Chapter 4

Corporate Governance, Corporate Law and Global Forces

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A MOVING TARGET

The Australian debate about corporate governance (indeed about corporate law) is at an important turning-point.[1] Curiously enough, the turn did not come with the enactment of the *Corporations Law* in 1991. In many ways, that profoundly, even overly, detailed statute was merely the continuation of the essence of the old company laws inherited from legislation enacted in England in the middle of the 19th century. But at least the final passage of as much national corporations law as could be squeezed into the permissible constitutional remit[2] encouraged lawyers, corporate officials, governmental officers, politicians and others in Australia to think in national terms and to contemplate a few new ideas and original approaches. That process is continuing.

My thesis is that these changes represent an overly conservative and belated response to radical challenges to corporate governance in Australia. As usual, lawyers and regulators are responding decades late to the corporate problems of earlier times. This is not an unusual position to be reached in law reform. The target moves. The reformer finds it hard to keep up.

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1 See A Corbett, "A Proposal for a More Responsive Approach to the Regulation of Corporate Governance" (1995) 23 Fed Law Rev 277 at 281.

2 *New South Wales v The Commonwealth* (1990) 169 CLR 482. See also *The Commonwealth v Tasmania* (1985) 158 CLR 1.

THE CORPORATION: A BRILLIANT LEGAL IDEA

In John Tillotson's *Contract Law in Perspective*[3] there is a quotation from Lord Wilberforce which exemplifies that great judge's general approach to the law:

> "If I am faced with the alternative of forcing commercial circles to fall in with legal doctrine which has nothing but precedent to commend it, or altering the doctrine so as to conform with what commercial experience has worked out, I know where my choice lies. The law should be responsive as well as, at times, enunciatory and good doctrine can seldom be divorced from sound practice."

This puts in a nutshell the lesson which we lawyers must learn when we are concerned with so intensely practical an area of the law as the regulation of corporate life. We must make clear the fundamental principles of honesty, integrity, transparency and regularity upon which the law insists for the governance of companies. We must help Parliament to give effect to those principles. But we must resist the ever-present tendency to turn companies into the playthings of the law, where virtually no important decision can be made without having a lawyer at the elbow of the company officer.

The reason why we must resist this temptation was explained by Lord Wilberforce in his Holdsworth Lecture "Law and Economics".[4] Delivered thirty years ago, this lecture described the way in which the limited liability company came into existence, first in England and very soon after in France in the middle of the nineteenth century. It was developed in England from the idea utilised when the Crown established charter companies for the conduct of very risky, but potentially hugely rewarding, overseas adventures in distant lands beyond the seas whose exotic produce could reap vast profits. The adaptation of the charter company by the enactment of legislation providing for the statutory corporation virtually changed England overnight from an agrarian economy into a modern commercial society:[5]

> "The company, abolition of the laws of usury, the introduction of cheques, the formulation of Patent Law and trademarks, were all part of a movement which

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3 Cavendish, 1995, 2nd ed, London, Butterworths 1985, 3.

4 Lord Wilberforce, "Law and Economics" in P W Harvey (ed) *The Lawyer and Justice*, London, Sweet & Maxwell, 1978, 73.

5 *Ibid*, 75.

> did not merely reflect the expansion of commercial practice; but also, perhaps more truly - gave an essential impulse to it."

According to Lord Wilberforce, our legal imagination ran out soon after this invention, as if exhausted by the brilliance and novelty of it. The maritime entrepreneurs went on with unlimited imagination. But the lawyers' ideas became fixed in stone. The concept of the limited liability company did not grow and adapt as the company tried to do. The notion of utilising the *ultra vires* doctrine, apt for a charter company but potentially devastating for a modern corporation, failed to change the "Berlin Wall between the corporate entity and its members"[6] established in *Salomon's case*.[7] This created many problems.

In short, according to Lord Wilberforce, the legal idea was both brilliant and creative. But it failed to adapt and grow as its creation, the company, did. Lord Wilberforce concluded:[8]

> "The thought I want to leave with you is that we lawyers need to reorient our thinking in this whole field, in the interest of the survival of capitalism as a system combining modernity and obvious justice - through recognition of the completely changed function of the limited companies - recognition, one must admit, of considerable abuses to which the system, and the superstructure which lawyers has put on it, has given rise...I want the climate of legal thinking to change."

Many other writers, in the thirty years since these words were written, have made similar calls for the fundamental rethinking of company law. So far, those calls have largely been ignored. Changes have occurred at the periphery. But the central features remain unchanged.

If companies themselves had remained substantially the same as they were in the middle of the nineteenth century, a lawyer could have no complaint. One would continue to see the merit of upholding the separate legal identity of the company; the independent mandate of the board of directors; the general inability of shareholders, with few exceptions,

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6 *Ibid*, 76.

7 *Salomon v Salomon & Co* [1897] AC 22 (HL). Cf *Bank of New Zealand v Fiberi Pty Ltd* (1992) 8 ACSR 790 (1992) 10 ACLC 1557 (NSWCA).

8 Wilberforce, above n 4, at 86.

to enjoy standing to bring an action against directors[9] and the fiduciary character of the obligations of directors. But a number of developments in the real world in which companies operate in Australia today, suggest reasons why it might be time for some fundamental rethinking in the field of corporations law.

CHANGING TIMES FOR COMPANIES IN AUSTRALIA

Globalisation

The chief indication of a radically changed environment is the growing globalisation of the markets within which companies typically operate, with the consequence that many companies are now truly global, or at least regional, in character. Indeed, unless Australian companies accept a global perspective, it is increasingly obvious that they will enjoy diminished returns and fail to achieve the very purposes of their existence.

This point was recently made in an analysis by McKinsey Global Institute concerning Australia's relative economic performance.[10] The Australian economy and corporate environment were analysed along lines previously explored relative to the productivity and employment performances of other developed countries including France, Germany, Italy, Japan, Sweden and the United States. The immediate purpose of the study was to help the clients of McKinsey and Company, management consultants, to understand the performance and opportunities of Australian corporations in a global context. The study makes rather depressing reading.

Whilst acknowledging significant and extensive reform of Australia's financial system, business regulation, industrial relations environment and reduced trade protection during the previous fifteen years, the study discloses that Australia's relative economic prosperity has not risen in real terms since 1970. It has a steady level of unemployment and needs "to step up the pace of productivity growth" if it wishes to "improve its economic standard of living".[11] That standard remains 30% behind the best performing country over the past 25 years, viz the United States.

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9 *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189. See discussion Corbett, above n 1, at 285-286.

10 McKinsey and Co Australia, *Growth Platforms for a Competitive Australia: Incentives, Aspirations, Innovations*, McKinsey and Co, Sydney, 1995.

11 *Ibid*, 7.

Various explanations are offered for the relatively poor performance of Australia's economy, which means, in reality, the poor performance of its corporate sector. They include less managerial innovation which is described as amongst the "primary causes of lower labour productivity in Australia";[12] inefficient product market regulation relative to Australia's smallish market size; slow adoption of innovative processes developed overseas; slower product and service innovation; lower use of collaboration with suppliers to improve processes of products; and lower management aspirations when compared to overseas countries. Amongst the external factors exacerbating these rather depressing problems are the legal restrictions imposed by market regulation and what are described as restrictive labour market regulation practices. According to the report, Australia must somehow lift the aspirations and innovation levels of its business leaders; develop better quality and effectiveness in middle management; introduce a pro-innovation culture that has been largely missing in the past and reduce the regulatory barriers and burdens that are seen as inhibiting entrepreneurship and risk-taking.[13]

One could be critical about various aspects of the McKinsey report. One could question some of the data and a number of the conclusions. One could question the confidence in the capacity of corporations, through market forces, to deliver all of the social objectives to which Australians aspire and be dubious about the importation of the cultural norms of other societies. But the point that is effectively made in the report is that the modern corporation can no longer retreat to fortress Australia. Increasingly, it is part of an economic world dominated by companies which know no national boundaries and owe loyalty to no particular nation state.[14] For such companies capital resources are shifted from one economy to another in such ways as advance the profitability of the corporation. Early in the century it might have been Australia. But more lately it became Korea and Taiwan. Today it is Thailand and Malaysia. Tomorrow it may be Vietnam and South Africa. Somehow, our corporations must operate in this global economic environment. Our corporations law must be conducive to successful operations in that environment. It must become part of the solution which assists corporate managers of intelligence and perception to meet the valid criticisms of corporate performance contained in the McKinsey report. The law should not be part of the problem.

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12 *Id*, 9.

13 *Id*, 49.

14 See for example on the issue of legal globalisation R T Nimmer and P A Krauthaus "Globalisation of Law in Intellectual Property & Related Commercial Contexts" (1992) 10 *Law in Context*, 80.

Institutional investors

A second feature of the modern corporation which empirical analysis would oblige us to take into account is the growth in the 30 years since Lord Wilberforce's Lecture, of the power of institutional investors. Such investors, with huge funds at their disposal, have relatively little motivation to be specially concerned about "good corporate citizenship" or to devote corporate attention to social values. Their interests are safety for their investment and maximum returns. In the United Kingdom, institutional ownership of shares has risen from 35% in 1963 to 75% today. In Australia 60% of publicly listed companies are owned by institutions. Sixty percent of this ownership is in the hands of the top ten fund managers.[15]

At a time when, belatedly, company law and theory were developing in common law countries towards the notion that the modern corporation owes duties not just to its shareholders but also to employees, the community and the country in which it is established, economic developments are occurring which tend to discourage these notions. The only way they can be reintroduced effectively is by an appreciation that, in the long haul, the companies which do best economically tend to be those which exhibit concern about their employees and about their community.[16] Sadly, institutional investors, which can shift huge funds overnight and are not generally limited to domestic investment, may not be overly concerned about the long run. They may be relatively impervious to the idealistic opinions of small shareholders whose voices are, in any case, muted amidst the clamour of powerful institutional investors. This is a second reality in which the Australian corporation today operates.

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15 M Blair and I Ramsay, "Ownership Concentration, Institution Investment and Corporate Governance: An Empirical Investigation of 100 Australian Companies " (1994) 19 MULR 153; J Hill and I Ramsay, "Institutional Investment in Australia: Theory and Evidence" in G Walker and B Fisse (eds) *Securities Regulation in Australia and New Zealand*, 1994, 289 at 293-297; D Macken, "The Soulless Corporations" in Sydney Morning Herald, 13 April 1996 at 65; G Stapledon, *Institutional Shareholders and Corporate Governance*, Oxford University Press, 1996.

16 P Wildblood, *Leading from Within: Creating Vision, Leading Change, Getting Results*, Sydney, Allen & Unwin, 1995 citing *Built to Last: Successful Habits of Visionary Companies*, New York, Harper Business, 1994, a book which examined 18 companies in the United States which had survived for 50 years to discern the common traits which they demonstrated. All of them put emphasis upon their staff and their chosen community as well as their shareholders. See Macken, above n 15.

Corporate "down-sizing"

Thirdly, there is the phenomenon of corporate "down-sizing" which is usually associated with the introduction of new labour-saving technology by executives who are often themselves paid huge salaries for their achievements. Although the Australian position in terms of salaries remains modest by global standards (in some countries top executives' annual salaries are expressed in multi-million dollar terms) there are many familiar examples where thousands of employees have been laid off at a time when executive earnings are reported to have risen substantially.[17] This reality must also be understood as a feature of the environment in which lawyers begin to suggest that directors' duties extend to the best interests of employees and of the community, as well as the traditional notion of pursuing the best interests of shareholders and investors. There is not much point speaking idealistically about the "larger mission" of the corporation in Australia if, in the real world, the Australian corporation, under pressure from overseas competitors and local fund-managers, is retreating from community concerns.

Privatisation

Fourthly, there is the phenomenon of privatisation of government services which is such a feature of the economy to-day. Former governmental corporations are privatised. Activities once performed by governments are sold, to non-governmental corporations. The extent to which this is occurring is well documented. The legal problems which it brings in its train are attracting the attention of academics.[18] Legislators may add "social responsibilities" to the duties of state-owned corporations.[19] Scholars may castigate the judicial failure to enforce a sense of social obligation upon the activities of state-owned corporations.[20] However, if the very purpose of corporatisation and privatisation is to take the government out of the marketplace, can courts really be blamed for giving full effect to this policy? As Nicholas Seddon points out in his recent book, the shift of formerly governmental functions to the private sector presents large challenges to the law in

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17 Macken, above n 15, cites Coles Myers Australia Limited whose profits between the years 1990 to 1995 dropped 18% in real terms. The group shed 24,000 employment positions. The number of employees earning over $100,000 a year reportedly quadrupled. The salaries of executives and directors reportedly more than tripled.

18 N Sedden, *Government Contracts: Federal State and Local, Federation,* 1995. See review (1996) 70 ALJ 498.

19 Cf *State Owned Corporations Act* 1989 (NSW), s 20E(1). There are similar provisions in the Acts of Victoria, Queensland and South Australia.

20 Eg M Taggart, "Corporatisation, Privatization and Public Law" [1991] *Public Law Review* pp 77-108.

developing effective mechanisms to protect the individual dealing with the corporation, where previously public administrative law could have been invoked.[21]

Particular local developments

Within the Australian scene, there are some additional and particular factors which affect the debates about the future directions of corporations law. They include:

Corporate crime: The sorry record of the high profile corporate offenders in the 1980s brought discredit to corporate activity in Australia. It has tended to discourage the most radical solutions of corporate law reform and the suggestion of the withdrawal of the regulators from this area of activity. The challenge remains that of retaining the entrepreneurial spark which is essential to the success of the corporation in the marketplace but in conditions of honesty to the general community and fidelity to shareholders. Whilst the memory of the serious corporate offenders is still so vivid in Australia, it is difficult to argue for significant withdrawal from regulation of corporations, at least in respect of dishonesty and breach of trust.

The courts: The annual reports of the Federal Court of Australia continue to demonstrate the shift of business in corporate law matters from the State Supreme Courts to the Federal Court.[22] A measure of competition between courts may be good for the corporate consumer. State Supreme Courts have certainly begun to fight back to retain or regain corporate law work. One result of this bifurcation of courts is the bifurcation of appellate authority in Australia. This produces the risk of disharmonious decisions in the corporate law area. Such decisions add to the difficulty of administering already complex legislation which, in the view of many, is over-detailed and over-technical.

RESPONSES TO THE CHANGES

The responses of Australian society and its legal system to the foregoing changes (and others) may be various.

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21 Above n 18.

22 For example, Federal Court of Australia, *Annual Report* 1993-94, AGPS, Canberra at 38 (Figs 5 & 6).

Traditional responses

Some will retreat to the notion that a sovereign state, like Australia, has a right and a duty to enforce its own notions of commercial morality. This approach will take us further down the track of traditional company law. Directors' liabilities for wrongful and negligent conduct will be increased, generally to a squeal of voices asserting that this does not occur in those competing economies of the region which are most successful. Directors will complain that lawyers are intruding too much and too often into the board room and casting their depressing spell over legitimate risk-taking. Without going the whole way with this special pleading, it is important always to keep in mind what the fundamental purpose of the corporation is. It is to take risks with other people's money. Those who take risks will, inevitably, sometimes fail. If they fail without illegality, dishonesty or neglect of fundamental duties, the law should be slow to impose personal or corporate sanctions on them. In *Vrisakis v Australian Securities Commission*,[23] Ipp J in the Supreme Court of Western Australia, explained why this is so:

> "The management and direction of companies involve taking decisions and embarking upon actions which may promise much, on the one hand, but which are, at the same time, fraught with risk on the other. This is inherent in the life of industry and commerce. The legislature undoubtedly did not intend...to dampen business enterprise and penalise legitimate but unsuccessful entrepreneurial activity."

It is timely for judges and other lawyers to remember the basic objectives of the corporation. Once law begins to approach the point of destroying, or seriously discouraging, the achievement of that purpose, it has begun to fail in the performance of its proper function in this area. In Australia we need to recognise this fact given the vulnerability of our economy and the reportedly mediocre performance of our corporations. This is happening in a region of the world where other economies and their corporations are doing spectacularly well. The law which should be the servant of society and a sustaining force for its institutions, should examine its own performance when its application deflects attention from "the main game of wealth creation which is, in turn, the driver of new investment and job

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[23] (1993) 11 ACSR 162 (SCWA), 212. See note R Baxt, "Have the Courts Been Too Generous in Excusing Directors for Breaches of Duty? Not in Respect of Financial Matters!" (1994) 22 ABLR 211.

creation".[24]

Simplification of the law

Another response may be to retain current doctrine but to chip away at the edges. This is basically what lawyers in Australia have been doing in recent years. The passage of the first *Corporate Law Simplification Act* 1995 (Cth), and the promise of stages 2 and 3 of that process, represent a serious effort on the part of the Federal Government and Parliament to address many particular concerns which have been voiced about the detail, complexity, unintelligibility and inefficiency of Australia's national regulation of corporations. The fact that more than simplification is required has been recognised by the present Federal Government in the announcement by the Treasurer, on 4 March 1997, that Australia's corporate law will be given a new economic focus to ensure that the law is not "out of touch with modern commercial practice".

A national general appellate court?

But it is not only in legislation that there has been inconsistency. As I have said, any court decisions in the field of company law have been inconsistent. A collection of some of the inconsistencies has been usefully made by Justice G F K Santow and Mr M Leeming.[25] The High Court of Australia has urged appellate courts throughout the nation, and single judges, not to depart from an interpretation placed upon national or uniform legislation - such as the *Corporations Law* - given by another court "unless convinced that the interpretation is plainly wrong".[26] If this injunction to respect the uniformity of decisions in the interpretation of uniform national legislation, such as the *Corporations Law*, is not effective, a graded response must follow. The Australian Securities Commission could take a more active part in intervening (as by statute it may) in proceedings in the courts to help promote uniform and informed decisions. The Federal Court, which is accepting an ever-increasing proportion of cases under the *Corporations Law* could institute, internally, arrangements to constitute appellate benches in this area likely to provide consistent and informed

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24 F Hilmer, *Strictly Boardroom, Improving Governance to Enhance Company Performance*, 1993.

25 G F K Santow and M Leeming, "Refining Australia's Appellate System and Enhancing its Significance in our Region" (1995) 69 ALJ at 348.

26 *Australian Securities Commission v Marlborough Goldmines Limited* (1993) 177 CLR 485 at 492.

authority.[27] An even bolder development, raised for consideration by the final report of the Constitutional Commission in 1988[28] would be the establishment of a national general appellate court, under the High Court of Australia. This would recognise the constitutional responsibilities of the High Court and the practical reality that the High Court can accept only a small proportion of cases seeking to come to it, including in the field of corporations law.

Regional issues

A further possibility is that we should learn from non-traditional sources of company law and practice. Are there lessons for us in the buoyant economies of the world, so far as their approaches are tolerable to our economic, social and legal cultures? Their law in the books may look rather similar. But how and why has it provided a more supportive legal environment and does this have any lessons for us?

There is an increasing understanding of the importance of the law of countries in our region. In this respect, the legal profession is simply reflecting the shifts in corporate activity directed to the region. A recent issue of the *Australian Journal of Corporate Law* contains essays on anti-trust law in Thailand; companies and securities legislation in Hong Kong; the new banking law regime in China; securities and investment law in China; economic reform in Vietnam; and an analysis of the insolvency law of six Asian legal systems: China, Hong Kong, Indonesia, Malaysia, Singapore and Taiwan.[29] Although in some ways the corporations laws of the countries of the region are undeveloped and the "economic miracle" of the region has occurred despite, not because of, law, there are undoubted lessons for Australia in the region. This is where our economic future lies.

Empirical research

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27 For the growth of the jurisdiction of the Federal Court see Federal Court of Australia, *Annual Report* 1993-4, AGPS, Canberra, 38 (Figs 5 & 6).

28 Vol 1, 1988, AGPS, 368-369.

29 S Supanit, "Anti-Trust Law in Thailand" (1996) 6 Aust J Corp L 154; Arjunan and Chee, "Companies and Securities Legislation: Hong Kong" (1996) 6 Aust J Corp L 161; O'Hare, "Regulation of the Securities Industry: Hong Kong FFC (1996) 6 Aust J Corp L 178; Srivastava, "China's New Banking Law Regime" (1996) 6 Aust J Corp L 201; Xi Qing Gao, "Developments in Securities and Investment Law: China" (1996) 6 Aust J Corp L 228; Lee Dang Doanh, "Economic Reform in Viet Nam" (1996) 6 Aust J Corp L 289; R Tomasic et al, "Insolvency Law: Six Asian Legal Systems" (1996) 6 Aust J Corp L 248.

The analysis of the Asian legal systems in the *Journal* just mentioned was based upon empirical research supported by the Centre for Corporate Law and Policy Research at the University of Canberra. The Centre for Corporate Law and Securities Regulation at the University of Melbourne has also emphasised the necessity of empirical research to understand the real operation of corporate law and securities regulation. I strongly support that tendency. My decade in the Australian Law Reform Commission taught me the importance of analysis that goes beyond the language of legislation and decisions of the courts. It is necessary to understand what actually happens in the boardrooms. That cannot be achieved by confining research to legal texts. It is essential to involve corporate officers with legal experts to derive lessons from their experience. Doubtless they will complaint about complexity. Perhaps they will say that risk-taking is becoming next to impossible for fear of legal suits designed to distribute the loss of risks that fail. If these are their complaints, it is important that lawyers and law-makers should try to understand them. The days of self-congratulations have passed. In the corporate sphere, particularly, Australia finds itself in the harsh world of international and regional competition. It is essential that lawyers and law-makers should listen to the voices of the corporations, and not just corporate lawyers who may share our legal culture.

CONCLUSIONS

We can continue to approach company law by playing with words and adjusting time-honoured models of corporate regulation. But in my opinion, this is not good enough. Above all, we should be looking at company law, with the benefit of empirical data concerning the reality of the economy and the society in which corporations in contemporary Australia operate. Any study of company law which ignores globalisation, institutional dominance of investment funds, the impact of technology, down-sizing of employment and the growth of privatisation of formerly governmental corporations, is bound to come up with artificial and ineffective responses.

Governments and those tackling corporations law simplification should familiarise themselves with the actual corporate environment in Australia. Beyond the bleating and generalities of complaint, they should particularly address the criticism of Australia's corporate performance and the reasons for its failings. They should consider whether, and in what way, the current *Corporations Law* is part of the problem.[30] To the extent that it

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[30] For an overview of statutory simplification, see I Govey, "Simplifying the Corporations Law - the First Stage" in Law Institute of Victoria, *Journal*, January 1996, 29. See also (continued...)

is, that *Law* should be reformed to the fullest measure consistent with other national goals.

Courts, at least in a general way, should be aware of this backdrop of economic reality which I have sketched. In the past I have myself been most stern in my approach to the obligations of the duties imposed by law upon corporations and their officers.[31] Perhaps it is necessary, from time to time, to remind one's self (as Lord Wilberforce does in his Holdsworth Lecture) that the corporation began as a speculative adventurer. When it loses entirely the spark of adventure and risk-taking entrepreneurship, it has lost its way.

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[30](...continued)
I Govey, "Corporate Law Simplification: Major Changes Expected" in *New Directions in Bankruptcy* (4) November 1995, 2. The simplification process has now been overtaken by the Corporate Law Economic Reform Program announced by the Federal Treasurer on 4 March 1997.

[31] See eg *Metal Manufactures Pty Ltd v Lewis* (1988) 13 NSWLR 315 (CA); *Darvall v North Sydney Brick and Tile Co Limited* (1989) 16 NSWLR 260 (CA), 276ff and *Woolworths Limited v Kelly* (1990) 22 NSWLR 189 (CA).