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Dear Judith

Shareholder primacy: Is there a need for change?

CPA Australia welcomes the opportunity to provide input to the Governance Institute of Australia's Discussion Paper Shareholder primacy: Is there a need for change? (DP). CPA Australia represents the diverse interests of more than 150,000 members in 121 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

We commend the Governance Institute of Australia on its efforts in the areas of corporate performance and good governance. These are areas that CPA Australia is engaged in, provides thought leadership and contributes through a multiplicity of means. We do not believe that there is a friction between the legal requirements, as they stand, and the capacity for directors to consider and act on stakeholder interests. Overall, in the specific areas around shareholder primacy and Corporations Act 2001 s 181 addressed in the DP, we do not consider that change is warranted. We do however suggest other areas of possible law reform that would assist Australia's corporate law in meeting some challenges.

To set a broad context for our response, we would like to present the following short quotation from a recent academic article:

> "The corporate form's major legal attributes, legal personhood and limited liability, combine to shelter chief beneficiaries, from responsibility for actions taken on their behalf. This state of affairs has been given more bite as the so-called primacy of the shareholder has become embedded ever deeper in corporate law and lore. People who have no reason to worry about how profits are made, who have no responsibility for harms done, are to be the primary beneficiaries of corporate endeavours. This cannot be good."[1]

[1] Professor Harry Glasbeek, "Piercing on steroids" (2014) 29 *Australian Journal of Corporate Law* 233

Without necessarily fully endorsing Professor Glasbeek's views, a number of preliminary points can be made which are relevant to the DP's overarching theme of shareholder primacy:

- The notion of shareholder primacy is not exclusively a construct of corporate law, it arises also as a consequence of "lore", which is built around western liberal assumptions of individual freedom and relatively unfettered pursuit of gain. Applied then to questions of law reform, this does not provide an appropriate or sufficient basis for law reform and risks creating uncertainty and subjectivity in the corporate law.
- The identified major legal attributes of "legal personhood" and "limited liability", which are directly embodied in statute and entrenched in judicial attitude, present deeper challenges in reshaping the ends to which corporate behaviour is applied and how these ends are pursued.
- Whilst necessary to critically review and challenge our assumptions about the corporate form's major legal attributes, this should not preclude the pursuit of more targeted reforms capable over time of achieving desired change to which there is broad consensus.

Discussion paper questions

The DP and questions 1, 2 and 3, are set in the context of seeking views as to the formal regard that should be given to non-shareholder stakeholders. CPA Australia's response to each question is stated and the rationale presented with reference to key conclusions drawn by CAMAC in its 2006 Report: *The Social Responsibility of Corporations.* In Question 3 we address some relevant specific matters over and above our general conclusion on the DP's key theme. It is emphasised that whilst we argue for the status quo in relation to the wording and interpretation of s 181, the DP provides an important opportunity for addressing other possible related law reform measures that may reinvigorate both market and stakeholder confidence in the corporate form in areas which have been under clear challenge.

1. **Is there a view that there is no need for a change to the corporations law, as it currently allows directors to take account of the interests of stakeholders other than shareholders?**

   We agree that there is no need for a change to the corporations law.

2. **Is there a need for a change to the corporations law, and should the equivalent of s 172 in the UK (permissive clause) be introduced to expand directors' duties so that they should have regard to the interests of stakeholders other than shareholders in promoting the best interests of the company?**

   CPA Australia is of the view that there is no need for a change to the corporations law and the equivalent of s 172 in the UK (permissive clause) should not be introduced to expand directors' duties so that they should have regard to the interests of stakeholders other than shareholders in promoting the best interests of the company.

3. **Is there a need for a change to the corporations law, and should an explicit clause be introduced to expand directors' duties so that they must take account of the interests of stakeholders other than shareholders?**

   CPA Australia is of the view that there is no need for a change in the corporations law and an explicit clause should not be introduced to expand directors' duties so that they must take account of interests of stakeholders other than shareholders.

   It is noted specifically in relation to Question 3 that the introduction of such explicit recognition would challenge and potentially undermine the position of shareholders along with posing consequential questions that would seriously undermine current certainty in the corporate law. Aside from legal personhood and limited liability, two further critical elements are the division of corporate power and the nature of the

corporate constitution. Reflective of some degree of coherence in Australian corporate law, statutory effect to the separate entity doctrine can be found in the vesting of power to manage the business of the company by or under the direction of directors (Corporations Act 2001 s 198A), the reserving of specific powers to the members in general meeting (for example altering the corporate constitution (s 136)) and the effect given in s 140 to the company's constitution as a contract between the company and each member, between the company and each director and between a member and each other member. The ideas of contract privity contained in s 140 are potentially undermined by the type of development contemplated in this question. The corporations law as it stands today is admirably tight in terms of the parties involved in formalised relationships. The introduction of stakeholders is at odds with these longstanding understandings of the corporate form and its internal and external functioning.

At a further practical level are consequential questions related to statutory rights and remedies. Section 234 (Who can apply for orders) of Part 2F.1 (Oppressive conduct of affairs) is highly specific as to who has standing to bring an action. Development of explicit statutory account to be given by directors in stakeholders (which, as the DP stresses in quite emphatic terms, do not apply to shareholders, being mediated instead through the "best interests of the corporation") begs larger complex questions around standing and the rights of a stakeholder alleging their interests being aggrieved. A further matter of indeterminacy concerns whether explicit reference would give rise to rights for non-shareholder stakeholders to challenge in general meeting, the valid business decisions of directors. The right presently granted to shareholders under s 250S is to ask questions and make comment, falling short of a power by resolution to formally express opinion as to how the constitutionally vested power of the corporation ought to have been exercised (*NRMA v Parker* (1986) 6 NSWLR 517).

4. Is there a role for the government to play in protecting the interests of stakeholders — not through amendment to the corporations law, but through other forms of social policy?

CPA Australia agrees that there is a role for the government to play in protecting the interests of stakeholders – not through amendments to the corporations law but through other forms of social policy.

Addressing here our responses to DP Questions 1, 2 and 3 in terms of the various social, environmental and economic issues summarised in the Executive Summary (pp. 3-4), we would like to draw attention to the further remark in the Executive Summary: "the argument against a shareholder primacy approach is that it is a corporate governance model that puts the private interests ahead of public interest." Elsewhere in the DP (pp. 11-12) the deficiency of shareholder primacy as a guiding principle in corporate governance is elaborated on.

The corporate law in its current statutory form is a combination of both public and private law elements, though tending more towards private law, particularly when considering its general law antecedence which have shaped directors' general law duties, including s 181. As such, it is erroneous to disregard the essential private character of the corporation and its internal relationships expressed in directors' duties, though on the other hand, the vagueness and subjectiveness of shareholder primacy should see it rejected as a model of corporate governance. This said, it in no way denies the embedding of the corporation in wider societal, environmental and economic contexts. An equally valid way to address the implications of the corporate form and the appropriateness of associated corporate governance models is through the notion of corporate personhood and limited liability as consequences of state concession. It is our view that the DP in this question underplays these attributes which help set the dichotomy between corporate law and public law. Social policy is no doubt vital is setting overarching direction. However, equally important is its translation into meaningful and

predictable public law. This perspective, CPA Australia urges, allows a clearer understanding of the limitations in the pursuit of social and environmental agenda through the corporations law, whereas legislation in relation to these needs potentially has far more reach, and appropriate means of implementation, when addressed through the wider public law which regulates the conduct of all persons.

Discussion Paper Questions 1, 2 and 3 and the 2006 CAMAC Report

Whilst the DP gives ample regard to the 2006 CAMAC Report, and a related 2005 Parliamentary Joint Committee (PJC) inquiry into Corporate Responsibility, it is worth repeating here those key parts of the Committee's concluding view in Chapter 3 (Duties of Directors).

> "The Committee acknowledges concern in many submissions about the need for companies to consider the environmental and social impacts of their conduct. The question is how best to respond to those concerns.
>
> "As noted in various submissions, the environmental and social matters referred to in the debate on corporate social responsibility are really factors that directors should already be taking into account in determining what is in the best interests of their corporation in its particular circumstances.
>
> "The Committee considers that the current common law and statutory requirements on directors and others to act in the interests of their companies - - - are sufficiently broad to enable corporate decision-makers to take into account the environmental and other social impacts of their decisions, including change in societal expectations about the role of companies and how they should conduct their affairs. The Committee is not persuaded that the elaboration of interests that, where relevant, can already be taken into account would improve the quality of corporate decision-making in any practical way. A non-exhaustive catalogue of interests to be taken into account serves little useful purpose for directors and affords them no guidance on how various interests are weighed, prioritised or reconciled.
>
> "Also, the courts, through their interpretation of the law, including the requirement in s 181 of the Corporations Act for directors and others to act in the 'best interests of the company', can assist in aligning corporate behavior with changing community expectations. Given this, it is unnecessary to amend that section along the lines of s 172 of the UK *Corporations Act 2006* and no worthwhile is to be gained.
>
> "The Committee considers that an amendment to the Corporations Act, either specifically to require or to permit directors to have regard to certain matters or the interests of certain classes of stakeholder, could in fact be counterproductive. There is a real danger that such a provision would blur rather than clarify the purpose that directors are expected to serve. In so doing, it could make directors less accountable without significantly enhancing the rights of other parties." (pp. 111 – 112)

CPA Australia views these as a particular strong position taken by what, up until recently, has been the Government's major source of advice on corporate law reform. It is appropriate of course to look at these views in the contemporary contexts of firstly, current behaviour and understanding of directors, and secondly, significant challenges to the efficacy of the corporate form which have occurred in the ensuing years. This, we believe, helps address both the more immediate concerns raised in the DP, and where present use of the corporate form is producing significant adverse outcome warranting the attention of policymakers.

Whilst both CAMAC and PJC draw a consistent conclusion about the sufficient permissiveness of corporate law in general, and s 181 in particular, it is important to consider how this translated into directors' understanding of their duties. A highly valuable insight on directors' understanding of the scope and parameters of their obligations is provided in

Ford's Principles of Corporations Law (15th ed., LexisNexis, 2013), which refer to research conducted by the University of Melbourne in 2007. This research surveyed the views of 400 company directors on such matters as their understanding of what 'best interests of the company' entailed and whether the law required them to act only in the interests of shareholders, and expressed in permissive terms, whether the law permitted them to consider a broader range of stakeholders. These questions are at the centre of the alleged pervasiveness of shareholder primacy and the related undermining of wider stakeholder interests. Tellingly, only 5.7 % of respondents were of the view that they could have concern only for shareholders, such that 94.3% understood the law as allowing them to take account of interests other than those of the shareholders; thus confirming the Committee's understanding of current law not inhibiting the pursuit of stakeholder interests. The authors of Ford's further comment that with 55% of respondents understanding their primary obligation to be the balancing the interests of all stakeholders, in contrast to 38.2% understanding the obligation to be one of balancing stakeholder interests for the long term benefit of shareholders, practice tended more towards an idea of "enlightened self-interest" (p. 33).

Taking the above insights into current practice and attitudes, CPA Australia's view is that the type of law reform contemplated in DP questions 2 and 3, is not warranted and may indeed be counterproductive. Shareholder primacy problems, such as those which may exist, are more likely a function of culture and attitude best addressed through means other than change to corporate law.

Our view however, does not dismiss the need to seriously reconsider legal attributes of the corporate form which have been a source of unresolved specific and serious concern in the period since CAMAC's 2006 Report. In the period from 2009 to 2012 considerable business community and legal fraternity attention was given the James Hardie Industries circumstances which were played-out, to some degree, in the High Court decision in *ASIC v Hellicar* [2012] HCA 17. It is sufficient here to recount only one, but highly significant, observation made by David Jackson QC in the 2004 Special Commission of Inquiry into JHI structuring and funding of the Medical Research and Compensation Foundation:

> "…circumstances have raised in a pointed way the question of whether existing laws concerning the operation of limited liability or the "corporate veil" within corporate groups adequately reflect contemporary public expectations and standards."

In the ten years since this landmark inquiry there has been little, if any, progress towards establishing either a unified or targeted approach to corporate veil piercing. CPA Australia would welcome as an outcome of the Governance Institute's promotion of meaningful debate about shareholder primacy, associated deliberation on whether the corporate law should take steps towards making available all assets of related corporations to satisfy product and industrial negligence claims, particularly where the group companies are in related lines of business and the use of multiple corporations is clearly not for purposes of investment diversification.

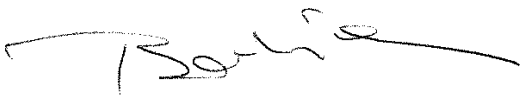
The above suggestion is admittedly substantive and may attract hostility from some quarters. We view it nonetheless as overdue and a critical element in possible reforms which give real meaning to stakeholder interests and address in a targeted manner the perverse incentives created by the corporate form's major legal attributes.

CPA Australia would also like to suggest for consideration some less radical reforms in the context of stakeholder interests:

- Whether the business judgment rule defence contained in s 180(2) might be extended beyond the duty of care and diligence to apply to s 181(1)(a), the exercise of powers and discharge of duties in good faith in the best interests of the corporation. This might, without need for direct reference, offer greater certainty about the treatment and balancing of stakeholder interests. It is noted that the language of s 181(1)(a) is similar to s 180(2)(a), though some caution would need to be taken in relation to s 181(1)(b) as much of the associated case law around the proper purpose of issues and allotting shares is expressed in fiduciary terms.
- Consideration of improving the scope and harmonisation of nonfinancial disclosures currently found in a variety of requirements and mediums including s 299A, s 299(1)(f), voluntary sustainability reports, reports prepared with reference to the IIRC's Integrated Reporting Framework and the ASX Corporate Governance Council's Principles and Recommendation. CPA Australia is of the very strong view that robust nonfinancial disclosure serves a variety of critical interrelated purposes including stakeholder engagement, risk management, business process improvement, compliance with substantive social and environmental law, and overall governance effectiveness.

We again commend the Governance Institute of Australia for raising matters of significant importance to the corporate and wider business community. If you require further information on any of our views expressed in this submission, please contact Dr John Purcell, CPA Australia's Policy Adviser ESG, by email at john.purcell@cpaaustralia.com.au, or by telephone (03) 9606 9826.

Yours sincerely



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