able to discharge its financial obligations, the directors' principal duty is to advance the interests of its members, to the exclusion of those of any other group. As Owen J has observed, '[i]n a practical commercial sense, when the company is a thriving going concern, the focus of attention is [and indeed should be] the size and compilation of the shareholders' funds'.[174]

169 See *Corporations Act ss 588G*(2)–(4). See further *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423; *Elliott v Australian Securities and Investments Commission* (2004) 10 VR 369.

170 See *Corporations Act* pt 2D.6.

171 These are specified in the *Corporations Act* s 206B.

172 The *Corporations Act* s 588G is one such provision.

173 *Corporations Act* s 206C.

174 See *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 541 [4421]. As has been bluntly put elsewhere, 'the predominant interests to which the directors of a solvent company must have regard are the interests of the shareholders as a whole': *Madoff Securities International Ltd v Raven* [2013] EWHC 3147, [187] (Popplewell J).

IV A PROPOSAL FOR REFORM

Australia's scheme of corporate governance has, as its core concern, the promotion of standards of best practice. This is because it is recognised that 'effective corporate governance structures encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved'.[175] The rules which define the obligations of directors play a central role in the achievement of this goal. Indeed, as the ASX Corporate Governance Council has succinctly observed, 'fundamental to any corporate governance structure is establishing the roles of the board and senior executives'.[176]

Sadly, as the discussion above has endeavoured to demonstrate, Australia's current law relating to the duties of directors is beset by some difficulty. It gives less than precise guidance as to whose interests directors are bound to promote when they exercise their wide discretionary powers.[177] Clearly, this is untenable. For this reason, there is need to reform the legal regime presently governing the exercise of directors' powers.[178]

In undertaking this task, it is important to recognise that a company is essentially a fund of money put together by a group of people to be used in certain activities to achieve some common objectives.[179] In light of this, it is suggested that the central objective of the law should be to ensure the augmentation of this fund for the ultimate benefit of its owners. Indeed, it has been boldly asserted by one leading corporate law scholar that corporate law's only distinctive feature is to serve as a means to increase shareholder value.[180] Quite noteworthy, this view commands support among some leading economists,[181] and some members of the judiciary.[182]

It is recognised in Australia today that members are the 'owners of the company',[183] being the people who have risked their capital in the hope of gain.[184]

175 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations with 2010 Amendments* (Australian Securities Exchange, 2nd ed, 2010) 3. See also Austin and Ramsay, above n 5, 364 ff [7.600]–[7.660]; Austin, Ford and Ramsay, above n 5, 5 ff [1.2]-[1.6].

176 ASX Corporate Governance Council, above n 175; See also Austin and Ramsay, above n 5, 366 ff [7.620]–[7.630]; Austin, Ford and Ramsay, above n 5, 5 [1.2].

177 See above Part II.

178 See above n 124.

179 Austin and Ramsay, above n 5, [1.320]–[1.350]; Lumsden and Fridman, above n 3, 156 ff.

180 Gilson, above n 14, 145. See also Macey, above n 12.

181 See, eg, Friedman, above n 14.

182 See *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 541 [4421] (Owen J).

183 See *Corporations Act* pt 1.5 [1.9]. See also *Caparo Industries plc v Dickman* [1990] 2 AC 605, 625E (Lord Bridge), quoting *Caparo Industries plc v Dickman* [1989] QB 653, 680 (Bingham LJ); Stout, above n 4, 667.

184 Austin and Ramsay, above n 5, 431 [8.095]; Easterbrook and Fischel, above n 12, 10 ff; Joint Committee on Corporations and Financial Services, above n 3, 11 [2.41]; Lumsden and Fridman, above n 3, 159.

While these capital venturers bear the greatest risk in the event of a company failing, they are generally not in a position to protect themselves from the spectre of directorial misfeasance, unlike other claimants such as employees and creditors who are able to do so through their contracts and other strategies.[185] In light of this, it would make eminent sense if the law was amended to provide utmost protection of the interests of the general body of the members of the company, as UK policy makers have done. By focussing on the interests of members, the new UK test has the virtue of promoting 'a more precise, concrete, material inquiry'.[186] On this approach, directors may competently take any decision only if it is calculated to secure the best outcome for members of the company. As such, in a company with a share capital, directors should aim to maximise shareholder wealth, as the benefit of shareholders is usually equated with this objective.[187]

Neoclassical economics teaches that shareholders come to the corporation with wealth maximisation as their goal.[188] In other instances, such as in the case of not for profit organisations, it should ordinarily be permissible for directors to make some decision only if its purpose is to achieve the aims for which members established the company.[189] In deciding whether a particular decision would be in the interest of members as proposed here, directors may take into account any range of other interests they consider relevant since it is recognised that 'being a corporate citizen, building trust, engaging with and supporting communities can add value to the bottom line in a variety of ways'.[190] At the same time, directors should only be too aware that failure to pay due regard to matters such as these can cause the company immense commercial damage.[191] This proposal will serve to ensure that directors do not engage in any conduct which does not confer any commercial advantage on members,[192] and thus avoid the prospect of weakening the position of members, which has potential to discourage the public from investing in companies, with possible detrimental consequences on the national economy.[193] The benchmark established here also has the distinct advantage that

185 See also below nn 211–12.

186 Heydon, above n 39, 123.

187 See above Part II(A)(2).

188 See generally Friedman, above n 14; Stephen M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' Governance' (2003) 97 *Northwestern University Law Review* 547, 558. See further Joint Committee on Corporations and Financial Services, above n 3, 59 [4.58]. See also n 174 of this article.

189 See also part of Lord Goldsmith's speech set out in the text accompanying above n 149 above.

190 See Joint Committee on Corporations and Financial Services, above n 3, 23 [3.21], quoting John Howard, 'The 1999 Corporate Public Affairs Oration' (Speech delivered at the Centre for Corporate Public Affairs, 26 March 1999) <https://accpa.com.au/resources.php?a=orations>.

191 Joint Committee on Corporations and Financial Services, above n 3, 19 [3.4].

192 See Austin and Ramsay, above n 5, 438–9 [8.130]; Joint Committee on Corporations and Financial Services, above n 3, 53 [4.39]; Lumsden and Fridman, above n 3, 165–8.

193 See further Lumsden and Fridman, above n 3, 158 ff.

it makes it much easier for all parties concerned to determine whether the directors have complied with the relevant governing rule.[194]

Before taking leave of this matter, it is important to note here that while it is postulated that the obligation to act in the best of the interests of the company requires directors to exercise their powers in the interest of members, its application can give rise to some practical problems. This is due principally to the fact that shareholder interests are highly fragmented.[195] As has been rightly observed by several scholars, shareholders are highly heterogeneous.

There are short-term and long-term shareholders.[196] Some shareholders own diversified portfolios while others are undiversified shareholders. Companies have hedged and unhedged shareholders. While many shareholders invest in companies for purely economic reasons, there are also some social shareholders.[197] Because shareholders are plagued by divergent interests and goals, they have different time horizons, risk strategies, tax brackets, dividend preferences, free cash preferences and enthusiasm for new projects.[198]

Clearly, in exercising their powers, directors cannot subordinate the interests of one group over those of another. As Megarry J observed in *Gaiman v National Association for Mental Health*, 'the interests of some particular section or sections of the association cannot be equated with those of the association'.[199] It is thus suggested that in discharging the duty proposed here, directors should not be guided by what actual present members want, but should act in accordance with the wishes of a hypothetical member, as recommended in *Greenhalgh v Ardene Cinemas Ltd*.[200] This hypothetical member, bereft of any sectional interests, is more likely to represent the collective interests of all members, present and future.

The proposal that directors should at all times act to protect the interests of members is susceptible to attack on the ground that it is likely to promote only the sectional interests of members. As noted already, there is a view in some quarters that directors ought not to be guided solely by the interests of the members of a company, but should also relevantly endeavour to serve the interests of various other stakeholders.[201]

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194 Ibid 167.

195 See further *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 534 [4394] (Owen J).

196 See further Joint Committee on Corporations and Financial Services, above n 3, 44 [4.6].

197 Iman Anabtawi, 'Some Skepticism About Increasing Shareholder Power' (2006) 53 *UCLA Law Review* 561, 588 ff.

198 Harry G Hutchison and R Sean Alley, 'Against Shareholder Participation: A Treatment for McConvill's Psychonomicosis' (2007) 2 *Brooklyn Journal of Corporate, Financial and Commercial Law* 41, 57 ff.

199 [1971] 1 Ch 317, 330G. See also the opinion of counsel in the Berkeley Hotel matters in Gower, above n 10.

200 [1951] Ch 286, 291 (Evershed MR).

201 See nn 17–21 above. See also Lumsden and Fridman, above n 3, 158.

It is recognised that companies affect a wide range of persons and other interests.[202] As such, in conducting the affairs of a company, directors must not be free to disregard these interests totally and consult solely the benefit of the company.[203] All the same, for the reasons canvassed here and before,[204] the activities of directors must, ultimately, be geared at promoting the interests of the company, in the sense of the general body of members.

There is no doubt that there is potential for actions taken by directors in the interest of their members to have some adverse impacts on the interests of other stakeholders. In this regard, the recent controversy surrounding the James Hardie group comes readily to mind.[205]

James Hardie Industries Ltd and some of its subsidiaries manufactured and sold asbestos products. These companies became the subject of heavy damages claims by some people who had suffered diseases arising from exposure to asbestos. The directors of the holding company became very concerned about the impact that this litigation was likely to have on the company's share price. There was also a fear of further claims being commenced and of laws being enacted to render the entire James Hardie group liable in respect of these matters. In order to address these concerns, the directors resolved to undertake a restructure of the corporate affairs of the James Hardie group so as to enable the holding company and its other subsidiaries to avoid the significant financial liabilities that they might otherwise face if this were to occur. They further resolved to change the domicile of the company by re-incorporating in the Netherlands.

The directors argued that taking steps to insulate the companies from their potential liability was clearly in the interests of the companies. They protected the financial interests of those companies and their members.[206] There is no doubt that to the extent they served to enable the companies to avoid their potential liabilities, these actions were in the interests of those companies. At the same time, however, it is also clear that they had potential to frustrate the interests of those other parties that had lawful claims against the companies concerned, especially if the subsidiaries then the subject of, and potentially liable to further damages claims, could not fully discharge their obligations.

In the circumstances, fears about the possible adverse consequences which might be visited on other stakeholders as result of the law focussing primarily on

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202 See further Joint Committee on Corporations and Financial Services, above n 3, 20 [3.6].

203 See further *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 WAR 1, 236 534 [4395] (Owen J); *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 367 [2049]–[2051] (Drummond AJA).

204 See above Part II(A)(2). See also Joint Committee on Corporations and Financial Services, above n 3, 44 [4.4].

205 See *Australian Securities and Investments Commission v Hellicar* (2012) 247 CLR 345.

206 For an interesting discussion of this saga, see H J Glasbeek, 'Contortions of Corporate Law: James Hardie Reveals Cracks in Liberal Law's Armour' (2012) 27 *Australian Journal of Corporate Law* 132, 133 ff.

the protection of the interests of members might seem well founded. While this may be so, however, it is important to remember that, as the Joint Committee on Corporations and Financial Services has correctly observed, '[t]he current directors' duties were intended to provide protection for shareholders, not to create a safe harbour for corporate irresponsibility'.[207] So, in case of events like those discussed here arising, the appropriate approach should be to examine their propriety or otherwise in light of the prevailing legal norms.[208]

Quite significantly, the idea that the affairs of a company should be run so as to primarily benefit its members has enjoyed strong judicial support for a considerable period of time. The cases discussed in Part II(A)(2) of this article attest to this.[209] To the extent they recognise that the directors' primary remit should be to protect and promote the interests of the persons who established the company, these decisions are eminently sensible. As a concomitant, it is highly desirable that the Parliament expressly recognises that the concept 'interests of the company' means 'interests of members'.

These considerations aside, there are other compelling reasons why granting freedom to directors to consult the interests of 'other stakeholders', to the possible detriment of members, is not such a good idea. Clearly, this approach makes it 'difficult for directors to know how to balance the various interests and how to do so in the context of the financial and other interests of the company'.[210] More disturbing is the fact, highlighted by Dr Sealy, that if, in the discharge of their duties, directors may relevantly consider 'potentially opposed interests, the duty [imposed on them] bifurcates and fragments so that it amounts ultimately to no more than a vague obligation to be fair'.[211] This has very serious consequences from the perspective of director accountability. Indeed, this particular problem led CLRSG to recommend against adopting the pluralist approach. CLRSG explicitly acknowledged that if directors were given power to decide issues in a 'pluralist' manner, then there would be too much unpoliced discretion residing in boards of directors.[212] This is an issue that Australian policy makers need to take particular note of.

In the circumstances, it is recommended that the Australian rules currently governing the exercise of directors' powers be modernised. In pursuance of this objective, Australia should adopt a rule making it explicitly clear that the

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207 Joint Committee on Corporations and Financial Services, above n 3, 48 [4.18].

208 For another interesting case involving circumstances very similar to those discussed here, see *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia [No 3]* (1998) 195 CLR 1.

209 See further Austin and Ramsay, above n 5, 438 [8.130]; Lumsden and Fridman, above n 3, 165; Joint Committee on Corporations and Financial Services, above n 3, 53 [4.39].

210 R Baxt, 'Company Law' (1986) 4 *Company and Securities Law Journal* 197, 199. See also CAMAC, above n 9, 108; Dawson, above n 9.

211 Sealy, above n 11, 176.

212 CLRSG, *Developing Framework Report*, above n 9, 14 [2.21]; Worthington, above n 91, 'Reforming Directors' Duties', 446.

directors' primary role is to always act so as to promote the interest of members of a company. Most matters affecting the interests of other stakeholders such as creditors, employees, suppliers, consumers and the community or nation are currently covered by specific legislation.[213] This should continue to be the case. There is no evidence that these particular laws are inadequate to protect the particular constituencies for which they are designed. More importantly, these parties are well able to protect themselves through their contracts with the company. Some, such as finance lenders to corporations, who are very often said to be in need of special protection are now, through the use of new innovative financial products, such as credit derivatives, able to almost insulate themselves from any risk of default.[214]

As is already known, section 172 of the *Companies Act 2006* (UK) sets out a catalogue of matters that directors may competently take into account in exercising their powers. However, there is some doubt as to the appropriateness of this step. As CAMAC observed in one of its reports, the inclusion of such a list has potential to cause serious problems. One such difficulty is that it could entrench in legislation particular stakeholder and other criteria that, while possibly reflecting current concerns, may not necessarily be appropriate for corporate decision-making in the future.[215] More seriously, the inclusion of such a list poses the real danger of blurring, rather that clarifying the purpose that directors are expected to serve. In so doing, it could make directors less accountable to shareholders without significantly enhancing the rights of other parties.[216] This is especially so where no guidance is provided on how the various interests are to be weighed, balanced, prioritised or reconciled.[217] More problematic, as the Joint Committee on Corporations and Financial Services observed, there is the real danger that inclusion of such a list may lead to 'a compliance-driven, box-ticking exercise, rather than an innovative, value-creating opportunity to improve performance'.[218]

In any event, a rule imposing on directors a requirement to promote the best interests of members is sufficiently broad to enable directors to take into account a range of factors external to the shareholders if this benefits members

213 See generally Joint Committee on Corporations and Financial Services, above n 3, 59–60 [4.60]–[4.62]; Lumsden and Fridman, above n 3, 168.

214 See, eg, Frank Partnoy and David A Skeel Jr, 'The Promise and Perils of Credit Derivatives' (2007) 75 *University of Cincinnati Law Review* 1019, 1023 ff.

215 See CAMAC, above n 9, 106–7.

216 Ibid 111 ff.

217 Ibid 111. See also Williams, above n 35, 367; Keay, 'Tackling the Issue of the Corporate Objective', above n 17, 597.

218 Joint Committee on Corporations and Financial Services, above n 3, 56 [4.48], quoting Chartered Secretaries Australia, Submission No 28 to Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value*, 15 September 2005, 10.

as a whole.[219] Indeed, this is currently done under the enlightened shareholder principle now underlying the rules governing the exercise of directors' powers.[220] Truly, as Berger J has previously opined, under such a rubric, directors can 'observe a decent respect for other interests lying beyond those of the company's shareholders'.[221] In the circumstances, it is suggested that should Australia be minded to reform its law governing the exercise of directors' powers along the path established by the UK, it should only adopt that part of section 172 of the *Companies Act 2006* (UK) which provides that '[a] director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole'.

Again, as CAMAC advised, subject to directors acting in the best interests of the company and complying with all applicable laws, it should be a matter for the commercial judgment of directors, not legislative prescription, what other interests to consider in particular situations and how to manage, balance or prioritise them.[222] Directors having an appropriate appreciation of their proper function can be expected to know that

> we cannot maximise the long-term market value of an organisation if we ignore or mistreat any important constituency. We cannot create value without good relations with customers, employees, financial backers, suppliers, regulators, communities, and so on.[223]

Very importantly, it should be noted that the approach suggested here substantially accords with both the English enlightened shareholder value view, upon which section 172 is premised, and the currently prevailing enlightened self-interest view preferred by the Joint Committee on Corporations and Financial Services. Both allow directors wide scope to take into account the interests of other stakeholders, provided this is for the ultimate benefit of the company. The essential difference between them is that, under the enlightened shareholder value system, directors are required to consider some specific matters, whereas the enlightened self-interest arrangement leaves directors free to take account of any range of matters they consider relevant and appropriate.

V CONCLUDING REMARKS

Business people and other persons who have dealings with companies need clarity in the field of the law relating to the exercise of directors' powers. Clarity

219 See CAMAC, above n 9, 107. See also Joint Committee on Corporations and Financial Services, above n 3, 52 [4.32].
220 See generally Joint Committee on Corporations and Financial Services, above n 3, ch 3.
221 *Teck Corporation Ltd v Millar* (1972) 33 DLR (3rd) 288, 299 (Supreme Court of British Columbia).
222 CAMAC, above n 9, 108.
223 Michael C Jensen, 'Value Maximisation, Shareholder Theory and the Corporate Objective Function' (2001) 7 *European Financial Management* 297, 309. See also Gilson, above n 14, 146.

promotes predictability and enables everyone concerned to plan their affairs with certainty. Unfortunately, the current Australian law does not ideally meet this challenge. For this reason, it would be helpful if some reform was effected to Australia's current regulatory regime. This reform should see the introduction of rules which expressly address the important issue of who must be the primary beneficiary of an exercise of any of the powers conferred on directors. Certain aspects of the reforms encapsulated in section 172 of the *Companies Act 2006* (UK) provide a helpful guiding light in this respect, and should be implemented in Australia subject to the modifications suggested here.