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15 September 2005

The Committee Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Department of the Senate  
Parliament House  
Canberra ACT 2600

Dear Secretary

### **Inquiry into Corporate Responsibility**

We make the following submissions in relation to the Committee's Inquiry into Corporate Responsibility, and in particular items 2, 3 and 4 of the Terms of Reference.

In the view of the Commercial Law Association there is no justification for extending the class of persons in whose interests corporate decision-makers should act.

Directors owe strict fiduciary duties to the company in equity, which duties are supplemented by statute.<sup>1</sup> They also owe a duty of care to the company at common law,<sup>2</sup> which duty is supplemented by a statutory duty of care and diligence.<sup>3</sup> The latter statutory duty is qualified by the business judgment rule in s. 180(2) of the Corporations Act 2001 (Cth). There are also various specific provisions in the Corporations Act and other legislation imposing duties and liabilities on directors, particularly in the insolvency context.

It is appropriate, in our submission, that directors owe their duties of a general nature to the corporation, and that those duties equate, except in cases of insolvency or marginal solvency, with the interests of shareholders as shareholders. The shareholders are, in substance, the owners of the business or other concern which the directors are charged with running. It is the shareholders' money which the directors are responsible for spending, retaining or returning in the form of dividends as the case may be.

Within the existing law a wide range of "stakeholder" interests, going beyond the interests of shareholders, can legitimately be taken into account by directors.

<sup>1</sup> Corporations Act 2001 (Cth) ss. 181, 182, 183

<sup>2</sup> *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438

<sup>3</sup> Corporations Act 2001 (Cth) s. 180

**First**, the legitimate interests of creditors are well understood in corporate law. Where a company is insolvent or nearing insolvency, the creditors are seen as having a direct interest in the company which cannot be overridden by the shareholders.<sup>4</sup> Thus, in approaching the statutory, equitable and common law duties described above, directors must consider the interests of creditors. In addition, directors have a statutory duty to prevent insolvent trading.<sup>5</sup>

Many classes of a corporation's "stakeholders", such as employees and suppliers, are creditors or contingent creditors, albeit that their interests may well go beyond the money which is owed to them or which may become owing in the future.

**Secondly**, even when a company is solvent there are situations where the interests of non-shareholder "stakeholders" can legitimately and responsibly be promoted by the directors of a company. Relationships are important in society and in business, as are public perceptions. Arguably, public perceptions are particularly important for large corporations, especially those catering to consumers. The long term interests of a corporation may well be influenced by its ability to harness positive public perceptions and to maintain good relations with important "stakeholders". Thus corporations may donate funds to charity, political parties and other causes, pay their employees above-award wages, honour the debts of an insolvent subsidiary, and otherwise take action or refrain from action notwithstanding the absence of immediate increment to the net assets of the corporation and notwithstanding the absence of any legal obligation. In this context the business judgment rule gives the directors of a corporation considerable scope to determine where the company's interest lies.

We would also point out that corporations in this country are legal persons and are subject to the law. There is no need for legislation with reference to directors' duties to bring this about. If a corporation breaches the law or a person's legal rights, criminal or civil liability will attach. In some contexts directors are faced with accessorial liability for their part in criminal acts or other wrongs of corporations.

In our submission, if the laws protecting particular vulnerable classes of persons or other subject matters – such as consumers, mortgagors, animals

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<sup>4</sup> *Re New World Alliance Pty Ltd; Sycotex Pty Ltd v Baseler* (1994) 51 FCR 425 at 444-445. (per Gummow J); *Spies v the Queen* (2000) 201 CLR 603 at 636

<sup>5</sup> Corporations Act 2001 (Cth) s. 588G

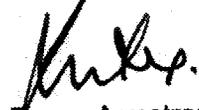
or the environment – are inadequate, then it is the responsibility of the legislature, not corporations, to take action. Governments, not corporations, have a clear mandate and responsibility to address broad social issues.

We do not support any extension of directors' duties which would permit directors to consider the interests of outsiders, or "stakeholders" other than in the context of the best interest of the corporation.

We would also make the point that the directors' duties referred to above relate to corporations large and small, public and private. If any particular extension of duties so as to encompass "stakeholders" is to be proposed, then we would encourage participants in the debate to consider the effect of such proposals on smaller companies.

We appreciate the opportunity to make this submission.

Yours faithfully



Daren Armstrong  
Secretary  
Legislative Review Task Force