

The legal debate on the duty of directors has become political

The traditional view of directors is that they represent shareholder interests, appoint the CEO and monitor corporate strategy to create shareholder wealth. A view is now emerging that directors have broader duties and broader legal liabilities.

Comments regarding the appropriateness of corporate donations during the Tsunami relief appeal and the concerns about the legality of the conduct of James Hardie directors have created an interest in the role of directors among some senior politicians.

Anyone concerned with the legal and ethical duties of a director will be closely following three parallel events, namely:

1. The reference to the Corporations and Markets Advisory Committee (CAMAC) to examine directors' duties and corporate social responsibility;
2. The Parliamentary Joint Committee on Corporations and Financial Services inquiry into corporate responsibility and triple-bottom-line reporting; and
3. The upcoming address of the Minister for the Environment and Heritage, Senator Ian Campbell to the ASX Corporate Governance Council on potential initiatives to enhance non-financial reporting.

One of the factors behind this push for greater clarity was arguably the devastation caused by the Boxing Day Tsunami. An extraordinarily generous response from the Australian Government and the general public was followed, after an initially tentative response, by the Australian business sector with many listed entities donating \$1 million.

A spokesman for Australian Shareholders Association (ASA) caused furor in the media by suggesting that such donations were inappropriate and that 'firms should not generally give without expecting something in return'. The ASA quickly retracted the comment and said it 'is not opposed to corporations making donations to assist the victims of the Tsunami. It is in everyone's interest

that the affected communities and economies recover as soon as possible'.

The Corporations Act 2001 requires directors to act in good faith, with care and diligence, 'in the best interests of the corporation'. The term 'corporation' hasn't been judicially interpreted but it is likely to have the same meaning as a 'company', that is, 'the shareholders as a whole' or, if the company is insolvent, 'the creditors'. This would seem to preclude directors from engaging in corporate philanthropy unless they can demonstrate a clear benefit to shareholders in financial terms.

However, courts have generally been reluctant to conclude that directors have breached their duty to the company. The introduction of the statutory 'business judgement' defence will arguably allow generous philanthropy to be justified on the basis of improving the company's reputation and, ultimately, improving shareholder wealth.

The political interest in directors' duties has also been sparked following comments from David Jackson QC's inquiry into the asbestos-related liabilities of James Hardie subsidiaries. According to Jackson QC, the shortfall in compensation exposed 'significant deficiencies in Australian corporate law'.

It may ultimately be found by the courts that the activities of James Hardie directors were justifiable on the basis that they were acting in the 'best interests of the corporation'.

Potentially the most important report will be the one ultimately released by CAMAC. It has been asked by the Parliamentary Secretary to the Treasurer, the Honourable Chris Pearce MP to clarify the extent to which directors may take into account the interests of specific

classes of stakeholders or the broader community when making corporate decisions. He has also asked if the Corporations Law should be revised and if Australian companies should be encouraged to adopt socially and environmentally responsible business practices.

CAMAC will also consider the suggestion that larger companies should have a mandatory requirement to produce a report on the social and environmental impact of the company's activities. Existing measures of corporate social responsibility such as the Reputex index and the St James Ethics Centre's Corporate Responsibility Index may ultimately form the basis for something more mainstream. Pearce notes that mandatory reporting of such information could allow interested investors to take account of these matters in making investment decisions.

Although the Tsunami and James Hardie events may lead to a fundamental change in the accepted duty of a director, this transition is not new. It should be noted that when the ASX Corporate Governance Council, back in March 2003, released its Principles of Good Corporate Governance and Best Practice Recommendations, the final principle is one that requires a listed entity to 'recognise the legitimate interests of stakeholders'.

It may be that changing societal expectations, as evidenced by the public opinion to the Tsunami relief, indicate that it is no longer enough for corporations to simply make profits and comply with the law. However, any attempt to define the other 'stakeholders' to whom directors may also owe a duty will undoubtedly cause further significant debate. **J**