CHAPTER 6

DIRECTORS' WIDER DUTIES - OTHER 'OUTSIDE' INTERESTS

6.1 Both judges and legislators have placed duties on directors, either directly or through laws governing corporations. Where the law specifies what conditions corporations must provide for employees, what safety measures they must take, how they are to treat the environment, within what areas they are to build their factories, directors must accommodate it because they have a duty to act in their companies' interests. They are the mind and will of the company. They must not allow the company to come into conflict with the law. In some instances, legislatures have chosen to make directors themselves subject to penalty for acts of a corporation: for example, section 53 of the Environmentally Hazardous Chemicals Act 1985 (NSW) makes a director personally liable for contraventions by the company, and section 252(1)(j) of the Income Tax Assessment Act 1936 makes a director liable for breaches of that Act in certain circumstances.

6.2 The courts have been mostly concerned with proprietary rights. Company case law provides a slender basis for extending directors' duties to anyone other than the company and those who have proprietary interests in it: the shareholders and, in certain circumstances, creditors.

6.3 The courts have associated directors' duties with the 'interests of the company'. This does not mean that directors must not consider other interests. The 'interests of the company' include the continuing well-being of the company. Directors may not act for motives foreign to the company's interests, but

> the law permits many interests and purposes to be advantaged by company directors, as long as

there is a purpose of gaining in that way a benefit to the company.[1]

Employees

6.4 In his 1987 AULSA speech, Mr Kennan referred to the interests of employees. He put employees on the same footing as creditors: 'at the very least the interests of employees and the interests of the company's creditors must be taken into account'.[2]

6.5 The courts have, to date, rejected suggestions that company directors owe the same kind of duty to employees as they owe to shareholders. The English case of Parke v Daily News Ltd[3] concerned 2700 employees of a business who lost their jobs when the employer-companies were sold. The directors planned to distribute proceeds of the sale to the dismissed employees by way of compensation and other benefits. A shareholder alleged that it was not in the power of the company to make such payments and that they would be illegal. An injunction was granted to stop the payments.

6.6 In the course of the judgment, Justice Plowman said:

> The view that directors, in having regard to the question what is in the best interests of their company, are entitled to take into account the interests of the employees, irrespective of any consequential benefit to the company, is one which may be widely held. ... But no authority to support that proposition as a proposition of law was cited to me; I know of none, and in my judgment such is not the law.[4]

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1. *Heydon, JD, 'Directors' Duties and the Company's Interests' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 120-36 at p 135.*
2. *'Comments on "Directors' Wider Responsibilities - Problems Conceptual, Practical and Procedural'", speech given by the Hon Jim Kennan, MLC, at AULSA conference, Monash University, 25 August 1987.*
3. *[1962] 1 Ch 927.*
4. *Ibid at 962-3.*

6.7 Professor Baxt has made the point that developments in industrial law - for example, workers' compensation, occupational health and safety and anti-discrimination employment practices - make it almost 'farcical' to retain the narrow approach exemplified by Justice Plowman in Parke v Daily News Ltd.[5]

Gratuitous benefits

6.8 In the context of acting in 'the interests of the company' there are situations where gratuitous benefits to employees or contractors, or general charitable gifts, may not amount to a breach of directors' fiduciary duty to the company. If conferring such a benefit is part of a generally accepted method of doing business, or if the benefit is conferred for the purpose of gaining some benefit for the company, it may be lawful. Examples of lawful gratuitous benefits are those paid to employees for the purpose of improving the company's relations with them and gifts to educational institutions for the training of people with skills needed by the company.[6]

6.9 The capacities in which 'charity may sit at the board'[7] in this way are limited. For example, gratuities to employees are not justified in law where the company's business is being brought to an end or sold off, as occurred in Parke v Daily News (the rationale being that there is little prospect that such action would bring a future benefit to the company).[8]

6.10 American courts have allowed directors to make charitable gifts where the only benefit to the company is a potential strengthening of faith in the 'free enterprise system'

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5. *Submission, para 43 (Evidence, p 205).*
6. *For these examples and more see Heydon, JD, 'Directors' Duties and the Company's Interests' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 120-36 at pp 135-6.*
7. *Hutton v West Cork Railway Co (1883) 23 Ch D 654 at 673.*
8. *Ibid; Parke v Daily News Ltd [1962] 1 Ch 927.*

amongst people who might not be happy with it,[9] but English and Australian courts are yet to approve actions with such a tenuous link to the company's interests.[10] Furthering the interests of the company in a fairly direct way must be the intent behind the directors' actions. Directors' fiduciary duties to the company as currently understood and applied will therefore often prevent directors making decisions on the basis of social responsibility.

The English situation

6.11 When considering the duties of directors it is often useful to compare company law in England with that in Australia. This is less so where employees are concerned than in other matters. Tribunals make laws which set wages and conditions in Australia but not in England. In the United Kingdom, agreements between employers and employees play a much larger part in settling wages and conditions. Because the corporations which they control are bound by comprehensive awards and determinations, Australian company directors are compelled by law, extrinsic to company law, to take into account a wide range of worker entitlements.

6.12 In 1980, the UK Companies Act was amended to require directors to take employees' interests into account in certain circumstances. Section 309(1) of the Companies Act 1985 provides:

> The matters to which the directors of a company are to have to regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.

6.13 The duty is expressed as being owed to the company:

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9. *Wedderburn, KW (Lord), 'The Social Responsibility of Companies' (1985) 15 MULR 4 at 17 and cases cited at n 86.*
10. *Heydon, JD, 'Directors' Duties and the Company's Interests' in Finn, PD (ed), Equity and Commercial Relationships, Law Book Co Ltd, Sydney, 1987, pp 120-36 at p 136.*

> the duty imposed by ... section [309] on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.[11]

It appears that only the company can enforce the duty. This limits the benefits employees would derive were they able to enforce it.

6.14 In a winding up situation, there might be no such thing as the 'interests of the company'. Section 719 of the UK Companies Act overcomes this. It enables a company to provide for its employees if the company's business is wound up.

6.15 It has been suggested that the English provisions are largely ineffective.[12] The duty is owed to the company, and situations in which the company will enforce it on behalf of the employees may well be limited. It is unclear whether to enforce the duty an employee/shareholder would have to launch a derivative action, and whether a breach of the duty could be ratified by the shareholders. An unenforceable duty is of questionable value.

6.16 Sealy argues that section 309 'is either one of the most incompetent or one of the most cynical pieces of drafting on record'.[13] This is because there is no room within the established framework of company law for employees to seek a direct remedy against directors, and because it is difficult to envisage a suitable kind of relief that the court might make available to employees.

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11. *Companies Act 1985 (UK), s309(2).*
12. *See, eg, Birds, J, 'Making Directors Do Their Duties' (1980) 1 Co Lawyer 67 at 73, and other articles cited in the submission from Professor Baxt, attachment 9 (Evidence, pp 333-4).*
13. *Sealy, LS, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' (1987) 13 Mon LR 164 at 177.*

6.17 Nevertheless section 309 has been recognised as a first step.[14] Gower commented that it would be 'anachronistic' to regard the company as consisting solely of its shareholders and to ignore the employees.[15]

6.18 The Australian Companies Code already recognises certain interests of employees - for example, sections 441, 443, 445 and 446 (Corporations Act, ss556, 558, 560, 561) make provision for the payment of debts due to employees in a winding up. Employees' interests generally are not beyond the scope of a director's consideration to the extent that they coincide with the 'interests of the company'. As a matter of practice, directors do concern themselves with such matters.[16] Employees have been described as a company's 'most vital asset'.[17]

6.19 It is difficult to reconcile the narrow approach company law has traditionally taken with contemporary reality. Mr Keith Byles, in a submission entitled 'Company Law and the Corporate "Good Employer": Limitations, Opportunities and Reform', urged that the law should

> set out a robust declaration that being a 'good employer' is not contrary to the interests of a company.[18]

6.20 Mr Byles argued that the law should not compel directors to take into account the interests of employees. He merely urged that it be made clear within the parameters of company law that taking employees' interests into account was not contrary to 'the

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14. *Eg MacKenzie, AL, 'The Employee and the Company Director' (1982) 132 NLJ 688.*
15. *Gower, LCB, Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana, Appendix I, Draft Companies Bill, 146 - cited in submission from Professor Baxt, attachment O (Evidence, p 335).*
16. *Eg, see Evidence, pp 504 (Dr Pascoe), 574 (Mr Bosch).*
17. *Evidence, p 504 (Dr Pascoe).*
18. *Submission, p 14.*

interests of the company'.[19]

6.21 Company directors must ensure their companies comply with the law, including the law relating to employees. Beyond that, they should be permitted by legislation to take the interests of the company's employees into account on the basis that there is a special relationship between employer and employee requiring goodwill between the two. In any event, fair treatment by the company of its employees will probably make it a more successful company.

6.22 It may be said that 'extending' the ambit of a director's proper concerns in this way would weaken the director's duty to shareholders because, when challenged by shareholders, he or she could argue that his or her decision, although disadvantageous to them, had taken into account the interests of the employees and therefore was not assailable. This would appear to be of little practical consequence. Most directors would instinctively look to the interests of shareholders, and shareholders' and employees' interests are not always mutually exclusive. In any event, evidence before the Committee suggests that employees' interests are already taken into account in practice. Permitting directors to do so by law would bring company law into line with a sensible practice.

6.23 The advantage of making it clear that the interests of a company's employees are a legitimate matter for directors to take into account is that it would make it clear that the approach of Justice Plowman in Parke v Daily News Ltd[20] (see paragraphs 6.5, 6.6) was no longer part of company law. In this way, company law would be brought into step with prevailing community values. Even though such a provision might not set out a formula by which directors could resolve any conflicts that might arise between

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19. *Submission, p 14.*
20. *[1962] 1 Ch 927.*

6.31 Mayne Nickless Limited considered the 'traditional' duties owed by directors to the company were sufficient to cover wider responsibility, for example, for the environment.[28] Mr Webber, Managing Director of Mayne Nickless Limited, said:

> [A]n EPA [Environment Protection Act] violation would reflect badly on the company in the public arena. It would have heavy costs, not only in the fines but in the correction of deficiencies in equipment and so forth, all of which ultimately come back to the fiduciary performance of the company. In other words, if a director is aware of those matters and is not urging action within the company, he is already guilty of not acting in accordance with his obligation. It is not as though that [ie the environmental legislation] is the only body of legislation against which companies are going to be tried and found wanting.[29]

6.32 The Managing Director of BHP, Mr Brian Loton, told the Committee:

> BHP cautions against moves to address, through the medium of directors' duties, wider questions concerning the role and responsibilities of corporate enterprises in the community. In BHP's view, the reformulation of directors' duties in terms of regard to interests other than those of the shareholders would at best achieve no more than is open to directors at present, and at worst would serve to confuse. As a practical matter directors in fulfilling their duties need to have regard to employees, customers and other groups or social interests.[30]

6.33 The environment is important and the community is highly conscious of that fact. Where necessary, measures should be taken to safeguard it. These should be provided in legislation specific

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28. *Evidence, pp 432-3 (Senator Cooney, Mr Webber).*
29. *Evidence, p 432 (Mr Webber).*
30. *Evidence, p 614.*

to the environment. It is its protection that is important, not whether the harm was perpetrated by a company, a partnership or an individual. It is a matter for environmental and not company law to restrain each and all who go beyond reasonable treatment of the environment.

Consumers

6.34 The development of company law to the point where directors are required, in certain circumstances, to take into account the interests of creditors, and the Committee's recommendation that company law be amended to make it clear that the interests of employees are not contrary to the interests of the company, may be explained on the basis of the special relationships between the company and creditors and between the company and its employees. The question then arises whether the consumers of a company's goods and services have such a relationship with the company that the law should make special provision for them.

6.35 Mr Kennan put forward the argument that 'the interests of consumers of the company's products and services' should be taken into account. He acknowledged that this matter may be more effectively addressed in specific consumer legislation.[31] Nevertheless, Mr Kennan said there was 'no harm' in including this matter in any checklist of interests that directors should take into account in their decision making.

6.36 On the one hand, in the market place a consumer can take his or her custom elsewhere, unless a monopoly situation prevails. It will be in the best interests of the company providing goods and services to be seen as a reliable and competitive supplier.

6.37 On the other hand, a consumer cannot be expected to have

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31. *See, eg, Pt V of the Trade Practices Act.*

special knowledge, sufficient to fully inform his or her choice, in relation to every item of consumption. The consumer therefore is entitled to protection, particularly as the consequences of a shoddy or unsafe product or service may be serious.

6.38 The Ford Pinto case in the United States illustrates the serious consequences that can flow from the purchase of a product with alleged safety defects. In that case, three people who had been travelling in a Pinto, a car manufactured by the Ford company, died in a road accident. Serious questions about aspects of the design of the Pinto had arisen prior to the collision and there was widely held concern that the company had sacrificed safety standards in pursuit of profits.[32]

6.39 In the Ford Pinto case, it is possible that even the most thorough and determined researcher would have been unable to bring to light accurate information regarding safety tests of the product. The case illustrates the monopoly that a producer of goods may have over information that might otherwise inform a consumer's choice.

6.40 The traditional role of the company director in furthering the company's interests will ensure that directors do not neglect the interests of consumers in circumstances where serving these interests will bring a benefit to the company. In the interests of the company's reputation, which may be vital to its success, directors will take these interests into account as a matter of practice. Beyond this, it is the role of specialised consumer protection legislation, extraneous to company law and applying irrespective of the form of the producer or supplier, to protect the consumer and to provide remedies when standards are not met.

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32. *See, generally, Cullen, Frances T, Maakestad, William J and Cavander, G, Corporate Crime Under Attack: The Ford Pinto Case and Beyond, Anderson, Cincinatti, 1987.*

Reconciling different duties

6.41 Directors' fiduciary duties might be enlisted in the service of corporate social responsibility by judicial development of the law - this has occurred with creditors' interests (see chapter 5) - or by the legislature prescribing various duties and declaring them to be fiduciary (thus signalling to the courts the standards of behaviour which should be applied). An example of the latter course is section 309 of the UK Companies Act (see paragraphs 6.12, 6.13).

6.42 Whichever course were to be taken, directors' duties could be 'widened' within the ambit of company law in at least three ways:

(a) Directors could be <u>required</u> to have regard to the interests of certain non-shareholders, but the duty to do so would be owed to the company. This would mean that only the company could sue for breach of the duty. This is the method used by section 309 of the UK Companies Act (see paragraphs 6.12, 6.13).

(b) Directors could be <u>permitted</u> to consider the interests of certain non-shareholders when making decisions. This would amount to a relaxation of the fairly strict rules as to when directors may confer benefits on non-shareholders. It would accord with what (according to some commentators[33]) directors do in practice and would have a similar effect to widening the notion of 'the company' to encompass what Sealy has called the 'corporate enterprise'.[34]

(c) Directors could be made subject to a <u>duty owed directly</u>

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33. *Sealy, LS, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' (1987) 13 Mon LR 164 at 174.*
34. *Ibid.*

to certain non-shareholders said to have an interest in the outcome of the directors' actions. The person suffering harm could sue for breach of the duty.

6.43 The inadequacies of the method outlined in paragraph 6.42, (a), are discussed at paragraphs 6.15, 6.16. Conceptual difficulties also arise with the other two methods.

6.44 If directors were permitted to take 'outside' interests into account (as in paragraph 6.42, (b)), and failed to do so, they would be in breach of no duty because the provision was permissive rather than mandatory, and there would therefore be no remedy against them. Meanwhile, shareholders' ability to bring directors to account for failing to act in the interests of the company would be weakened by the directors' legal licence to have regard to the interests of outsiders. These problems would only arise in the event that the interests were in conflict.

6.45 Duties owed to non-shareholders (as in paragraph 6.42, (c)) would also create problems. In the case of creditors, if (as has occurred) the duty is confined to periods of insolvency or near-insolvency, it is possible to identify a reasonably coherent set of 'beneficiaries' with similar interests. The same cannot be said where other non-shareholders are made the beneficiaries of the duty. If that were to occur, the people to whom the duties were owed could have diverse and often directly opposed interests. A director cannot meaningfully act 'in the interests' of such a group. All that can be asked is that he or she act 'fairly' as between the various elements.

6.46 To impose a duty to act fairly between entities as diverse as creditors, employees, consumers, the environment, is to impose a broad and potentially complex range of obligations on directors. Such a duty could be vague. Directors are already required to act fairly between competing groups of shareholders, but, in that situation, shareholdings provide a set of similar,

or at least comparable, rights from which criteria for fairness can be developed (for example, that directors may not act with the aim of altering the balance of those rights). This is not the case where the competing interests are of completely different kinds. With no firm standard by which to judge directors' actions the law 'abandons all effective control over the decision maker'.[35]

6.47 Without a legally-ordered set of priorities between the various groups, it would be difficult for any claim by one group to be upheld, as the directors' action could probably be characterised as being in the interest of some other group or groups. The question of who could enforce the various duties in the courts would also be difficult.

Conclusion

6.48 Mayne Nickless suggested that '[o]nce you start identifying special interest groups ... you are ... creating a conflict in the obligation of directors'.[36]

6.49 Widening directors' fiduciary duties to protect non-shareholders other than creditors could place the directors beyond the effective control of shareholders without significantly enhancing the rights of non-shareholders. It is Sealy's assessment that

> company law (at least as it stands, but probably in any form it could potentially take) must acknowledge that it has no mechanism to ensure the fulfilment of obligations of social responsibility.[37]

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35. *Sealy, LS, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' (1987) 13 Mon LR 164 at 175.*
36. *Evidence, p 432 (Mr Webber).*
37. *Sealy, LS, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' (1987) 13 Mon LR 164 at 176.*

6.50 Mr Kennan echoed Sealy's concerns but called for creative law reform:

> It is simply not acceptable to argue that because our legal culture is not presently constructed to allow for an extension of directors' duties, we must accept the law as it is.
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> . . .
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> [These issues] are not issues which we can allow ourselves to dismiss because they do not fit neatly into accepted ways of thinking about legal problems. The challenges these issues offer us must ... be taken if our laws are to remain responsive to and reflect modern Australian society.

6.51 It is the shareholders' investment that creates the company. Directors' fiduciary duties are premised on this fact and are designed to protect that investment. If company law were to impose new and, at times, contradictory duties (such as looking after interests which may be directly opposed to those of the corporators), directors' fiduciary duties could be weakened, perhaps to the point where they would be essentially meaningless. In general, requirements aimed at securing responsible corporate behaviour are therefore best provided in other than company law.

6.52 The Company Directors' Association told the Committee that

> [t]he specific legislation - not the Companies Act law - should have the power to address [the] problem.[38]

6.53 Professor Baxt expressed a similar opinion. He acknowledged that environmental protection was a serious issue, but told the Committee that it should be dealt with as a discrete

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38. *Evidence, p 104 (Mr Peters).*

issue, 'not through the Companies Act'.[39]

6.54 Mr Bosch, chairman of the NCSC, foresaw 'practical difficulties'[40] with imposing further specific duties on directors, but suggested that society had done 'a fairly reasonable job' in legislating generally in relation to consumer protection and employment.[41]

6.55 It is appropriate that matters external to the company be dealt with in separate and specific legislation, as has been suggested recently in New South Wales and South Australia. This is because companies legislation should deal only with corporate structure and organisation and matters arising as and between the constituents of the corporate body. Whether directors should be personally liable under such legislation for the acts of their companies is another issue which is dealt with elsewhere (see chapter 12).

6.56 The Committee recommends that **matters such as the interests of consumers, or environmental protection, be dealt with not in companies legislation but in legislation aimed specifically at those matters.**

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39. *Evidence, p 358.*
40. *Evidence, p 596.*
41. *Evidence, p 596.*