Law Assignment Sample 1

**Abstract**

The present paper has made an attempt to understand whether section 181 of the 2001 Act (Australia) must be replaced with section 172 of the 2006 Act (United Kingdom).

Every duty comes with several responsibilities along with several repercussions that may be faced if the same is not performed. In Australia, the corporation directors are believed to act within the best interest of the corporation.

Now, the basic question is whether the directors actually cater such duty or whether there is a need for its reformation.

The present paper has answered all such questions with an outcome which suggests that there is no requirement of any amendments or replacement of section 181 of the 2001 Act.

The paper was initiated by understanding the backgrounds of section 181 and section 172. Section 181 was scrutinized by analysing the views and suggestion made by several government authorities, authors. Section 172 of the 2006 Act was also analysed with a brief overview of the reasons which lead to the establishment of the section. Thereafter, the main theme of the paper was discussed with the prime focus that section 181 must not be replaced with section 172. The paper is concluded in the end.

**Introduction**

Every Corporation has the responsibility to adhere to the principle of ‘Corporate Social Responsibility’ (CSR) which emphasises on balancing and managing the environmental, social and economic impact of the corporation itself[[1]](#footnote-1). Directors of a corporation are considered as the authoritative personnel to conduct ‘CSR’ with the main aim to act in the best interest of the corporation.

The main issue of concern is whether the responsibilities that are casted upon the directors permit them to act in a manner that is in the best interest of the corporation or not? The same is also doubted by Austin J by submitting that the director’s duties along with considering the shareholders interest ‘*has been a vexed one for many years’,*[[2]](#footnote-2) however, the same was rebutted by ‘The Senate Standing Committee’ (SSC) in its report in 1989.

However, with several developments an issue arose, that is, whether there is a need to amend the provisions of the Corporation Act 2001 to meet the challenges ahead.

In the present paper a specific attempt is made to analyse whether there is a need to replace or amend section 181 of the Corporation Act 2001 (Act) with section 172 of the Companies Act 2006 of the United Kingdom (2006 Act).

The assignment is divided in three parts.

*The first part* of the paper analysis the background of section 181 of the Act and section 172 of the 2006 Act. An attempt is also made to understand as to why a need arose to replace/amend section 181 of the Act. Further, section 172 of the companies Act was also analysed in depth.

*The Second part* has made an attempt to critically analyse the various actions that can be undertaken after understanding both the provisions that, is section 181 and section 172, such as, whether there is a need for replacement, amendment or a hybrid provisions if required.

*The third part* concludes the paper by suggesting the option to be availed as discussed in part two and any alternatives or suggestions to be implemented.

**Background on Section 181 of The CorporationsAct 2001 and Section 172 Of The UK Companies Act 2006**

Generally, the power of the management of a corporation is carried out by the directors (198A of the Act) and is wide in nature. SSC (1989) submitted that ‘*directors are the mind and soul of the corporate sector[[3]](#footnote-3)’* and is retreated by the Privy Council[[4]](#footnote-4). Further, there are duties that are casted upon a director under common and tort law, contract and statutory enactment[[5]](#footnote-5).

The present paper has made an attempt to critically evacuate section 181 of the Act.

Section 181 of the Act imposes a duty of ‘Good Faith’ on directors and officers and submits that they must *“discharge their duties in good faith in the best interest of the corporation and for a proper purpose”*. When acting in the best interest, no regard must be made to the interest of individual shareholders[[6]](#footnote-6).

The most important element of section 181 of the Act is to act in “*the best interest of the company*”. The concept submits that the actions of the directors must be in corporation interest and not bring any advantage to the stakeholder personally. However, there are instances which show that the directors have considered the interest of the stakeholders as well[[7]](#footnote-7) especially in situations of gratuitous payments provided it is making some benefit to the corporation as well[[8]](#footnote-8).

However, there are various views that are submitted in respect to section 181 of the Act.

1. Review of the Government–
2. SSC – In 1989 an observation was made by SSC, i.e, whether to amend the director’s duties so that they can look beyond section 181. It was submitted by SSC that tough directors must act in the ‘best interest of the corporation’ but it may look at the interest of other stakeholders provided the same is in the benefit of the corporation, such as, gratuitous payments[[9]](#footnote-9). The SSC stated that since it is the stakeholder’s investments that are at stake thus there exist some duty of the director to protect such investment[[10]](#footnote-10).
3. Report by CAMAC and Parliamentary Joint Committee (PJC) –

PJC committed an enquiry (June 2006) regarding the CSR of the directors in regard to the interest of the stakeholders. It was submitted by PJC that there is no requirement to amend section 181 and does not favours section 172 of 2006 Act as it causes uncertainty.

An enquiry by CAMAC was on same footing as of SSC and PJC. It was submitted that there are adequate provisions within the Act which permits the directors to consider the stakeholders interest. Any changes in the provision will only risk the accountability of the directors[[11]](#footnote-11).

1. Ability of the Directors to acknowledge the interest of persons other than shareholders – CAMAC submitted that the directors are allowed to look at the interest which is outside the interest of shareholders provided it benefits the corporation. PJC further, provided evidence which submits that directors do take interest of the stakeholders while carrying out their duties.

AICD submitted that the directors must consider the maximization of profits considering the interest of the stakeholders as well[[12]](#footnote-12). It is submitted by PJC that the number of corporations which report on CSR is increasing with the passage of time thereby portraying the concept of ‘best interest of the corporation’ is extended to the interest of the stakeholders and employees[[13]](#footnote-13).

Now important to understand section 172 of the 2006 Act and the reasons for introducing the section.

Prior the 2006 Act, there were serious complicated issues that were dealt by the English Company Law. There was a dilemma to select between the concept of shareholder value or stakeholder value. This dilemma was resolved by the incorporation of section 172 of the 2006 Act which enlightened the concept of shareholder value. However, much criticism was received on the basis that there is hardly any change that has been brought in by the enactment of section 172[[14]](#footnote-14).

Section 172 emphasis on one fundamental duties of a director i.e, he must act in good faith and in the best interest of the company[[15]](#footnote-15). Sub section 1 specifically submits that a director must act in good faith and in such manner so as to promote the company and its members as a whole (shareholders)[[16]](#footnote-16). However, while formulating his duty the director has to give regard to several factors which is a non –exhaustive list (Section 172 (1) (a)-(f)), covering the cultural change and the manner a company carries out his business[[17]](#footnote-17) thereby making the decisions of the directors more enlightened. But not much change has been brought by section 172 as:

1. Section 172 (1) does not covers creditors although employees/suppliers are included though sub section 3. Thus, creditors protection is provided specially during financial problems thereby retreating the common law and further decreases the position of employees governance[[18]](#footnote-18)
2. The earlier law to consider the employees interest while catering directors duties was repealed by section 172 and the employee’s interest is only considered when it is promoting the interest of the company. Further, there was no supplementary provision in the common law, thereby the position of employees is preserved resulting in ‘no change’;
3. An obligation is imposed on directors to consider the interest of stakeholder while undertaking any decision, however, it was analysed that the shareholders interest still remain supreme thereby not making much change in the new law[[19]](#footnote-19).
4. The director does not own any independent responsibility towards the stakeholders

Thus, there is no balance amid the stakeholder and shareholder interest that is achieved by the incorporation of Section 172 and is supported by ICSA[[20]](#footnote-20).

**ANALYSIS: SHOULD AUSTRALIA REPLACE SECTION 181 OF THE ACT WITH WORDING SIMILAR TO SECTION 172 OF THE 2006 ACT[[21]](#footnote-21)**

After analysing both the section, it is submitted that the interpretation of the section in regard to the stakeholder’s interest varies. Also, the corporations varies in their actions, such as, some corporations have adopted CSR while the other have narrowed their vision on their view towards stakeholders interest[[22]](#footnote-22).

On the basis of such dual application, the Attorney General of NSW has submitted its report to CAMAC and stated that there is a need to bring reform to the duties of the directors under the Act[[23]](#footnote-23). He sought codification of the practices of the directors in the Act.

Likewise, in UK, the DTI conducted a review on director duties which resulted in the incorporation of section 172 of the 2006 Act. The approach adopted by section 172 was very different from the approach taken by section 181 of the Act and as submitted by PJC ‘the wordings of section 181 must be replaced with the wording of section 172’[[24]](#footnote-24).

However, when further analysis is done upon section 172 of the Act, it was found that the wordings of the section are not clear and is not easy in its implementation.

At this stage, it is critically submitted that section 172 of the 2006 Act has many faults and errors as analysed by DTI, CAMAC and PJC and thereby it is submitted that section 181 of the Act **MUST NOT BE REPLACED** with section 172 of the UK Act. The various reasons for the same are critically evaluated herein under:

1. There is uncertainty in the wordings of section 172 of the UK Act.

There are few words which are part of section 172 which are not clear.

*The First* is “Promoting the success of the company”. Section 172 emphasis that the directors must act in such a manner so as to ‘promote the success of the company’. The concept is right and every company director must act so that it leads to the company’s success. But the very word SUCCESS is not clear in its interpretation. The Law society of the UK submitted in its report to DTI that the word SUCCESS may result in significant difficulties[[25]](#footnote-25). Likewise the Confederation of British Industry’s (‘CBI’) while submitting its report to DTI seeks clarification regarding the meaning of the word SUCCESS and how the same can be measured[[26]](#footnote-26).

*It is critically analysed that the interpretation of the term SUCCESS varies depending upon the interpreter and is not equivalent to the concept of ‘to act in the best interest of the company’. Since the traditional word is not used, thereby a presumption is raised that probably the legislature of UK is intending some different meaning.*

*It is also critically submitted that the submission made by the Ministerial Statements on the Companies Act that ‘the word must be considered as a preliminary point and the main objectives of the company must then be clarified’ does not provide with a clear interpretation of the word[[27]](#footnote-27). Even if the clarification is followed then it will aim at enhancing the company profit at the cost if stakeholders which ultimately results in limiting the concept of SUCCESS.*

*The second word* is “for the benefits of its members as whole”. The wording is against the general law which emphasis on the director duty to act in the best interest of the company as a whole. Instead of the word COMPANY, the word MEMBERS is used and thereby a direct responsibility is made towards the shareholders.

*Thus there is doubt that in particular circumstances the director still owns a duty towards the shareholders as against the company.*

*The third word is* “have regard to”.Section 172 of the Act submits that a director must follow section 172 (1) (a)-(f) interests while furnishing his duties. However the same was disregarded by many authors as it will add to complexity[[28]](#footnote-28). Further, there are no clear guidelines as to which interest must be preferred over the others when there is situation of conflicts. The section also does not include ‘creditors’ in its list of interest.

The section further focuses that the director must act in such manner so as to analyse his impact on the community. But the term ‘community’ itself is not defined[[29]](#footnote-29).

*It is critically analysed that it is very difficult for the directors to act in such manner and thus it will make the duty onerous. It is thus suggested that the act must not amended to incorporate such a duty which is so much ambiguous and unclear.*

1. Restrain of decisions and enhanced cost–

One of the prominent feature of section 172 is that it must consider the interest (section 172 (1) (a)-(f)) while making any decision which ultimately affects the board proposals. Thus it imposes an obligation upon directors to document his actions which enhances the cost of reporting/bureaucracy/auditing and is analysed by Deloitte & Touche LLP[[30]](#footnote-30).

Further, Hon. Margaret Hodge submitted that section 172 obligates the directors to do such actions which they otherwise would have not done resulting in enhanced cost and restraining in decision making[[31]](#footnote-31).

*Thus, it is critically analysed that the implementation of section 172 will enhance the overall costs of the decision making bringing unnecessary burden to the financial position. Further, an added bureaucracy will result in restraining of decision making thereby hampering the working of the company.*

*Thus, section 181 of the Act must not be replaced with section 172 of the 2006 Act.*

1. A new duty is imposed – One of the drawbacks of section 172 is that it allows the shareholders and other stakeholders to challenge the decision of the directors. Further, Section 172 permits the courts to defy and review the decision made by the directors, especially when the directors are making any public decision. Though Note 327 that the decision by the directors in good faith is not challengeable in court, however, when decision regarding the extra criteria is made by the directors then the same are much liberal to get challenged in courts[[32]](#footnote-32).

The Australian Bankers Association retreated the above stand and submitted that the directors obligation to take into consideration interest of ‘other stakeholders’ will make the decisions challengeable by the minority shareholders resulting in unwanted litigation[[33]](#footnote-33). ASIC submitted that if the directors will consider the interest of other stakeholders then it will hamper the enforcement abilities of the directors[[34]](#footnote-34). The main reason is that the more ambiguous the duty and to whom it must be catered, the harder to establish its violation.

The SSC in 1989 submitted that since the directors have to consider ‘other interest’ while carrying out his duties it ultimately results in decreasing the ability of the shareholders to challenge the duties cater by the directors[[35]](#footnote-35).

Also, the duty imposed upon a director is owned to the company thereby limiting the role of the stakeholders/members to challenge the decision of the director[[36]](#footnote-36) except in some instances[[37]](#footnote-37).

*Thus, it is critically analysed that the enforceability of section 172 is very rigid and limited and hardly any rights are granted to the stakeholder and members to challenge such duty thereby causing great hardship to them.*

1. The Fallacy of the Corporation Act 2001

Also, the most important question is whether the 2001 Act itself is the right choice to consider the stakeholder’s interest. It is submitted by CAMAC, ASIC and SSC that a separate legislation must be incorporated for the same which are clear and contains enforcement powers[[38]](#footnote-38).

Thus, it is not justified in submitting that the 2001 Act must be altered or amended the duties of the director so as to take into account the interest of stakeholders. The argument was also supported by AICD that a separate law will bring a benefit and cost analysis and a separate consultation process which will be better than incorporating the same in the 2001 legislation[[39]](#footnote-39).

*Thus, it is cortically analysed and submitted that if separate legislations are enacted in regard to the stakeholder’s interest then there is need to replace section 181 as it will unnecessary impose a burden on the corporations.*

1. Ultimately eliminates the flexibility of section 181 – Presently, section 181 is flexible and is necessary because of the diversified nature of the corporations[[40]](#footnote-40). In SSC, professor Finn submitted that putting the law in a straightjacket will hamper its flexibility and thus must be avoided[[41]](#footnote-41). Further as per ASX Guidelines, Good Corporate Governance Principles, Principle 3, that the corporation must consider the interest of other stakeholders[[42]](#footnote-42). Also, a code of conduct (Box 3.1) must be formulated which guides as how the obligation of stakeholders must be complied.

*When compared with section 172 of 2006 Act it is submitted that the guidelines of ASX for listed corporations provided a much flexible approach and thus any replacement of section 181 will not be justified.*

Also, the concept of CSR is also undertaken by many companies and is evolving with passage of time[[43]](#footnote-43) and is rightly established by the Australian and New Zealand Bank & the National Australia Bank[[44]](#footnote-44).

Thus, if section 181 is amended in order to incorporate CSR then it will result in hampering the compliance culture[[45]](#footnote-45). Further, it will also hamper the evolving process of CSR[[46]](#footnote-46) .

*Thus, it is critically analysed that if section 181 is replaced with the wordings of section 172 then the law will forgo its aptitude to adjust with the situations and thereby results in loosening the flexibility of the law. Hence there must not be any replacement.*

1. Effect on the place of business itself – Australia

Any replacement of section 181 will have tremendous negative effects on the Australian business. As per AICD if the directors are made obligatory to consider the stakeholders interest while formulating their decisions then it will hamper the investors’ confidence and ultimately affects the business of the company[[47]](#footnote-47). Also, if section 172 will be introduced a perception is made that the actions of directors are easily litigated thereby hampering the activities of the corporation and its growth[[48]](#footnote-48). The Law council of Australia also submitted that will negatively hamper the insurances availability for the corporations[[49]](#footnote-49)

*Thus, it is critically analysed and recommended that in order to avoid any negativity upon the business, it is suggested that no replacement or amendment must be made to section 181 of the Act.*

As rightly submitted by McConvill that the directors do takes into account the interest of the stakeholders and thus there is no need to change the current Act of Australia. He argued that the discussion of replacement may come to an end if the exact meaning of stakeholders can be understood.

**CONCLUSION**

To conclude, it is submitted that no replacement or amendment must be made to section 181 of the Act (either as a whole or by some words) with section 172 of the 2006 Act. Section181 imposes a duty on the directors to act in the best interest of the corporation which implies that it must take into account the interest of the stakeholders as well. Any deviation will negatively affect the corporation’s interest and thus raises questions on the ability of the director performance and his duties. It may also result in regulatory intervention, government inquiries and unnecessary litigation. Though section 181 is criticised on the ground that the duties of the directors in regard to all the stakeholders is not defined still the section is very much flexible to disregard the criticism.

Section 172 has several problems and issues. The wordings of Section 172 are ambiguous and are not supported by precedents. The section also results in enhancing the bureaucracy and lack of coincidence in the investors because of the list of other interest provided within section 172 to be catered by the directors.

Thus, it is not justified to replace section 181 with section 172 as it is not the right place to consider the interest of other stakeholders rather a separate legislation must be formulated for the same as suggested by PJC, CAMAC and SSC.

Thus, it is justified in concluding that section 181 of the Act must not be replace with section 172 of the 2006 Act.

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36. A Keay, n 28, 593. [↑](#footnote-ref-36)
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