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Shareholder Primacy in Changing Times



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I INTRODUCTION

The duties and responsibilities of company officers have been highly topical in recent times, with a number of corporate scandals and seemingly widespread contraventions of financial laws that have outraged the community, the media and our politicians. Indeed, a variety of events have contributed to an ongoing battle over the shape of corporate cultures inside Australian companies.² The APRA report into the Commonwealth Bank has, rightly, generated considerable debate within Australia's boardrooms.³ In particular, the report criticises the bank for too great a focus on financial success and on managing financial risks, at the expense of non-financial risk management and a lack of focus on customers.

The ongoing Banking and Financial Services Royal Commission has highlighted seemingly widespread conduct, from both large and small businesses, that has fallen well below community expectations. The Commission's *Interim Report*, released on 28 September 2018, puts much of the blame on greed, both at the individual and institutional level.⁴ Many of the companies involved have been consistently successful in generating high returns for shareholders and have performed strongly on the stock market over a long period. Greed, it seems, is no longer good, or at least not good enough.⁵ Making consistently high returns for shareholders is no longer enough, if indeed that ever was enough, to satisfy directors' legal duties owed to their companies.

In recent years, international corporate governance codes have been pushing against a singular corporate focus on shareholder returns, in favour of concepts such as stewardship, broader stakeholder engagement, diversity in the workplace and maintaining a social license.⁶

These developments raise legitimate questions about what role the law can, and should, play in regulating conduct inside corporate boardrooms. The contours of the debate focus on the continuing relevance of the 'shareholder primacy norm', which refers to the idea that corporate directors and managers should focus their efforts on generating returns for shareholders. The scope of this idea is discussed below. The central question that this paper considers is, to what extent is the shareholder primacy norm still relevant in Australian company law in 2018, and what might the future hold for the continued use of the norm in our law? Before discussing the extent to which the shareholder primacy norm is recognised in Australian corporate law, it is useful to discuss the origin and scope of this norm.

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² See Jason Harris, 'Corporate Cultures under Scrutiny' (2018) 92(11) *Australian Law Journal* (forthcoming).

³ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia by APRA* (April 2018), available from www.apra.gov.au.

⁴ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, 28 September 2018, "Executive Summary", available at <https://financialservices.royalcommission.gov.au/Pages/interim-report.aspx>

⁵ Apologies to Gordon Gecko (played by Michael Douglas) in 'Wall Street' (1987, Oliver Stone, 20th Century Fox).

⁶ See for example, Financial Reporting Council, 'UK Corporate Governance Code 2018' (July 2018); ASX Corporate Governance Council, 'Corporate Governance Principles and Recommendations 4th ed', consultation draft May 2018.

II BACKGROUND TO THE SHAREHOLDER PRIMACY DEBATE

The debate concerning shareholder primacy has a long history in corporate law, dating back at least to the Great Depression. The frequently-cited debate between Professors Adolf Berle and Merrick Dodd has provided the basic framework for the debate since the 1930s. Professor Berle's research was focussed on the nature of large public companies, and in 1932 he published (with economist Gardiner Means) the seminal work on corporate governance "The Modern Corporation and Private Property",⁷ which noted the separation of ownership and control in large public companies in the United States.⁸ The authors expressed concern that large amounts of private wealth and property in America were under the control of corporate managers, who could not be effectively controlled by what had become often a large and dispersed group of shareholders.

The year before the book's release (in 1931), Professor Berle published an article in the *Harvard Law Review*,⁹ where he argued that directors were to exercise powers "only for the eatable benefit of all the shareholders as their interest appears."¹⁰ Professor Dodd responded to this article the following year,¹¹ and wrote:¹²

"it is undesirable...to give increased emphasis at the present time to the view that business corporations exist for the sole purpose of making profits for their stockholders... public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function, that this view has already had some effect upon legal theory, and that it is likely to have a greatly increased effect upon the latter in the near future"

Berle's response, in the same year, was to argue that moving away from shareholder primacy to broader constituencies would result in a dilution of the system of accountability for directors and their management teams.¹³

Both Professors' Berle and Dodd shared a similar concern: that companies controlled vast amounts of property and wealth in society and, therefore, the law should be concerned with how to control the use of that property and wealth for the benefit of society generally. Berle's argument was that shareholder primacy was needed to protect private property tied up in corporations.¹⁴ Berle saw corporations as essentially a private problem for the notional owners of that property (hence shareholder primacy). Professor Dodd, on the other hand, saw the problem that large public corporations posed as very much a *public problem*, with companies affecting every aspect of society, and this was used to justify companies owing an obligation to serve the broader community. Dodd drew support for this view from quotes from a number of leading business leaders who spoke of the need for business to serve community interests.¹⁵ Dodd also argued that management was becoming increasingly professional and, as such, this would generate an inherent sense of public duty and public

⁷ The Macmillan Company, 1932.

⁸ For a discussion of the background of this research project see Harwell Wells, 'The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century' (2002) 51 *Kansas Law Review* 77.

⁹ Adolf Berle, 'Corporate powers as powers in trust' (1931) 44 *Harvard Law Review* 1049.

¹⁰ *Ibid*, at 1049.

¹¹ Merrick Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145.

¹² *Ibid*, at 1147-1148.

¹³ Adolf Berle, 'For whom corporate managers are trustees; a note' (1932) 45 *Harvard Law Review* 1365 at 1167-1168.

¹⁴ *Ibid*, at 1369.

¹⁵ Merrick Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145 at 1154.

benefit, even if such goals were aligned with long-term shareholder wealth in helping to minimise the potential for more restrictive regulation.¹⁶

Berle later came to concede that Dodd's view had seemingly prevailed (at least up until that time in the 1950s),¹⁷ and went on to advocate for management to focus on the social responsibilities of corporations as social and political forces in the community.¹⁸

The public debate concerning the social responsibility of companies and the legal duties of their boards continued in the United States after the end of World War II, as American industrial conglomerates grew in size and power, together with increasing government regulation, particularly into the 1970s with a series of corporate scandals driving the public debate.¹⁹

The shareholder primacy debate was significantly reignited in 1970, with economist Milton Friedman's article in the *New York Times Magazine* declaring that the only responsibility of corporate managers was "to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom".²⁰ This was justified on the basis that the corporate managers were agents of the owners of those corporations (i.e. the shareholders). In Friedman's view, corporate social responsibility involved spending shareholders' money to support some general social interest. Allen Afterman, in one of the first treatises on the law applicable to company directors, also published in 1970 in Australia, explained:²¹

"As a matter of law, the commercial interest of the company may be considered only in so far as it serves the shareholders (present and future) who are its real beneficiaries."

The view that corporate managers were acting in an agency capacity with the owners of capital provided to the corporation really took hold in the 1970s with the work of Professors Jensen and Meckling, who examined the problem of agency costs involved in companies that had outside equity (i.e. shareholders who were not also managers). Building on the work of Nobel Prize winning economist Professor Ronald Coase,²² Jensen and Meckling conceived the corporation as a 'nexus of contracts' between the providers of capital with the managers of that capital.²³ This, of course, denies the corporation any separate existence. It is not a thing that can be owned, but rather a network through which managers and capital providers deal with one another. Corporate law's role in such a system is aimed at facilitating the contractual nexus by reducing transaction costs through the imposition of mandatory

¹⁶ Ibid, at 1153-1154.

¹⁷ Adolf Berle, *The 20th Century Capitalist Revolution*, Harcourt Brace, 1954, at p169.

¹⁸ See the detailed summary in Harwell Wells, 'The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century' (2002) 51 *Kansas Law Review* 77.

¹⁹ Larry Soderquist and Robert Vecchio, 'Reconciling Shareholders' Rights and Corporate Responsibility: New Guidelines for Management' [1978] *Duke Law Journal* 819; Harwell Wells, 'The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century' (2002) 51 *Kansas Law Review* 77.

²⁰ Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits', *The New York Times Magazine*, 13 September 1970. The full text of the article is available from <http://umich.edu/~thecore/doc/Friedman.pdf>

²¹ Allen Afterman, *Company directors and controllers: their duties to the company and the shareholders*, Law Book Company, 1970, at p46,

²² Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386.

²³ Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 4 *Journal of Financial Economics* 305. For a detailed exposition of this concept see further, Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, 1991.

and enabling rules.²⁴ Jensen's subsequent work built on this to focus on executive remuneration and the market for corporate control which boomed during the 1980s in the United States.²⁵

The hostile takeover boom in the United States in the 1980s took place during the Reagan administration's push for smaller government and deregulation. Shareholder primacy became highly topical again, as corporate raiders underwent activist campaigns to topple incumbent boards of what were argued to be uncompetitive companies that were failing to serve their shareholder owners.²⁶

Jensen and Meckling's nexus of contracts framework for corporate law and agency theory has had a profound influence on the design and interpretation of corporate governance rules around the world.²⁷ The lynchpin of this 'contractarian' approach to corporate law, is the notion that shareholders are the residual risk bearers within companies. This is based on the argument that shareholders only get paid through dividends if the company makes enough money to pay all of its creditors.²⁸ Shareholders are said to have open-ended claims on the company's future earnings, while creditors are said to have fixed claims. Creditors usually receive repayment of their debt, and possibly with interest. Creditors do not usually share in the future profits of the business, unlike shareholders who can potentially receive increasing dividends well into the future. In theory, this provides shareholders with a better economic incentive to monitor corporate management than creditors have. If creditors only receive fixed claims repaid, then they have little economic incentive to monitor management so as to produce any excess returns above what's needed to repay their debt, but shareholders do.²⁹ This theory says nothing of whether shareholders actually have the capacity or willingness to effectively monitor corporate management.

Jensen's work contributed significantly to debates from the 1980s about pay for performance, which sought to align executive remuneration incentives (particularly the vesting of stock options) with long-term shareholder financial benefits (such as increasing share prices and overall shareholder returns).³⁰ The Global Financial Crisis has caused a broad reconsideration of executive remuneration, particularly for financial services firms, and raised questions about the myopic pursuit of shareholder returns and the utility of linking short and medium-term executive remuneration to those short term returns.

The traditional justification of shareholder primacy, derived from the concept of shareholders as residual risk bearers, has been extensively criticised both at a general conceptual level, and more specifically in so far as it purports to justify management focus on stock prices and short-term shareholder financial returns. One of the leading critics of shareholder primacy was Professor Lynn Stout, who argued that shareholders were not owners of the

²⁴ For a detailed discussion see further Brian Cheffins, *Company Law: Theory, Structure and Operation*, Clarendon Press, 1997.

²⁵ See further Michael Jensen, *Foundations of Organizational Strategy*, Harvard University Press, 1998.

²⁶ See further, William Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo Law Review* 261; Harwell Wells, 'The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century' (2002) 51 *Kansas Law Review* 77.

²⁷ See for example, Henry Hansman and Reiner Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439.

²⁸ Corporations Act 2001 (Cth) s 254T.

²⁹ See further, Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, 1996, Ch 3 (voting).

³⁰ For a critical analysis see Lucian Bebchuck and Jesse Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation*, Harvard University Press, 2004.

corporation, were not the only residual risk bearers and that stock prices were a particularly poor measure of a company's financial success.³¹

Stakeholder theory is often raised as an alternative to the shareholder primacy norm. It provides a panoply of perspectives that centre on the need for corporations to be managed through the balancing of a variety of stakeholder interests, rather than just in the interests of shareholders. The key difference is the obligation this imposes on boards to balance competing interests, not simply because to do so is better financially for the company in the long-run and should therefore benefit shareholders in the long-run, but because each stakeholder has a legitimate interest in the conduct of the company. There is no universal definition of stakeholders unfortunately.³²

Communitarian corporate law scholars provide a variant of stakeholder theory by directing corporate governance requirements to require management to consider the effect of corporate decisions on the broader community, including the effect on the environment and local communities in proximity to the company's operations, not just specific stakeholders such as shareholders and employees. Communitarian scholarship also requires directors to focus on relationships that the company has with its communities, and in doing so to look beyond the narrow category of contractual relationships and economic exchanges to include non-economic values such as trust, mutual respect and inter-dependence.³³

The common criticism of stakeholder and communitarian theories is that they lack effective lines of accountability for corporate boards, with the frequently stated concern being that 'to serve two masters is to be accountable to neither'. The common argument being that while shareholder primacy may not be perfect, it at least provides corporate boards with a supposedly clear goal. If it achieves that goal then, in theory, companies should be making profits and governments can decide to redistribute wealth through the tax and welfare systems to address perceived inequalities and unfairness. Of course, the obvious problem with such a Kaldor-Hicks view of the world is that often the trickle down benefits to those disadvantaged by the system do not provide perfect compensation for the negative externalities created by corporate conduct.

These concerns regarding accountability are the same as those that occupied the Berle and Dodd debate in the 1930s.

The competing arguments as to the proper objective of directors' duties differ on fundamental lines of what a corporation is and what the law's purpose in regulating corporate decision making can and should be. From one perspective, the corporation is not a real thing, it is simply a device of convenience used by the law to support a nexus of private relationships centred on the proper exploitation of private property. On the other hand, the corporation is a public entity, given legal recognition because of the important role that it plays in our society and should therefore be regulated not merely to promote private profits of shareholders, but also to produce benefits to society. These differences may well be irreconcilable, seeing as they cannot agree on the very nature of what a corporation is. However, the long-standing difficulties produced by this debate demonstrate the law's limits in being able to effectively regulate corporate decision-making to produce perceived social beneficial outcomes. In the author's view, the law cannot, and should not, attempt to regulate all forms of corporate decision-making. The law is only one factor that influences how

³¹ Margaret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247; Lynn Stout, 'Bad and Not-So-Bad Arguments for Shareholder Primacy' (2002) 75 *Southern California Law Review* 1189; Lynn Stout, 'Share Price as a Poor Criterion for Good Corporate Law' (2005) 3 *Berkeley Business Law Journal* 43.

³² See further Andrew Keay, *The Corporate Objective*, Edward Elgar, 2011, Ch 3.

³³ See Lawrence Mitchell (ed), *Progressive Corporate Law*, Westview Press, 1995.

corporate boards make decisions, and, as will be argued below, it may not be the most effective tool to drive change.³⁴

We will now examine how Australian corporate law deals with the shareholder primacy norm.

III LEGAL RECOGNITION OF SHAREHOLDER PRIMACY

The legal duties of company directors are derived from both general law and under statute.³⁵ The most relevant duty for present purposes is the equitable duty to act “bona fide in the interests of the company”. There are a number of slight variations on this wording of the duty that can be found in judicial statements, such as “for the benefit of the company”, “for the best interests of the company” and for “the company as a whole”.

The classic statement of the duty was given in *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306, where Lord Greene MR explained that when directors exercise discretionary powers given to them under the company’s articles, they must:³⁶

“exercise their discretion bona fide in what they consider — not what a court may consider — is in the interests of the company, and not for any collateral purpose.”

The High Court of Australia had earlier held that the decision by directors to exercise a discretionary power was to be “bona fide in what they believed to be the interests of the Company.”³⁷

The decision in *Re Smith & Fawcett*, makes it clear that the test to assess whether directors have contravened this duty is subjective.³⁸ However, a director’s mere statement of subjective good faith is not sufficient to establish compliance with the duty.³⁹ The courts will evaluate the director’s conduct and expressed bona fides in all of the circumstances as part of the assessment of the voracity of the evidence.⁴⁰ Furthermore, in the leading decision in *Hutton v West Cork Railway Co* (1883) 23 Ch D 654 at 671 Bowen LJ explained that:

“Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational. The test must be what is reasonably incidental to, and within the reasonable scope of carrying on, the business of the company.”

In that case, the directors obtained approval from a resolution passed at a members’ meeting to pay over a portion of the surplus funds left over from the sale of the company’s business (which would otherwise have been distributed to the members and debenture

³⁴ This was recognized by both CAMAC and the PJC reports into corporate social responsibility over 10 years ago: Corporations and Markets Advisory Committee, *The social responsibility of corporations* (December 2006); Parliamentary Joint Committee on Corporations and Financial Services, *Corporate responsibility: Managing risk and creating value* (June 2006).

³⁵ Corporations Act 2001 (Cth) ss 180-185. See further, Robert Austin, Harold Ford and Ian Ramsay, *Company Directors: Principles of Law and Corporate Governance*, LexisNexis Butterworths, 2005, Part B.

³⁶ Cited with approval in *Abrahams v Federal Commissioner of Taxation* (1944) 70 CLR 23. A similar statement was made by Latham CJ in *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 481.

³⁷ *Australian Metropolitan Life Assurance Company Ltd v Ure* (1923) 33 CLR 199.

³⁸ *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239; (2008) 70 ACSR 1 at [4619].

³⁹ It must be remembered that those seeking to impugn the conduct bear the onus of establishing a lack of good faith in the interests of the company: *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199.

⁴⁰ *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199; *Allen v Townsend* (1977) 31 FLR 431 (Full FCA); *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239; (2008) 70 ACSR 1 at [4619] (though note that on appeal, Drummond AJA explained that the court’s role is not merely to assess the voracity of the evidence: *Westpac Banking Corp v Bell Group Ltd (in liq) (No 3)* [2012] WASC 157; (2012) 44 WAR 1 at [1983].

holders)⁴¹ to compensate the company's officers for their loss of employment as well as to pay remuneration to the directors (who had not previously been paid).⁴² The decision in *Hutton* was applied in another often-cited case of *Parke v Daily News Ltd* [1962] Ch 927,⁴³ and has been applied in subsequent cases.⁴⁴ Clearly, the distinguishing features of both *Hutton* and *Parke* were that the company's business had closed down.⁴⁵ This prevented the boards from seeking to justify their decision by reference to any future benefit to the company in making payments to employees. Where a company remains a going concern, the decision to make *ex gratia* payments to employees may be justified by management as trying to increase productivity and quality through incentivising the workforce.

The duty to act in good faith in the best interests of the company is not a fiduciary duty, because it requires positive action (*to act* in good faith in the best interests of the company), and is therefore prescriptive not proscriptive.⁴⁶ However, there are cases that refer to the duty as being fiduciary in nature, either in general terms grouped together with other duties, or occasionally in specific terms.⁴⁷

This duty is also found in the statute in s181(1)(a) of the Corporations Act 2001 (Cth), which states:

- (1) A director or other officer of a corporation must exercise their powers and discharge their duties:
- (a) in good faith in the best interests of the corporation; and
 - (b) for a proper purpose.

Although there are different lines of authority as to whether this provision involves one overarching duty or two separate duties (good faith and proper purpose), there is majority support for the latter view.⁴⁸ The focus of this paper is therefore on the scope of s181(1)(a), and in particular the meaning of the phrase "the best interests of the corporation". As this phrase appears in both the general law and statutory formulations of the rule, they will be considered together unless otherwise clearly stated.

The meaning of the phrase "the best interests of the company" has been widely criticised both by academics and in the courts. It has been described as:

- "a slippery concept",⁴⁹

⁴¹The holders of debenture stock were entitled to attend and vote at the meeting, but chose not to, which provided the foundation of the dissenting judgment of Baggallay LJ. Fry LJ's reasoning for invalidating the resolution relied on the failure to give specific notice of the special resolution. However, the decision of Bowen LJ has been most frequently applied in subsequent decisions and that is the focus of this paper.

⁴² There was no provision in the company's articles to make these payments so approval was sought from the members.

⁴³ Cited with approval in *Australian Innovation Ltd v Petrovsky* (1996) 21 ACSR 218.

⁴⁴ *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd* [1991] 2 Qd R 360.

⁴⁵ In *Hutton*, the company was being wound up while in *Parke* the company continued but the employee's contracts had been terminated after the relevant business was sold.

⁴⁶ *Breen v Williams* (1996) 186 CLR 71.

⁴⁷ See the discussion in *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239; (2008) 70 ACSR 1 at [20.6.3]. See also Rosemary Teele Langford, *Directors' Duties*, Federation Press, 2014, Ch 4 (which describes the bona fide rule as being the 'principal fiduciary duty of directors'). See however, the cogent criticism of this approach in Dyson Heydon, Mark Leeming and Peter Turner, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies*, 5th ed, LexisNexis Butterworths, 2015, at [5-410] to [5-440].

⁴⁸ See Robert Austin and Ian Ramsay, *Ford Austin and Ramsay's Principles of Corporations Law*, Lexis Advance Pacific, at [8.065].

⁴⁹ Jennifer Hill, 'Protecting minority shareholders and reasonable expectations' (1992) 10 *Company and Securities Law Journal* 86 at 86.

- a concept that presents “a major difficulty”;⁵⁰
- “an indefinite phrase”;⁵¹
- a concept “that defies elucidation”;⁵²
- giving “obscure and incomplete guidance”;⁵³
- “a cant expression in these matters but is not yet a shibboleth”;⁵⁴
- a phrase subject to “judicial equivocation”;⁵⁵
- a concept that presents “conceptual indeterminacy”;⁵⁶ and
- “a Delphic term employed by different judges in different circumstances to signify different things”.⁵⁷

The commonly recognised starting point for judicial use of the phrase is the decision in *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656,⁵⁸ where Lindley MR explained (at 671) that powers given to members in a general meeting to amend the articles (now described as the corporate constitution): “must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded.”

This test for assessing the validity of resolutions to change the constitution was subject to strong criticism in number of subsequent decisions in the High Court of Australia in *Peters*⁵⁹ and was subsequently rejected in the *Gambotto* case.⁶⁰

The ‘benefit of the company as a whole’ test from *Allen* was applied by the High Court of Australia in *Richard Brady Franks v Price* (1937) 58 CLR 112 at 135-136, where Latham CJ held:

“The powers of directors must be exercised not only in the manner required by law but also bona fide for the benefit of the company as a whole (*Allen v. Gold Reefs of West Africa Ltd*). A court, however, does not presume impropriety. In this case there is no doubt that the issue of the debentures was within the powers of the directors. The onus is on the plaintiff who challenges the action of the directors to establish that they did not act bona fide for the benefit of the company...It is not for a court to determine whether or not the action of the directors was wise. The question is whether it is shown that they did not honestly act for what they regarded as the benefit of the company.”

⁵⁰ 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.

⁵¹ *Mills v Mills* (1938) 60 CLR 150 at 188 per Dixon J (although his Honour also stated that “its meaning admits of little doubt”).

⁵² Harold Ford, *Principles of Company Law*, 2nd ed, 1978, Butterworths at [1704].

⁵³ *Kirwin v Cresvale Far East Ltd (in liq)* (2002) 44 ACSR 21 at 127 per Giles JA.

⁵⁴ *Mills v Mills* (1938) 60 CLR 150 at 169 per Rich J.

⁵⁵ John Farrar, ‘The duties of controlling shareholders-complex relationships, legal confusion and new approaches’ (2015) 30 *Australian Journal of Corporate Law* 140.

⁵⁶ Michael Whincop, ‘Overcoming Corporate Law: instrumentalism, pragmatism and the separate legal entity concept’ (1997) 15 *Company & Securities Law Journal* 411 at 426.

⁵⁷ 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 at 454. See similar statements in William Heath, ‘The corporations law, section 181: a two-edged sword’ (2000) 18 *Company & Securities Law Journal* 377.

⁵⁸ The *Allen* case seems to have been the first time that this phrase was used in a reported decision: *Residues Treatment & Trading Co Ltd v Southern Resources* [1989] SASC 1698. Note, however, that McPherson AJA in *Heydon v NRMA Ltd* (2000) 51 NSWLR 1, traced the phrase back to *Pender v Lushington* (1877) 6 Ch D 70, but acknowledged that it is common to identify *Allen v Gold Reefs* as the common starting point: at [472].

⁵⁹ *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 512 per Dixon J.

⁶⁰ *Gambotto v WCP Ltd* (1995) 182 CLR 432. It should be noted that this approach has not been followed in the UK: *Citco Banking Corporation N.V. v. Pusser’s Ltd* [2007] UKPC 13.

The phrase ‘the interests of the company’ is not defined in the Corporations Act 2001 (Cth). The most frequently cited authority on the meaning of the phrase is the decision in *Greenhalgh v Arderne Cinema* [1951] Ch 286, which concerned a company whose constitution required shares to be sold to existing members if any such members were willing to purchase them. The managing director (who, together with his associates, held a majority ordinary shares) convened an extraordinary members meeting to change the constitution to require directors to transfer shares to an outsider where the members passed a resolution and named the transferee in the resolution. After the constitution was changed by passing a special resolution, a resolution was then immediately passed to allow the sale from the majority shareholder of a large parcel of shares to an outsider. A minority shareholder then challenged the resolutions approving the sale. Evershed MR then stated (at 291):

“Certain principles, I think, can be safely stated as emerging from those authorities. In the first place, I think it is now plain that “bona fide for the benefit of the company as a whole” means not two things but one thing. It means that the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase, “the company as a whole”, does not (at any rate in such a case as the present) mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.

I think that the matter can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and the minority shareholders, so as to give to the former an advantage of which the latter were deprived.”

The court held that there was no evidence of any bad faith in passing the resolution as it did not unfairly discriminate between shareholders, any of whom could have sold their shares as part of the transaction. The resolutions were therefore upheld.

The statement of principle from *Greenhalgh's* case was applied by the High Court of Australia in *Ngurli v McCann*.⁶¹ It has been broadly accepted that when Evershed MR spoke of the ‘corporators’, his Honour was referring to the shareholders of the company.⁶²

There is also ample authority for the view that when a company becomes insolvent the interests of creditors will take priority over the interests of shareholders,⁶³ although this does not go so far as to impose a duty owed from directors to creditors directly.⁶⁴ The question of what other interests, if any, directors may take into account in order to comply with this duty is the focus of the remainder of this paper.

The test of ‘bona fide for the benefit of the company as a whole’ has been applied beyond assessing changes to the corporate constitution, most notably in cases involving questions of whether share issues could be invalidated, such as in:

- *Grant v John Grant & Sons Pty Ltd* (1950) 82 CLR 1 (issuing shares to enable persons to stand for election as directors was held not to be exercised bona fide

⁶¹ See also *Reid v Bagot Well Pastoral Co Pty Ltd* (1993) 12 ACSR 197 at 206; *International Swimwear Logistics Ltd v Australian Swimwear Company Pty Ltd* [2011] NSWSC 488; *Idyllic Solutions Pty Ltd; ASIC v Hobbs* [2012] NSWSC 1276 at 1488.

⁶² See for example, *Provident International Corporation v International Leasing Corporation Ltd* [1969] 1 NSW 424 at 437 per Helsham J (applied in *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239; (2008) 70 ACSR 1 at [4392]); *United Petroleum Australia Pty Ltd v Herbert Smith Freehills* [2018] VSC 347 at 748. See also *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260 at 281 per Kirby P (diss), who referred to corporators as members (without referring to *Greenhalgh*).

⁶³ *Walker v Wimborne* (1976) 137 CLR 1; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722; *Westpac Banking Corp v Bell Group Ltd (in liq) (No 3)* [2012] WASC 157; (2012) 44 WAR 1.

⁶⁴ *Spies v R* (2000) 201 CLR 603.

in the best interests of the company as a whole because it did not involve raising capital);

- *Ngurli Ltd v McCann* (1953) 90 CLR 425 (governing director shareholder issuing new ordinary voting shares);
- *Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614 (issuing shares to defeat a takeover); and
- *Whitehouse v Carlton Hotel Ltd* (1987) 162 CLR 285 (issuing shares to influence voting power).

There is further Australian authority for the view that the meaning of the term “the interests of the company as a whole” refers specifically to the interests of shareholders as a whole.⁶⁵ Indeed, in one case the very suggestion of any distinction between the interests of the company and the interests of the members was rejected as being a fundamentally flawed argument.⁶⁶ It has even been held that “the consideration as to whether directors have complied with their duties involves a determination of whether the conduct diverged from the interests of the company’s shareholders”.⁶⁷

The imperative to act in the interests of the members as a whole is also found in various statutory provisions in the Corporations Act 2001 (Cth), such as:

- s232(d) (dealing with rights of minority members);
- s207 (dealing with the purpose of the related party transaction provisions in Ch 2E);
- s254T (protecting the interests of the ‘shareholders as a whole’ when deciding whether dividends could be paid); and
- s256B (protecting the interests of the ‘shareholders as a whole’ in authorised capital reductions).

The above discussion demonstrates that there is considerable authority, both under statutory and at general law to support shareholder primacy in Australian company law. However, equating the interests of the company with the interests of shareholders poses numerous conceptual and practical problems to which we now turn our attention.

⁶⁵ *Australian Metropolitan Life Assurance Company Ltd v Ure* (1923) 33 CLR 199 per Isaacs J (powers given to directors must be exercised honestly in the interest of the shareholders as a whole); *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 512 per Dixon J; *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260 at 281 per Kirby P (diss); *New South Wales Rugby League v Wayde* (1985) 1 NSWLR 86 at 96; *Australian Growth Resources Corp Pty Ltd v Van Reesema* (1988) 13 ACLR 261 at 268 per King CJ; *Australian Innovation Ltd v Petrovsky* (1996) 21 ACSR 218 at 222 per Lockhart J.

⁶⁶ *Japan Abrasive Materials Pty Ltd v Australian Fused Materials Pty Ltd* (1998) 16 ACLC 1172 (based in the High Court’s acceptance of Greenhalgh in *Ngurli*).

⁶⁷ *International Swimwear Logistics Ltd v Australian Swimwear Company Pty Ltd* [2011] NSWSC 488 at 102 per Ward J (as her Honour then was).

III CRITIQUE OF THE *GREENHALGH* TEST

Sir Douglas Menzies, writing extra-judicially in the aftermath of the decision, in one of the first detailed articles on the Australian law of directors' duties, noted that company directors and their legal advisors may have some difficulty in following *Greenhalgh*.⁶⁸ A conceptual difficulty was expressed by the learned author as follows:⁶⁹

“it may appear to be something of a contradiction to say on the one hand the directors owe no duty whatever to the shareholders but only to the company, and then to say that in considering the exercise of their powers they must consider the interests of shareholders, that is, those to whom they owe no duty.”

The learned author also expressed concern about the practicality of identifying and applying what could be considered to be the interests of the general body of shareholders.⁷⁰

Prior to *Greenhalgh*, it had been held that the interests of the company as a whole meant the company as a separate trading entity, regardless of who the shareholders happen to be.⁷¹ This is consistent with the reasoning in the seminal decision of *Salomon v A. Salomon & Co Ltd* [1897] AC 22. The principle effect of the ruling in *Salomon's* case is that the separate legal status of a properly registered company is not to be diminished by the identity of the controlling shareholders. Put simply, the validity and legal consequences of the company's decisions (such as whether to incur debts) does not depend on who the shareholders are. As was stated by the English Court of Appeal in *Fulham Football Club Ltd v Cabra Estates plc* [1992] BCC 863 at 876, “[t]he duties owed by the directors are to the company and the company is more than just the sum total of its members”.

The precedent value of *Greenhalgh's* case is enhanced significantly in Australian law due to the fact that the High Court of Australia's decision in *Ngurli Ltd v McCann* approved of the relevant passage quoted from Evershed MR.⁷² However, there is learned commentary that argues that the reasoning in *Ngurli's* case did tie the duty to the corporate entity rather than the shareholders. An eminent panel of legal minds argued in 1977 that the High Court's decision in *Ngurli* did recognise the company as a separate commercial entity and not merely as the sum of its shareholders/corporators.⁷³ In particular, they considered the following passage from *Ngurli* (at 90 CLR 447–448):

“the right to issue new capital is an advantage which belongs to the company. Any attempt by directors or by the company to exercise this right not for the benefit of the company but so as to benefit the majority to the detriment of the minority could be restrained in a suit brought by the minority against the company and the majority.”

The learned authors argued that the reference to “the company” in the last phrase could not sensibly mean “the corporators” as the majority members were already included in the relevant group of defendants, but rather must refer to the company as a separate and distinct entity.⁷⁴

⁶⁸ Douglas Menzies, ‘Company Directors’ (1959) 33 *Australian Law Journal* 156 at 168. Professor Ford also described the decision as “difficult to accept”: Harold Ford, *Principles of Company Law*, Butterworths, 2nd ed, 978 at [1704].

⁶⁹ Douglas Menzies, ‘Company Directors’ (1959) 33 *Australian Law Journal* 156 at 168.

⁷⁰ *Ibid.*

⁷¹ Douglas Menzies, ‘Company Directors’ (1959) 33 *Australian Law Journal* 156 at 168. LCB Gower, *Principles of Modern Company Law*, Stevens and Sons Ltd, 2nd ed 1957, pp 474–475 (discussing the famous Savoy Hotel report). See also *Geary v Melrose* [1930] NZLR 768.

⁷² (1953) 90 CLR 425 at 438.

⁷³ B. H. McPherson, L. J. Priestley, R. E. S. Argyle, A. B. Greenwood and Senator P. E. Rae, ‘Duties of directors and the powers of shareholders’ (1977) 51 *Australian Law Journal* 460 at 468.

⁷⁴ *Ibid.*

Greenhalgh's case was considered in detail by Owen J in *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239; (2008) 70 ACSR 1 at [4393] and [4395], who explained that Evershed MR's statement (quoted above):

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

It is, in my view, incorrect to read the phrases 'acting in the best interests of the company' and 'acting in the best interests of the shareholders' as if they meant exactly the same thing. To do so is to misconceive the true nature of the fiduciary relationship between a director and the company. And it ignores the range of other interests that might (again, depending on the circumstances of the company and the nature of the power to be exercised) legitimately be considered. On the other hand, it is almost axiomatic to say that the content of the duty may (and usually will) include a consideration of the interests of shareholders. But it does not follow that in determining the content of the duty to act in the interests of the company, the concerns of shareholders are the only ones to which attention need be directed or that the legitimate interests of other groups can safely be ignored."

This passage was not specifically discussed on appeal.⁷⁵ There is support for this view in the High Court of Australia's decision in *Pilmer v Duke Group (in liq)* (2001) 207 CLR 165,⁷⁶ where it was stated by McHugh, Gummow, Hayne, Callinan JJ (at [18]) that it:

"may be readily accepted that directors and other officers of a company must act in the interests of the company as a whole and that this will usually require those persons to have close regard to how their actions will affect shareholders."

This recognises that the interests of shareholders *are distinct* from the interests of the company, and that these interests will often overlap, but that does not make them the same.

The passage from the *Bell* trial above was cited with approval in *Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd* [2013] VSC 543 at 28. Although that decision was overturned on appeal,⁷⁷ the Victorian Court of Appeal confirmed that the duty is owed to the company with clear statements distinguishing the company from the shareholders.⁷⁸ Similarly, in *Brunninghausen v Glavanics* (1999) 46 NSWLR 538 at [57], Handley JA (with whom Priestley and Stein JJA agreed) stated that: "The general principle that a director's fiduciary duties are owed to the company and not to shareholders is undoubtedly correct, and its validity is undiminished." (emphasis added)

Recently in *United Petroleum Australia Pty Ltd v Herbert Smith Freehills* (2018) 128 ACSR 324 at [748]-[749], the Court raised doubts as to whether *Greenhalgh* still represented the law and noted statements in *Pilmer* and *Australasian Annuities* that affirmed the duty to the company and not to the shareholders, stating: "In more recent times, the view has been expressed that the general body of shareholders does not always, and for all purposes, embody 'the company as a whole'."

⁷⁵ *Westpac Banking Corp v Bell Group (in liq) (No 3)* [2012] WASC 239; 39 WAR 1. See however, *BCI Finances Pty Ltd (in liq) v Binetter (No 4)* (2016) 117 ACSR 18, which also discussed the balancing exercise.

⁷⁶ This was applied in *Hart Security Australia Pty Ltd v Boucousis* [2016] NSWCA 307; (2016) 117 ACSR 408 at [117].

⁷⁷ *Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd* [2015] VSCA 9; (2015) 104 ACSR 312.

⁷⁸ *Ibid* at [57] per Warren CJ; at [221] per Garde AJA.

There are further appellate cases that suggest that the interests of the company are separate from the interests of the shareholders as a whole.⁷⁹ For example, in *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112 at 143, Dixon J stated:⁸⁰

“Those impeaching the transaction must sustain the burden of proving that the directors acted in their own interests and were not in fact exercising their powers in supposed furtherance of any purpose or advantage of the company. In considering such a question, it is important to ascertain what are the purposes for which powers are given and to remember that the fiduciary duty of the directors is to the company and the shareholders.” (emphasis added)

These cases clearly envisage that the interests of the company can be more than the interests of the shareholders.

It should be noted that directors are, of course, not obliged to follow the wishes of the actual shareholders, as the decision in *Automatic Self-Cleansing Filter Syndicate Company Ltd v Cuninghame* [1906] 2 Ch 34 demonstrates.⁸¹ Directors are usually given the power to manage the affairs of the company, either directly or through supervising executive officers.⁸² Where directors are given that power by the terms of the constitution, then the members in a general meeting may not usurp it.⁸³ Furthermore, directors can't be compelled by the shareholders to exercise their management powers.⁸⁴

Furthermore, even if directors were required to consider the wishes of actual shareholders, they would soon discover that this is a statement easier said than done. Shareholders, even in closely-held companies are not a homogenous group⁸⁵ and their interests may change over time, particularly where board decisions affect economic returns to members, such as through dividend policy and decisions about reinvesting surplus funds. Such decisions pose particular tensions between the interests of current shareholders and the interests of future shareholders. Clearly, the law does not require directors to defer reinvestment into the business (which would favour the short term interests of current shareholders over future interests), but neither does it require directors to always defer benefits to current shareholders in order to improve the position of future shareholders.⁸⁶ Problems of conflicting interests can also arise where a company has multiple layers of capital, such as ordinary shares and preference shares.⁸⁷

Company law responds to such divisions by asking directors to fairly balance the competing interests of different levels of shareholders.⁸⁸ As Arden J (as her Honour then was) explained

⁷⁹ *Re Bright Pine Mills Pty Ltd* [1969] VR 1002 at 1013 per O'Bryan (who delivered the judgment of the Court); *Ferrari Investment (Townsville) Pty Ltd (in liq) v Ferrari* [2000] 2 Qd R 359 at 52 per Shepherdson J (“the obligation which the law casts on the directors ... to act honestly and in the best interests of that company and its shareholders”); *Brunninghausen v Glavanics* [1999] NSWCA 199; (1999) 46 NSWLR 538 at [69] per Handley JA (with whom Priestley and Stein JJA agreed).

⁸⁰ This statement was applied in *Brunninghausen v Glavanics* [1999] NSWCA 199; (1999) 46 NSWLR 538; *Provident International Corp v International Leasing Corp* [1969] 1 NSW 424 at 440 per Helsham J.

⁸¹ Cited with approval in *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 837. See also Dyson Heydon, ‘Directors’ Duties and the Company’s Interests’ in Paul Finn (ed), *Equity and Commercial Relationships*, Law Book Company, 1987, Ch 5 at p125.

⁸² Corporations Act 2001 (Cth) s198A.

⁸³ *Automatic Self-Cleansing Filter Syndicate Company Ltd v Cuninghame* [1906] 2 Ch 34 (applied in *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199 at 218 per Isaacs J).

⁸⁴ *Walker v Willis* [1969] VR 778 (directors do not hold their powers in trust for the shareholders).

⁸⁵ LCB Gower, *Principles of Modern Company Law*, Stevens and Sons, 2nd ed, 1957 at p474.

⁸⁶ *Ibid.*

⁸⁷ See for example, *Mills v Mills* (1938) 60 CLR 150; *Woods v Cann* (1963) 80 WN (NSW) 1583 (founders shares and ordinary shares).

⁸⁸ *Mills v Mills* (1938) 60 CLR 150 at 164 per Latham CJ; *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 481 per Latham CJ, at 495 per Rich J. See also *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11; *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155.

in *Re BSB Holding Ltd (No 2)* [1996] 1 BCLC 155 at 251 “the law does not require the interests of the company to be sacrificed in the particular interests of a group of shareholders”. The fair balancing requirement is undertaken by applying the standard of the hypothetical shareholder, not the actual interests of the respective groups of shareholders. Using a hypothetical shareholder standard helps to manage the problems of inherent and inevitable conflicts between shareholders, which can make an overall assessment of the actual collective interests of the shareholders “inappropriate, if not meaningless, and ... an impossible inquiry”.⁸⁹

Greenhalgh’s case purports to provide an answer to this dilemma by positing that ‘the interests of the corporators’ is not the interests of the actual shareholders but rather the interests of the “individual hypothetical member”.⁹⁰ This hypothetical member is a device used to address concerns about excessive short-termism, because the hypothetical member is interested in the long term success of the company. This gives corporate managers sufficient flexibility to run the company as they see fit, as long as their decisions can be justified as being in the long term interests of the company.⁹¹

The hypothetical member incorporates both present and future members, as was explained in *Gaiman v National Association for Mental Health* [1971] Ch 317 at 330:

“The association (*i.e. a company limited by guarantee*) is, of course, an artificial legal entity, and it is not very easy to determine what is in the best interests of the association without paying due regard to the members of the association. The interests of some particular section or sections of the association cannot be equated with those of the association, and I would accept the interests of both present and future members of the association, as a whole, as being a helpful expression of a human equivalent.”

However, the device of the hypothetical member has its limits, and in cases where dispute involves conflicts between radically different interests then the device serves little utility, and may simply be impossible to apply.⁹² In such a case, the reasoning of Latham CJ in *Mills v Mills* must be relied upon to simply assess the exercise of power to determine whether the board has acted fairly between the competing groups of shareholders. This demonstrates clearly that the interests of the company will not always be the interests of the shareholders, because there are no single group of consistent and coherent shareholder interests.

It is unlikely that the Master of the Rolls in *Greenhalgh* was intending to set down a universally applicable rule for assessing the validity of directors’ duties. The case after all was not concerned with directors’ duties, but rather with resolutions of members in a meeting to alter the constitution, which of course serves as a statutory contract between the members and the company and between the members’ themselves. The key quote from the case (the ‘second thing’ mentioned by Evershed MR) clearly explains the scope of the phrase ‘the company as a whole’ within the context of the members’ vote by stating “(at any rate in such a case as the present)”. Assimilating the meaning of the interests of the company with the interests of the corporators was for this purpose alone. The test may work better when the impugned conduct affects all members in a similar way, but (as discussed above) does not work well when the interests of the members themselves diverge, such as when the

⁸⁹ *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 512 per Dixon J.

⁹⁰ Applied in *Reid v Bagot Well Pastoral Co Pty Ltd* (1993) 12 ACSR 197 at 206, which was itself applied in *Goozee v Graphic World Group Holdings Pty Ltd* (2002) 42 ACSR 534.

⁹¹ For a detailed critique of the hypothetical shareholder standard see: Daniel Greenwood, ‘Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited’ (1996) 69 *Southern California Law Review* 1021; 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.

⁹² *Woods v Cann* (1963) WN (NSW) 1583 at 1596 per McLelland CJ (in Eq); *Messenberg v Cord Industrial Recruiters* (1996) 14 ACLC 519 at 527 per Young J.

impugned conduct would affect different shareholder groups differently.⁹³ As one commentator noted, referring to the interests of the company as being the interests of the shareholders as a whole “risks substituting one legal quagmire for another”.⁹⁴

Aligning the test to the interests of the company as an entity, whose long-term prosperity rests with the good faith business judgment of the board of directors and the executive managers they supervise, rather than assimilating the company’s interests to a hypothetical shareholder, or, harder still, the actual interests of real shareholders, seems an appropriate way to manage the duty of good faith, sitting within the range of duties that are owed to the company and not to shareholders.⁹⁵

IV TAKING BROADER INTERESTS INTO ACCOUNT

The question of whether directors can take non-shareholder interests into account while still complying with their duty to act in good faith in the interests of the company is largely settled. In *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 rejected the test of assessing whether the directors’ power was exercised for the benefit of the company as a whole as being sufficient on its own. The Privy Council (at 836-837) approved of the reasoning in *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288, where Berger J held (at [107]) that directors were entitled to exercise their managerial discretion to balance a range of interests (shareholders, employees and the community):

“if they (the directors) observe a decent respect for other interests lying beyond those of the company’s shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company”

Justice Berger went on (at [109]) to confirm that directors could consider the potential consequences of a successful takeover for the company. The reasoning in the *Teck* case was explicitly approved by Wilson J in *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 305, and is consistent with the decision in *Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483 at 493:

“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”.

To that line of authority we must also add the much-debated comments of Mason J in *Walker v Wimborne* (1976) 137 CLR 1 at 7, where his Honour stated that directors must take into account both the interests of the company’s shareholders and its creditors, which have been applied subsequently to involve a duty to consider creditor interests when the company is insolvent. That has been examined extensively in the literature and the cases and will not be further discussed here.⁹⁶

When exercising management decision-making power, company directors are permitted to take into account a range of considerations, as long as such considerations are not tainted by bad faith or some collateral purpose, that is, a purpose other than seeking to benefit the

⁹³ Bruce McPherson, ‘Duties of Directors and Powers of Shareholders’ (1977) 51 *Australian Law Journal* 460, at 468, cited with approval by G.F.K. Santow, P.T. Crouch, P.H.N. Opas and V.R. Smith, ‘Defensive measures against company take-overs’ (1979) 53 *Australian Law Journal* 374.

⁹⁴ AA Sommer, ‘Whom Should the Corporation Serve-The Berle-Dodd Debate Revisited Sixty Years Later’ (1991) 16 *Delaware Journal of Corporate Law* 33 at 50.

⁹⁵ *Heydon v NRMA Ltd* [2000] NSWCA 374; (2000) 51 NSWLR 1 at [474] per McPherson AJA.

⁹⁶ See Andrew Keay, *Company Directors’ Responsibilities to Creditors*, Routledge-Cavendish, 2006.

interests of the company.⁹⁷ The company's interest may often overlap with the actual (or hypothesised) interests of shareholders, but (to apply Owen J's statement from *Bell*, quoted above) those interests remain distinct. The board may keep shareholder interests front of mind, because to fail to do so may result in them losing their board positions through a membership vote, or may encourage an activist investor campaign, but it is not because the law demands that that must be the only focus of their attention.

V IS LEGISLATIVE CHANGE REQUIRED?

Over the past 30 years, there has been a movement to give greater scope for corporate boards to take into account stakeholder interests, through the introduction of constituency statutes, which involve legislative provisions that specifically permit directors to consider non-shareholder interests. These are found in over 40 states in the United States (where corporate law is state-based), although not in the leading corporate law state of Delaware.⁹⁸ The first state to introduce such provisions was Pennsylvania in 1983 and they have since spread to major corporate law states including New York, Illinois and Texas. For example, the provision in New York law states:⁹⁹

“§717(b) In taking action, including, without limitation, action which may involve or relate to a change or potential change in the control of the corporation, a director shall be entitled to consider, without limitation, (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following:

- (i) the prospects for potential growth, development, productivity and profitability of the corporation;
- (ii) the corporation's current employees;
- (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation;
- (iv) the corporation's customers and creditors; and
- (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.

Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions.”

The move for constituency statutes arose initially from the corporate social responsibility movement in the US in the 1970s, with several large companies changing their constitutions to give greater recognition to stakeholders. The movement to legislative change came during the hostile takeover boom in the 1980s, combined with leading corporate law decisions such as *Revlon*¹⁰⁰ recognising the duty of directors to obtain the best price during takeover efforts. Concerns about how anti-takeover efforts could infringe duties to consider shareholder returns led dozens of states to introduce statutory recognition of the right of directors to consider stakeholders when making decisions in the best interests of the

⁹⁷ Dyson Heydon, 'Directors' Duties and the Company's Interests' in Paul Finn (ed), *Equity and Commercial Relationships*, Law Book Company 1987, Ch 5 at pp 134-135.

⁹⁸ See Caroline Flammer and Aleksandra Kacperczyk, 'The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment' (2016) 62 *Management Science* 1982.

⁹⁹ *New York Business Corporation Law* (Chapter 4 of the Consolidated Laws of New York)

¹⁰⁰ *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

company.¹⁰¹ It should be noted however that these provisions do not require that non-shareholder interests be considered, but merely permit them to be taken into consideration without breaching directors' duties.

A variation of the constituency statute has been the relatively recent enactment of the so-called "enlightened shareholder model" in the Companies Act 2006 (UK) s172, which provides:¹⁰²

s172 Duty to promote the success of the company

(1) A director of a company must act in the way 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 as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

This provision specifically endorses non-shareholder considerations to be considered by directors, and does so in a non-exclusive manner so that interests which do not fall on the list in s172(1) could be considered by the directors. The determination of what matters should be considered for particular decisions before the board will involve the directors' exercise of their business judgment, acting in accordance with their duty of care.¹⁰³ The learned authors of *Buckley on the Companies Acts* argue that the 'success of the company' should equate to 'long-term shareholder value'.¹⁰⁴ This provision is clearly does not reject shareholder primacy, because the wording of s172(1) makes it clear that the 'promotion of the success of the company' is 'for the benefit of the members as a whole'. Furthermore, while a range of stakeholder interests are recognised, there are no specific enforcement mechanisms provided to non-shareholder stakeholders. It is arguable that the provision adds value in better educating directors of their legal entitlement to consider a broad range of interests in promoting the success of the company.¹⁰⁵

This brief overview of constituency statutes shows that shareholder primacy is not being seriously challenged by these legislative reforms, at least in so far as *requiring* directors to balance competing stakeholder interests. While constituency statutes appear to give

¹⁰¹ See further, AA Sommer, 'Whom Should the Corporation Serve-The Berle-Dodd Debate Revisted Sixty Years Later' (1991) 16 *Delaware Journal of Corporate Law* 33.

¹⁰² See further, Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance*, Routledge, 2012; Shuangge Wen, *Shareholder Primacy and Corporate Governance Legal Aspects, Practices and Future Directions*, Routledge, 2013; Richard Williams, 'Enlightened shareholder value in UK company law (2012) 35 *University of New South Wales Law Journal* 360.

¹⁰³ LexisNexis, *Buckley on the Companies Acts*, (Lexis Advance Pacific) at [924].

¹⁰⁴ *Ibid* at [923].

¹⁰⁵ This is the central thesis of Shuangge Wen, *Shareholder Primacy and Corporate Governance Legal Aspects, Practices and Future Directions*, Routledge, 2013.

directors greater flexibility in decision-making, this flexibility is already available under existing law. This is one of the main reasons why government inquiries into corporate social responsibility have previously rejected the need to introduce constituency statutes into Australian company law.¹⁰⁶

VI CONCLUSION

Is the shareholder primacy norm under threat from the seemingly rising community concerns about the standard of corporate conduct in Australia? Is law reform needed to address these concerns? In the author's view, the answer to both questions is no.

This paper has argued that while concerns about whether the shareholder primacy norm prevails over stakeholder theory continue to give rise to active debate (with vociferous and keenly entrenched positions on both sides). In the author's view, that debate may well be intractable, but it is not one that should seriously concern Australian corporate boards, at least in terms of worrying about whether they have complied with their legal directors' duties. While there are a number of cases that seek to assimilate the interests of the company with the interests of the shareholders (or a hypothetical concept of a model shareholder), there are an equally weighty array of legal precedents that recognise that directors can and should take into account a variety of factors when making decisions.

The law should not seek to unduly constrain board decision making by mandating that particular considerations be taken into account. Offering a smorgasbord of options for consideration won't lead to decisions that are more socially desirable. That is because company law has long allowed directors to take into account broad considerations, while holding them accountable by discouraging and constraining self-dealing and improper exercises of power done in bad faith. It is for the board to consider what the best interests of the company are, not the courts, and preferably not the legislature either.

Attempts to treat the company's interests as being restricted to shareholder interests reveal a penchant for early 19th century corporate law. This harks back to a time when members were treated (and in many cases actually were) partners in a 'joint stock company'. The members' had interests in the collective assets of the venture and, in such cases, it made perfect sense to say that the conduct of the venture was solely to benefit its members. However, company law has moved on from this joint stock paradigm. Shares no longer represent a proportionate interest in the company's assets, but are themselves personal property,¹⁰⁷ and property that is embedded with a range of statutory and contractual rights *against the company, as a separate legal entity*. No one seriously disputes the separate legal existence of the company, and directors' duties are undoubtedly owed *to the company*, so why should we persist with an antiquated concept of the beneficiary of the duty of good faith? The interests of the company should be left to the directors to determine, with protection offered by the range of general law and statutory duties and obligations.

When board members make decisions they include a variety of considerations. They do so not simply because the law directs them to, but because of the commercial benefit in doing so. Shareholder primacy is not seriously under threat by these changing times, because it has only ever been one part of the story.

¹⁰⁶ Corporations and Markets Advisory Committee, *The social responsibility of corporations* (December 2006); Parliamentary Joint Committee on Corporations and Financial Services, *Corporate responsibility: Managing risk and creating value* (June 2006). See also the empirical study of directors' attitudes to stakeholders in Shelley Marshall and Ian Ramsay, 'Stakeholders and Directors' Duties: Law, Theory and Evidence' (2012) 35 *University of New South Wales Law Journal* 291, which showed majority support for stakeholder consideration by directors.

¹⁰⁷ Corporations Act 2001 (Cth) s1070A.